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US Import Tariff Escalation: Are there unintended Consequences for IsDB Member Countries?²

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Abstract

Using GTAP9, the paper simulated the challenges posed by the current U.S. tariff escalations on the agricultural and manufacturing sectors and GDP of tariff-targeted countries and selected member countries of Islamic Development Bank (IsDB). The analysis reveals that the tariffs have led to declines in GDP and real income for China, Canada, and Mexico, with Mexico suffering the most severe impact. Conversely, while the U.S. also experienced a GDP decline, it saw a slight increase in income. It highlights that the agricultural sector is facing challenges due to reduced production linked to these tariffs.

Introduction

This brief provides an overview of the implications of import tariffs, particularly considering recent actions taken by the United States. It serves as a briefing for stakeholders, highlighting the potential challenges and opportunities that arise from the shifting global economic landscape.

Import tariffs are essentially taxes levied by one country on goods and services imported from another. They serve multiple purposes, including the protection of emerging domestic industries, addressing trade deficits, and responding to perceived unfair trade practices from other nations. The current escalation of tariffs by the U.S. primarily targets China, Canada, and Mexico, with two main objectives articulated by President Donald Trump: to address the widening trade deficits with these countries and to encourage the return of manufacturing jobs to the U.S. The expectation is that by making imported goods more expensive, domestic products will become relatively cheaper, thus incentivizing consumers to favor local goods over imports. Additionally, the hope is that foreign manufacturers will relocate their production facilities to the U.S. to avoid tariffs, which could further boost domestic production and employment while reducing trade deficits.

However, while tariffs can generate revenue for the government, they often lead to increased prices for consumers, effectively transferring income from consumers to the government. This can create economic distortions and inefficiencies in the short term. Interestingly, countries that are subject to tariffs may not suffer entirely; they might enhance their production processes to become more competitive or seek new markets for their goods.

Furthermore, while tariffs can influence trade dynamics, fundamental factors such as productivity and consumer preferences are not easily swayed by price changes alone. Tariffs may lead to increased domestic prices, which could raise the cost of living in the U.S., and a strengthened dollar could have adverse implications for developing countries with dollar-denominated debts. The analysis of the current U.S. tariff situation will utilize a computable general equilibrium (CGE) model based on the Global Trade Analysis Project (GTAP) database, focusing on the impacts on the U.S., the countries targeted by tariffs, and some member countries of the Islamic Development Bank (IsDB).

US Trade with Tariff targeted Countries and IsDB MCs

On February 1, 2025, President Donald Trump announced significant tariff measures aimed at addressing the United States' growing trade deficit. The new tariffs include a 25% levy on imports from Canada and Mexico, alongside an additional 10% tariff on imports from China,³ which could bring the total tariff on Chinese goods to as high as 35%.⁴ This decision follows a series of tariffs imposed during Trump's first presidency, which ranged from 7.5% to 25% on various Chinese imports.

The rationale behind these tariffs is rooted in the belief that unfair trade practices have contributed to a widening trade deficit, which reached \$1.2 trillion in 2023. The U.S. is currently the largest importer and the second-

³ <https://www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-imposes-tariffs-on-imports-from-canada-mexico-and-china/>.

⁴ <https://www.reuters.com/markets/asia/trump-unleash-nearly-40-tariffs-china-early-2025-hitting-growth-2024-11-20/>.

largest exporter of goods globally, with China, Canada, and Mexico being its primary trading partners. In 2023, these three countries accounted for a substantial 42.9% of U.S. merchandise imports and 40.8% of exports (Table 1).

The implementation of these tariffs has sparked threats of retaliation from the affected countries, raising concerns about the potential onset of a new trade war that could have far-reaching consequences for the global economy. The implementation with respect to Mexico and Canada has been temporarily paused, awaiting further bilateral discussions. In the case of China, the tariff went into effect immediately, and China has responded by imposing 10% tariff on crude oil, agricultural equipment, heavy and light truck, and 15% on coal and natural gas from the USA.⁵ Unlike the USA tariffs, the Chinese counter-tariffs are not sweeping but selective affecting six sub-sectors. The scope of our models covers only three broad macro-sectors (agriculture, Manufacturing, and others) to focus on the effects of the sweeping USA tariffs that aim to affect the manufacturing sectors.

