TONG'S PORTFOLIO

Trump's 'big' blunder — and no, it is not tariff per se

BY **TONG KOOI ONG** + **ASIA ANALYTICA**

US President Donald Trump has just committed a big blunder, and it is not the tariffs he has imposed per se, but the size of them. Confused? Read on.

While not often articulated, it is in fact possible for a country with market power (able to influence world prices) to improve its own welfare by imposing a tariff on imports. The optimal tariff theory says that a country with market power can improve its terms of trade by imposing a small positive tariff on imports — by shifting the cost of the tariff onto foreign exporters. Effectively transferring income from the rest of the world to the tariff-imposing country (in this case, the US) by lowering the price the country pays for imports relative to exports. This is Trumpianomics and the Make America Great Again (MAGA) goal.

How does it work? Most goods in the world do not have perfect elastic supply (that is, quantity supply will vary with price changes). When a large country imposes a tariff, it reduces global demand for that particular good, and its price will fall (in its own domestic currency). The importing country pays less, although its domestic consumer may pay more (Trump is hoping that this will be offset by the corresponding rise in the US dollar and not cause a price inflation). Meanwhile, the government collects tariff revenue, while the foreign exporter receives less revenue. And this increases the national welfare of the US — as long as gains from improved terms of trade outweigh the losses to consumers (arising from higher prices in the US).

This simple model is based on three determinants: (i) the elasticity of the foreign export supply (more inelastic, little change in supply even if the price goes up or down, therefore more favourable to the US); (ii) the elasticity of domestic import demand (more inelastic, more favourable, smaller loss in consumer surplus); and (iii) most critically, the relative size of the country in terms of global trade — to influence world price, and why the US can, but not others.

The optimal tariff rate = $1/\varepsilon$, where ε is the foreign export supply elasticity. The more inelastic or the lower the elasticity, the higher the potential optimal tariff rate.

In layman's terms: for a product that is very inelastic, say, a unique variety of tomatoes that cannot be processed or canned but must be eaten fresh. Within limits and over a short period of time, the farmers harvesting those tomatoes will sell all their products regardless of the price. The total supply of tomatoes will remain the same even if the farmers now have to absorb the tariffs. So, the optimal tariff rate that can be set is very high!

By the way, does the formula $1/\varepsilon$ not look a little familiar? Perhaps because it is the same one revealed by the White House to compute the reciprocal tariffs on all other nations in the world.

Here is the formula: $\Delta t = (X-M) / (\varepsilon \times \varphi \times M)$

where Δt = the change in tariff on imports

X = US exports to that country

M = US imports from that country

ε = price elasticity of import demand and

φ = elasticity of import prices with respect to tariffs (+ currency offset)

The White House added that it assumed ε and φ to be very insignificant. If we assume $(\varepsilon \times \varphi) = 1$ or unit elasticity (price rise by 10% is accompanied by a 10% fall in quantity demand and vice versa).

Hence, $\Delta t = (X-M) / M$

Let's use an example to understand this better. Suppose for country A, M = \$1,000 and X = \$600. US trade deficit with country A = \$400

Using the above formula, the tariff = (600-1,000)/1,000 = -400/1,000 = 40%

Trump gives country A a 50% discount. So, the imposed reciprocal tariff = 20%

How does this formula tie with the optimal tariff formula?

Assuming the elasticity is very low (same quantity of supply even at lower prices), then a 40% tariff would mean the value of the imports (M) will fall from \$1,000 to \$600. The quantity will remain the same, but the price will fall by the tariffed percentage, thereby reducing import value. And voilà, the US no longer suffers a trade deficit with country A.

Of course, your immediate response is, why would any supplier from a foreign nation sell the same quantity at much lower prices? Think of the reverse for a moment. Before we had refrigerators, a fisherman would catch fish daily and sell all of it, whether prices were up or down. Let's move from macroeconomics to microeconomics — the theory of the firm.

For ease of understanding, we will use a simple cost structure for our example, company Y, which produces widgets (see Table 1).

Now, would company Y sell at a price 40% lower (that is, it absorbs the entire tariff) or at \$3 per widget? The answer is "YES, in the short term" because doing so still allows it to cover the cash cost of production. If it refuses to accept a lower price and finds no other buyer, then the company would suffer a negative cash flow of \$500,000 a month (the fixed cash cost).

For economics, the short-term supply curve is the marginal cost curve, which lies above the average variable cost (companies shut down when they cannot cover variable costs). Obviously, in the longer term, companies must be profitable (that is, cover all costs, fixed and variable, cash and non-cash).

