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Original Article

A Critical Analysis of the Impact of Recent Tariffs Imposed by the USA: Its End Goal, the Countervailing Reaction by China, and Its Influence on Major Macroeconomic Indicators of Both Countries

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Abstract - *The recent rounds of tariffs that the Trump administration has announced have led to countervailing tariffs being imposed by other countries. As the US had the highest trade deficit with China, President Trump decided to impose the maximum penalty on this economy. On the other hand, China reacted by imposing taxes on US goods entering its economy. Economic theory has always indicated that tariffs lead to the misallocation of scarce resources. However, despite this, the primary need for economies to impose protection duties is to help their own agricultural, manufacturing, and service sectors grow, thereby increasing income and employment of their citizens, as well as tax revenues. This paper has analyzed the theoretical Impact of tariffs on the growth of the economy and has indicated that this would lead to a misallocation of resources. It also examines the Impact of these taxes on the home country, specifically on growth and employment, as well as on the valuation of the dollar and the yuan. The final Impact of the tariff will be documented only shortly before a complete year or more has passed.*

Keywords *- Tariffs, Misallocation of resources, Trade retaliation, Economic growth, Currency valuation.*

1. Introduction

A tariff is a tax imposed by one country on the goods and services imported from another country. They are an additional cost that is added to the price of the good. It is primarily used to protect the domestically produced commodity from competition. It was used by countries at the early stages of development under the "infant industry argument". This means that in developing countries, as companies have not yet achieved economies of scale, nascent industries require protection from competition so that they can utilize their resources efficiently and effectively.

Normally, these tariffs are withdrawn after a certain period of efficient and full employment of resources. Continuous adoption of tariffs leads to the misallocation of scarce resources. It could also lead to higher unemployment, higher inequality, and real exchange rate appreciation. It could also cause a medium-term decline in domestic output and productivity.

Tariffs imposed on intermediate goods or inputs lead to the increase in the price of the final good adversely impacting consumers and supply chains by an immediate increase in prices (the prices have increased due to the imposition of tariffs making the imported input out of reach for the domestic producer, who then subsequently depends on domestic produced inputs the price of which is much higher than the original imported one). *These are known as input tariffs.* All of this increases the price of the final good. It could lead to consumers opting for substitutes for the product, thus eventually reducing the demand for the original product. In this case, both the producer and consumer are harmed, as the consumer pays a higher price and the producer supplies the goods at a higher price. *As opposed to input tariffs, there are output tariffs, which are in the form of taxes imposed on the finished goods.*

Given these Adverse Economic Impacts, why do Countries still use this Route to Protect their Home Industries?

Since World War II, when tariffs were at very high levels, there has been a concerted effort by all countries to reduce levels through international organizations like the GATT (General Agreement on Tariffs and Trade) and the WTO (World Trade Organization), which work towards lowering and simplifying tariff agreements across the world. One of the main reasons why tariffs are imposed is the

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revenue that is earned for the government by their imposition. Besides this, it also targets important infrastructural elements, including basic pharmaceutical drugs, aluminum, and steel, which are important for any economy's progress. Complete dependence on the import of such goods could adversely impact an economy's capability to produce basic, important inputs. At times, the tariffs are imposed to protect and enhance the output of domestic industries, such that the country is not dependent on imports of basic inputs in spite of the imported commodity being cheaper than the domestically produced one. These goods are encouraged for security reasons. Yet another reason for an immediate increase in tariffs could well be an increasing foreign exchange deficit of the economy. It is possible that through trade negotiations, the tariffs could decline across the spectrum of commodities, leading to an eventual decline in the adverse trade deficit.

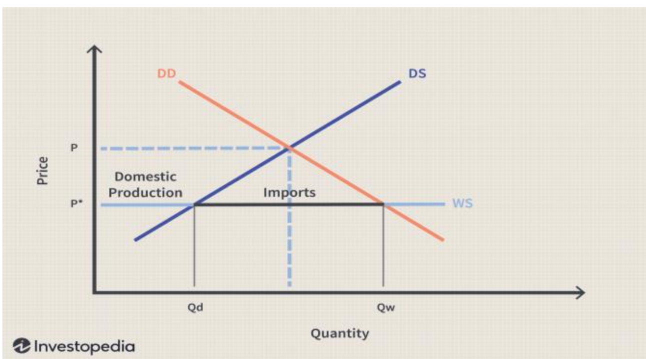

Fig. 1 Reasons for imports and price benefits to the consumer
Source: Investopedia

