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Destructive Trade Policy

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We are living through an astoundingly destructive period in U.S. trade policy. Jumble-headed thinking and reckless decision-making are harming the economy, damaging U.S. relations with allies and trading partners, and destroying the tattered trading order that supported prosperity and security for eighty years.

Uncertainties around U.S. trade policy are at unprecedented levels, souring the economic outlook.

- Figure 1: U.S. Trade Policy Uncertainty Hit Unprecedented Levels Even Before "Liberation" Day[1]
- Figure 2: Trade Policy Uncertainty Indexes for Three Major U.S. Trading Partners

The extraordinary nature of the trade policy rupture is also apparent in the stock market. One piece of evidence: The frequency of daily U.S. stock market jumps >|2.5%| from 26 March (first new Trump tariffs) to 17 April 2025 attributed to trade policy in next-day newspaper accounts is about 800 times greater than its baseline level from 1900 to 2023.

- Figure 3: Daily Percent Change in S&P 500, 3 January to 17 April 2025
- Figure 4: U.S. Equity Market Volatility Tracker for Trade Policy[2]

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[1] The US TPU index reflects scaled monthly frequency of articles from over 2000 US newspaper archives in Access World News database, containing at least one word from three term sets: economic/economy (E), uncertain/uncertainty (U), policy-related terms (P) such as legislation, deficit, regulation, Congress, Federal Reserve, White House ***and*** at least one trade policy term listed in Appendix B of "Measuring Economic Policy Uncertainty" by Baker, Bloom and Davis (2016). The series is multiplicatively normalized a mean value of 100 from 1985 to 2010.

[2] The Trade Policy EMV tracker is the product of the overall EMV tracker and the share of EMV articles that contain one or more terms related to trade policy from 11 major US newspapers. The overall EMV tracker reflects scaled monthly counts of articles that contain at least one word in each of three term sets:

The U.S. Economic Policy Uncertainty index has reached new highs in recent weeks, surpassing the peak levels experienced during the 2008-09 financial crisis and the COVID pandemic.

- Figure 5: U.S. Economic Policy Uncertainty Index, Weekly

Unlike previous episodes with high policy uncertainty, this one is almost entirely the consequence of ill-advised policy decisions. No financial crisis, pandemic, or war drove us to the present moment. We did it to ourselves.

Tremendous uncertainty around tariff rates is making consumers anxious and fearful. That will lead to cutbacks in discretionary spending. (Tariff hike anticipation effects work in the opposite direction, which may obscure and counter near-term uncertainty effects on consumer spending.)

The uncertainty also causes companies to cut or defer investment spending, as they wait for clarity about tariffs. You can't make sound decisions about what to produce, how to source inputs or where to invest when tariffs are subject to drastic changes at the President's whim. So, you wait.

This wait-and-see behavior by households and businesses means less demand for labor and fewer job opportunities for American workers. Historically, industrial production falls 3-4 months after upward policy uncertainty shocks, with peak responses after 6-8 months. Employment effects settle in more slowly, with peak responses at about 10-14 months. See Baker, Bloom and Davis (2016) and the large follow-on literature.

Thus far, hard data show little evidence of a slowdown in U.S. economic activity. New claims for unemployment insurance benefits have yet to rise. But job openings show a drop of about 5 since late March.

- Figure 6: U.S. Job Openings, LinkUp 10,000 Global Employers

Another negative effect: Now, and for the foreseeable future, the chief priorities of many business executives are (a) to grapple with uncertainties around trade policy and (b) to lobby the Trump administration for tariff breaks. That diverts attention and energy from serving customers, developing products, training

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economic/economy (E), stock market/S&P/equity (M) and volatility/uncertainty/risk (V), which is then normalized the mean value of CBOE Volatility Index from 1985 to 2015.

workers, and improving operations. It creates incentives for businesses to focus on rent seeking rather than socially productive business activities.

Are we better off when Apple's CEO Tim Cook, Nvidia's Jensen Huang, and Microsoft's Satya Nadella focus on (a) and (b) instead of how to improve iPhones, computer chips, and software. Obviously not. This point extends to thousands of other business leaders and their staff.

It's unpersuasive to say, in rebuttal, that business leaders can or should address (a) and (b) **and** their usual challenges. They have 24 hours in the day and limited energy, just like anybody else. More time and energy on (a) and (b) mean less for everything else. And if we incentivize business leaders to succeed via rent-seeking activities, that's what we will get.

Let's turn to recent financial market developments. The yield on 10-year U.S. Treasury bonds rose by 47 bps from April 4 to April 11 (FRED). Over the same period, the yield on 10-year constant maturity, inflation-indexed U.S. Treasury bonds rose by 45 bps and the Dollar fell by about 1.5 percent (on a trade-weighted basis). The Dollar has dropped about 3.3 percent during the second Trump presidency to date (21 January 21 to 17 April 2025, FRED).

Rising U.S. bond yields and a falling dollar are unusual developments in a period of intense uncertainty and falling U.S. stock prices. These developments reflect heretofore rare doubts about the safe-haven status of U.S. Treasuries and a loss of confidence in the U.S. capacity for sensible policymaking.

Why is this important? First, higher Treasury bond yields mean higher borrowing costs for businesses and households, especially for longer term investments. That dampens business investment and hiring, residential construction, and consumer spending by debt-laden households.