What about φ? The elasticity of import prices with respect to tariffs is how much the prices of imported goods change when tariffs change. If it is unity or 1, then a 10% tariff increase raises price by 10%. If it is less than 1, the domestic price increases by less. Empirical evidence shows import prices mostly rise by less than the full tariff, since foreign producers absorb part of the tariff. Also, Trump believes the US dollar will rise on the back of tariffs and therefore, the price increase will be partially offset by a stronger greenback (we wrote about this in the first of our three-part series, "Trumpianomics: Why tariffs, and their effects on the US economy, inflation, interest rates, competitiveness and the US dollar" published in *The Edge* [March 17, 2025]).

Therefore, it is a totally reasonable assumption that ε and φ are small, highly inelastic in the short term. Thus, the optimal tariff rate (yes, reciprocal tariff is a misnomer) is approximated by (X-M) / M.

In other words, Trump's formula is very sound. There is a theoretical framework. And for large economies that can influence prices of goods due to the size of their demand, imposing tariffs can be net positive.

BUT — and the "BUT" is critical — there are limits to this theory:

1. The effects of retaliation
2. The decline in global welfare
3. Critically, estimating the elasticities and therefore, the optimal tariff in practice is extremely difficult.

In other words, while the theory and plan are indeed sound, the execution was a disaster!

For those who are academically inclined, you may read more on the impact of tariffs arising from the above responses, and under different theoretical models (such as Krugman's New Trade Theory or the Melitz model). Suffice here for us to summarise them in a table (see Table 2).

In 2018, when Trump imposed tariffs of 25% on steel and 10% on aluminium imports to boost domestic production and protect jobs, the European Union (EU), China and others retaliated.

US steel imports fell 20% in the following year and prices rose (15%-20%). Downstream manufacturing suffered higher input costs. Gains in steel jobs were modest at less than 9,000. Meanwhile, jobs lost in downstream manufacturing were estimated to be high, at about 100,000. US consumers lose with higher prices. Revenue from tariffs gained was small at less than US\$1 billion. Net welfare effect is said to be negative for the US due to retaliation.

So, what are we saying? Tariffs imposed by the US can be wealth positive (for the US), provided the tariff rate is sufficiently low because the exporting nation will more likely be able to absorb the tariff — and there is no retaliation leading to a trade war. In Part 1 of Trumpianomics, we mentioned that most economists believe the optimal tariff to be less than 20%. It is interesting that China did not retaliate until the US imposed a tariff greater than 20% (see Table 3).

Assuming Trump and his advisers are familiar with the optimal tariff theory, why then did Trump shock the entire world by imposing

Table 1

Why companies will sell at lower prices short term, to cover fixed cash expenses

COMPANY Y	MONTHLY
Quantity sales (assuming full capacity)	1,000,000
Selling price per widget	5
Total sales	5,000,000
Cash cost to produce 1,000,000 units	
– wages for labour (assuming all paid @ \$1 per unit)	1,000,000
– raw materials @ \$1.50 per unit	1,500,000
– logistics, fuel and so on (assume fixed cost)	500,000
	3,000,000
Non-cash costs	
– depreciation and capital allowances	800,000
Total costs	3,800,000
Pre-tax profit	1,200,000
Pre-tax profit margin	24%

Table 2

Summary of tariff impact based on different theoretical models

MODEL	TARIFF IMPACT	TERMS OF TRADE GAINS	NET WELFARE
Optimal tariff theory	Positive (if large country)	Yes	Possible gain
Krugman	Fewer goods, higher prices	Maybe	Usually loss
Melitz	Firm exit, less competition	Rare	Usually loss
Real world	Retaliation, inefficiencies	Short term	Often loss

