How to Counter Trump's Tariffs Productively?

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NEW YORK – After months of threats and speculation, US President Donald Trump has officially launched his long-anticipated trade war. He has just imposed 25% tariffs on all steel and aluminum imports. His new 10% tariff on Chinese imports will further strain the world's second-largest economy, which is already grappling with slowing growth and unfavorable demographics. And his postponed – but not canceled – 25% tariffs on Canada and Mexico, together with threats to impose new tariffs on the European Union, India, and many more countries, put greater pressure on key US allies.
While many countries are considering retaliatory tariffs on US goods, such measures are both unproductive and unlikely to deter Trump. One reason is that most countries run trade surpluses with the United States and therefore have fewer US goods to target than the US does. More importantly, higher tariffs on US imports would hurt their own citizens and firms. Consequently, their ability to counter Trump's tariffs is severely limited.

A more productive approach would be to focus on minimizing the economic fallout. To do so, it is important to recognize that both a trade and a financial channel could cause Trump's trade war to trigger a global economic downturn.

Beyond his tariffs on metals and China, Trump has previously pledged to impose a 10% tariff on all imported goods. More recently, he proposed targeting only countries with which the US has a trade deficit, as well as a "Fair and Reciprocal Plan" that would tailor tariff rates to US trading partners' own barriers. While that may sound like a more measured approach, the US currently runs bilateral deficits with most countries – including 12 of its top 15 trading partners.

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Although Trump's tariffs will inflict economic pain on US households and businesses, that is unlikely to discourage him, partly because he views tariffs as a way to offset – at least partly – the revenue losses from his planned tax cuts. The fact that his tariffs will ultimately be paid by American consumers, especially middle- and low-income households, does not appear to concern him.

Although Trump's tariffs probably will not reduce the US trade deficit, they will have far-reaching implications for interest rates worldwide. If the Federal Reserve takes no action, the

tariffs will drive up the prices of both imported goods and domestically produced goods that compete with them or rely on imported inputs.
But the Fed is unlikely to sit idly by, especially with US inflation already above its 2% target. Instead, it will likely delay its planned interest-rate cuts or even raise rates to offset the inflationary impact of Trump's tariffs. Financial markets already anticipate such a response: the dollar has been appreciating with each new tariff threat.

Higher US interest rates will likely trigger a global liquidity squeeze, putting corporations and governments with high dollar-denominated debts at risk of default. If other central banks follow the Fed's lead on interest rates, as they often do, even firms and households without significant dollar debts could face financial difficulties.

Governments can take several steps to mitigate the Trump trade shock. First, they must devise effective retaliation strategies. The EU's Anti-Coercion Instrument provides a useful model for applying economic pressure without directly harming domestic industries. For example, these measures could allow the bloc to suspend intellectual-property protections for US software and streaming services or restrict US banks and financial-service providers from operating within EU markets. Developing countries might find such measures especially attractive, because the US tends to run large trade surpluses in intellectual property and financial services.

China's mineral-export restrictions offer another example. Since China effectively controls the global supply of several critical raw materials, these measures could hurt US corporate profits while simultaneously raising those of domestic firms. China had refrained from doing this in the last decade after losing a World Trade Organization case on restricting rare-earth exports. Since the US tariffs also violate its obligations under the WTO, the Chinese may feel less constrained this time. A number of other countries have market power in some key products they export, and might explore a similar approach.

Governments must also consider the indirect yet significant impact of interest-rate and exchange-rate fluctuations from Trump's tariffs. For emerging markets and developing economies, this means keeping short-term foreign debt at sustainable levels. Globally, companies must prepare for the possibility that interest rates will remain elevated for longer than anticipated.

Beyond individual responses, countries must pursue collective action. Strengthening regional economic integration by removing trade and investment barriers within existing trade blocs would be much more productive than raising tariffs on US goods. Expediting negotiations on new trade and investment agreements – including inter-regional partnerships like the incipient one between the EU and Latin American MERCOSUR bloc – could also serve as an effective countermeasure.

The Trump administration's trade war is like a Category 5 hurricane: while inherently destructive, its impact can be mitigated. By avoiding panic and fostering strategic partnerships, the world economy could better weather the storm.

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