Article

Tariffs in U.S. Trade Policy: Historical Patterns, Economic Effects, and 2025 Projections

Victoria Torino, EA, CPA

Victoria Torino is a senior finance professional with extensive management and nonprofit experience. She has a Master's degree in Jurisprudence from Texas A&M and an MD in Science in Accountancy from the State University of New York. She is a certified accountant licensed with Virginia and North Carolina boards of CPA and a licensed tax professional with the IRS. E-mail: vtorino@tamu.edu

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US tariff policies, Holdup Theory, international trade, international relations, World Trade Organization (WTO).

ABSTRACT:

This paper examines the historical economic impact of US tariff policies and draws lessons for proposed 2025 tariffs. Through analysis of major tariff policies - including the Smoot-Hawley Act, Roosevelt's Reciprocal Trade Agreements Act, NAFTA, China's WTO accession, and AUSFTA -the research integrates historical data with economic frameworks like holdup theory to provide a comprehensive understanding of tariffs' effects on economic growth, trade, employment, and international relations. The findings indicate that while tariffs historically served as important revenue sources and protection mechanisms, their modern application has often led to significant economic costs. Analysis of recent tariffs (2018-2019) demonstrates substantial trade diversion and welfare losses, with consumers bearing most costs through higher prices. The paper concludes that future tariff strategies should be highly selective and strategically designed rather than broadly applied, with careful attention to sector-specific vulnerabilities and complementary adjustment assistance programs to mitigate negative distributional effects.

PALABRAS CLAVES:

Políticas arancelarias de EE.UU., Teoría de Holdup, comercio internacional, relaciones internacionales, Organización Mundial del Comercio (OMC).

RESUMEN:

Este artículo examina el impacto económico histórico de las políticas arancelarias estadounidenses y extrae lecciones para los aranceles propuestos para 2025. A través del análisis de políticas arancelarias importantes—incluyendo la Ley Smoot-Hawley, la Ley de Acuerdos Comerciales Recíprocos de Roosevelt, el TLCAN, la adhesión de China a la OMC y el AUSFTA—la investigación integra datos históricos con marcos económicos como la teoría del holdup para proporcionar una comprensión integral de los efectos de los aranceles en el crecimiento económico, el comercio, el empleo y las relaciones internacionales. Los hallazgos indican que, si bien los aranceles históricamente sirvieron como importantes fuentes de ingresos y mecanismos de protección, su aplicación moderna ha llevado frecuentemente a costos económicos significativos. El análisis de aranceles recientes (2018-2019) demuestra una desviación comercial sustancial y pérdidas de bienestar, con los consumidores soportando la mayoría de los costos a través de precios más altos. El artículo concluye que las estrategias arancelarias futuras deberían ser altamente selectivas y diseñadas estratégicamente en lugar de aplicarse ampliamente, con atención cuidadosa a las vulnerabilidades específicas de cada sector y programas complementarios de asistencia para mitigar los efectos distributivos negativos.

MOTS CLES :

Politiques tarifaires américaines, théorie du hold-up, commerce international, relations internationales, Organisation mondiale du commerce (OMC).

RESUME :

Cet article examine l'impact économique historique des politiques tarifaires américaines et en tire des enseignements pour les tarifs douaniers proposés pour 2025. À travers l'analyse des principales politiques tarifaires – notamment la loi Smoot-Hawley, la loi Roosevelt sur les accords commerciaux réciproques, l'ALENA, l'adhésion de la Chine à l'OMC et l'AUSFTA –, la recherche intègre des données historiques à des cadres économiques tels que la théorie du hold-up afin de fournir une compréhension globale des effets des tarifs sur la croissance économique, le commerce, l'emploi et les relations internationales. Les résultats indiquent que, si les tarifs ont historiquement constitué d'importantes sources de revenus et mécanismes de protection, leur application moderne a souvent entraîné des coûts économiques importants. L'analyse des tarifs récents (2018-2019) met en évidence d'importants détournements de trafic et pertes de bien-être, les consommateurs supportant l'essentiel des coûts par le biais de prix plus élevés. L'article conclut que les futures stratégies tarifaires devraient être très sélectives et conçues de manière stratégique plutôt qu'appliquées à grande échelle, en accordant une attention particulière aux vulnérabilités sectorielles et en mettant en place des programmes d'aide à l'ajustement complémentaires pour atténuer les effets distributifs négatifs.

