

## What's a Little 25% Tariff Among Friends?

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Steve Odland: Welcome to C-Suite Perspectives, a signature series by The Conference Board. I'm Steve Odland from The Conference Board and the host of this podcast series. And in today's discussion, we're going to talk about tariffs and inflation, two things that seemingly go hand in hand.

Joining me today is Erin McLaughlin, Senior Economist at the Economy, Strategy, and Finance Center of The Conference Board. Erin, welcome.

Erin McLaughlin: Thank you, Steve.

Steve Odland: So Erin, you're an expert at all things trade and tariffs and inflation and all this stuff, but let's start with some of the basics. So what's a tariff?

Erin McLaughlin: That's a great question because we hear sometimes our leaders say, we're going to put tariffs on China. And actually the tariff is not on a country. It's on the goods that are imported from that country. So when the US imports goods from China or Canada or Mexico, and they come to our borders, the federal government essentially assesses a fee—a tax, some people call it—on those goods at a percentage of their value.

And that is paid by the importer, which is generally, obviously, a US or multinational company that's either going to use them for manufacturing or sell the products to consumers here in the US.

Steve Odland: So a tariff is actually like a tax, or a fee, but it's actually money that's collected by—so a US tariff, then, on another country's goods are collected at the border. So that's money that goes right to the US Treasury, then.

Erin McLaughlin: It is, yes. And some have reflected that is an advantage, and that could help us since we have a large amount of federal debt.

But the reality is, it's a very small percent that would go into the Treasury. So the benefits of a tariff with regards to that aspect are usually not seen as very heavy-weighted.

Steve Odland: Well, if it's such a small thing, why are we making such a big deal of it?

Erin McLaughlin: Well, that's a great question. There's been a lot of talks about tariffs with the new Administration, and it definitely seems like it's a negotiation tool, firstly. Secondly, the US has a trade deficit with most of its trading partners. And so the current Administration feels that evening out these various trade deficits will strengthen the US economy and will bring manufacturing home.

Steve Odland: Yeah. And we have to point out that The Conference Board is completely nonpartisan.

Erin McLaughlin: We are nonpartisan. Yes.

Steve Odland: And nonpolitical. So anything that we're talking about, we're not supporting or against what's happening. We're just trying to explain what's going on. But this is an important point because the strategy, as you said, of the administration is to try to level the playing field a little bit here. And what they keep saying, all these other nations have tariffs on our goods that we ship there. For instance, you can't find an American car in Europe because of the tariffs, but yet we've had, pretty much, open borders.

And so this is what they've announced is, we're going to match whatever tariffs y'all are putting on us. Is that the right way to think about the strategy here?

Erin McLaughlin: That is one of the ways to think about the strategy. Your example of European tariffs, or on tariffs at the global level, those are expected to be announced in April.

So the administration is currently undergoing an evaluation of over 200 economies with the idea that instead of having essentially free trade, which is what we have with most of the world right now, that the US will assess different levels of tariffs on goods, depending on which country they come from and what kind of tariffs that country may or may not have in place.

And we may also decide to assess tariffs based on some nonfinancial or nonretaliatory measures, as well. Obviously, the hot topic of today is the tariffs that are now in place with our three largest trading partners, which are Mexico, Canada, and China.

Steve Odland: Yeah. And that's of concern. Now you said that essentially, it's a tax. And that's one way to think about it, meaning that the money is collected, it goes to the US Treasury. But it doesn't necessarily get passed on through the consumer. Sometimes the manufacturer lowers their prices so that the net effect is the same. Sometimes there's some compensation from the country of origin. But what I think you're concerned about

and other economists are concerned about is the increase in prices that come through and the potential impact on US inflation. Is that a way to think about it?

Erin McLaughlin: Absolutely. Yes. In fact, yesterday, one of the big manufacturing surveys that a lot of us follow was released, and it showed the largest price increase in manufacturing inputs in about the last two-and-a-half years.

