FREE TRADE FACTS

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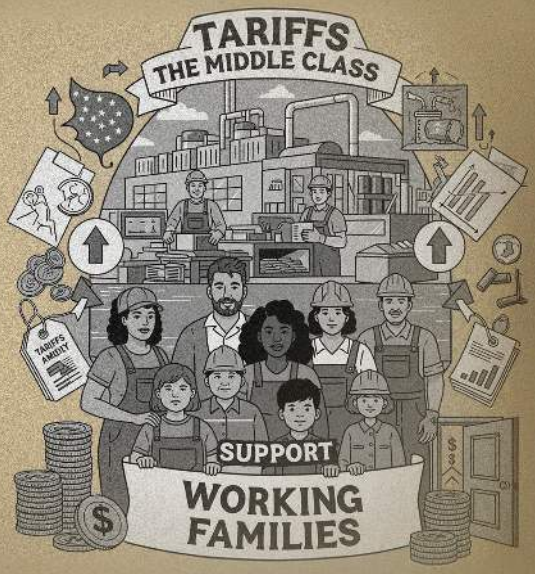
Tariffs, the Middle Class, and Manufacturing:

Why Protectionism Costs More than It Saves

Erica York
Vice President of Federal Tax Policy,
Tax Foundation



Introduction

The goals of supporting working-class families, creating incentives for domestic investment, and increasing opportunities for workers are worthy ones. However, attempting to reach these goals by imposing higher tariffs will not deliver the intended result—instead, it will harm the very people and businesses policymakers seek to help.

A better path lies in policies that lower tax and regulatory burdens on investment and promote growth through competition, not protectionism.

Tariffs Create a Regressive Burden on the Middle Class and Small Businesses

Tariffs place a larger tax burden on low- and middle-income households than on high-income households. Tariffs on consumer goods reduce the after-tax value of income, like wages and other types of employee compensation, which lowers returns to work. And, in contrast with a broad-based consumption tax, tariffs apply to a narrow tax base, meaning households that purchase a larger share of imported goods affected by tariffs will face above-average tax burdens.

The burden on workers occurs regardless of whether tariffs are passed on to final consumer prices. In the case of tariffs passing through to retail prices, households would have to pay more for taxed goods while their income stays the same. If grocery prices increase, for instance, but one's income does not, that person is made poorer because their income does not go as far. If businesses cannot pass tariffs on, workers directly bear the burden through a combination of layoffs,

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reduced hiring, and lower wages. Across the entire US economy, some firms will be able to increase prices after tariffs and some will not, but in all cases, the real, after-tax value of income will be lower—and disproportionately so—for workers in the lower- and middle-income range.

Tariffs will hurt businesses of all sizes, but smaller businesses are particularly vulnerable to the costs of higher and uncertain tariff policy. A preliminary survey of more than 4,000 small and medium business leaders found most expect costs to increase and sales to decrease, and most said they "wouldn't be able to secure price reductions from suppliers abroad."[1] Smaller businesses tend to have less cash flow, less liquidity, and less negotiating power than larger businesses. As a result, higher costs of tariffs place outsized harm on small businesses. Smaller firms may also be at a disadvantage in the lobbying process: Research shows politically connected businesses have historically been more likely to receive tariff exemptions.[2] Exemption (or inclusion) processes incentivize businesses to waste scarce resources on lobbying rather than to use them for investing in growth.

Tariffs Are a Tax on Capital Investment

Tariffs on capital goods and inputs to capital goods function as a tax on capital investment. In 2024, more than half of US goods imports were capital goods and industrial supplies and materials, not finished goods to be sold directly to final consumers. Tariffs on capital goods create similar distortions as an income tax, increasing the relative prices of capital goods and discouraging capital investment in the United States.[3]

Depressing investment through higher tariffs on capital goods will shrink the size of the US capital stock, lower worker productivity, and reduce long-run wages and economic output. Taxing capital inputs through a tariff increases the cost of producing in the United States and creates a competitive disadvantage relative to operating in jurisdictions with lower taxes on capital inputs.