Contents:

1 INTRODUCTION

Internationalization, marked by increasing global economic interconnectedness, has profoundly reshaped national economies and policy landscapes (Garrett & Lange, 1991; Bhagwati, 2004). This process has intensified domestic political debates and policy responses, often varying by economic structure and political ideology (Keohane & Milner, 1996). Within this context, tariffs have been a central yet controversial tool in US trade policy since the nation's founding. This paper examines how US tariff policies have historically shaped economic outcomes and draws lessons for proposed 2025 tariffs. By integrating historical analysis, holdup theory, and empirical evidence, we provide a comprehensive understanding of tariffs' complex impacts on growth, trade, employment, and international relations.

The U.S. economy has become highly internationalized, especially after World War II. Internationalization refers to the increasing economic interconnectedness among nations through cross-border flows of goods, services, capital, and information. This process fundamentally transforms how national economies operate and interact with one another.

Research by Garrett and Lange (1991) demonstrates that internationalization isn't merely about quantitative increases in trade volumes or foreign investment, but represents a qualitative shift in how economic activities are organized globally. As transaction costs for international exchanges decrease relative to domestic ones, not just greater trade volumes but fundamental changes in economic structures and policy landscapes emerge (Frieden & Rogowski, 1996).

According to Bhagwati's (2004) work on globalization effects, internationalization creates significant pressures on domestic political institutions as they navigate between satisfying local constituencies and responding to global economic forces. This tension produces varying responses based on domestic political arrangements - notably, left-wing governments tend to pursue different adaptation strategies than right-wing ones when facing similar international pressures (Alvarez, Garrett, & Lange, 1991).

The research indicates that a nation's specific economic characteristics, such as factor endowments and economic specialization - significantly influence how internationalization affects its political economy (Frieden & Rogowski, 1996). Capital-rich economies may push for greater openness while capital-poor ones might resist, creating divergent policy trajectories despite facing similar international forces.

Studies by Rodrik (1997) reveal that as internationalization deepens, domestic political debates increasingly focus on international economic issues. Policies concerning trade, exchange rates, and foreign investment become central to political discourse and coalition formation, reshaping internal politics through external economic forces.

Internationalization doesn't create policy convergence across nations, but rather transforms how domestic interests are articulated and pursued within unique national contexts. The result is a complex landscape where international forces interact with domestic institutions to produce distinct national responses within an increasingly integrated global economy (Guillen, 2003).

Tariffs' increase proposed by U.S. Republicans is a return to centuries-old protective national policies that were implemented consistently in periods of economic turbulence and have been a central component of US trade policy since the nation's founding. The history of US tariffs reveals a cyclical pattern of protectionism and liberalization, with consequential impacts on economic growth, trade balances, employment, and international relations,

which provides rich data to analyze possible effects of the 2025 tariff increase from a historical perspective.

This paper analyzes the economic impacts of major tariff policies throughout US history, with particular attention to the Roosevelt-era Reciprocal Trade Agreements Act, China's WTO admission, NAFTA, and AUSFTA. By examining tariffs through economic frameworks such as holdup theory and incorporating empirical evidence from pivotal trade agreements and policy shifts, this research aims to provide context for contemporary trade policy debates.

2 HISTORICAL CONTEXT OF US TARIFF POLICIES

2.1 REPUBLICAN-LED TARIFF POLICIES AND THE SMOOT-HAWLEY ACT

The Republican Party historically favored protectionist tariff policies from the Civil War era through the early 20th century (Irwin, 2019). Protectionism reached its peak with the Smoot-Hawley Tariff Act of 1930, which increased import duties by approximately 20 percent during the early stages of the Great Depression. Within the two years following the implementation of the Smoot-Hawley tariff in June 1930, the United States experienced a staggering decline in the volume of imports, which plummeted by over 40 percent. The tariff has often been associated with a broader economic collapse that included the onset of the Great Depression. Meltzer (1976) suggests that the tariffs' sharp rise in duties led to a significant drop in imports of semi-finished goods and exports of food and caused the Depression. Gordon and Wilcox (1981), Saint-Etienne (1984), and others agreed that Smoot-Hawley tariffs intensified the depression.