Second, it means higher debt-servicing costs for taxpayers. U.S. government debt held by the public is roughly 1.2 times annual U.S. GDP (CBO). A 50 bps rise in Treasury yields across the maturity spectrum eventually raises the government's debt-servicing costs by 0.6 percent of GDP. That's $180 billion per year in extra debt-servicing costs at current debt and GDP levels.[3]

The Trump administration, like the Biden administration, displays no serious intention to address the unsustainable U.S. fiscal trajectory. So, the negative fiscal

[3] The U.S. federal deficit about $1.8 trillion in fiscal year 2024 (6.4% of GDP).

consequences of policy actions that undermine confidence in the United States – its economy and its government – will intensify over time.

Recent U.S. tariff policy is helping drive a tremendous loss of good will, undermining the United States in its geopolitical contest with China.

- Figure 7: Losing Friends
- Figure 8: Creating Openings for Adversaries

My foregoing remarks give little attention to standard economic arguments against tariffs and in favor of free trade (comparative advantage, specialization, variety, scale economies, competition, idea diffusion). Those arguments are well understood and, for the most part, uncontroversial among economists. I won't review those arguments here, but they are also important. If we eventually settle at a new equilibrium with much higher tariffs than in recent decades, it will harm America and other countries beyond the negative effects of the present disruption.

Let me close by quoting Doug Irwin, writing recently in *The Economist*:

> [Trump's] tariffs blow an enormous hole in the liberal trade order that America has led and fostered since the second world war. They undermine every free-trade agreement America has ever signed. … If Mr Trump is willing to rip up his own agreement—known as the USMCA —with [Canada and Mexico] then all past agreements are null and void, and future ones are of limited value. No one can sign any such deal with confidence if tariffs can be imposed on a whim.

In addition to its economic harms, Trumpian Trade Policy has brought a huge loss of trust in the reliability of the U.S. government. It will take many years, much work, and internal U.S. reforms to repair the damage.[4]

[4] Internal reform efforts include lawsuits that challenge the legality and constitutionality of the Trump Administration's recent tariffs. See, for example, the discussion of *VOS Selections, Inc. v. Trump* in Somin (2025).