In their survey, it's the manufacturing PMI survey, companies said that there was just so much uncertainty about, as you said, whether or not part of these tariffs would be absorbed by the exporter or the importer or the manufacturer or whomever is selling the end product or the consumer.

So where in the supply chain tariffs get absorbed is really dependent upon the parties that are part of the supply chain. One of the big concerns is that at a tariff rate of 25%, which is what we're looking at right now with Mexico and Canada, that's such a high percent that many business leaders are saying that consumers will definitely feel the impact.

Steve Odland: Yeah, and your point is if it was a small amount, maybe the manufacturer could eat it, the supplier could eat it, but it's hard to eat 25% because people's margins are not, bottom-line margins aren't that high. So it is presumed to have a net cost increase, but then, you think about substitutability.

So let's just say the cost of one brand of car goes up, but that doesn't mean all cars go up. So people can shift their demand because there's alternate supply. How much of this just gets washed out and moves market share?

Erin McLaughlin: Well, that's a great question. I think it depends upon the commodity. And it depends upon how it's being sourced. We did model out the 25-25 Canada/Mexico tariffs and a 10% on China recently. And it showed that over the course of four quarters in the US that it would create a 0.6% increase to inflation. We know that this most likely will be inflationary.

When it comes to consumers having choices and market demand, the biggest import that we have from these three largest trading partners includes food as number one, and it does certainly include automobiles, electronics, et cetera. And it really just depends on the commodity.

For example, the US manufacturers of automobiles, for example, which could be Chevy, Ford, Chrysler, are classic US manufacturers. They've been treating North America for many years now as one trade zone. So a lot of our companies that we consider US-branded automobiles are actually perhaps made in Mexico or made in Canada, and if you go buy a Chevy or a Ford, you may not even realize that, but that is the reality. Imposing, for example, 25% tariffs on Mexico and Canada, which is what we're seeing starting today, is going to increase those prices.

Steve Odland: Yeah, and it's because we've treated North America as an integrated trading area, but also there's a global supply chain, so parts for vehicles are all over the place, made all over the place. And so even though, it's got an American label on it, it could have an impact on the overall price, or it could reduce the margins such that profitability was hit, which is why the stock market has taken a tumble over these tariffs.

Now, an interesting thing that came out of the administration is they said that—it's not an exact quote, but something to the effect that this will likely hurt in this very short term, but not the long term. So what does that mean their strategy is?

Erin McLaughlin: I take that as the strategy: Seeing that reshoring will occur, that US companies or global companies will choose to set up manufacturing facilities in the US if they are selling to US customers. And for many years, and it's sort of nonpolitical, many consumers have said, I would prefer to buy USA products, but the reality of our global economy means that really hasn't always been the choice, especially for certain things where it just makes sense to source from markets with different kinds of materials or cheaper labor or what have you.

In the short term, definitely, prices are going to increase because we don't have the supply chain set up domestically, and we do not have factories, for example, that are set up to make apparel or sneakers or certain things that we are accustomed to buying overseas. My concern, and I have a background in infrastructure economics and analysis, is it takes several years to get a factory up and running.

Obviously, if you have a very small product, maybe you could lease part of a factory, or you could outsource. But for a lot of large companies that are producing offshore and want to bring their manufacturing, even if they strongly desire and can figure out the numbers back into the US, the time it will take to design, build, and outfit with things like computers and automation, a factory, takes years.

Steve Odland: Yeah, this whole notion, and I think this is where people are getting scrambled, because the whole notion of a domestic product is, it is not necessarily the same as it was years ago.

You look at a Ford F-150 pickup truck, and that's the number one light vehicle sold in the United States. Only 50% of the components come from the US. Whereas a Honda Accord, which is thought of as a Japanese vehicle, because Honda is a Japanese company, it has domestic content of, roughly 70%. So it's actually more American than a Ford F-150. And this is what you're saying. This is a very complex thing when you're thinking about it.

Erin McLaughlin: Very complex.