Modern economic research suggests that while Smoot-Hawley tariff did not cause the Great Depression, it contributed to its severity by triggering retaliatory measures from trading partners and reducing global trade. While the Smoot-Hawley tariff was a noteworthy factor in U.S. trade decline, the basic economic conditions during the period, including deflation and reduced income, played an even more pronounced role (Irwin, 1988). Hence, the implications are clear: while protectionist policies like Smoot-Hawley can lead to decreased trade volumes, it is essential to consider the broader economic context when evaluating their true impact on trade and the economy at large. The tariff's small direct shock may have been overwhelmed by larger systemic issues within the economy, complicating the narrative associating it with the Great Depression. Further research is needed to expand on the implications of these findings on economic policy and international trade relations moving forward.

A study by Eckes (1995) that challenged the conventional wisdom about Smoot-Hawley's historical significance followed the same chain of logic: while its negative impacts were substantial, they weren't as catastrophic as often portrayed in historical narratives. Hayford and Pasurka (1991) similarly demonstrated that while Smoot-Hawley was highly protectionist, it wasn't necessarily the highest tariff regime in US history when measured by effective rates of protection.

2.2 ROOSEVELT'S SHIFT AND THE RECIPROCAL TRADE AGREEMENTS ACT

In response to the economic devastation of the Great Depression, President Franklin D. Roosevelt's administration shifted toward trade liberalization with the Reciprocal Trade Agreements Act (RTAA) of 1934. This landmark legislation marked a fundamental shift in US trade policy although the Reciprocal Trade Agreements Act was technically, an amendment to the Hawley-Smoot Act of 1930 (Burke, 1962).

According to Haggard's (1988) research published in International Organization, the RTAA represented a critical institutional foundation for American economic hegemony. The act

gave President Roosevelt both the authority to adjust tariff rates and the power to negotiate bilateral trade agreements without requiring prior congressional approval. This represented a significant transfer of trade authority from Congress to the executive branch, a move justified by proponents as necessary for economic recovery.

By early 1939, the United States had ratified multiple trade agreements with various countries, reflecting a commitment to fostering international trade relationships. These agreements contributed to a substantial reduction in US tariffs, with average nominal duties on foreign products declining from an average of 46 percent in 1934 to 12 percent by 1962 (Haggard, 1988).

The institutional design of the RTAA proved very durable. The RTAA's significance extended beyond immediate economic recovery to establishing a framework for US trade policy that would persist throughout the 20th century. It also established the foundation for the post-World War II international trading system, serving as a precursor to the General Agreement on Tariffs and Trade (GATT) and NAFTA. Although in the 19th and early 20th centuries, the U.S. government relied heavily on tariffs for revenue. Then the government ran deficits, tariff rates increased; when it ran surpluses, tariff rates decreased (Hansen, 1990). Roosevelt administration significantly shifted away from tariffs as a revenue source through the Reciprocal Trade Agreements Act of 1934, while simultaneously expanding government programs that required more revenue than tariffs could provide, thus cementing income taxes as the primary federal revenue source during his presidency.

2.3 NAFTA AND ITS ECONOMIC CONSEQUENCES

The North American Free Trade Agreement (NAFTA), implemented in 1994, fundamentally reshaped economic relations among the United States, Mexico, and Canada. This section analyzes the empirical evidence on NAFTA's economic impacts.

Burfisher, Robinson, and Thierfelder (2001) published a comprehensive assessment of NAFTA's impact on the United States in the Journal of Economic Perspectives. Their research found that both the US and Mexico benefited from NAFTA, though with much larger relative benefits for Mexico. Their analysis concluded that "NAFTA has had little effect on the U.S. labor market" and that "trade creation greatly exceeds trade diversion in the region under NAFTA, especially in intermediate goods."

Blecker and Esquivel (2013) in their research confirm that the expectations associated with NAFTA were high, with Mexico hoping to boost exports, attract foreign direct investment, create new industrial jobs, and, most importantly, bridge the economic development gap with the United States. However, the reality of NAFTA's impact on Mexico has not aligned with these expectations. The lack of deeper regional integration or cooperation between Mexico and the United States has hindered the fulfillment of NAFTA's promises. On the other hand, the deepest concerns raised by NAFTA opponents about anticipated negative impacts on American labor markets, potential mercantilist arguments regarding trade with Mexico, the implications for agricultural sectors, and the broader consequences for migration patterns were not confirmed either. Predicted job losses in the textile industry did not align with post-NAFTA realities, as production in the U.S. ultimately increased, driven by the efficiencies and competitive advantages rendered by NAFTA's structure and rules of origin provisions.

