The Economic and Fiscal Effects of the Trump Administration's Proposed Tariffs

The Budget Lab at Yale
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On January 31, the White House announced a slate of tariffs of 25% on Canadian and Mexican imports, with a special lower 10% tariff on Canadian petroleum imports, and a 10% tariff on Chinese imports. This note estimates the economic and fiscal implications of this tariff proposal. It extends the methodology of The Budget Lab's earlier tariff analysis from last October.

Summary Economic & Fiscal Effects of 25% Tariff on Mexico & Canada* + 10% Tariff on China

	Conventional Score****					Add'l Dynamic Effects in Equilibrium
	2026-35		In Equilibrium			
	$billions	% of GDP	% Change in PCE Price Level*	Decline in Average Real Dispoable Income per Household (2024$)**	Add'l Effective Tariff Rate (p.p.)***	% Change in Medium-to-Long Run Real GDP Level
With Retaliation	$1,439	0.4%	0.76%	-$1,245	6.30	-0.2%
No Retaliation	1,539	0.4%	0.72%	-1,170	6.10	-0.2%

* Assumes 10% tariff on Canadian crude oil.
** Pre-substitution. *** Post-substitution.
**** Under relaxed conventional assumptions.
Source: Congressional Budget Office, GTAP v7 [Corong et al (2017)], The Budget Lab analysis.

The Budget Lab modeled the economic and fiscal impact of the tariff proposal both with and without retaliation.[1] The results are summarized in the table above.

- **Aggregate price effects.** The proposed tariff puts upward pressure on the PCE price level of 0.72-0.76% before consumer substitution, depending on the extent of retaliation from Canada, Mexico, and China. Pre-substitution is the best way to gauge the hit to consumer welfare. That is the equivalent of a loss of purchasing power of about $1,200 on average per household in 2024$.

  Even after consumers substitute, and assuming the Federal Reserve does not tighten monetary policy to counteract the tariff's price effects, the level of PCE prices is still persistently 0.6% higher in the medium-term, a loss in purchasing power of about $1,000 per household in 2024$.
- **Output effects.** In the medium-to-long run, the size of the US economy is persistently 0.2% smaller in real terms under the package, even after the US and global economies rebalance.

[1] As with the October 2024 analysis, The Budget Lab assumed the tariffs apply only to goods, not services.

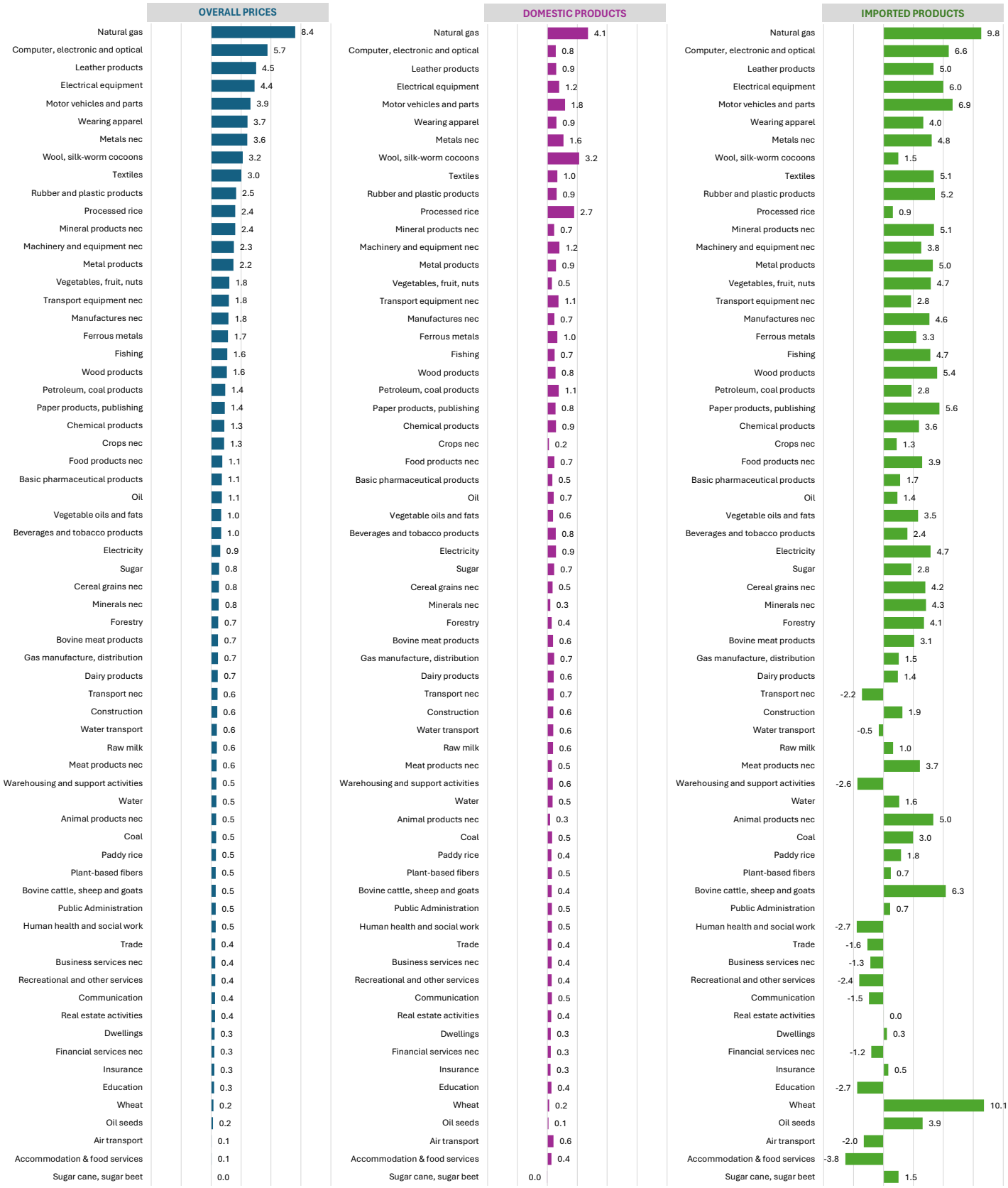
This long-run result does not differ meaningfully between retaliation and no retaliation scenarios.[2] [3]

