REALTIME ECONOMICS

Trump's threatened tariffs projected to damage economies of US, Canada, Mexico, and China

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President-elect Donald J. Trump has made unusual threats to impose tariffs against Mexico, Canada, and China, not in response to economic disputes but rather to conflicts over illegal immigration and flow of drugs, especially fentanyl. Our analysis finds that these tariffs would damage all the economies involved, including the US. But history suggests that Trump may not act on his threats.

Writing on Truth Social after the election, on November 25, 2024, Trump made unfounded assertions about drugs and immigrants illegally entering the US and stated, "On January 20th, as one of my many first Executive Orders, I will sign all necessary documents to charge Mexico and Canada a 25% Tariff on ALL products coming into the United States, and its ridiculous Open Borders." Later that day he again referenced drug trafficking and made a similar threat against China, "Until such time as they stop [exporting fentanyl], we will be charging China an additional 10% Tariff, above any additional Tariffs, on all of their many products coming into the United States of America." Since then, he has pointedly repeated the threats.

Meanwhile, in stark contrast to Trump's threats, the European Union concluded negotiations to update its Global Agreement with Mexico, aiming to deepen and widen EU-Mexico political dialogue and cooperation, as well as create economic opportunities for both sides, including for EU agrifood exports to Mexico.

MODELING THE ECONOMIC DAMAGE FROM TRUMP'S TARIFF THREATS

We examine what President-elect Trump's threats, if carried through, might mean for the economies of the US, China, Mexico, and Canada using G-Cubed, a multi-country, multi-sector hybrid dynamic stochastic general equilibrium-computable general equilibrium model (McKibbin and Wilcoxen 1999, 2013).[1]

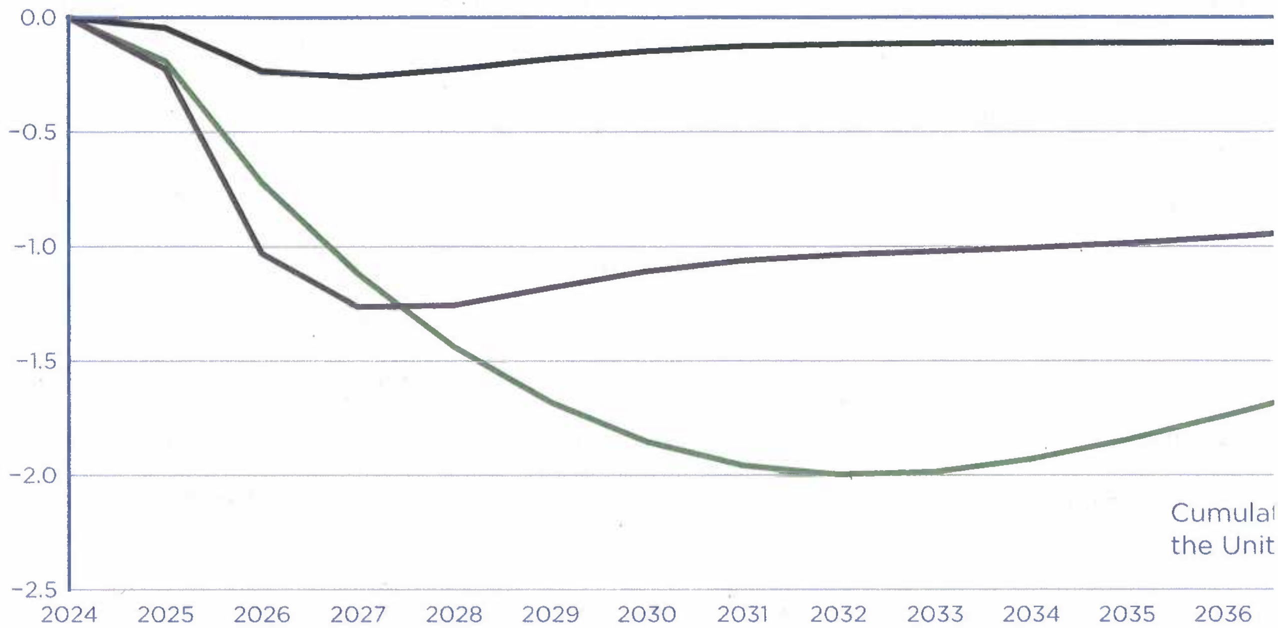
We begin with the threat to impose a 25 percent tariff on all goods from Mexico and Canada. Figure 1 shows that the imposition of the tariff would slow growth and accelerate inflation in all three countries. (Click on the tabs in the figures to filter by "Real GDP" and "Inflation.") For the duration of the second Trump administration, US GDP would be around $200 billion lower than it would have been without the tariffs. Canada would lose $100 billion off a much smaller economy, and at its peak, the tariff would reduce the size of the Mexican economy by 2 percent relative to its baseline forecast.