Steve Odland: So then when you think about the impact on US GDP and inflation and all that, your answer, which is the right answer, is it depends. It depends on the category. It depends on where these things are and how much can be flexed. But I think your point is

really important that it takes years. It's taken us 30 years to get the supply chain set up in China where it was done primarily for labor arbitrage. It's just for labor over there, but it's taken us 30 years to get in. It's going to take us a long time to get out. You can't just snap your fingers.

So therefore there is going to be some short-term hurt here. So the administration must think that a little bit of inflation here is OK, but they can't be planning on this lasting for very long. So is this all just negotiating strategy, negotiate, and therefore they think that countries will come around and capitulate to, whatever demands we're making and everything will be fine here within the year?

Erin McLaughlin: Well, that's a great question, and I think that's what a lot of business leaders and even consumers are asking themselves. We definitely, in the last few years, and with the previous administration, a lot of us had conversations about what it's like to create a resilient supply chain with regards to national security, whether that be medical components, masks, vaccines, and then chips and things that go into semiconductors. Items that we need for national security, for defense, and that's long been supported.

And concepts around reshoring or nearshoring from China and some other countries that maybe have not traditionally been our allies, or that are physically very far away, definitely was a trend, I think, that was supported by the business community and supported by consumers.

But the conversation in these last couple months, and the activities of the last couple days, is a bit more mystifying. Because when we're talking about countries like Canada and Mexico that are allies, where we have this sort of borderless supply chain—and I think the word "intermediary" is going to be the new supply chain word—all these things that come in and out, and there's so many mini parts that make up a whole part, including a Ford F-150, that's where we stop and say, OK, what is this really about?

The administration has stated that it's about illegal border crossings, and that it's about fentanyl. But a lot of folks also consider that perhaps this is also about causing a bit of tension before we renegotiate the NAFTA 3.0, which is, we're in NAFTA 2.0, the US-Canada-Mexico trade alliance that expires in 2026. And so, some of this stuff is really anyone's guess at this point, but there are certainly are, I believe, other reasons besides what is positioned under the emergency act that is allowing for these tariffs right now.

Steve Odland: And this is a really important point that you're making because USMCA, which is the NAFTA 2.0, it expires. And so a lot of people believe this is just a negotiating strategy to renegotiate that and maybe do it earlier and get a better deal between Canada and Mexico. Otherwise, why would you take on Canada and Mexico first? Your two biggest trading partners. The problem is, as the administration can't come out and just say, whisper to everybody, hey, we're just negotiating here, don't worry about it, because otherwise they give away their strategy, but it is a worrisome way to do it.

Erin McLaughlin: Many folks thought that—so these tariffs against Canada and Mexico,

against their products that were imported from Canada and Mexico, were put off 30 days. So this is proposed in February, the first week in February, put off until now. Many folks, I think, really thought that this would be put off again, or that there would be exemptions, and that it wouldn't be so blunt of a force that's being issued. So I think that, when they went into effect at midnight, it surprised many people.

Steve Odland: Yeah, and, of course, the stock market has given back all of its gains since the election, and so there's big reactions there. We're talking about tariffs and trade, and we're going to take a short break and be right back.

Welcome back to C-Suite Perspectives.

I'm your host, Steve Auden from The Conference Board, and I'm joined today by Erin McLaughlin, the senior economist at our economics center at The Conference Board and an expert in trade and tariffs and all this stuff.

Erin, we were talking about the renegotiation of the USMCA and maybe this is the start of that. China's a different issue, though. Canada and Mexico are part of that. China's different. Talk about that.

Erin McLaughlin: Well, China, some of this is not a surprise because our current president, during his first term in office, he also put on tariffs against China, and many of them have been held up since.

China is a unique economy, and a lot of what we have traditionally thought about, that we purchased from China either is electronics and things that we were looking at with regards to semiconductors, or items that a lot of firms had begun to source maybe from other Asian countries, like Vietnam, or had even brought back to Mexico.