While tariff affected countries can experience direct adverse effects on their economies, other trading partners could benefit. For example, one unintended consequence of these tariffs may be the diversion of trade towards other U.S. trading partners, including the Islamic Development Bank (IsDB) member countries. Malaysia, Indonesia, Türkiye, the U.A.E., and Saudi Arabia are identified as potential beneficiaries of this trade shift, with Malaysia leading at 1.3% of U.S. trade (Table 1). This trade diversion could stimulate economic growth in these countries, highlighting the complex interplay of international trade dynamics in response to U.S. tariff policies.

Table 1: USA Trade with Tariff-affected Countries and IsDB MCs, 2023

USA's Trading Partner	Exports merchandise, % of total US merchandise export, (value)	Imports merchandise, % of total US merchandise import	Total merchandise, % of US trade
Canada	17.5	13.6	15.1
Mexico	16.0	15.2	15.5
China	7.3	14.1	11.5
Malaysia	1.0	1.5	1.3
Indonesia	0.5	0.9	0.7
Türkiye	0.7	0.5	0.6
U.A.E.	1.2		0.6
Saudi Arabia	0.7	0.5	0.6
Rest of the world	51.3	43.8	45.1

Source: United Nations Conference on Trade and Development, 25 October 2024

However, the tariffs also pose a risk of adverse income effects on the IsDB MCs. As the tariffs reduce economic growth in Canada, Mexico, and China, the resulting decrease in income may lead to reduced consumption and demand for imports from their trading partners, including the IsDB MCs. Notably, China is a major trading partner for the five IsDB MCs, constituting significant portions of their merchandise trade—**26.17%** for Indonesia, **19.34%** for Saudi Arabia, **17.1%** for Malaysia, and **14.02%** for the U.A.E. Conversely, trade with Canada and Mexico is minimal, accounting for less than **1%** of trade activity with these countries (Table 2).

Table 2: MCs trading with the USA targeted countries, 2023

MC Trading with	USA tariff targeted countries		
	Canada	China	Mexico
Malaysia			
Exports merchandise (% of Malaysia export)	0.29	13.48	1.31

⁵ <https://edition.cnn.com/2025/02/04/business/china-us-trade-retaliation-hnk-intl/index.html>.

Imports merchandise (% of Malaysia import)	0.35	21.35	0.25
Total merchandise (% Malaysia trade)	0.32	17.10	0.83
Indonesia			
Exports merchandise (% of Indonesia export)	0.42	23.54	0.59
Imports merchandise (% Indonesia import)	1.35	29.23	0.14
Total merchandise (% of Indonesia trade)	0.85	26.17	0.38
Türkiye			
Exports merchandise (% of Türkiye export)	0.19	0.00	0.02
Imports merchandise (% of Türkiye import)	0.98	1.62	0.07
Total merchandise (% of Türkiye trade)	0.97	1.60	0.06
UAE			
Exports merchandise (% of UAE export)	0.18	10.02	0.19
Imports merchandise (% of UAE import)	0.63	18.15	0.30
Total merchandise (% of UAE trade)	0.40	14.02	0.25
Saudi Arabia			
Exports merchandise (% of KSA export)	0.48	17.96	0.05
Imports merchandise (% of KSA import)	0.81	21.57	0.51
Total merchandise (% of KSA trade)	0.61	19.34	0.23

Source: United Nations Conference on Trade and Development, 25 October 2024

Model Results and Analysis

The analysis employs a Computable General Equilibrium (CGE) model using the GTAP framework. It is a static system of 10x3x5: 10 regions (USA, 3 tariff targeted regions, 5 IsDB MCs, and rest of the world), 3 sectors (agriculture, manufacturing, and others), and 5 factors of production (land, skilled labor, unskilled labor, and natural resources). The model treats the import tariff as a shock variable, with all factors of production considered exogenous and output variables endogenous. It follows a nine-step process (as outlined by Hieu and Harrison, 2011) for applying shocks and analyzing results (see Annex A for data aggregation result).

The analysis identifies four critical economic variables affected by tariffs: GDP, real income, sector output, and terms of trade. The findings show that tariffs reduce GDP and real income in China, Canada, and Mexico, with Mexico being the hardest hit (Table 3). The USA, while experiencing a GDP decline of 0.47%, sees a slight increase in income of 0.66%, which partially offsets the GDP loss. The findings aligned with previous research indicate that tariffs can weaken the currencies of affected countries, leading to a decrease in their terms of trade. The simulations of Bank of Canada (January 2025) have also arrived at similar conclusions that both USA and Canada will see reduced GDP and high inflation, especially if Canada retaliates.⁶ The solutions also confirm the findings of O'Neil and Huesa (2025) that tariffs could weaken the currencies of the affected countries as their terms of trade decrease.

