

# **Discussion: “Tariffs in 2025: Short-Run Impacts on the U.S. Economy”**

Fajgelbaum & Khandelwal (2025)

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March 2026

## What the Paper Does

### A real-time accounting of the 2025 tariff episode

#### Empirics:

- Average applied tariff  $\uparrow$  from 2.4%  $\rightarrow$  9.6% by Dec 2025 — highest in 80 years
- 57% of imports still duty-free; applied  $<$  statutory rate
- Tariff variation correlated with bilateral goods deficits; *not* with geopolitical alignment
- 90% pass-through of tariffs to import prices

#### Quantification/Policy Evaluation:

- Welfare impact:  $-0.13\%$  to  $+0.10\%$  of GDP
- Revenue raised: \$264 bn (4.9% of federal receipts)
- Decoupling from China successful: import share  $\downarrow$  from 23% (2017) to 7% (2025m12)
- No evidence of friend-shoring or strategic sector targeting

**Comments focus on identification, dynamics, what “no retaliation” really means**

## Comment 1: Endogenous Treatment Definition

The paper defines treatment using applied tariffs: but applied tariffs are endogenous

The problem:

- Treatment: switches on when applied tariff exceeds its pre-trade war max by  $> 2\%$
- Applied tariff = shaped by importer behavior, exclusions, USMCA compliance, shipping lags
- Endogenous adjustment can mean **statutory tariff rises but applied tariff does not** (footnote 10)
- Such varieties end up in the *control* group — but they experienced a real policy change!
- **Control group contamination**  $\Rightarrow$  **estimated treatment effects are attenuated**

Why is this a concern now more than in 2018–19?

- In 2025, the statutory–applied gap is much larger
  - Exemptions, USMCA compliance, bonded warehouses, shipping lags all bite harder at higher rates
- Note, authors' previous QJE uses statutory tariffs for treatment

## Comment 1b: Is the Statutory Tariff a Valid Instrument?

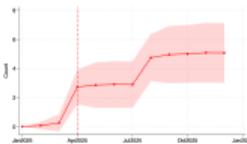
Pass-through/elasticity regressions: applied tariffs instrumented with statutory tariffs

Requirements for validity:

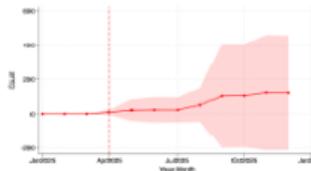
- 1 Statutory tariffs uncorrelated with supply/demand shocks at the variety level ✓ (plausible, if tariff motive uncorrelated with US variety-time shocks)
- 2 Statutory tariffs uncorrelated with *other bilateral policy changes* that directly affect trade  
⇒ This is harder to defend in 2025

Why? The 2025 episode is saturated with correlated non-tariff policy:

- Investment agreements (e.g. Japan: \$550 bn), framework deals with EU, UK, India, ...
- Export controls on strategic goods
- Policy uncertainty shocks correlated with tariff announcements
- Manova, Novy, Sampson, Tang (2026): Database of all 2025 trade policy announcements



(a)  $N^{\text{Announce}}$



(d)  $\text{Tariff}^{\text{Mess}}$

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**Partial remedy:** Construct a “clean” instrument excluding products/partners subject to concurrent non-tariff measures

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- We are in the short-run after 2025: prices sticky, firms slow to switch suppliers, capacity constraints, customer-market frictions
  - paper's own estimates show shifting adjustment over time
- Huge policy uncertainty: what are the expectations of the time path of tariffs and trade policy?
  - front-loading of imports pre-LD, stock market collapse after
  - Handley and Limao (2017), Alessandria et al (2025) – policy uncertainty key to understand response
- How plausible are the welfare estimates from a static/deterministic framework here?
  - Baqaee and Malmberg (2025), Kleinmen et al (2023) – incorporating capital depreciation results in 2× larger welfare impacts

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- How plausible are the welfare estimates from a static/deterministic framework here?
  - Baqaee and Malmberg (2025), Kleinmen et al (2023) – incorporating capital depreciation results in 2× larger welfare impacts
- NB: dynamic trade models are available to capture some of the frictions in quantification
  - why not use one?

