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Tariffs, tax cuts and deportations could all drive prices higher. So could firing Powell.

Trump's Economic Plan Has Inflation Written All Over It

By Alan S. Blinder

Among the many ironies in the recent election is this: One of the main reasons why Donald Trump defeated Kamala Harris was the high inflation of 2021-23. Yet almost every economist will tell you—as many did before Nov. 5—that Mr. Trump's proposed policies are inflationary.

Three such policies received the most attention during the campaign: tariffs, tax cuts, and the mass deportation of illegal immigrants. I'll take those up first, before turning to what poses the biggest inflationary danger: the threat to the Federal Reserve's independence.

No matter how many times Mr. Trump denies it, tariffs are (discriminatory) sales taxes. Discriminating against imported goods is their purpose. Sales taxes, of course, raise prices for consumers, and research says American consumers have paid for almost 100% of recent tariff hikes.

How much inflation can we expect from another round of tariffs? Well, imports are about 14% of U.S. gross domestic product, though a lot of that is inputs used by American firms, not consumer goods. If the average tariff rate is 10% to 20% (I'm guessing here—tariffs on Chinese goods will be higher) that's about 1.4% to 2.8% higher prices. Most important, this is likely a oneshot price increase. Not even Mr. Trump would raise tariffs every year. Would he?

What about the tax cuts? Readers with long enough memories will recall that many economists in 2017 worried about the inflationary effect of the tax cuts because fiscal stimulus boosts spending. That inflation never happened. Ironically, however, Republicans successfully blamed the inflationary surge of 2021-23 on President Biden's American Rescue Plan—a different sort of fiscal stimulus. Probably, only a little inflation stemmed from that law. Likewise, only a little inflation is likely to come from more Trump tax cuts. *

Then there is the potential 800pound gorilla in the room: the threatened mass deportation of illegal immigrants. That will be inflationary by restricting the supply of U.S. labor. But we can only guess the magnitude. What will the second Trump administration actually try to do? How many will they round up? With what timing? In terms of inflation, which is certainly not the most important way to judge the policy, it's anybody's guess. My own is on the low end, but I could be wrong.

So if you put all this together, the new Trump policies might add 2% to 3% to total inflation over two to three years, a percentage point a year.

This brings me to the Federal Reserve, which Mr. Trump will try to bully—or worse. If the new president eliminates, or even seriously undermines, the Fed's independence, that could prove more inflationary for much longer.

During his first term, Mr. Trump berated Chairman Jerome Powell and the Fed constantly as they lifted interest rates gently off the floor. He even inquired whether he could fire Mr. Powell, and was told he couldn't. The Fed chair serves a four-year term and can be removed only for cause. The post was designed to be nonpolitical, not to turn over when the presidency does.

But that was Trump I, when there were still some guardrails in the form of sensible people in the administration. What about Trump II with no guardrails? Mr. Powell has said he won't resign if Mr. Trump asks him. Good for Mr. Powell, who has already shown more backbone than the Republican caucus.

What happens then? Can we really imagine Pam Bondi as attorney general telling her boss that he can't fire Mr. Powell? It's easier to imagine the issue going to court. If it goes all the way to the Supreme Court, it's all too easy to imagine the 6-3 conservative majority siding with Mr. Trump. If so, Federal Reserve independence goes out the window.

What could stop this awful scenario from playing out? Good judgment on the part of the president-elect? Please stop laughing and read on.

Or Congress, which created the Fed in 1913, refusing to enact the changes in the Federal Reserve Act that Mr. Trump might request? Not unless there are mass backbone transplants on Capitol Hill.

Or the Supreme Court ruling in favor of Mr. Powell and the Fed? Maybe there's a prayer. But remember, the Federal Reserve—not to mention its independence—is nowhere to be found in the Constitution. And these same six justices ruled that Mr. Trump, while president, has a lot of immunity for official acts. *

That brings me to the last—and likely most effective—line of defense: the markets. At the first sign that Mr. Trump will seriously undermine, or even subjugate, the Fed, the stock and bond markets will tank. Thousands of points off the Dow might be what's needed to dissuade Mr. Trump.

We know that the president-elect keeps score by watching the stock market, which isn't a method I'd normally recommend. But this may be one case in which we're glad he does.

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