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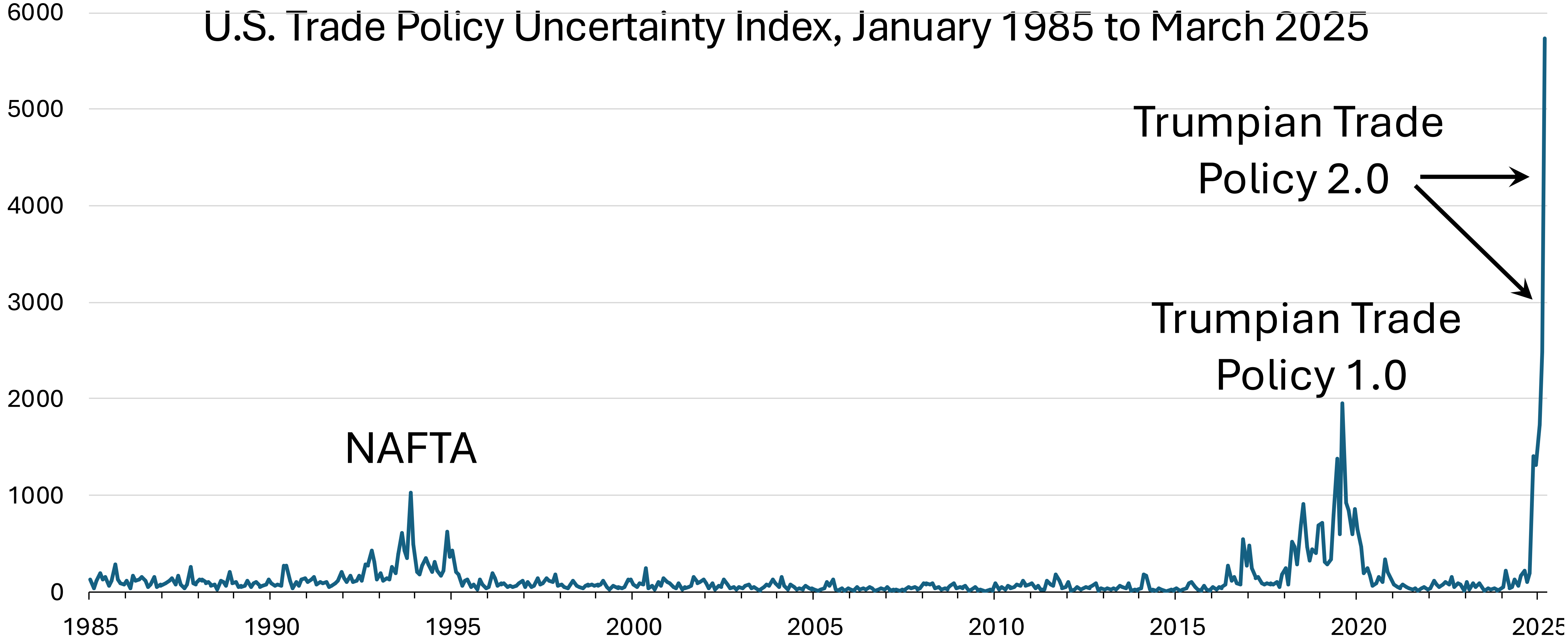
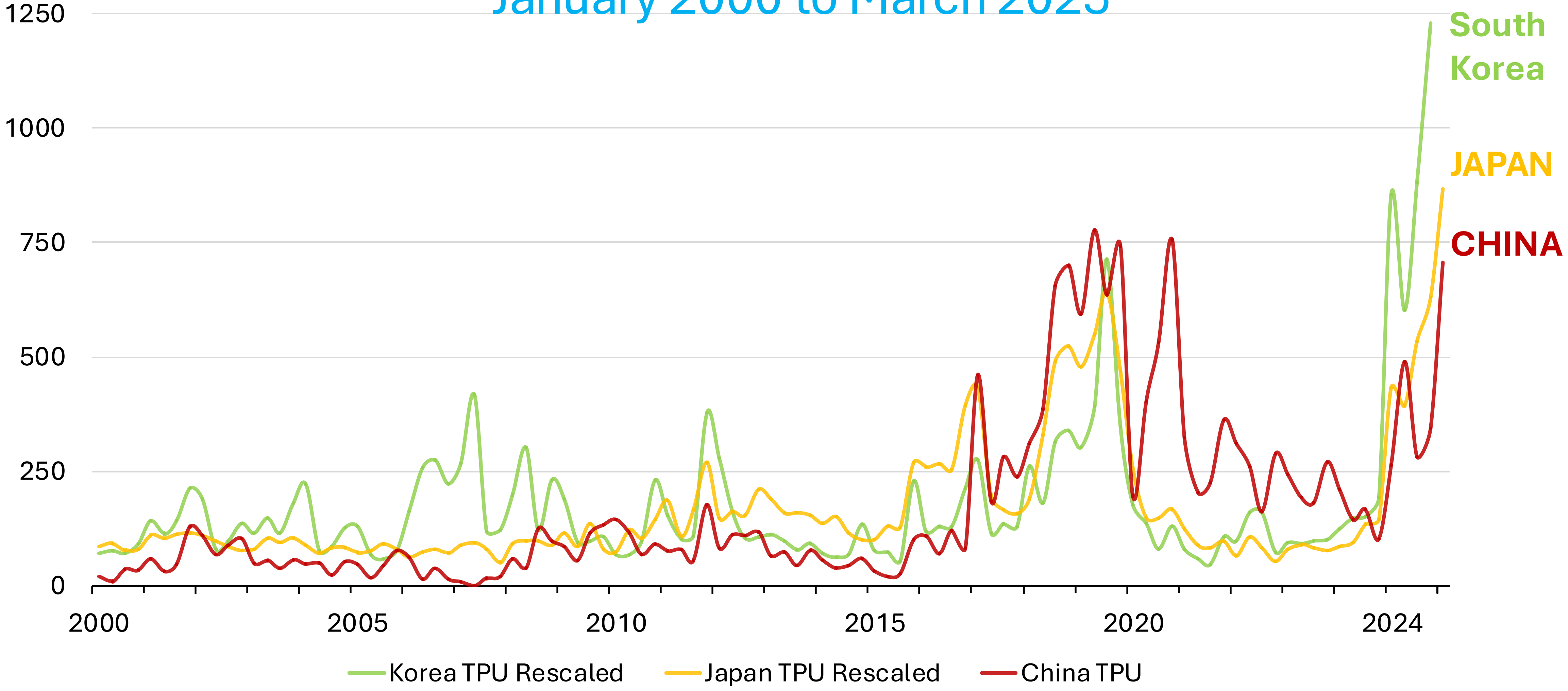
Figure 1: U.S. Trade Policy Uncertainty Hit Unprecedented Levels Even Before "Liberation" Day



Source: Baker, Bloom and Davis (2016), as updated at www.PolicyUncertainty.com

Figure 2: Trade Policy Uncertainty Indexes for Three U.S. Trading Partners January 2000 to March 2025



Source: Arbatli et al. (2023) for Japan; Davis, Liu and Sheng (2019) for China; and Cho and Kim (2023) for South Korea; as updated as updated at www.PolicyUncertainty.com. The monthly series for Japan and South Korea are rescaled to match the mean value for the China TPU series from January 2000 to December 2022. The chart shows quarterly averages from 2000 Q1 to Q3 2024 and monthly values thereafter through March 2025 (February 2025 for South Korea).

Trade Policy Shocks & Extreme Stock Market Moves

1900 to 2023: U.S. stock market moved > |2.5%| on 1,193 trading days, close to close.

- That's 3.5% of all trading days.