Chart 1

Chart 2

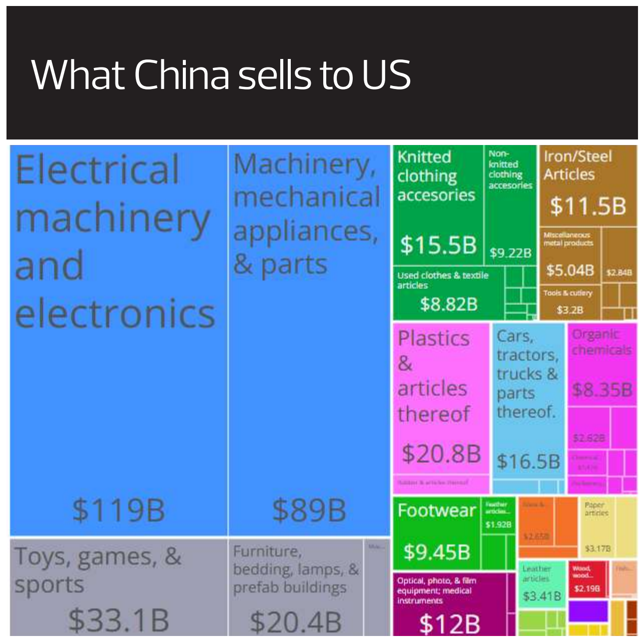


Chart 3

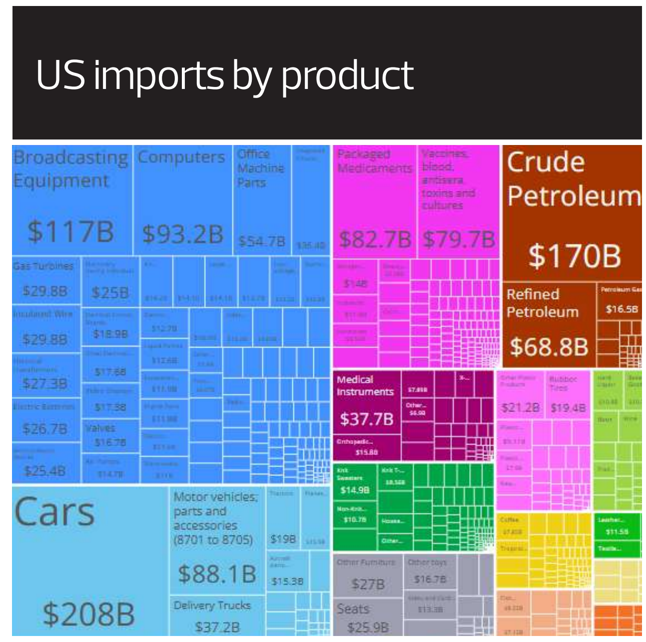
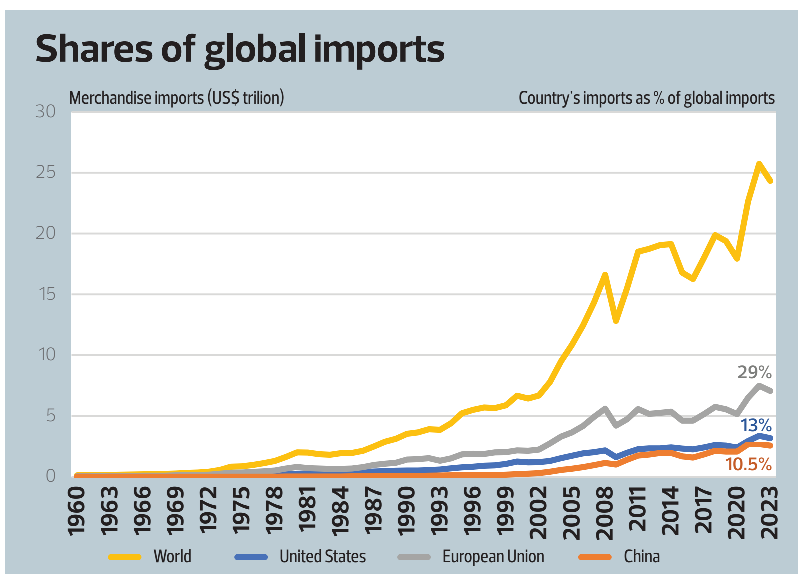


Chart 4



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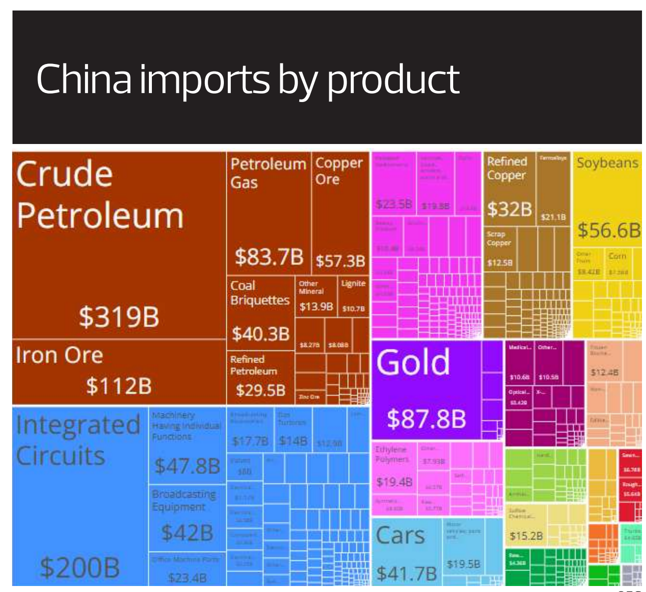

such huge tariffs, up to 50% for some countries and, in the case of China, a total of 54% (20% previously imposed in February-March + 34% reciprocal tariff in April)?