- **Fiscal effects.** Over 2026-2035, this tariff package raises $1.4-1.5 trillion under "relaxed" conventional assumptions (keeping income constant for the US but allowing it to fall for foreign countries). Conventional revenues under retaliation are 6% smaller than under non-retaliation assumptions.
  Net revenues would, in reality, likely be even lower than this once dynamic effects are taken into account, given the smaller size of the US economy. Under Congressional Budget Office (CBO) rules of thumb, a -0.2% permanent shock to the size of the US economy that phases in over three years—akin to how The Budget Lab models tariff impacts—lowers revenues by an additional roughly-$130 billion over a decade.
- **Average effective tariff rate.** The average effective tariff rate would rise by approximately 6.1-6.3 percentage points under the proposal, once consumers and businesses substituted towards domestic or non-tariffed imported goods. This would put the overall average effective tariff rate at 8.6-8.8%, the highest US average tariff rate since 1946.
- **Commodity price effects.** The figure below shows detail from GTAP on how the longer-run price level effects are distributed across different goods and services, and how prices would change for both domestic and imported products. These are the net effects after the US and global production re-balances to account for the tariffs. A few high-level observations:
  - Tariffs not only raise prices for imports, but drive domestic producers to raise prices too, though by how much depends on the size of the tariff, the exposure of the market to both foreign and domestic competition, and the price sensitivity of customers.
  - The individual commodity with the largest price increase is natural gas. The average price rises 8.4%, which is a weighted average of the domestic price increase (4.1%) and imported price increase (9.8%).
  - Fresh produce ("Vegetables, fruits, nuts") rises in price by 1.8% on average.
  - Crude oil prices rise 1.1% in the long run. Gasoline prices ("Petroleum, coal products") rise 1.4% on average, the equivalent of an additional $0.04 per gallon in today's prices. Note that these are longer-run effects after the US shifts its supply chains for crude oil; shorter-run effects on oil and gasoline prices may be larger.
  - Auto prices rise 3.9% on average, the result of a 6.9% rise in imported auto prices and a 1.8% rise in domestic auto prices.

[2] GTAP v7, the model The Budget Lab uses to calibrate the economic and trade effects of tariff proposals, does not provide intertemporal, short-run detail on economic effects; therefore, these results do not rule out the possibility that short-run outcomes may differ meaningfully between the retaliation and no retaliation scenarios.
[3] Under the retaliation scenario, The Budget Lab assumed that Canada, Mexico, and China applied tariffs on each exported US commodity exactly equal to the ones imposed by the US on those respective countries.

Commodity Price Effects from the Jan. 2025 Tariff Proposal

Percent change to price level, medium-to-long run



"nec" = "Not elsewhere classified"

Source: GTAP v7 [Corong et al (2017)], The Budget Lab analysis.