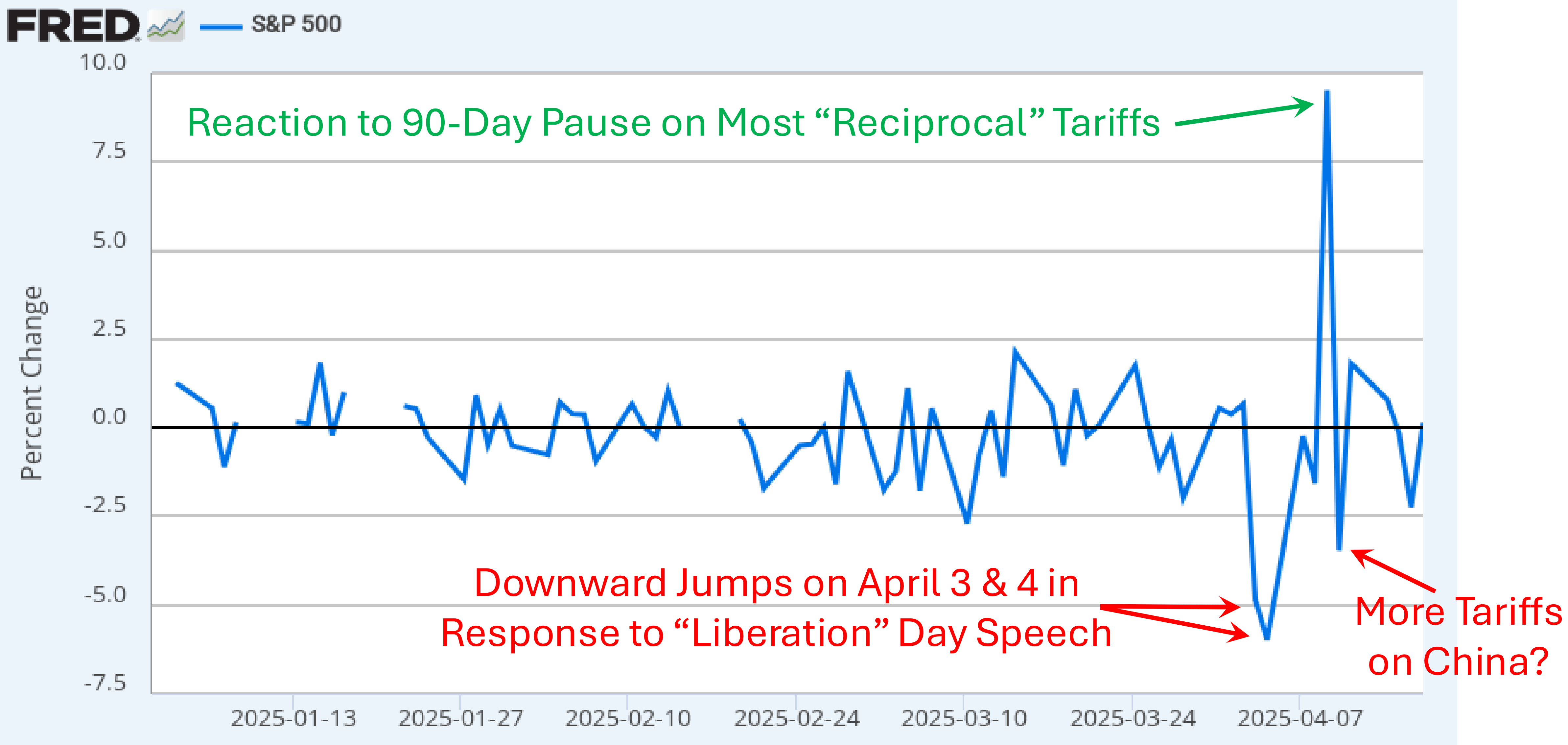
Next-day newspaper accounts attribute **ten** of these daily jumps to trade policy news (Baker et al., 2025b).

- Half occurred in 2018 and 2019.

26 March (first new Trump tariffs) to 17 April 2025: Trade policy news triggered **4 (3?)** daily jumps > |2.5%|.

- That's ~800 times the frequency of daily jumps triggered by trade policy news from 1900 to 2023.

Figure 3: Daily Percent Change in S&P 500, 3 January to 17 April 2025



Source: S&P Dow Jones Indices LLC via FRED®

Shaded areas indicate U.S. recessions.