The April 2025 Federal Reserve Bank of Dallas's Texas Business Outlook Surveys of 356 Texas executives indicates that 58.9 percent of respondents expect tariffs to have a negative impact on their business. (Excluding the "don't know" responses raises the share expecting a negative impact to 74.3 percent.) More than two-thirds responded that they expect tariffs will raise input costs, and nearly 40 percent said they expect tariffs *will decrease their capital spending*. Among manufacturing firms in the survey, 67.1 percent (76.4 percent when adjusting for "don't know" responses) expect tariffs to have a negative impact on their business, with more than 80 percent expecting higher input costs and more than 44 percent expecting *decreased capital spending*.[4]

Tariffs Misallocate Resources and Decrease Manufacturing Jobs

Tariffs diminish productivity, decreasing how much output we get for the time and resources used. By changing incentives across different types of production, tariffs reallocate employment and investment toward more costly and less efficient areas of the economy. For instance, the United States is the largest exporter of aircraft[5] and the largest importer of textiles.[6] Higher tariffs would incentivize manufacturing activity to move

1 Ana Elena Azpúrua, "Charting Tariff Pain: Small Businesses Brace for Job Cuts, Falling Sales," Harvard Business School Working Knowledge, April 4, 2025, https://www.library.hbs.edu/working-knowledge/charting-tariff-pain-small-businesses-brace-for-jobs-cuts-falling-sales.

2 Dan Armstrong, "Politically Connected Corporations Received More Exemptions from U.S. Tariffs on Chinese Imports, Study Finds," *Lehigh News*, October 8, 2024, https://news.lehigh.edu/politically-connected-corporations-received-more-exemptions-from-us-tariffs-on-chinese-imports.

3 David Baqaee and Hannes Malmberg, "Long-Run Effects of Trade Wars," Working Paper No. 33702 (National Bureau of Economic Research, April 2025), https://www.nber.org/papers/w33702.

4 "Texas Business Outlook Surveys," Federal Reserve Bank of Dallas, April 28, 2025, https://www.dallasfed.org/research/surveys/tbos/2025/2504q.

5 "Leading Countries with the Highest Aerospace Exports in 2023," Statista, October 23, 2024, https://www.statista.com/statistics/263290/aerospace-industry-revenue-breakdown/.

6 "Textiles," The Observatory of Economic Complexity, accessed May 26, 2025, https://oec.world/en/profile/hs/textiles.

away from aircraft and toward textile production,[7] meaning economic activity would shift to produce fewer airplanes for export and more T-shirts for domestic consumption.

Tariffs do not grow production; they reshuffle it—often in a less efficient way. Domestic producers benefit from higher prices and sales, but their benefit comes at the expense of other people and businesses in the domestic economy. For this reason, tariffs are redistributive, 1) taking income from some and giving it to protected businesses and 2) pulling resources from where they are productively employed and reallocating them to less efficient producers.

While tariffs are often sold as tools to create more jobs, the higher costs they impose and retaliation they invite end up costing more manufacturing jobs than they create. For example, the tariffs imposed in 2018 and 2019 created benefits for protected industries, but some studies have found that higher input costs and retaliation fully offset the benefits of protection, resulting in net losses in production and employment in the US economy overall.[8] Other studies have found that the 2018 steel tariffs supported about 1,000 job gains in steel production, but manufacturing firms that had to pay higher prices for steel lost at least 75,000 jobs,[9] and while the tariffs boosted the value of steel and aluminum production by $2.8 billion per year on average, production across downstream industries fell by $3.4 billion on average.[10]

Tariffs Weaken US Competitiveness and Disrupt Supply Chains

Tariffs reduce export competitiveness by increasing the value of the dollar. When tariffs reduce imports, fewer dollars flow abroad. That strengthens the dollar, which raises the price of US exports—hurting manufacturers, farmers, and other exporters in global markets. This leads to losses in sales, income, and production in the export sector.

Exporters may also be hurt through foreign retaliation, which often targets agriculture and manufacturing. Foreign retaliation increases the costs of US goods in foreign markets, leading to a similar loss in sales, income, and production in the export sector. For example, in 2018 and 2019 foreign governments targeted US agriculture exports with retaliatory tariffs, leading to a significant reduction in agriculture exports totaling more than $27 billion.[11]

In the United States, the largest importing firms are also the largest exporting firms. US exporters rely on a complex web of global relationships and value chains to source parts, materials, and equipment in order to produce and create jobs in the United States. According to one source, in 2018 and 2019, firms that "faced tariff increases on their imports accounted for 84% of all exports" and represented "65% of manufacturing employment. For all affected firms, the implied cost [was] $900 per worker in new duties," or the equivalent of placing a tariff on US exports of 2 percent for an average product and 4 percent for products with higher exposure to tariffs.[12] With higher and broader tariffs, US exporters will face significantly higher costs.

7 Douglas A. Irwin, *Three Simple Principles of Trade Policy* (The AEI Press, 1996), 5, https://www.aei.org/wp-content/uploads/2014/04/-three-simple-principles-of-trade-policy_142937157317.pdf.