Terms of trade have weakened in all the three affected countries and strengthened in the USA, indicating that the USA exports have become relatively expensive, and effectively the consumers in the affected countries could now buy fewer imports from the USA. The reduction in the USA GDP is also consistent with finding of Amiti et al (2019). They assessed the 2018 USA administration tariffs on China and found that there was a complete pass-through of the tariffs into domestic prices of imported goods, and the burden fell squarely on the

⁶ <https://www.bankofcanada.ca/publications/mpr/mpr-2025-01-29/in-focus-1/>.

domestic consumers and importers. Their solution estimated a monthly US1.4 billion reduction in the USA aggregate output by the end of 2018. Using panel data of 151 countries for the period 1963-2014, Furceri et al (2020) find that tariff increases are associated with an economically and statistically and persistently decline in the economic output for both parties.

The situation remains marginally positive for the rest of world, including the IsDB MCs, with Malaysia being the highest beneficiary. In addition, the terms of trade in the IsDB MCs have improved, implying that one unit of their exports can now buy more units of import.

Table 3: Impact on GDP, Real Income and terms of trade

Country	% change in GDP	% change in real income	Terms of trade, change direction
Rest of world	0.05	0.88	up
China	-0.33	-2.94	down
Canada	-0.14	-5.47	down
USA	-0.47	0.66	up
Mexico	-0.20	-9.09	down
Indonesia	0.02	0.98	up
Malaysia	0.04	1.27	up
Saudi Arabia	0.00	0.47	up
Türkiye	0.01	0.66	up
UAE	0.01	0.65	up

Source: Author's model solutions using GTAP9

The manufacturing production declined in tariff-targeted countries (Canada, Mexico, and China), while the USA manufacturing production increases 2.05%. Canada is the hardest hit, followed by Mexico. There are positive unintended increases in the manufacturing production in Malaysia, Indonesia and Saudi Arabia, while Türkiye and UAE saw slight unintended reduction in their manufacturing production. China and Canada saw indirect improvement in their agriculture production, while the USA's agriculture production declined. With the USA agriculture production decreasing, all the IsDB MCs, except Saudi Arabia, witness slight reductions in their agriculture production.

Table 4: Impact on Sector Output, % change

Sector	China	Canada	USA	Mexico	Indonesia	Malaysia	Saudi Arabia	Türkiye	UAE
Agriculture	0.65	6.48	-1.02	5.96	-0.34	-0.89	0.14	-0.08	-0.12
Manufacture	-0.52	-13.02	2.05	-8.95	0.31	0.76	0.13	-0.02	-0.28
Others	0.13	1.8	-0.32	1.56	0.01	-0.15	-0.03	0.02	0.11

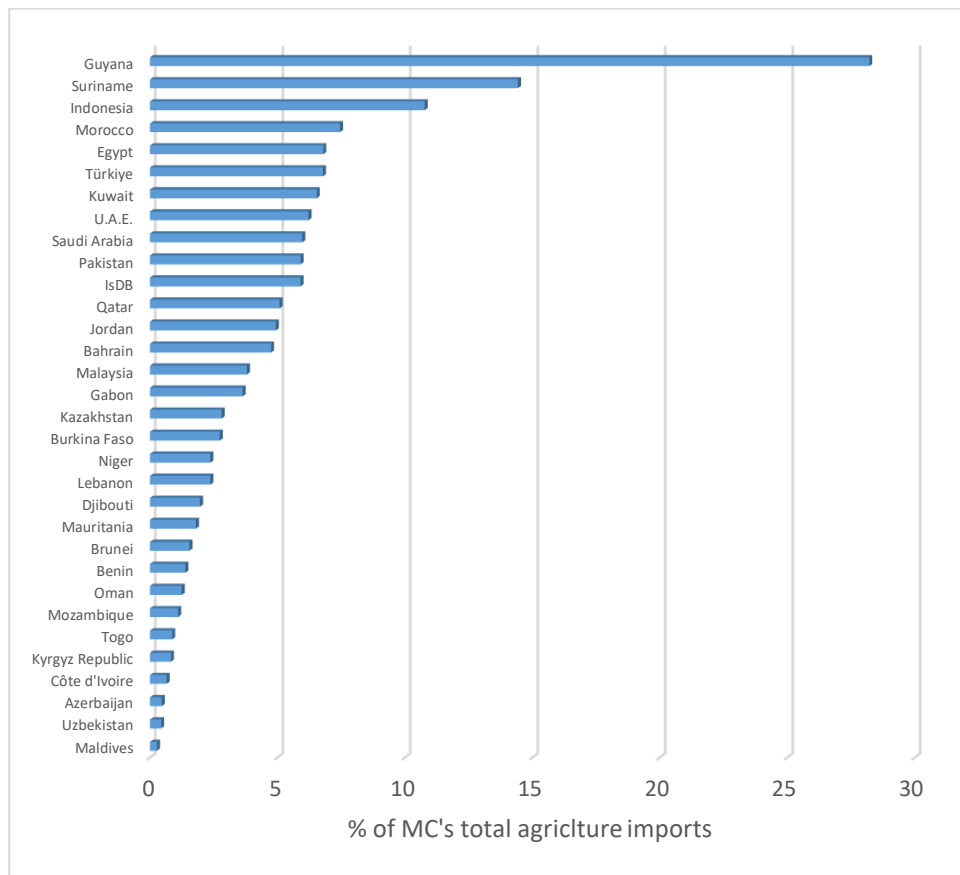
Source: Author's model solutions using GTAP9