Figure 1

25 percent tariffs on Canada and Mexico would cause lower GDP and higher inflation than otherwise

Projected percent change from baseline forecast for each country, 2024–40

Click to filter by: Real GDP Inflation



PIIE **Source:** Warwick McKibbin, Megan Hogan, and Marcus Noland, ***The international economic implications of a second Trump presidency,*** PIIE Working Paper 24-20.

However, these figures likely underestimate the real damage to the three economies, which are highly integrated—but asymmetrically, with Mexico and Canada being much more dependent on trade with the US than the other way around. Intermediate goods—especially in motor vehicles—cross the borders multiple times before final assembly. The imposition of tariffs at each stage of fabrication would be disastrous.

In the case of Mexico, exports account for roughly 40 percent of its GDP, and roughly 80 percent go to the US. Approximately 16 percent of national value-added is sent to the US in the form of exports, the most of any major trading partner. In essence, Mexico ships one-sixth of its annual economic output to the US in the form of exports.

Many of those exports originate in maquiladoras within 30 miles of the border. This economic activity is geared to serve the US market, making Mexico far more vulnerable than say a large industrial country like Germany that operates globally and could more easily reorient its exports. For Mexico, a 25 percent tariff would be catastrophic. Moreover, the economic decline caused by the tariff could increase the incentives for Mexican immigrants to cross the border illegally into the US—directly contradicting another Trump administration priority.

But there are reasons to believe that Trump will not carry out his threats. During his 2016 presidential campaign, Trump repeatedly threatened to impose a 30 percent tariff on Mexico. Once in office, however, he did not impose the tariff but rather demanded—and received—a renegotiation of the North American Free Trade Agreement (NAFTA). The renegotiation produced a new agreement, with a new name—the US-Mexico-Canada Agreement (USMCA)—which modernized the agreement but also by tightening rules of origin and lengthening schedules for tariff removal, moving the agreement away from free trade, and earning the new agreement the mocking sobriquet NAFTA 0.7.

Subsequently, in 2019, Trump threatened Mexico with a 5 percent tariff that would gradually increase to 25 percent unless Mexico stopped illegal immigration across the border, but he did not follow through.

USMCA is scheduled for review in 2026, but if the review is expedited to 2025, the tariffs could be avoided by making concessions in the agreement to placate the Americans. If Trump were to impose those tariffs, in effect he would be blowing up (albeit for noneconomic reasons) the agreement that his first administration negotiated. And indeed, a telephone call on November 27 with Mexican president Claudia Sheinbaum, which Trump characterized as a "very productive conversation," seemed to lower the heat. However, Trump's public musings about using economic coercion to make Canada the "51st state" contributed to Canadian prime minister Justin Trudeau's resignation, and the upheaval in Canadian politics may make resolution via USMCA more difficult.

For unclear reasons, Trump threatened China with a lower 10 percent additional tariff. (How this tariff relates to the 60 percent tariff he threatened against China in the presidential campaign, and the 100 percent tariff on the BRICS countries of which China is a member, is unknown.)