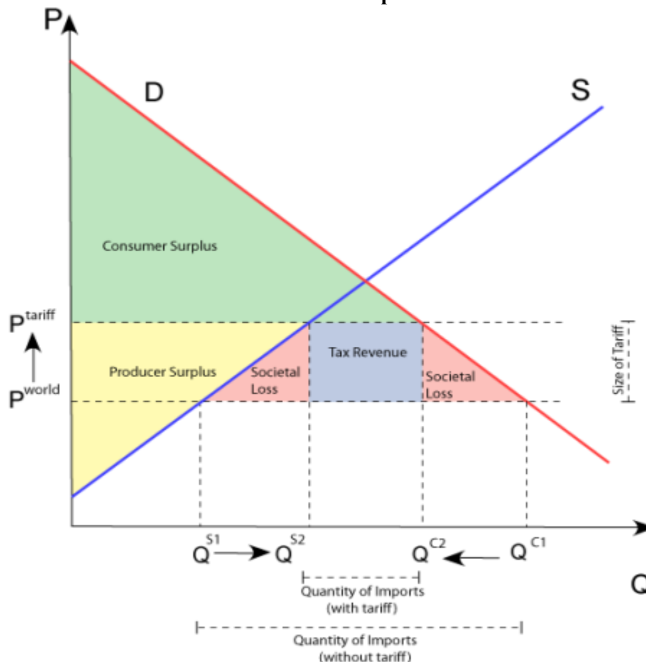

Fig. 2 Imposition of a Tariff indicating "deadweight loss" or "societal loss".
Source: Acropolis Investment Management

2. Research Gap: Given the History of Tariffs, this paper will analyze the Present Imposition of High Rates of Tariffs on Imported Goods into the US, leading to: a. Misallocation of Scarce Resources, b. This Process is Detrimental to a Country's Macroeconomic Indicators: GDP, Employment, and Manufacturing

From 2016 through early 2025, the United States has witnessed significant shifts in its fiscal and external balances, which are essential for understanding the effects of tariff policy on macroeconomic performance and resource allocation. In particular, 2018 stands out as a benchmark year when President Trump imposed steep tariffs on Chinese imports. Although the US debt-to-GDP ratio remained relatively stable at around 104 % before 2018, the current-account deficit surged to about –US$ $440 billion, suggesting that imbalances in trade, rather than debt strain, triggered the protectionist response. By raising costs on imported goods, the tariffs contributed to the misallocation of scarce resources, ultimately affecting GDP growth, employment, and manufacturing output.

Fiscal and external pressures intensified between 2018 and 2021. Debt-to-GDP climbed modestly to 107 % in 2019 but then jumped sharply to approximately 129 % in 2020 amid pandemic relief spending. The external deficit similarly widened, reaching –$597 billion in 2020 and a record –$868 billion in 2021. These developments reflect how emergency fiscal measures, rather than trade policy, dominated macroeconomic outcomes during this period. After Trump left office, the debt ratio edged down to ~113 % in 2022 and remained around 115 %–124 % through 2024, while the current-account shortfall first deepened (exceeding –$972 billion in 2022) and then narrowed to –$304 billion in Q4 2024. These trends underscore a persistent external imbalance even as fiscal pressure eased slightly, highlighting how tariffs and other structural factors continued to shape macroeconomic outcomes.

Table 1. Year, Debt/GDP Ratio, and Current Account Balance in Bbn USD

Year	Debt/GDP (%)	Current-Account Balance (US$bn)
2016	105	-396.2
2017	104	-367.6
2018	105	-439.9
2019	107	-441.8
2020	129	-597.1
2021	124	-868.0
2022	113	-1012.1
2023	115	-905.4
Q4 2024	124	-303.9

When import taxes are reduced, unproductive businesses leave, which improves resource allocation. Import taxes cause resources to be misallocated. The misallocation increases with the import tariff. At this point, only two inputs, mostly labor and capital, are considered.

3. Methodology

The methodology would be primarily quantitative, using authentic secondary data available for the United States. The Impact of the taxes imposed in 2025 by President Trump on commodities would be deduced from the current estimates available. Findings suggest that high tariffs, specifically those above the median, result in a 0.15 percent decrease in productivity measured by a standard deviation due to firm-specific input decisions, revealing misallocation with broader productivity impacts. In a sample where import tariffs fell by 6 percentage points from 2001 to 2007, this decrease is responsible for almost the entire reduction in labor misallocation.