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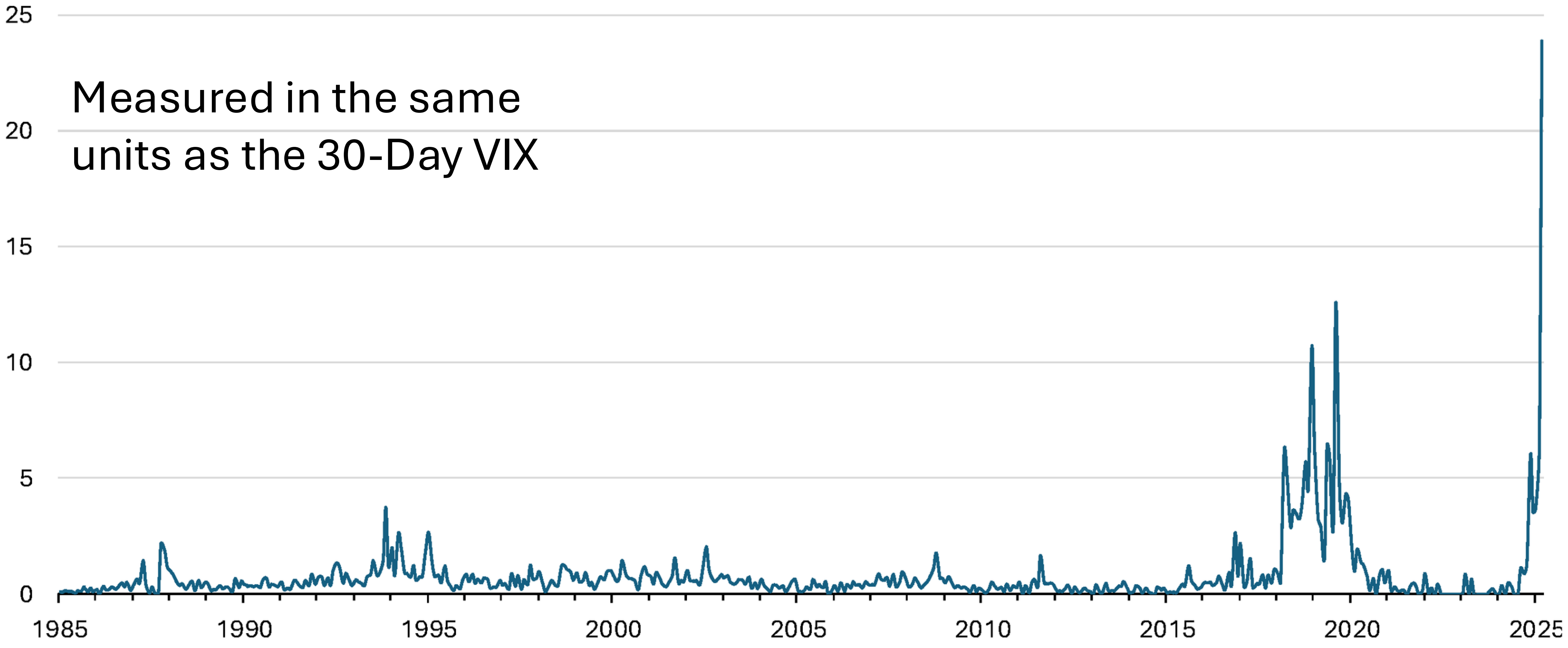
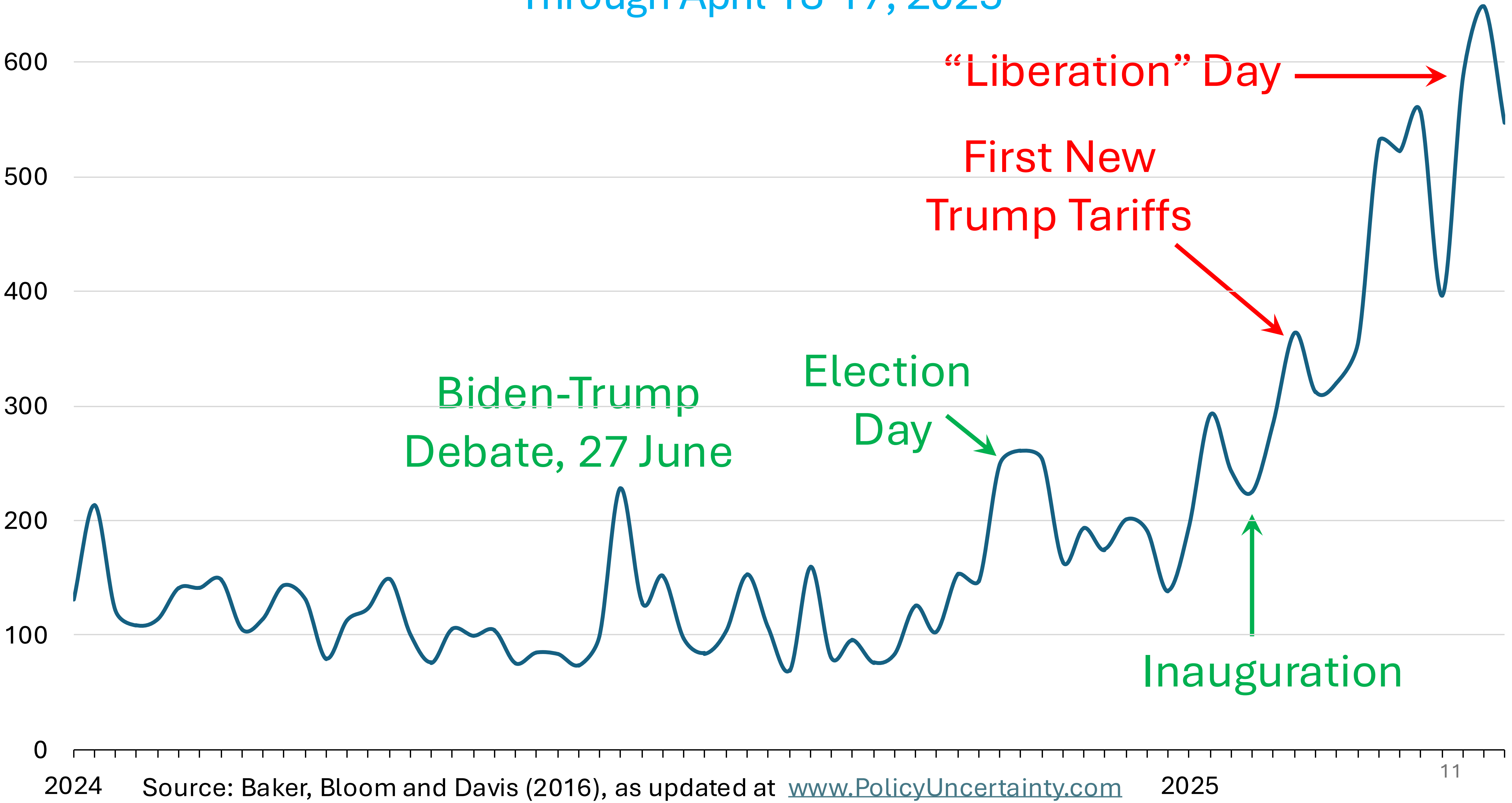
Figure 4: U.S. Equity Market Volatility Tracker for Trade Policy, January 1985 to March 2025



Source: Baker, Bloom, Davis and Kost (2025), as updated at www.PolicyUncertainty.com.