Research from the Peterson Institute for International Economics (PIIE) (2014) estimated that the United States became approximately $127 billion richer annually due to increased trade facilitated by NAFTA, though this translated to only about $400 per person given the US population size at the time of the study. This modest aggregate benefit is consistent with

most economic research finding that NAFTA had a positive but relatively small impact on US GDP.

2.4 SECTORAL AND DISTRIBUTIONAL EFFECTS

Research on NAFTA's sectoral impacts reveals a more nuanced picture. While aggregate economic effects were modestly positive, specific industries and regions experienced significant disruption. Manufacturing industries and communities in certain regions of the United States faced adjustment challenges as production shifted to Mexico. By 2024, Mexico became the 7th largest passenger-vehicle manufacturer in the world, with its automotive sector comprising 3.6 percent of gross domestic product. Hundreds of thousands of auto manufacturing jobs were created in Mexico, and most empirical studies found that the agreement increased productivity and lowered consumer prices in Mexico (Council on Foreign Relations, 2020).

NAFTA boosted Mexican farm exports to the United States, which tripled after implementation.

NAFTA catalyzed Mexico's transformation from one of the world's most protectionist economies to one of the most open to trade. Prior to NAFTA, Mexico had an average tariff level of 10 percent, and joining NAFTA helped lock in Mexico's economic reforms and increased investor confidence in Mexico's economy.

The possible economic impact of NAFTA tariffs was deeply disrupted by China joining the World Trade Organization (WTO) and obtaining "permanent normal trade relations" (known also as "most favored nation") status from the United States in 2001. The influx of Chinese and other Asian imports into the U.S. market not only reduced Mexican exports to the United States but also decreased U.S. exports of intermediate goods that would have been sent to Mexico for assembly.

3 CHINA'S WTO ACCESSION AND ITS ECONOMIC IMPACT

China's accession to the World Trade Organization in December 2001 fundamentally altered global trade patterns and had significant impacts on both the US and global economies. This section examines the empirical evidence on these impacts from the academic literature.

3.1 ECONOMIC GROWTH EFFECTS

Research by Ching et al. (2004) in the Pacific Economic Review found that China's WTO accession had significant positive effects on China's economic growth. Using a synthetic control methodology to create a counterfactual "synthetic China," researchers at Cambridge University (2018) demonstrated that China's economic growth outpaced what would have been expected without WTO membership. Relative to the 2001 GDP, China's economy had grown 61% within five years after WTO entry, while the synthetic counterfactual had only grown 41%.

However, this research also indicates that WTO accession was only one of several factors contributing to China's dramatic economic growth during this period. Other contributing factors included massive infrastructure development, higher education expansion, foreign direct investment increases, and domestic economic stimulus programs.

3.2 LABOR MARKET IMPACTS IN THE UNITED STATES

The most significant body of research on US labor market impacts from China's WTO accession comes from Autor, Dorn, and Hanson (2013), who identified what has become

known as the "China Shock" - the rapid increase in import competition following China's integration into global markets.

Their research documented that, areas in the United States with industries exposed to Chinese import competition experienced significant and persistent economic disruption. Manufacturing employment declined sharply in the sectors most affected by rising imports, and wages in those local labor markets remained depressed for at least a decade. These regions also saw a notable decrease in labor force participation alongside a rise in unemployment rates. Workers faced greater job instability, with increased rates of job churning and significant reductions in lifetime earnings. Compared to NAFTA's possible impact on labor force bleeding that was the major concern before 1998, the U.S. manufacturing employment did experience a sharp decline, but this downturn did not begin immediately after NAFTA's implementation. Instead, it occurred after 2001, seven years later. Approximately three million manufacturing jobs were lost following the 2001 recession and China's entry into the WTO that same year. Importantly, Autor et al. (2013) estimate that import competition from China was responsible for approximately 25 percent of the aggregate decline in US manufacturing employment between 1990 and 2007, representing about 1 million jobs lost.