These estimates would be from various sources, which will be cited and compiled, to understand their Impact. The data will be presented in both tabular and graphical form, highlighting its Impact on macroeconomic indicators.

The earlier Impact of tariffs is discussed in the literature review, as considerable work has already been done. This would be in both quantitative and qualitative form.

4. Why do Countries Impose Tariffs?... Developing Economies and Developed Economies

The reasons why these countries impose tariffs differ. Developing economies impose them for the following reasons:

- protecting domestic industries
- generating government revenue
- responding to unfair trade practices.
- counteracting foreign measures
- promoting local production
- developing specific industries

4.1. Developing Economies

The main reason that tariffs are imposed by developing economies is to protect their domestic market. The Indian economy, after it liberalized in 1991 and subsequently participated in the Uruguay Round Commitment of 1995, agreed to reduce tariffs and quantitative restrictions (QR) on a wide range of commodities. The participation and adoption of policy measures were primarily due to the acceptance of the fact that:

- Tariffs cause inefficiencies that distort prices
- This results in the excessive use of scarce resources
- That leads to social welfare losses both in production and consumption.

The equilibrium of the market, through the intersection of supply and demand, without any interference by the authorities, results in an efficient and full utilization of all resources. The pricing of commodities indicates whether the resource is available in short or abundant supply. The imposition of tariffs leads to an artificial price that automatically results in inefficient and underutilization of resources.

In 1991, India, after the Uruguay Round, reduced tariffs and QR restrictions on a wide range of commodities. The areas where India was made to negotiate were primarily in the following commodities:

- textiles
- agricultural
- manufacturing
- mining

According to Professor Goldar, the Impact of the reduction of tariffs was superficial as far as textiles are concerned, as India did not gain much from exports or imports. The reason is that other measures were in place, namely.

- Nearly half of the products entered the country illegally through the Silk Road Route (Mehta 2000)
- Due to the above, the removal of QR did not make a difference.
- Several agricultural commodities were canalized and thus escaped the Impact of the reduction of tariffs.
- Alternatively, some goods were under the heading of "trade defensive measures," which helped them avoid tariffs and QRs, thus leading to their inequalities and inefficiencies.

Few researchers have indicated that the actual tariffs imposed by India were low, ranging from 1.7%-2.3% (2017 Brookings Edu). Due to the following reasons,

- Most Favoured Nation (MFN) categories to a large number of trading partners
- using basic customs revenue rather than total customs revenue
- Agriculture was the only sector possibly protected by high tariff rates, while the other sectors had tariffs ranging from 0% to 10%.

Reforming the tariff structure by making it more transparent would increase and improve investment and would be an asset to programs like "Make in India."

There has been evidence that liberalization and globalization, which the Indian economy undertook in 1991, had a greater impact on the specialization and

competitiveness of domestic firms, leading to high-tech, value-added exports over time, rather than the Impact of the reduction in tariffs and QR. The only area that still commands high protective tariffs is the agricultural sector. The textile sector in India seems to have lost its competitive edge over other countries like Bangladesh and Taiwan. The imposition of tariffs does not seem to have a positive direct relationship with an increase in GDP. Other macro measures need to be put in place to achieve a higher GDP and welfare for the economy.

4.2. The Impact of the Imposition of Tariffs in and by Developed Economies like the US.

Tariffs are used as an alternative to "dumping". The concept of dumping involves foreign firms selling goods at below-market prices so that consumers can pick up the cheaper, imported commodities, vis-à-vis more expensive domestically produced commodities. Short-term, targeted tariffs may help protect vulnerable US sectors in such cases. Sometimes, governments impose tariffs, not only for the protection of domestic industries but also to generate revenue and simultaneously have an upper hand in trade negotiations, such that they eliminate "unfair foreign trade practices" (Babson Edu)

5. Answering the Research Gap

While tariffs have long been used as tools to protect domestic industries, the current wave of high-rate tariffs, particularly those enacted by the United States in recent years, has introduced renewed challenges to macroeconomic stability.

Today's tariffs risk:

- Misallocating scarce economic resources
- Diverting capital and labor toward less efficient domestic industries at the expense of more competitive global alternatives
- Undermines the principle of comparative advantage
- Leading to inefficiencies that impact the weight of national output.