Figure 5: U.S. Economic Policy Uncertainty Index, Weekly

Through April 13-17, 2025



Source: Baker, Bloom and Davis (2016), as updated at www.PolicyUncertainty.com

Figure 6: U.S. Job Openings, LinkUp 10,000 Global Employers

Inauguration Day to 11 April 2025

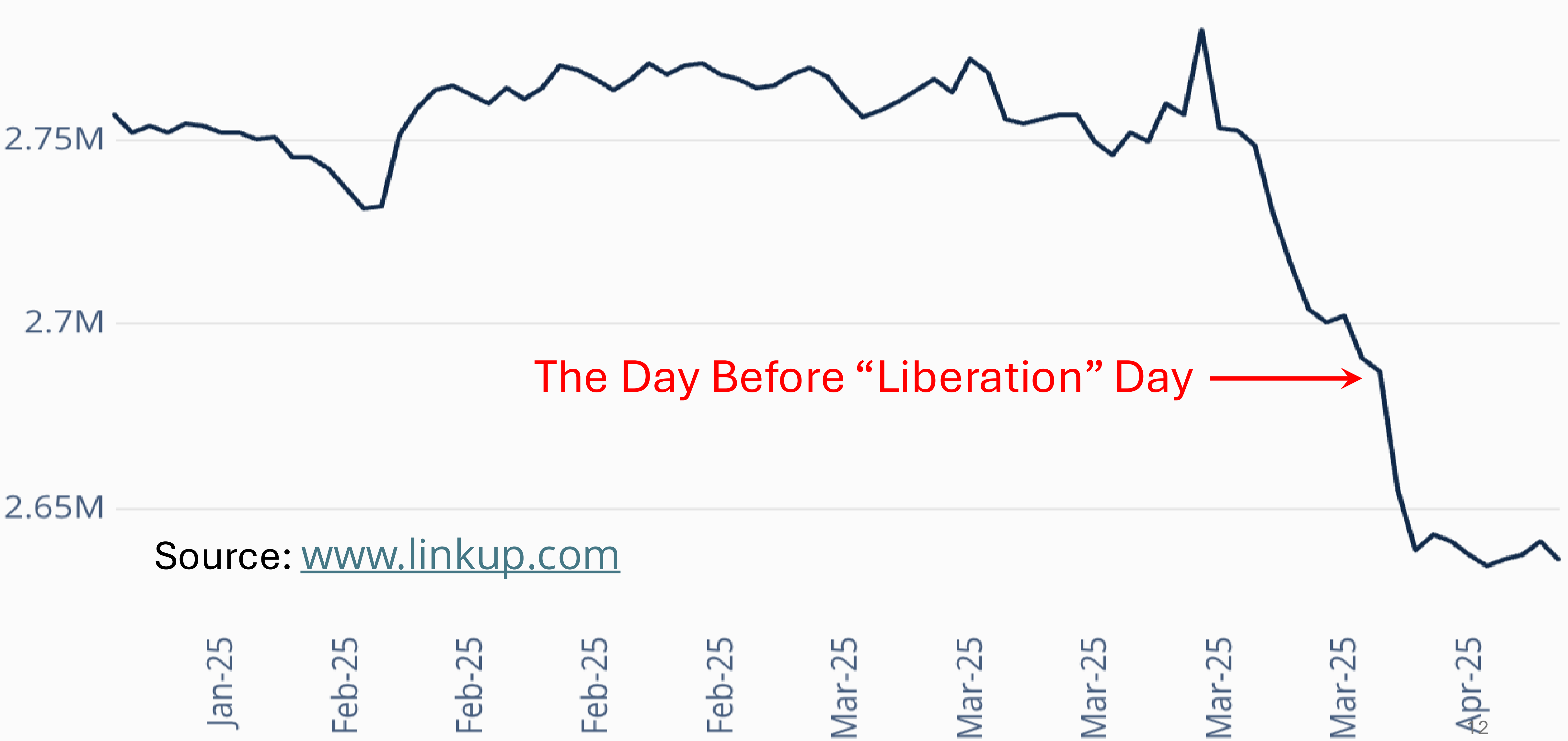
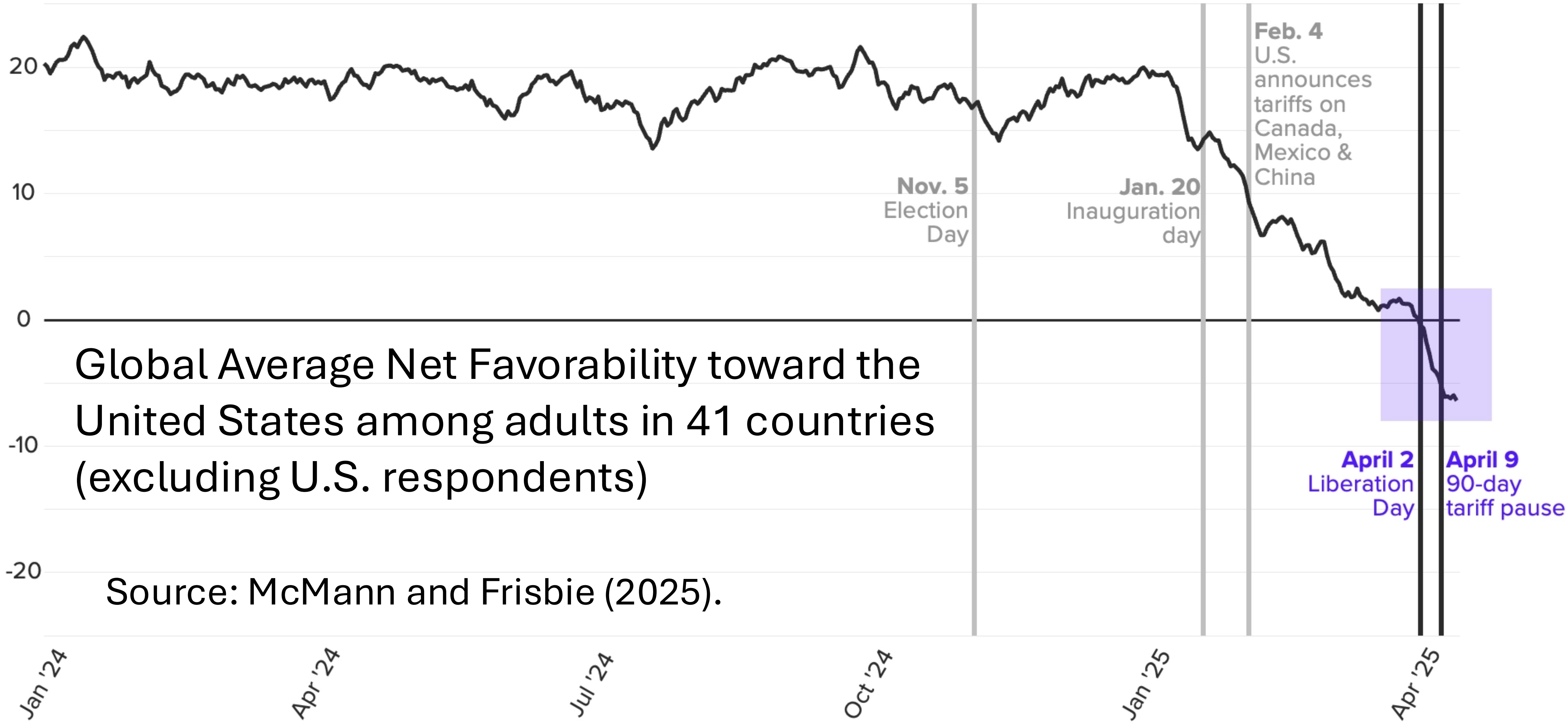
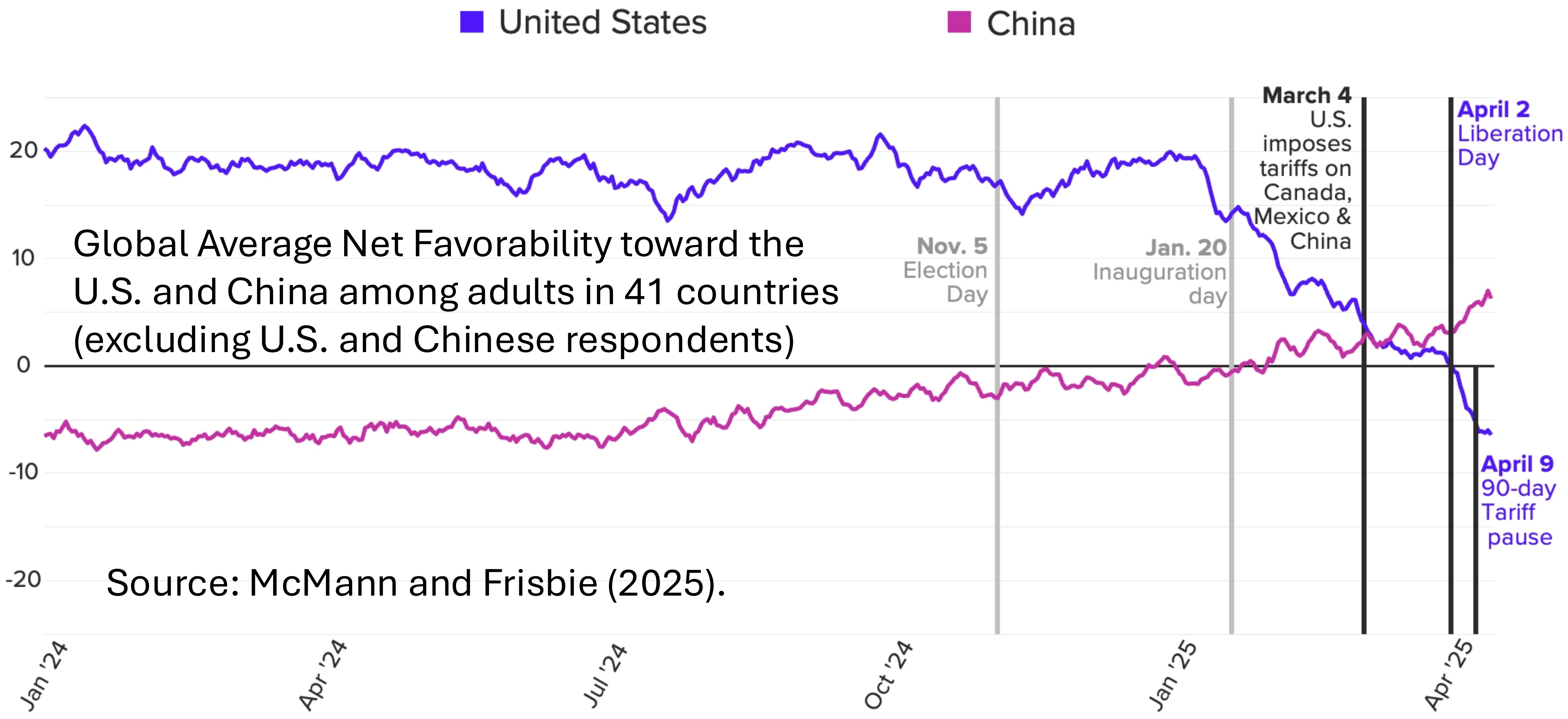