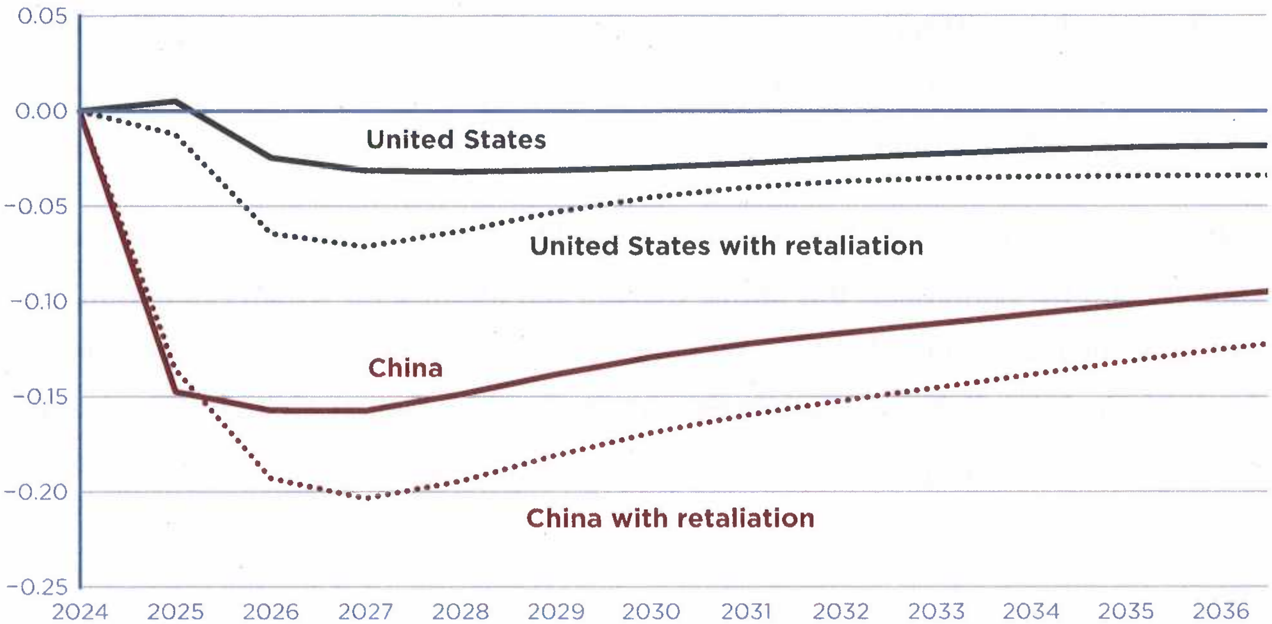
Figure 2 shows the damage that an additional 10 percent tariff could inflict on the Chinese and US economies. But unlike Canada and Mexico, for which retaliation would be inconceivable, China has retaliated in the past and would likely do so again. For analytical simplicity, we assume that retaliation is tit-for-tat, though China would obviously have other options. Figure 2 also shows the results of a retaliation scenario (dotted lines).

Figure 2

An additional 10 percent tariff on China would damage both the US and Chinese economies

Projected percent change from baseline forecast with and without retaliation by China, 2024–40

Click to filter by: Real GDP Inflation



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If the US imposed an additional 10 percent tariff on China and China responded in kind, US GDP would be $55 billion less over the four years of the second Trump administration, and $128 billion less in China. Inflation would increase 20 basis points in the US, and after an initial dip, 30 basis points in China. The initial fall in inflation in China is caused by a temporary tightening of Chinese monetary policy aimed at offsetting the depreciation of the Chinese currency.