8 Aaron Flaaen and Justin Pierce, "Disentangling the Effects of the 2018–2019 Tariffs on a Globally Connected U.S. Manufacturing Sector," Finance and Economics Discussion Series No. 2019-086 (Federal Reserve Board, December 23, 2019), https://doi.org/10.17016/FEDS.2019.086.

9 Kadee Russ and Lydia Cox, "Steel Tariffs and U.S. Jobs Revisited," EconoFact, February 6, 2020, https://econofact.org/steel-tariffs-and-u-s-jobs-revisited.

10 Erica York, "USITC Report Highlights Trade-Offs of Using Tariffs," Tax Foundation, September 27, 2023, https://taxfoundation.org/blog/usitc-report-tariffs/.

11 Stephen Morgan et al., *The Economic Impacts of Retaliatory Tariffs on U.S. Agriculture* (Economic Research Service, 2022), https://ers.usda.gov/sites/default/files/_laserfiche/publications/102980/ERR-304_Summary.pdf

12 Kyle Handley et al., "Rising Import Tariffs, Falling Export Growth: When Modern Supply Chains Meet Old-Style Protectionism," International Finance Discussion Papers No. 1270 (Federal Reserve Board, National Bureau of Economic Research, February 2020), https://doi.org/10.17016/IFDP.2020.1270.

Rearranging supply chains to avoid tariffs comes at a cost. Businesses must spend time and money finding new suppliers, and research suggests businesses often have to settle for less productive partners. These changes reduce efficiency and impose long-term economic costs.[13] Overall, the intricate nature of global supply chains, combined with the likelihood of foreign retaliation, makes extracting any gains from tariffs highly difficult.[14]

Uncertainty and Capital Flight

Uncertainty itself can have a chilling effect on the economy, as businesses and people pause decision-making when they do not know what the near-term policy environment will entail. The Trade Policy Uncertainty Index provides a useful metric, calculating the frequency of joint mentions of trade policy and uncertainty terms that appear in major newspapers.[15] From 2000 through 2015, the average index reading was less than 29. In the 2018–2019 trade war, it reached previously unheard-of highs in the upper 200s, and research from the period found that the effect of uncertainty itself lowered aggregate US investment by more than 1 percent in 2018.[16] By early May 2025, the index had reached a reading above 1,100, dwarfing previously unprecedented highs.

The on-again, off-again nature of current US tariff policy may also have harmful effects on capital markets. While tariffs on their own lead to currency appreciation that can be offset by foreign retaliation, the US dollar slumped after major tariff announcements in April.[17] One possibility for the dollar's downturn could be a decrease in confidence for investing in the United States. Historically, the United States has been viewed as a very attractive place to invest. As a result, foreigners have invested more in the United States than Americans invest abroad. However, if the United States becomes a less attractive place to invest, it could lead to a decline in the value of the dollar as foreigners reduce investments in US assets.

Tariffs may sound "pro-worker," but in practice they raise costs, shift jobs to less efficient sectors, and leave middle-class families and small manufacturers worse off.

13 Gene M. Grossman and Elhanan Helpman, "When Tariffs Disturb Global Supply Chains," Working Paper No. 27722 (Federal Reserve Board, National Bureau of Economic Research, August 2020), https://www.nber.org/papers/w27722.

14 Mary Amiti et al., "Do Import Tariffs Protect U.S. Firms?," Liberty Street Economics, December 5, 2024, https://libertystreeteconomics.newyorkfed.org/2024/12/do-import-tariffs-protect-u-s-firms/.

15 "Trade Policy Uncertainty (Caldara, Iacoviello, Molligo, Prestipino and Raffo)" Economic Policy Uncertainty, accessed July 21, 2025, https://www.policyuncertainty.com/trade_cimpr.html.

16 Dario Caldara et al., "The Economic Effects of Trade Policy Uncertainty," *Journal of Monetary Economics* 109 (January 2020): 38–59, https://doi.org/10.1016/j.jmoneco.2019.11.002.

17 "US Dollar Index," Yahoo Finance, accessed July 21, 2025, https://finance.yahoo.com/quote/DX-Y.NYB/?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAJnT7i6l_hepC7PQNPG7v8FvGbdkutrowS1pRDmrbrriGVwA2qB-IcwlJZEMxc3DME-bChqGVkTFfI6Yy1NT8iex8C6yK4MYVTkfkkJdyaKzmupKX7OfMLcNCi-wUgJUdzdzodEdCmkK7Lv_4DQD0x396EN9JdXUvcrTbCjIGRVnw.