Figure 7: Losing Friends



Source: McMann and Frisbie (2025).

Figure 8: Creating Openings for Adversaries



Source: McMann and Frisbie (2025).

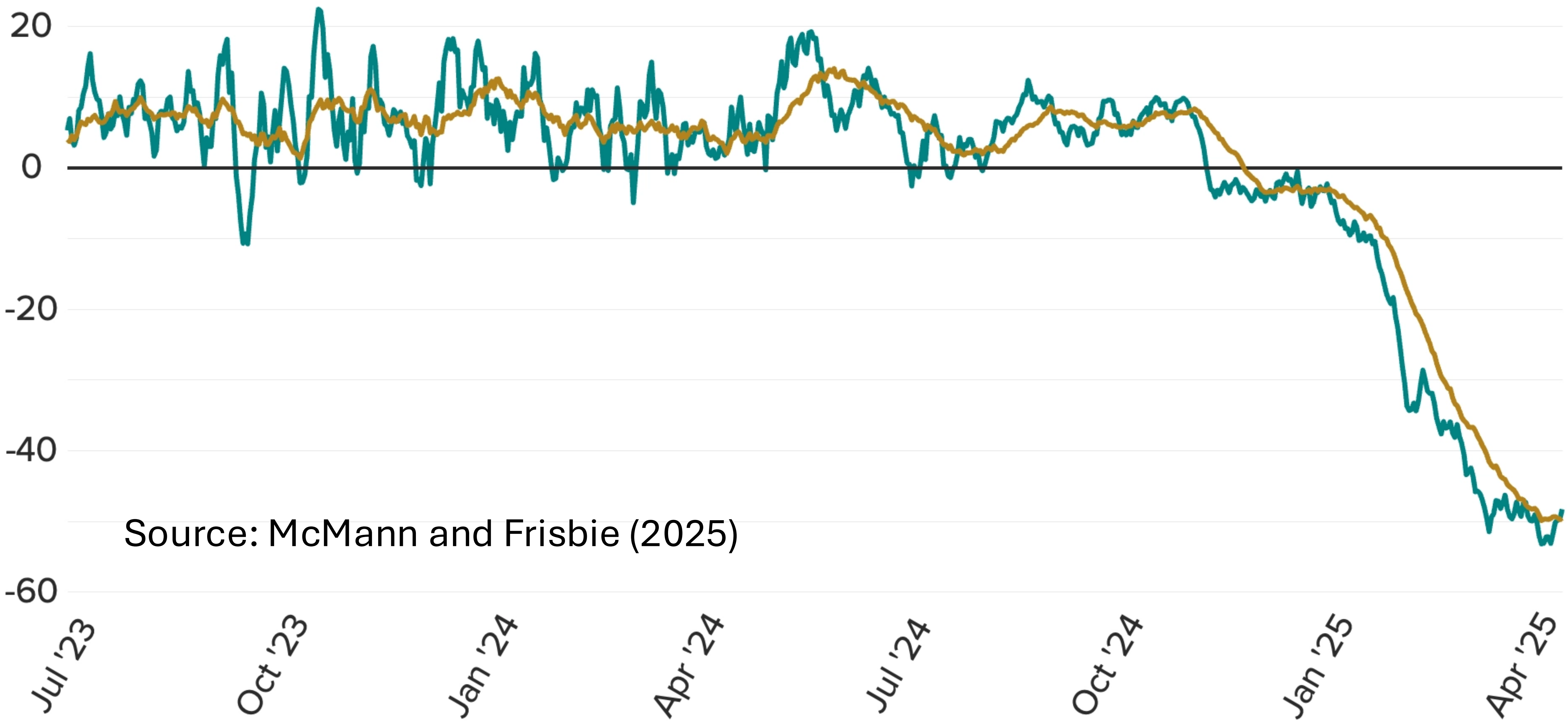
Shredding Past Trade Agreements, Devaluing Future Ones

[Trump's] tariffs blow an enormous hole in the liberal trade order that America has led and fostered since the second world war. They undermine every free-trade agreement America has ever signed. … If Mr Trump is willing to rip up his own agreement—known as the USMCA —with [Canada and Mexico] then all past agreements are null and void, and future ones are of limited value. No one can sign any such deal with confidence if tariffs can be imposed on a whim.

Douglas Irwin, *The Economist*, 3 April 2025

Extra Slides

Figure A1: Canada, Net Favorability toward the U.S.



Source: McMann and Frisbie (2025)

Figure A2: Mexico, Net Favorability toward the U.S.