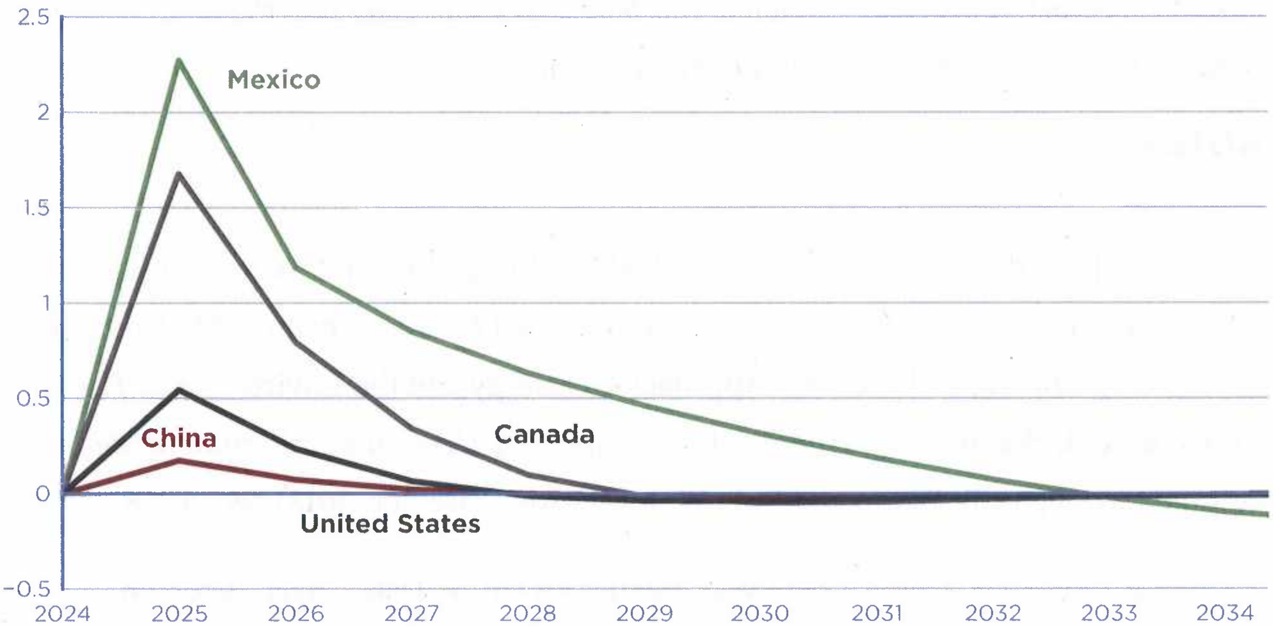
The result of combining the threats—a 25 percent tariff on Canada and Mexico and an additional 10 percent tariff on China (which retaliates)—is shown in figure 3. The damage is worse for the US than any of the previous scenarios, basically because the possibilities for substituting trade between Mexico and China are reduced, generating larger GDP losses and higher inflation. The results for the three partners are similar to the previous scenario.

Figure 3

25 percent tariffs on Canada and Mexico with an added 10 percent tariff on China would cause lower GDP and higher inflation than otherwise

Projected percentage point change from baseline forecast for each country, 2024–40

Click to filter by: Real GDP Inflation



Notes: Scenario assumes that China retaliates.

To conclude, all the countries involved suffer damages from Trump's threatened tariffs, particularly Mexico. Renegotiating USMCA would be preferable instead. While Trump's positive response to his call with Sheinbaum was encouraging, the political uncertainty in Canada tempers hope of finding a resolution.

The situation with China is even cloudier. During his first term, Trump launched a trade war with China (Bown 2023),[2] demonstrating the credibility of his current threats. He also appears to have an unduly negative appraisal of the effectiveness of his first administration's negotiations with China over fentanyl trade (Noland, Contreras, and Rengifo-Keller, forthcoming).[3] For the US and China, collision may be even more difficult to avoid.

CORRECTION: *We project that imposing a 25 percent tariff on all goods imported to the US from Mexico and Canada would reduce Mexico's GDP by 2 percent relative to its baseline forecast. A previous version of this blog post incorrectly said the tariff would reduce Mexico's economic growth rate by 2 percent.*

NOTES

1. For details on the model, see Warwick J. McKibbin and Peter J. Wilcoxen, The Theoretical and Empirical Structure of the G-Cubed Model, *Economic Modelling* 16, no. 1 (1999): 123–48; and A Global Approach to Energy and the Environment: The G-Cubed Model, chapter 15 in *Handbook of Computable General Equilibrium Modeling,* volume 1, ed. Peter B. Dixon and Dale W. Jorgenson (Elsevier, 2013): 995-1068.