1. According to Commerce Secretary Howard Lutnick, Trump wants to increase revenue by US$1 trillion. Since the US goods imports in 2024 totalled US$3,295 billion, it takes close to an aggregate tariff of 30% to achieve the US$1 trillion. This is in line with the reciprocal tariffs that were announced on Liberation Day, April 4.
2. *The Art of the Deal* — Coercion. Quoting from the book written by Trump, "I like thinking big. I always have … One of the keys to thinking big is total focus. I think about it all the time. I think about it when I wake up, when I eat, when I sleep. I think big. The bigger you think, the bigger your negotiating position." Basically, Trump's "think big" mentality can lead to an advantageous position in negotiations and result in significant achievement. "My style of dealmaking is quite simple and straightforward. I aim very high, and then I just keep pushing and pushing and pushing to get what I'm after."

As we have articulated from the very beginning, tariffs are a means to an end. The tariffs Trump imposed are meant to get concessions from other nations. Pushing very high tariffs gives Trump room to subsequently reduce as part of his coercive dealmaking. And threats — so that other nations are frightened away from retaliation.

But Trump may have just committed a huge blunder — getting carried away by "thinking big". The tariffs are simply TOO BIG. As we said in our March 17 article, Trumpianomics will not be easy to execute and the window of success small, even for the world's most powerful nation.

Why do we say so?

Empirical evidence shows that manufactured goods like automobiles have short-term elasticity of 0.5-0.9; that is, low. This was assumed by the White House in its computations. The reason being high capital costs and rigid capacity.

But in the long term, elasticity will be high

Table 3

China did not retaliate until US tariffs went beyond 20%

2025	NEW US TARIFFS ON CHINA (%)
Feb 4	10
March 4	10
April 9	34
April 9	50
Total	**104**

as supply responds to prices. A study on the US' machinery industry found the supply elasticity at 5. To quote Home Depot co-founder Ken Langone: "The 46% import duty on Vietnam is bullshit and the 34% tariff on China is too aggressive, too soon."

When a nation is tariffed at 54% as in the case of China, you cannot hurt the nation any further with additional tariffs, even to, say, 540%. It makes no difference to China's exports to the US whether it is a 54% or 540% tariff rate. Once set too high, Trump backs himself into a corner. And when Treasury Secretary Scott Bessent said, "I think it was a big mistake, this Chinese escalation, because they're playing with a pair of twos", it reflects more on the weaker position of the US than China — that it simply acted tough and refused to reach out to the US for a negotiation.

What do we think is a likely outcome in a few months — after all the grandstanding? The US will blink and walk back on the tariff rates, although tariffs on all nations (including the ones where only penguins inhabit) will remain at a minimum of 10%.

The Liberation Day tariffs were largely meant to get nations to kowtow and approach the US for a deal. At some 30% on average, it is clear to all that the net welfare effect to the US is a huge negative. The higher prices US consumers must pay reduce American welfare. The disruptions to supply chains, the higher import prices will raise costs and reduce US companies' competitiveness. And these costs will exceed the additional revenue earned from the tariffs.

For China, as we said previously, it is now a "NO-LOSS BET". It either becomes better off with a deal or loses nothing more even if Trump goes ahead and raises the tariff from 54% to 104% (as he had). Trump also has probably never read the history of the Opium Wars, which we wrote as a sidebar a few weeks back. The justification of the Chinese Communist Party (CCP) in governing China is to ensure the country never suffers another "Century of Humiliation" — when Western powers forced China to accept opium and surrender its land because of the trade surplus China was then accruing.

China is also not only better at weathering this out but has more firepower to fight a trade war than the US at present. We will write more on this in a few weeks but just look at the economics. China's gross domestic product (GDP) is about US$18 trillion. Its final consumption is US$10 trillion, accounting for 56% of GDP. Household consumption alone is US$7 trillion, or 40% of GDP. For the US, consumption to GDP is 85% and for the EU, it is 70%-80%. There are many books and research done that show China's consumption to GDP can rise by 10%-15% of GDP with financial liberalisation (transfer wealth to depositors from corporate borrowers), reforming pension plans (raising retirement age, private pensions and so on) and reforming the *hukou* system (easier for workers to access urban services and feeling more secure financially).

China's exports to the US are US$436 billion (see Chart 1). This is 4.4% of current domestic consumption in China and 2.4% of GDP. And China knows it can raise its domestic consumption, if it wants to. China will be hurt by a tariff war with the US — but it undoubtedly has a lot more firepower to retaliate. And the CCP does not require populist votes to stay in power. It can play the long game.

