INTERVIEW

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# Trade War: The Cost of Import Tariffs in the Home Market

## Interview with Lei Li, EPoS Economic Research Center

Bonn, Mannheim, 01.08.2024 – **Sourcing products and materials globally has become a pivotal aspect of international trade. While this strategy works well in times of low tariffs, it can backfire when trade tensions rise. Economists have measured the impact of retaliatory import tariffs imposed by China on the stock market value of domestic companies in 2018, during the US-China trade war. They find that the tariff shock had a net negative impact on individual stock returns. These are results of a new study by the EPoS Economic Research Center at the Universities of Bonn and Mannheim published in the discussion paper "Hedging along the Global Value Chain: Trade War and Firm Value".**

**Ms. Li, what impact did China's retaliatory import tariffs have on domestic companies?**

**Lei Li**: Depending on the firm, import tariffs take the form of output and input tariffs. Output tariffs are imposed on imported goods and protect domestic companies producing similar products from foreign competition. Yet, the same does not apply to input tariffs, which are imposed on intermediate goods needed in production. Let us take the car industry as an example: If additional import tariffs are added to engines, domestic engine producers gain while domestic car producers importing engines from abroad are hit and face higher production costs. This is why, in times of trade tensions, production organized in the global value chain can backfire on companies relying on imports.

**In your research, you studied the effects of both, input and output tariffs, in terms of firm value. What did you find?**

**Lei Li**: In 2018, retaliatory tariffs led to negative stock returns looking at a three-day time window, during the US-China trade war. Apparently, rising input costs have put downward pressure on stocks. This negative effect more than offsets the benefits for certain domestic producers.

We studied a total of 1,495 Chinese listed companies, most of them manufacturers, and found that most of these firms were harmed by retaliatory tariffs imposed by China: 94 percent faced severe downward pressure on their stock prices.

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Our conclusion for China: On average, tariff shocks have a net negative impact on individual stock returns through trade exposures. The negative effect will be larger for firms with limited options to replace the imported intermediate goods with domestic alternatives.

**What do your observations mean for investors?**

**Lei Li**: The negative effect on stock returns we found is an indication that investors are aware of the risks of protectionism. They apparently account for the rising costs for imported goods in the future. Higher production costs will have trickle-down effects on the whole value chain. In the end, trade protectionism creates a lose-lose-situation – for foreign suppliers and domestic importers.

**Which lessons can be drawn?**

**Lei Li**: Tensions among major economies always introduce significant uncertainties to the global trade landscape. The effects described are likely to be similar for other countries' stock markets and in other trade contexts. Investors around the world should be aware of the risks of rising input costs due to raised tariffs in today's intertwined economies.
Firms relying on imports might consider adjusting their strategies to build resilience. They could, e.g., enhance the substitutability of their inputs. This will mitigate the adverse effects of rising input costs caused by protectionist tariffs.

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The presented discussion paper is a publication without peer review of the Collaborative Research Center Transregio 224 EPoS. Access the full discussion paper here: https://www.crctr224.de/research/discussion-papers/archive/dp531

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**The Collaborative Research Center (CRC) Transregio 224 EPoS**
Established in 2018, the Collaborative Research Center Transregio 224 EPoS, a cooperation of the universities Bonn and Mannheim, is a long-term research institution funded by the German Research Foundation (Deutsche Forschungsgemeinschaft, DFG). EPoS addresses three key societal challenges: how to promote equality of opportunity; how to regulate markets in light of the internationalization and digitalization of economic activity; and how to safeguard the stability of the financial system.

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