2. Chad P. Bown, US-China Trade War Tariffs: An Up-to-Date Chart, Peterson Institute for International Economics, April 6, 2023.

3. Marcus Noland, Julieta Contreras, and Lucas Rengifo-Keller, *Illicit Drug Prices and Policy: Fentanyl, China, and Overdose Deaths*, PIIE Working Paper, Peterson Institute for International Economics (forthcoming, 2025).

DATA DISCLOSURE

The data underlying this analysis can be downloaded here [zip].

RELATED DOCUMENTS

20250117-mckibbin-noland.zip (571.1 KB)

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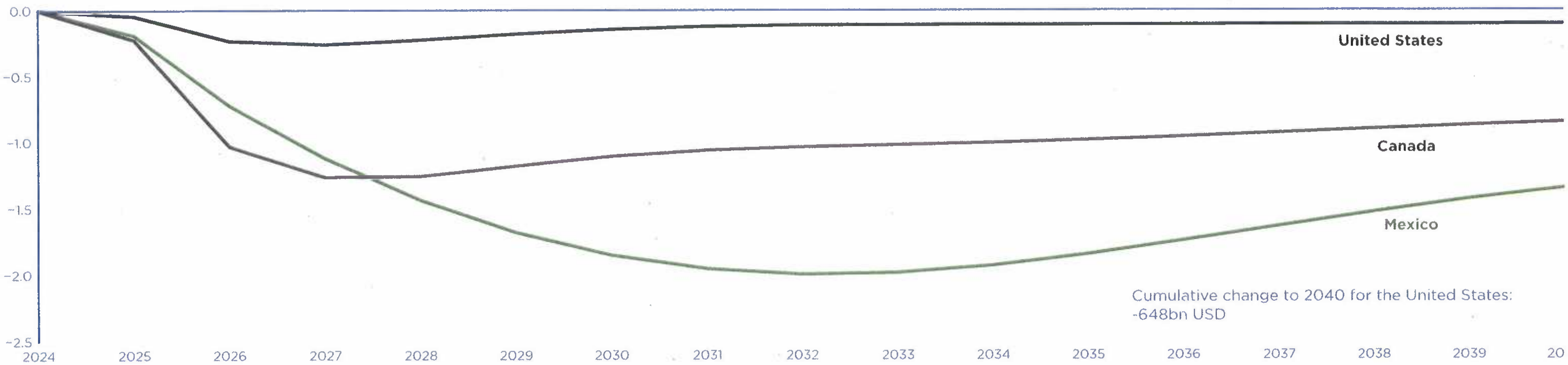

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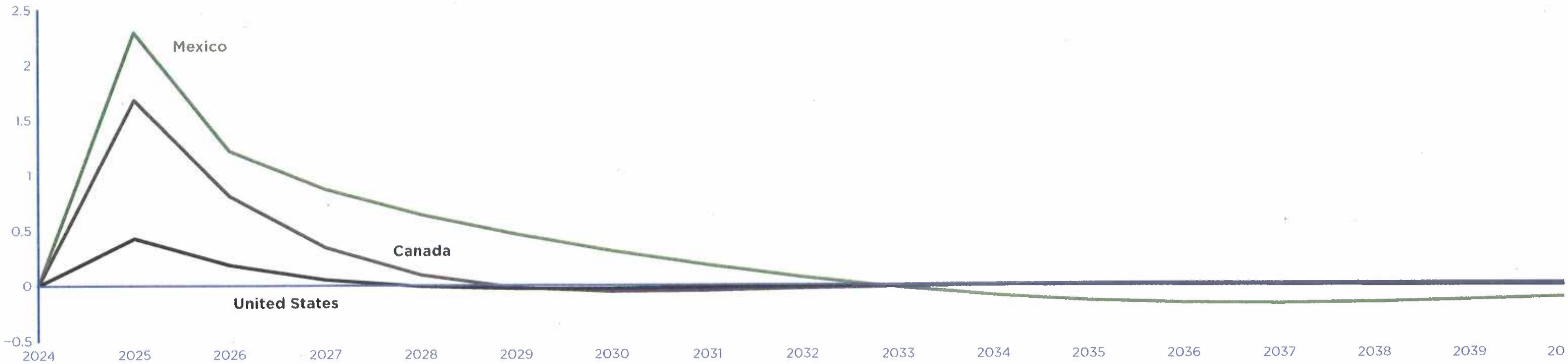