Erin McLaughlin: So I think that the move away from China is not a new move. Today's tariffs are plus 10 over the 10% from last month. So even having 20% tariffs on China, I don't think, has been as much of a surprise for folks as the tariffs against Canada and Mexico, and what we may experience between now and the first week in April, when we may see additional tariffs on other commodities and other countries.

Steve Odland: so basically it gets painted with the same brush, but they're really two different strategies here.

Erin McLaughlin: Yes.

Steve Odland: Canada and Mexico are one strategy. China's a different deal now. We have to point out that, the reason this started with China back in the first Trump administration dealt with the saber-rattling in the South China Sea and our concern that 90% of the world's advanced semiconductors are made in Taiwan. And so that creates a geopolitical risk.

The last administration, the Biden administration put in the CHIPS Act, which helps to

underwrite and fund reshoring of some of these semiconductor plants, and Intel being the biggest beneficiary of that, which they started this big plant, but now they said that the opening of that first plant will take till 2030.

So they've delayed it and it takes, to your point earlier—

Erin McLaughlin: It takes a very long time, yes. And it's interesting because I've done some research and wrote a paper within the last few months on smart manufacturing, which is manufacturing, in the in our current time. Manufacturing, as you said, is not what it was a couple decades ago.

A lot of advanced manufacturing facilities depend on robotics, depend on their own sort of chips, electronics. And certainly, especially with my background in infrastructure in the built environment, seeing tariffs on steel and aluminum, they're coming into effect this month from all countries, and seeing tariffs with lumber being called out. Those material commodity tariffs are going to impact our ability to effectively cost estimate and build the infrastructure, both buildings and the transportation infrastructure that we need in order to reshore some of these activities. So it's going to be expensive.

Steve Odland: And it's all uncertain because you don't know whether it's simply, this is the administration negotiating, it'll be done in a month or be done in a few months. And so the uncertainty then freezes the business community. CEOs say, hey, time out. Everybody wait. Let's just see—cause you don't know what your costs are going to be. If you don't know your costs, you can't make an investment.

Erin McLaughlin: Exactly.

Steve Odland: You can't guarantee a return and that you're not wasting money.

Erin McLaughlin: It's interesting because in that manufacturing survey I referenced that was released this week, the price increase of manufacturing components has jumped substantially, but the rate of new orders and the backlogs decreased substantially.

And that is being attributed to companies, just as you said, not knowing, are things going to get worse or better, more expensive, less expensive? Or do I need to change which countries I'm sourcing my products from?

Steve Odland: There's some substitutability, but there's no substitute for a chip.

Erin McLaughlin: There's no substitute for a chip. There may not be an easy substitute for an avocado, either.

Steve Odland: Well, you can substitute a corn chip for a potato chip, but you can't substitute a semiconductor or an avocado for anything else. No, you're right. 90% of avocados come from Mexico, which is why you raised the avocado issue.

But let's just go back to China for a minute. So if these tariffs are really substantial—and

some are talking about 60% tariff rates—then what happens? Cause all of the benefits of the labor savings goes away, and you can do some substituting. Where do you go? You can't just throw up a plant. So then what happens here? Does everything just freeze?

Erin McLaughlin: I think globally, economies slow down, and although right now, we do not see a recession in the US as a result of this, most economists do foresee a recession in Canada and Mexico if this sticks.

I think, unfortunately, the idea of pulling away from China and maybe some other countries and nearshoring to Mexico, which has a low labor cost, was also a strategy for a lot of companies. And that strategy now seems off the table, which contributes to the uncertainty, or at least off the table for a while.

And so I think altering supply chains, or knowing as a business leader or supply chain manager how to alter your supply chains, right now, you don't know. We don't know. We have to wait and see for a little bit to see how many of these stick, to see what the other retaliatory tariffs come out of the analysis of the 200 economies. Prices are going to go up.