In addition to Autor et al.'s findings on the 'China Shock,' studies by Pierce and Schott (2016) and Handley and Limão (2017) further document the labor market disruptions from trade liberalization.

Interestingly that a more recent analysis found "no support for net negative effects on aggregate U.S. employment from the China shock" (Bloom, et al, 2019). Instead, it showed a geographic reallocation of economic activity across the U.S., potentially accelerating regional inequality rather than causing overall job loss. A 2023 review concluded that while US-China trade since the early 2000s caused aggregate welfare gains in both countries, the adjustment costs were highly uneven, creating clear winners and losers (Caliendo & Parro, 2023). The benefits of trade with China (primarily lower consumer prices and higher corporate profits) were broadly distributed, while the costs (job losses and wage depression) were geographically concentrated in specific regions and industries. The recent trade war led to welfare losses, had minimal effects on employment, and failed to reverse the distributional consequences of the China Shock.

4 THE AUSTRALIA–UNITED STATES FREE TRADE AGREEMENT

While NAFTA and China tariff agreements created trade deficits and labor force redistribution, trade agreements with developed countries had a different effect. The Australia–United States Free Trade Agreement (AUSFTA) opened 99 percent of U.S. manufactured exports to Australia and substantially increased bilateral services trade. By 2022, bilateral trade had grown to over $76 billion, up from $30 billion in 2005, and investment had ballooned to $2.16 trillion, compared to $637 billion in 2005. The U.S. became the largest foreign investor in Australia and the top destination for Australian outbound investment. Australian exports to the U.S. and U.S. investment income accounted for 7 percent of Australia's GDP by 2019, helping to finance Australia's investment-savings gap. Employment ties also deepened: Australian firms employed over 150,000 workers in the U.S., and American firms employed over 320,000 workers in Australia (Australian Government, 2023).

The preceding analysis reveals that although tariffs have historically constituted a foundational revenue and protection mechanism for the Republican Party, the outcomes of trade agreements vary significantly across contexts. The indiscriminate application of reciprocal tariffs, absent careful calibration to sectoral dynamics and geopolitical realities,

risks exacerbating domestic discontent, provoking international retaliation, and ultimately subverting the strategic and economic objectives they are intended to advance.

While this paper primarily focuses on historical lessons, it is essential to also consider the economic implications of evolving supply chain theories, such as holdup theory and related models, which are poised to shape the structure and effectiveness of reciprocal tariffs and broader trade measures in 2025. Newer theoretical frameworks, including holdup theory, provide critical insights beyond traditional models by recognizing the dynamic and relationship-specific nature of modern international trade.

5 HOLDUP THEORY AND TARIFF ANALYSIS. THEORETICAL FRAMEWORK

The holdup theory from institutional economics provides a valuable theoretical framework for understanding the economic implications of tariffs beyond standard trade models. This section explores how holdup theory enhances our understanding of tariff impacts.

Theoretical Framework: The holdup problem, a concept from institutional and contract economics, offers important insights into the broader economic effects of tariffs. In international trade, firms frequently make relationship-specific investments under conditions of incomplete contracts and weak cross-border enforcement. Tariff shocks exacerbate these vulnerabilities by increasing uncertainty and destabilizing investment incentives.

Ornelas and Turner (2008) show that tariffs worsen underinvestment problems in bilateral trade relationships by discouraging foreign suppliers from making cost-reducing, relationship-specific investments. Trade liberalization, conversely, strengthens these incentives and promotes multinational integration. Martin and Otto (2019) provide empirical evidence that tariff reductions in upstream industries significantly boost downstream investment, especially for firms sourcing differentiated inputs.

Institutional frameworks like the World Trade Organization (WTO) help mitigate political holdup risks by enforcing credible trade rules. However, sudden tariff hikes - as in the 2018 U.S. case -can undermine these protections, forcing costly supply chain reorganizations, as documented by Grossman and Helpman (2020).

Applying holdup theory to potential 2025 U.S. tariffs suggests that anticipation of trade barriers may already be deterring investment in sectors reliant on cross-border specialization. Firms facing tariff risks may underinvest, seek costly alternative suppliers, or vertically integrate prematurely, all of which reduce economic efficiency.