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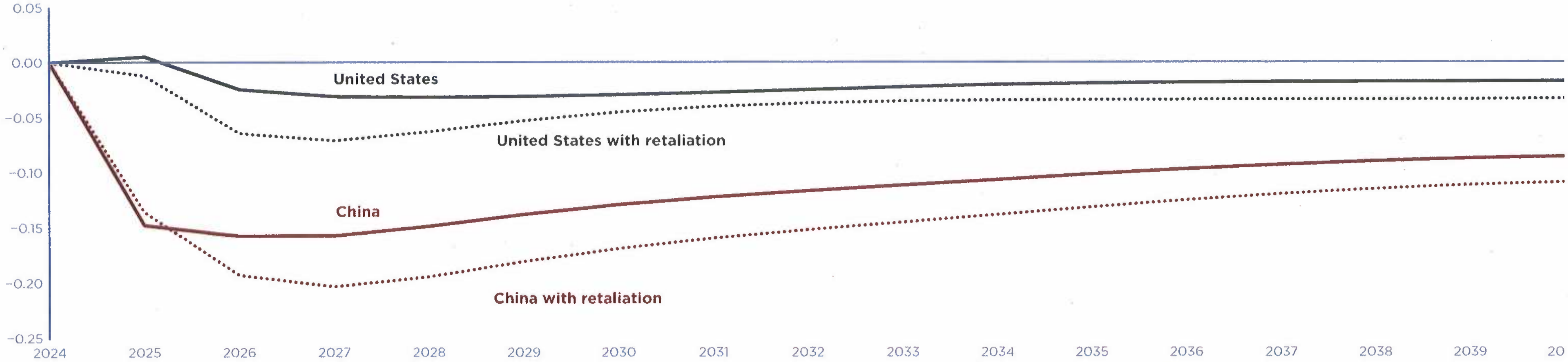

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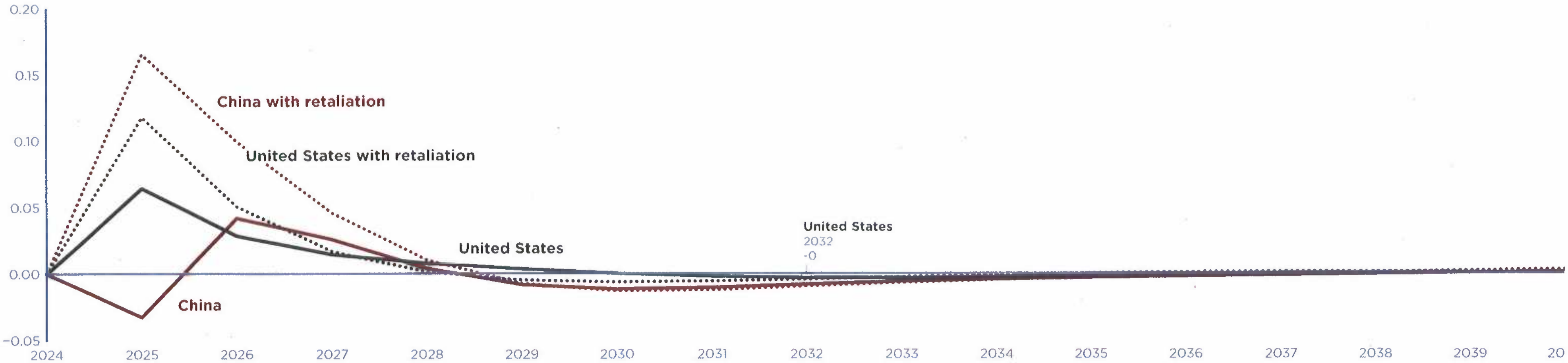