One thing that I found that was really interesting is our most imported good by value into the US currently is pharmaceuticals. And a lot of our generic and over-the-counter pharmaceuticals are coming from China and India. And similar to food, things like over-the-counter medicine, generic prescriptions, those are things that US consumers are buying every week, every month, and they will see the higher price.

Steve Odland: Yeah, and one of the most visible things to us, because the drug pricing is a little opaque, but an automobile—so the average price of an automobile in the US today is \$50,000. Most people buy them with a car loan or a lease and finance that. OK. So interest rates are sitting at 5-6% on those things. Now you raise the price by what—15%, 20%—because of input costs. Wow.

Erin McLaughlin: Yeah. Right now, Michigan-based economic analysis, it said that adds up to \$12,000 on a new car potentially.

Steve Odland: Which then is financed, and your monthly payments then exceed your paycheck. So this materially changes, the purchasing behavior. Maybe the value of substitutability is used cars versus new cars, but the whole thing shifts, the whole world shifts. And at a minimum, people slow down their buying or they substitute for cheaper goods or they wait to replace things.

Erin McLaughlin: Yes.

Steve Odland: And hence the economy slows down. Your point, GDP has to take a hit here.

Erin McLaughlin: Yes. Absolutely. Americans generally own their cars. I believe we're up

to 12 or 13 years at this point, cars last longer than they used to. But if you were thinking of buying a new car and it's going to cost \$12,000 more, potentially, in the next year or two, you may run out and try to buy one this week. Or you're going to repair your car. You're going to get by with the car you have. You're going to wait and see what happens.

Steve Odland: Yeah. Cause you don't have a choice. What final area here is what should businesses be thinking about here? Should they just say, yeah, this is short term, we'll get through it. Should they be building inventories? What should they be doing?

Erin McLaughlin: I think most businesses have had several years to reflect on what they source from China. And so a lot of businesses, a lot of retailers in the US have expressed that they have pulled their supply chains away from China, and they have diversified their supply chains. And that may have taken months or even quarters or years to do that.

At this point, business leaders need to really understand their supply chains. Even if they're not taking action on them right this week or this month, they need to understand where their components, including their intermediaries, are coming from what countries, so that when the dust settles a little bit—because eventually the dust will settle one way or the other—they understand what their options are. And then, of course, if the product they are selling can be produced in the US competitively, or they have the ability to source and produce domestically, they should consider that.

Steve Odland: Yeah, but they keep saying, oh, we're going to bring jobs back to the US, but A, we're at historically low unemployment.

Erin McLaughlin: We are. We are.

Steve Odland: We've got a skill set shortage. So we don't have enough people to fill the job. So if you bring more jobs back, we don't have any people to put in them. So it just means everything's got to be automated, and that doesn't. And that doesn't happen overnight, as you said.

It doesn't happen overnight. And again, there's tariffs on the materials for all of that equipment that are going to go into your new factory, go into the robotics. And it would be good to see more of a scalpel when it comes to tariffs. If tariffs are going to be used in this way, more precision in what kind of materials and commodities and products and countries tariffs are being put upon so that, if you really want to go down this path, so that we get something that is achievable and that doesn't feel so hard hitting and so fast.

And hence, you come back and you say, OK, China's a different deal. That's a geopolitical thing. But it just sure does feel like Canada and Mexico is short term because they're going to, to force a better trade deal, a better USMCA, better NAFTA with the North American market. I think that's what most CEOs are concluding on this, but it does mean short-term hurt. And it may be a year before that happens, and it may require post-election in Canada, which is coming up in the next few months, I think. So lots of

change.

Erin McLaughlin: Lots of change. Yes.

Steve Odland: Erin McLaughlin, thanks for being with us today.

Erin McLaughlin: Thank you.

Steve Odland: And thanks to all of you for listening in to C-Suite Perspectives. Tune in for more on tariffs, the economy, and what's happening in the global trade. I'm Steve Odland, and this series has been brought to you by The Conference Board.

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