Such misallocations have already contributed to a decline in GDP growth, a slowdown in employment expansion, and stagnation in areas of manufacturing. These effects are compounded by retaliatory measures from other nations and global supply chain disruptions, which negatively impact long-term economic performance. Analyzing the macroeconomic implications of these high tariffs reveals that the intended protection of domestic industries may weaken the broader economy by misdirecting resources away from their most productive uses.

6. Recent US-China Tariff War

After the global financial crisis (2008), protectionism rose, especially in the US under the Trump administration's "America First" policy (2017). US tariff hikes mostly targeted intermediate goods, which is important because of global supply chain integration.

Table 2. Tariffs are placed by both countries every other year

Year	Tariffs on Chinese Goods by the US (in Billions of USD)*	Tariffs on US Goods by China (in Billions of USD)**	Percentage of Chinese Goods Entering the US Market **
2008	320	542	17.67
2010	370	707	17.99
2012	420	-	17.20
2014	460	1001	16.95
2016	450	835	18.39
2018	520	777	19.28
2020	420	946	17.48
2022	510	1679	16.22
2024	540	439	11

*https://wits.worldbank.org/CountryProfile/en/Country/USA/Year/2008/Summarytext#:~:text=Tariffs%202008&text=The%20simple%20average%20tariff%20across,items%20share%20was%2054.20%20percent.
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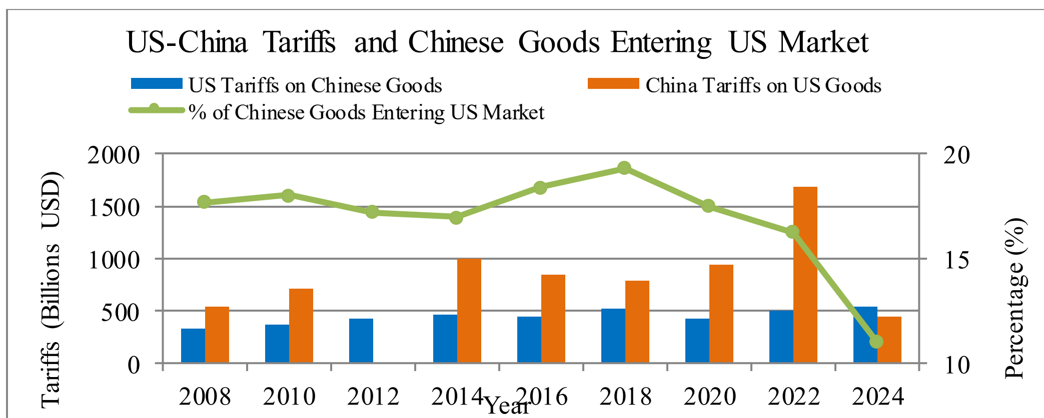

Fig. 3 US-China Tariffs and Chinese Goods Entering the US Market

6.1. Global Supply Chain: Meaning and Significance in the Tariff War between the US and China. Products that have changed over time and their Impact on the US trade deficit

The global supply chain refers to the worldwide system of production and distribution in which goods are manufactured in multiple countries and assembled in others before reaching the final consumer. The US-China tariff war has significantly disrupted this intricate network, particularly because China serves as a central hub for intermediate goods used in electronics, machinery, textiles, and consumer products.

When the United States began imposing higher tariffs on Chinese goods, many of these affected products were key inputs for American manufacturers. For instance, tariffs on semiconductors, auto parts, and consumer electronics components increased input costs for US companies that depend on Chinese imports for final assembly or distribution. Over time, this has led to supply chain fragmentation, price inflation, and production delays.

Importantly, this disruption has hurt the US more than China in several areas. Chinese firms have been able to redirect exports to other markets (such as ASEAN nations or the EU), while American businesses have struggled to find cost-effective alternatives due to high labor and production costs domestically or limited supply from other countries. Furthermore, the US consumer has borne much of the tariff burden in the form of higher prices, contradicting the intended protective function of these tariffs.