Moreover, Amiti, Redding, and Weinstein (2020) find that the 2018 tariffs were almost fully passed through to domestic prices, magnifying welfare losses. When accounting for both direct price effects and investment distortions, the costs of tariffs appear substantially higher than traditional models predict.

In sum, holdup theory underscores that tariffs not only impact immediate trade flows but also reshape global production structures by discouraging investment, destabilizing supply chains, and generating dynamic welfare losses. Policymakers evaluating future tariff strategies must weigh these complex, longer-term risks alongside traditional trade considerations. Interesting that applying holdup theory to Smoot-Hawley tariff, we can see how sudden tariff hikes disrupted relationship-specific investments. Foreign suppliers, facing higher US tariffs, were deterred from investing in cost-reducing technologies tailored to the US market, exacerbating the decline in trade volumes.

2018-2019 US Tariffs: Research by Fajgelbaum et al. (2020) published in The Quarterly Journal of Economics used a general equilibrium model to analyze the impacts of the 2018-2019 US tariffs and retaliatory measures. They also made a connection to the protectionist policies discussed earlier. Their findings indicate that:

The tariffs imposed led to substantial trade diversion, redirecting approximately $136 billion of global trade flows away from targeted suppliers. Empirical evidence indicates that U.S. consumers and firms that relied on imports bore nearly the full economic burden of the tariffs, as domestic prices increased almost one-for-one with the tariff rates, offering negligible improvements in terms of trade. Consequently, the aggregate welfare loss to the U.S. economy was estimated at approximately 0.27 percent of GDP, underscoring the broader economic costs associated with protectionist measures.

6 ESTIMATED LONG-TERM IMPACTS AND POLICY CONCLUSIONS

While historical U.S. tariffs, particularly in the 19th century, generated substantial federal revenues and occasionally produced fiscal surpluses that supported early industrial development, modern economic analysis suggests that the long-term costs of sustained tariff policies may outweigh their benefits. Although tariffs once played a critical role in protecting nascent industries and funding the federal government, today's globalized economy imposes very different dynamics and risks.

6.1 ECONOMIC IMPACT OF RECENT TARIFFS

Recent projections, such as the Penn Wharton Budget Model (2025), estimate that maintaining tariffs imposed during 2018-2025 would reduce U.S. long-run GDP by 6-8 percent and lower average wages by 5-7 percent, with middle-income households facing substantial lifetime income losses between $22,000 and $58,000. These projected losses are nearly twice those estimated from a revenue-equivalent increase in corporate taxation, highlighting the particular inefficiency of tariffs as a contemporary fiscal instrument. In most cases, tariffs have acted as a broad tax on consumers and producers alike, raising domestic prices and reducing aggregate welfare.

However, the long-run economic impact of new tariffs might differ if accompanied by complementary policy actions. For instance, some theoretical models suggest that tariffs on certain inputs can mitigate supply-chain hold-up problems by giving domestic suppliers more bargaining power. When tariffs make foreign alternatives more expensive, buyers have fewer options to switch suppliers, which encourages domestic firms to invest in specialized production. Strengthened domestic supply chains can, in theory, support industrial resilience and strategic autonomy. Nevertheless, unless tariffs are highly targeted and carefully designed, research shows they usually raise costs and cause more economic harm than benefit (Ornelas & Turner, 2005).

6.2 THEORETICAL PERSPECTIVES: SUPPLY CHAINS AND HOLD-UP THEORY

Holdup theory provides an important framework to understand these effects. In cross-border production, firms are often reluctant to make relationship-specific investments—such as building tailored manufacturing facilities if contractual enforcement across borders is uncertain. Blanket tariffs can worsen this problem by introducing new uncertainties and raising input costs, discouraging investment. However, strategically imposed tariffs on specific sectors might protect and encourage such investments by making domestic production comparatively more attractive.

At the same time, deliberate efforts to reshore industries back to the United States could strengthen domestic supply chains and help local firms capture some of the value previously going to foreign producers (Kouvelis at al, 2022). If combined with institutional safeguards and trade adjustment support, these strategies might partially offset the traditional costs of tariffs. Nevertheless, this optimistic scenario remains largely speculative. It is prudent to avoid overly optimistic claims until more empirical research evaluates the extent to which reshoring and improved contracting conditions can truly enhance long-term economic outcomes.