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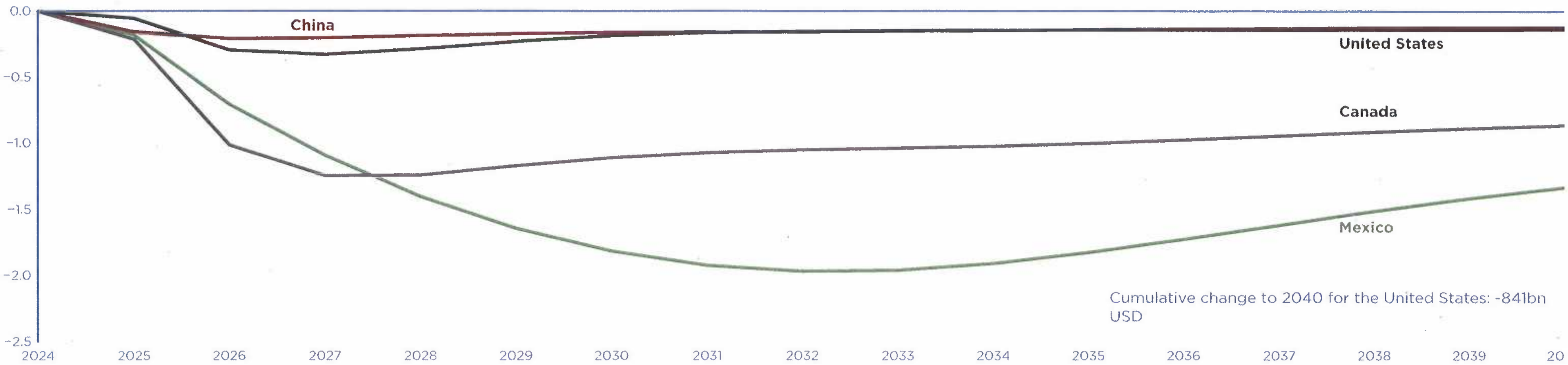

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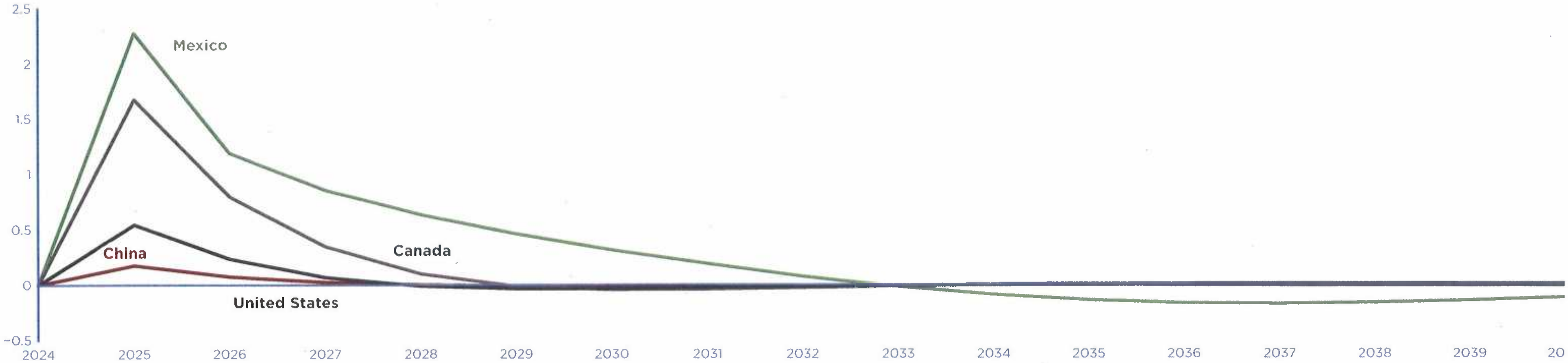

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