Table 3. Short-Run and Long-Run Tariff Impact on Metrics

Metric	Short-Run Impact (Estimated)	Long-Run Impact (Estimated)
Overall Average Effective Tariff Rate	20.6% (highest since 1910)	19.7% (highest since 1933)
Overall Price Level Increase	2.10%	1.80%
Clothing and Textiles (Apparel Prices)	40% higher	18% higher
Clothing and Textiles (Shoe Prices)	44% higher	20% higher
Food Prices	4.1% higher	3.3% higher
Fresh Produce Prices	7.0% initially	3.9% higher
Motor Vehicle Prices	14.1% higher	10.3% higher
Core Inflation (excl. food & energy)	Not specified	2.9% (June Y-o-Y)

In essence, rather than decoupling from China, many US companies have been forced to restructure their supply chains, without fully eliminating Chinese components. This misalignment has underscored the importance of the global supply chain and how protectionist policies, if misapplied, can have adverse economic consequences, indicating that:

- US imports of goods from China declined by roughly 40% from early 2018 to late 2019 for products heavily impacted by tariffs, a significant reversal in a long-standing trading relationship.
- As Chinese imports receded, other trading partners filled the void, with imports from Mexico and the European Union increasing gradually relative to their early 2018 levels.

6.2. Escalation after 2018 and its Impact

The trade war escalated sharply in 2018 when President Trump implemented a series of tariffs targeting over $250 billion worth of Chinese imports. In response, China imposed retaliatory tariffs on US goods. The fallout from this policy shift has had measurable economic consequences for both countries, though the effects have not been evenly distributed. These consequences include inflation in goods. Research indicates that the 2018 tariffs were largely passed through to US domestic consumers, with estimates that these tariffs led to a 0.3 to 0.5 percentage point increase in CPI inflation within the first year and resulted in a reduction in aggregate US real income of approximately $1.4 billion per month by the end of 2018.

6.2.1. US

For the US, the tariff escalation led to higher input costs, reduced industrial output, and a misallocation of resources. The increased cost of intermediate goods forced many manufacturers to either absorb losses or raise prices, neither of which supports long-term economic health.

Key macroeconomic indicators that show this misallocation are:

- GDP growth slowed from 2.9% in 2018 to around 2.1% in 2019.
- Manufacturing employment plateaued and then declined by 2020.
- US manufacturing output fell by nearly 2% by late 2019, reversing previous gains.
- Business investment dropped significantly due to uncertainty and elevated production costs.

*https://wits.worldbank.org/CountryProfile/en/Country/USA/Year/2008/Summarytext#:~:text=Tariffs%202008&text=The%20simple%20average%20tariff%20across,items%20share%20was%2054.20%20percent.

The trade imbalance persisted: while tariffs were intended to reduce the US current account deficit with China, it stood at –$440 billion in 2018, indicating that tariffs had little Impact on improving trade balances but instead strained domestic industries and consumers. Additionally, retaliatory tariffs by China on agricultural and industrial goods caused distress among US farmers and exporters.

In macroeconomic terms, these dynamics reflect a misallocation of scarce resources, capital, and labor shifted away from export-oriented, globally competitive sectors such as agriculture (soybeans, pork), advanced manufacturing, and technology industries, toward politically favored but less globally efficient sectors like domestic steel, aluminum, and certain legacy manufacturing industries. Rather than fostering a competitive industrial base, the tariffs disrupted market signals and eroded investor confidence.

6.2.2. Third-Order Heading

While China was also affected, the Impact was relatively less severe and more strategically managed. Chinese policymakers mitigated shocks by:

- Devaluing the yuan to offset tariff costs: The Chinese yuan depreciated by approximately 8.3% against the US dollar from April 2018 to January 2019, making Chinese exports cheaper and helping to absorb some of the tariff burden.
- Redirecting trade flows to Asia, Africa, and the EU: Chinese exports to the US significantly declined, prompting a redirection of trade. For instance, Chinese exports to the Euro area saw a statistically significant increase of 2-3% in imports from China, and trade was also strongly redirected towards South and Southeast Asian countries. China's trade with Africa continued to grow, with Chinese FDI flowing to Africa reaching almost $5.4 billion in 2018.
- Boosting domestic subsidies and investment in high-tech sectors: China increased domestic support, for example, soybean subsidies nearly doubled from 2017 to 2018, to about $340 per acre to support domestic production. There was also a strategic focus on boosting investment in high-tech and other strategic sectors to reduce reliance on foreign technology and build domestic resilience.

