

# How long will tariffs cause inflation?

Are Trump's tariffs finished causing inflation? Those who think so argue that tariffs will cause a one-time increase in the price level; and after that, tariff's influence on inflation will be over. For instance, suppose tariffs cause the price of shirts to increase by 15 percent. This price increase will contribute – in a small way – to an increase in the overall price level.

**Joe McGarrity**



But this effect will be short lived. Once the price of shirts stops rising, shirts will stop contributing to inflation.

Ruth Simon, writing for the Wall Street Journal, reports that many companies did not react to Trump's tariffs right away. Instead, they waited to see what the effect of the tariffs would be on their profits, and they waited to see if the tariffs would remain in place. Simon reports that Levi Strauss and McCormick (the spice manufacturer) plan to increase the prices of some of their goods by between 5 percent to 9 percent. Simon also mentions the results of a survey of businesses that shows that a signif-

icant number of firms are planning large increases in their prices.

So why is it taking firms so long to respond to tariffs? One answer is that real-world decision making is tougher than economic models let on. A student, looking at an economics textbook, might see a demand curve, which tells her how many jeans consumers buy at different prices. But firms, like Levi Strauss, do not have accurate demand curves that tell them how consumers respond to price changes. Sure they have estimates. But until the firms increase their prices, they do not really know how consumers will react. When jean prices increase, consumers might only buy slightly fewer jeans, or they might buy significantly fewer jeans. The firms will have to increase their prices to find out how consumers actually respond. Fear of losing out on a lot of sales may cause firms to postpone price hikes.

Firms face another problem as well. Consumer responses may change over time. Consumers who have made plans may stick with those plans if they see an unexpected price hike. However, once they see the price hike, they have a chance to think about ways to avoid paying the high price. In

the case of Levi jeans, a consumer may decide to buy chinos instead. These revised plans take time to formulate. They make consumers' responses to price changes larger as time goes by. These large changes, of course, make firms reluctant to increase prices. Firms often will not know if increasing the price was a good idea until quite a bit of time passes and consumers have made new plans. Firms will also be unsure about whether they changed prices too much.

It appears that the effect of Trump's tariffs on inflation may last a lot longer than he hoped. At least according to the Wall Street Journal, firms that have been putting off increasing prices are now ready to jack them up. At the time I wrote this, the Supreme Court still had not ruled on whether Trump could legally use emergency powers to implement his tariffs. If the court rules against Trump, perhaps some firms that decided to hold off on increasing prices will decide not to increase them – knowing the emergency tariffs will stop eating into their profitability. We will see what happens.

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