6.3 HISTORICAL PARALLELS: 1934 AND 2025 TARIFFS

The current 2025 tariff initiatives bear a notable resemblance to the reciprocal tariff framework established under the Reciprocal Trade Agreements Act (RTAA) of 1934. Reciprocity became a cornerstone of U.S. trade negotiations and the international trading system after World War II and help facilitate trade liberalization by making agreements politically acceptable domestically (Rhodes, 1993). Both policies center around reciprocity: responding to foreign trade barriers with corresponding U.S. measures. However, there is a critical difference in direction. The RTAA of 1934 was designed to systematically reduce the high tariff levels created by the Smoot-Hawley Tariff Act of 1930, aiming to liberalize trade and stimulate economic recovery during the Great Depression. In contrast, the 2025 tariffs propose to raise barriers in response to perceived unfair practices, representing a shift toward greater protectionism.

This reversal of intent raises important concerns. In the interconnected global economy of today, higher tariffs risk fragmenting supply chains, increasing costs for U.S. firms and consumers, and exacerbating geopolitical tensions. While reciprocal agreements in the 1930s helped stabilize international trade relations after years of economic turmoil, today's context demands more careful calibration to avoid triggering new economic inefficiencies and political retaliation.

7 SCENARIOS FOR 2025 TARIFFS AND IMPLICATIONS

The proposed 2025 tariffs, while lacking specific details, can be analyzed through historical parallels. If these tariffs mirror the broad scope of Smoot-Hawley, we might expect significant trade diversion and welfare losses, as seen in the 1930s. Conversely, if targeted strategically, they could potentially strengthen domestic supply chains in critical sectors. In some cases, the deadweight loss caused by a tariff may have been more than compensated for by an improvement in the country's terms of trade. If a nation has sufficient influence over world markets to affect the prices of its imports or exports, imposing an import tariff or an export tax can enhance its terms of trade, potentially leaving the country better off overall (Irwin, 2020).

However, given the speculative nature of this analysis, we draw on recent projections from the Penn Wharton Budget Model (2025), which estimates that maintaining 2018–2025 tariffs would reduce long-run GDP by 6–8 percent.

7.1 POLICY IMPLICATIONS

Historical experience reinforces the complexity of tariff outcomes. Trade agreements such as NAFTA and AUSFTA demonstrated that liberalization can generate aggregate welfare gains while simultaneously exposing specific industries and regions to concentrated adjustment costs. Similarly, the WTO accession of China in 2001 spurred broad economic

growth but inflicted substantial localized damage to U.S. manufacturing - a phenomenon now referred to as the "China Shock."

Applying holdup theory to these outcomes reveals that stable, enforceable trade relationships encourage firms to make relationship-specific investments critical for efficiency. Conversely, sudden or blanket tariff shocks, particularly without clear targeting, discourage investment, destabilize supply chains, and amplify welfare losses.

In light of these lessons, the application of tariffs in 2025 and beyond must be highly selective and strategically designed rather than blanket in nature. Our analysis suggests that targeted tariffs, crafted with careful attention to sector-specific vulnerabilities and incorporating lessons from past agreements, would more effectively balance national interests with economic efficiency. Notably, the holdup problem with Chinese firms may evolve differently under the current environment, as U.S. companies are increasingly structuring contracts, sourcing strategies, and institutional safeguards to mitigate opportunistic behavior. Certain sectors could experience improved investment dynamics if policies are calibrated carefully.

For instance, targeted tariffs on semiconductors could incentivize domestic production, while retraining programs for displaced manufacturing workers, modeled on post-NAFTA Trade Adjustment Assistance, could mitigate labor market disruptions.

7.2 ENGAGING PROTECTIONIST ARGUMENTS

Proponents of tariffs often cite national security and infant industry protection as justifications. However, as Baldwin (1969) noted, infant industry protection requires temporary, targeted support, not broad-based tariffs.

Overall, while selective, strategic tariffs may serve limited economic or national security purposes, broad-based protectionist measures risk imposing significant aggregate costs that outweigh localized benefits. Policymakers should complement any future liberalization efforts with robust adjustment assistance programs and prioritize maintaining stable, predictable institutional frameworks that encourage investment, supply chain resilience, and dynamic global economic integration.

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