China's export sector proved more flexible than expected. For example, although exports to the US declined, overall export volumes remained relatively stable due to growth in non-US markets. This adaptability limited the negative effects on China's GDP and employment levels. However, Chinese manufacturers did face reduced access to US technology, higher uncertainty, and investment constraints. *China's more centralized control over its economy allowed it to absorb and redistribute these shocks more effectively than the US, where market-driven systems had less room for short-term correction.*

7. Impact of Tariffs on Valuation of Currency

Some economists have indicated that an increase in tariffs would lead to an appreciation of the dollar, the demand for imported goods would decline, and there would be less outflow of the currency.

The other argument is that fewer imports mean that foreign countries have fewer dollars to spend on exports, which might lead to a falling demand for the dollar, possibly not such a high appreciation as expected.

The immediate Impact of the tariff wars and appreciation of the currency. With the trade deficit decreasing, the dollar would have a definite positive impact.

8. Analysis

America and China are imposing tariffs and countervailing tariffs at different rates on different items.

Table 4. Tariffs imposed by the US and China on various goods

Product	Tariff Imposed by the US	Tariff Imposed by China
Steeel	55%	
Fentanyl	20%	1.80%
Autos	25%	18% higher
Optical Fibers		104%
Agricultural, meat, and dairy		10-15%
Coal		15%
Rare-Earth Minerals	55%	10%

It is anticipated that the tariffs set by President Trump:

- Would raise $2.5 trillion in revenue over the next decade and decrease the US GDP by 0.8% over the same period.
- Reduce the market income by 1.4% in 2026.
- Inflation levels would increase by 2.1% in the short run
- High inflation would impact the real GDP growth in 2025 by -0.9pp, lower than all 2025 tariffs.
- The long-run effect will likely witness the US economy persistently smaller by 0.5%. This is the equivalent of $135 billion annually in 2024.
- The unemployment rate would rise 0.5 percentage points by the end of 2025.

China, on the other hand, has officially declared that its GDP growth rate has, in fact, increased from 5.1% in 2024 to 5.2% in 2025. They have indicated the robustness of demand for their products from

1. Domestic demand
2. External demand from countries besides the US

9. Limitations of the Data

The current data sets that have been analyzed may not be indicative of what is going to happen in the future, as they are just forecasts. The forecasts for the American economy seem bleak, and the future may be more than what has been indicated.

The data from the Chinese government is centralized, and there may not be authentic validation of the sources that have been cited. The American data is more open and can be subject to scrutiny, which is not possible for the Chinese economy.

The Impact of tariffs may unfold differently depending on future employment and inflation conditions in both economies.

10. Conclusion and the way ahead

As the US continuously enters into various trade agreements with countries all over the world, especially those with which they have a high trade deficit, notably amongst them being China, the current data that has been released, at the end of June 2025 by the China's National Bureau of Statistics, has indicated a GDP growth rate of 5.2% which is higher than the 5.1% of the same period in 2024. They do not appear to be affected by the exorbitant tariff rates that impact their exports and the manufacturing sector. There could be various reasons for this. Some of them can be the robust domestic demands, and others could relate to the increasing demand for exports from China by other economies of the world.

Tariffs, perhaps, as indicated above, do not lead to major economic gains. All pure economic theory has continuously reiterated that the imposition of tariffs leads to the misallocation of scarce resources. Despite validation from economic theory, several countries enter into this sphere of high imposition of tariffs, stating that the primary aim is to protect the domestic industry. By imposing tariffs, it would protect the domestic industries and help them reach high levels of growth that were not possible under competition from foreign-made goods. With an increase in growth, there would be a simultaneous increase in employment, and the linkage effect would be in terms of higher savings, consumption, taxes, etc. Recent data from the US Commerce Department in June 2025 indicated that prices have increased sharply due to tariffs in areas such as home furnishing, toys, and appliances. Companies like Adidas, Procter and Gamble, Walmart, Mattel, and other such large corporations have indicated that they would be passing on the Impact of higher tariffs to the consumer. It would be difficult for the producers to absorb the increase in prices due to the sharp imposition of tariffs. The Bureau of Labor Statistics indicated on 08/02/2025 that the number of jobs added in July was only 73,000, and those added in May and June were also much lower than previously estimated. All this clearly indicates that the economic Impact of tariffs may not be as anticipated. There might be gains in the decreasing balance of deficit, which has to be weighed against higher inflation levels and lower job opportunities. The main Impact is the political gain for the country.

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