Implications for IsDB MCs

The model solutions show that the select IsDB MCs face no serious threats to their GDP and real income. Instead, they may see some slight improvements in GDP and income as they benefit from trade diversion dynamics. In this case, Indonesia and Malaysia are best positioned to invest in their manufacturing sectors and harness the trade diversions. However, due to strengthening USA terms of trade and negative tariff impact on the USA agriculture sector, the selected IsDB MCs, except Saudi Arabia, have seen slight reductions in their agriculture sector production. This may have adverse implications for food security if the affected MCs have moderate to high dependence on agriculture imports from the USA, or if they cannot easily find substitutes for

their agriculture imports from the USA. Figure 1 shows that there are 12 MCs that source more than 10% of their agriculture imports from the USA. This metric is 10.8% for Indonesia, 6.8% (Türkiye), 6.2% (UAE), 6.0% (Saudi Arabia), and 3.8% (Malaysia). Therefore, the slight negative implications in Table 4 are linked to these import metrics. Diversifying agriculture import sources could help the affected MCs to alleviate the negative effects caused by the USA tariff escalation.

Figure 1: MCs’ Agriculture Imports from the USA



Source: United Nations, Food and Agriculture Organization, 23 July 2024 with calculations of Mohamed Elgoussi, GCE, IsDB.

Conclusions and recommendations

The brief provides an analysis of the economic effects of tariffs on China, Canada, Mexico, and the USA. It highlights that tariffs have led to declines in GDP and real income for these nations, with Mexico experiencing the most severe impact. Although the USA also faced a decline in GDP, an increase in income helped to somewhat alleviate the negative effects on its economy.

The unintended effects on the five IsDB MCs appears to be slightly more favorable, with Malaysia emerging as a notable beneficiary. The improved terms of trade for these countries indicate that they can now acquire more imports compared to their exports, thereby enhancing their overall economic standing in the global market.

However, it emphasizes the complexities of global trade dynamics, particularly the adverse effects of tariffs on the agricultural sector. The strengthening of the USA's terms of trade, coupled with the negative repercussions on its agriculture, could be associated with slightly reduced agricultural production in some IsDB member countries, raising concerns about the need for enhancing agriculture import diversification.

Considering these challenges, the brief stresses the importance of strategic investments and adaptability in response to the evolving economic landscape. It is recommended that IsDB member countries focus on

investing in manufacturing and enhancing food security to diversify their economies. By doing so, they can better navigate the challenges posed by tariffs and capitalize on the opportunities arising from the disruptions in global trade.

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Annex A: Global Trade Analysis project (GTAP) data adjustment result

GTAPAgg Database Aggregator: subscriber's edition (unlimited) [License file: C:\GTPAg2\gtapagg.lic]

Package

Instructions and Help	Un-modified aggregation from file C:\GTPAg2\GTAP9a\GTAP\UStariff1033.agg 140 old regions map to 10 new regions 57 old sectors map to 3 new sectors 8 old factors map to 5 new factors
Choose source data	
Read aggregation scheme from file	Release: GTAP9A Product: GTAP Year: 2011 Flows data from file: C:\GTPAg2\GTAP9A\GTAP\2011\BaseData.har DREL: R9.0A_2011_Apr2016
View/change regional aggregation	
View/change sectoral aggregation	
View/change factor aggregation	Licensed to current user (v9 publicly available). Single Academic User License No. 9.0-0000.
Save aggregation scheme to file	
Create aggregated database	
View output files	