## Comment 2b: Dynamic Trade Models are tractable too

Boehm et al (2025): tractable closed-form ACR-like GFT formula for class of dynamic trade models featuring sluggish trade adjustment to trade cost shocks

- margins: firm entry (Krugman/Melitz), customer acquisition, capital, explicit role for tariffs

- **ACR (static):**

$$\hat{W}_{ACR} = \lambda_{jj}^{\frac{1}{\varepsilon_{LR}^T + 1}}$$

- **BLPT (dynamic):**

$$\hat{W}_{BLPT} = \lambda_{jj}^{\frac{1}{\varepsilon_{LR}^T + 1 + \chi}}$$

- $\chi > 0$  captures dynamic adjustment margin; larger  $\Rightarrow$  **larger dynamic gains from trade**
- To measure  $\chi$ , one option is the ratio of long to short-run tariff elasticity
  - can use results in this paper for quick calculation
- NB: dynamic baseline ignores positive welfare impact of tariff revenue *given* observed change in  $\lambda_{jj}$ 
  - Modified formula available; also requires knowledge of  $\chi$

## Simple Dynamic Welfare Calculation

### Inputs:

- Short-run tariff elasticity: here  $\epsilon_m = 1.71$
- Long-run tariff elasticity: 2-5 (debated)
- implied  $1 + \chi \approx 1.3 - 2.9$
- Using ex-post changes in domestic absorption, tariff revenue/GDP in 2025:
  - **Welfare change range: -1.3% to -2.7%**
  - With tariff revenue adjustment: -0.9% to 2.8%
- Note: many simplifications, no intermediates, assume future time path of tariff policy known, etc... can be enriched

**Some changes to assumptions: large changes to implied welfare gains/losses**

## Revised Welfare Estimates: A Sensitivity Check

How sensitive are the  $\pm 0.1\%$  GDP estimates?

Assumption	Without ToT	With ToT
Baseline (paper)	-0.13%	+0.10%
+ full in-kind retaliation	-0.34%	-0.34%
+ implicit retaliation via FTA diversion capital adjustment	Direction: unambiguously negative $\geq 2\times$ larger losses	
Simple BLPT formula	-2.7% to 2.8%	

**Key takeaway:**

- What do we really know about the welfare impact of the 2025 tariffs so far?

## Comment 3: “No Retaliation” — A Misleading Benchmark?

**Narrative: China retaliated, other countries did not**

**Trade diversion as implicit retaliation:**

- EU–India FTA negotiations accelerated in 2025; EU–Mercosur deal finalised
- Regional trade agreements exclude the U.S., raising *relative* tariffs on U.S. exports
- Implication: identical in welfare terms to explicit retaliation against the U.S

**Sustainability of cooperation:**

- Bonadio, Levchenko and Pandalai-Nayar (2026): Repeated-game framework to study post-Liberation Day incentives of *other* countries
- Even assuming no explicit retaliation against the U.S., the minimum discount factor for global cooperation to dominate Nash *barely changes*
  - average (median) changes from 0.39 (0.39) to 0.49 (0.44)
- Incentives to cooperate have *not* been destroyed
- Open question: have they been strengthened?

## Minor Comment: The Shock Is Larger Than It Looks

**Focusing on the applied tariff (9.6%) masks endogenous compositional adjustment, among other issues**

**The mechanical issue:**

- Applied tariff = duties  $\nabla \cdot$  import value (current weights)
- As high-tariff goods are substituted away, their weight falls  $\Rightarrow$  denominator shrinks  $\Rightarrow$  applied rate is pulled down endogenously
- Using 2024 import weights: **12.5%** shock vs 9.6%

The applied tariff is useful to understand endogenous adjustment, but endogenous adjustment to a shock doesn't change the magnitude of the shock....

## Contribution: Debate on the Trade Elasticity

**The paper estimates  $\hat{\sigma} \approx 1.9$  (origin-substitution) and implied macro elasticity  $\approx 1.8$**

- Debate on the trade elasticity – Boehm et al (2023) estimate 2-3
- Alessandria et al (2025) estimate around 13-14
- Key: sluggish adjustment of trade to shocks, policy uncertainty
- Estimates here in a static framework, implicitly long-run, but using short-run variation
- Continued estimation over time for steady state elasticity?

## Conclusion

**Important contribution to real-time accounting of 2025 tariff shock**

### **Open questions:**

- Instrument endogeneity — does this change the estimated elasticities/pass-through?
- Modest welfare impacts: is this plausible?