Analysing the products China exports to the US, they consist of very low-cost items like toys, clothing and plastics for which prices for US consumers must rise if these Chinese products are no longer sold in the US (see Chart 2). These products have very high elasticity of supply and demand. And in any case, the US does not want the jobs that will be created to make these products. The biggest items are electrical and electronics — including parts that go into the manufacture of Apple iPhones sold in the US and worldwide. Raising these prices through tariffs will only cause US companies to be less competitive globally.

And if you analyse US imports by product, the big items are not made in China. Cars are huge but they are European, Canadian and Mexican, Japanese and South Korean. Crude petroleum, broadcasting equipment, computers, medicaments and vaccines — none of these are Chinese products. The US cannot put a squeeze on China by product (see Chart 3).

And the 20% tariff on the EU? Last we checked, the EU accounts for 29% of all global imports. The US stands at 13% and China at 10.5% (see Chart 4). To be fair, much of China's imports are commodities and intermediate goods (see Chart 5) — and, therefore, re-exported. That is not the case for the EU. In other words, the EU can pack a bigger punch. You don't pick on a person who is much bigger than you to fight.

The EU, like China, can also begin to target the services sector where the US has a surplus, like consultancy, licensing fees, legal, movies, banking, software licensing and ad revenue for Google, Meta and so on.

Americans think that other countries need the US more than it needs them. It is true that the US is still the single largest market by country, but it is a declining share, where its consumers are already spending more than

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TONG'S PORTFOLIO

Trump will walk back and declare a win

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they save. Typical overconfidence or a fact? This time, it will be tested.

But sadly, the same cannot be said of small nations. How will they fight back? Quick surrender — promises to not retaliate against the US plus offers to negotiate, as Vietnam has done, were met with "Vietnam's 0% tariff offer is not enough. It's the non-tariff cheating that matters" from White House trade adviser Peter Navarro.

Yes, Trump could still cut off his nose to spite his face. Just keep pushing tariffs higher in a trade war even as it hurts the US badly. The fact that giving in to Trump will have very long-term consequences means that many nations may find it more worthwhile to pay the price for the next three to four years, until the US gets a new president.

And since it is almost certain Trump will dig his heels in — walking back now will trigger a wave of retaliation that the US desperately needs to avoid — this crisis will prevail for quite a while, although one would suspect a deal eventually. Trump, after all, prides himself on being a dealmaker.

There must be many Trump advisers now looking at couching a narrative of a WIN, even as he walks back from the high tariffs imposed. Walking back will take a while, but it will happen because Trump is a businessman and is transactional. Meanwhile, the markets will remain volatile, with rising fears of recession. A recession is possible, but unlikely to happen as it does not serve a president with less than four years to go.

Had Trump imposed an average tariff of, say, 10%-15%, he might well have gotten away with it — without retaliation. This revenue would have helped offset the fiscal deficit, even attracting investments and creating new jobs over time. And Trump could have declared victories. So, yes, big is not always better. Better is better.

To use Trump's oft-quoted phrase, "You have no card to play". Trump may have overplayed his hand with the cards he has, and is now getting caught "bluffing" in a game of poker. It is difficult to fold, but if he goes all in and loses, it spells "disaster".

The longer-term outlook:

1. Economic and military dependency on the US will be reduced. New alliances will form.
2. A trade war that will take many months to find a compromise. And US tariffs at lower levels will persist. Small nations without leverage against the US will end up paying for the wealth transfers to the US Treasury, to help the US balance its fiscal budget.
3. New economic relationships will be fostered — China, South Korea, Japan plus India. Trade between the US and the rest of the world will grow slower than global trade on average.
4. China's excess supply will find its way to other nations, hurting their domestic producers, especially in small countries.
5. Countries will pursue more aggressively alternatives to the US dollar as a reserve currency and, for international payments, perhaps adopt a wider use of Central Bank Digital Currencies.

The Malaysian Portfolio fell 1.5% for the week ended April 9, performing better than the market benchmark FBM KLCI, which fell 8.2%. This is attributed to the defensive stance we have taken over the last few weeks — reducing our stock holdings to just two plantation stocks, United Plantations (-5%) and Kim Loong Resources (-5.8%), and Insas Bhd – Warrants C (-33.3%). Cash now accounts for nearly 81% of total portfolio value. Total portfolio returns now stand at 180.5% since inception. This portfolio is outperforming the benchmark index, which is down 23.5% over the same period, by a long, long way.

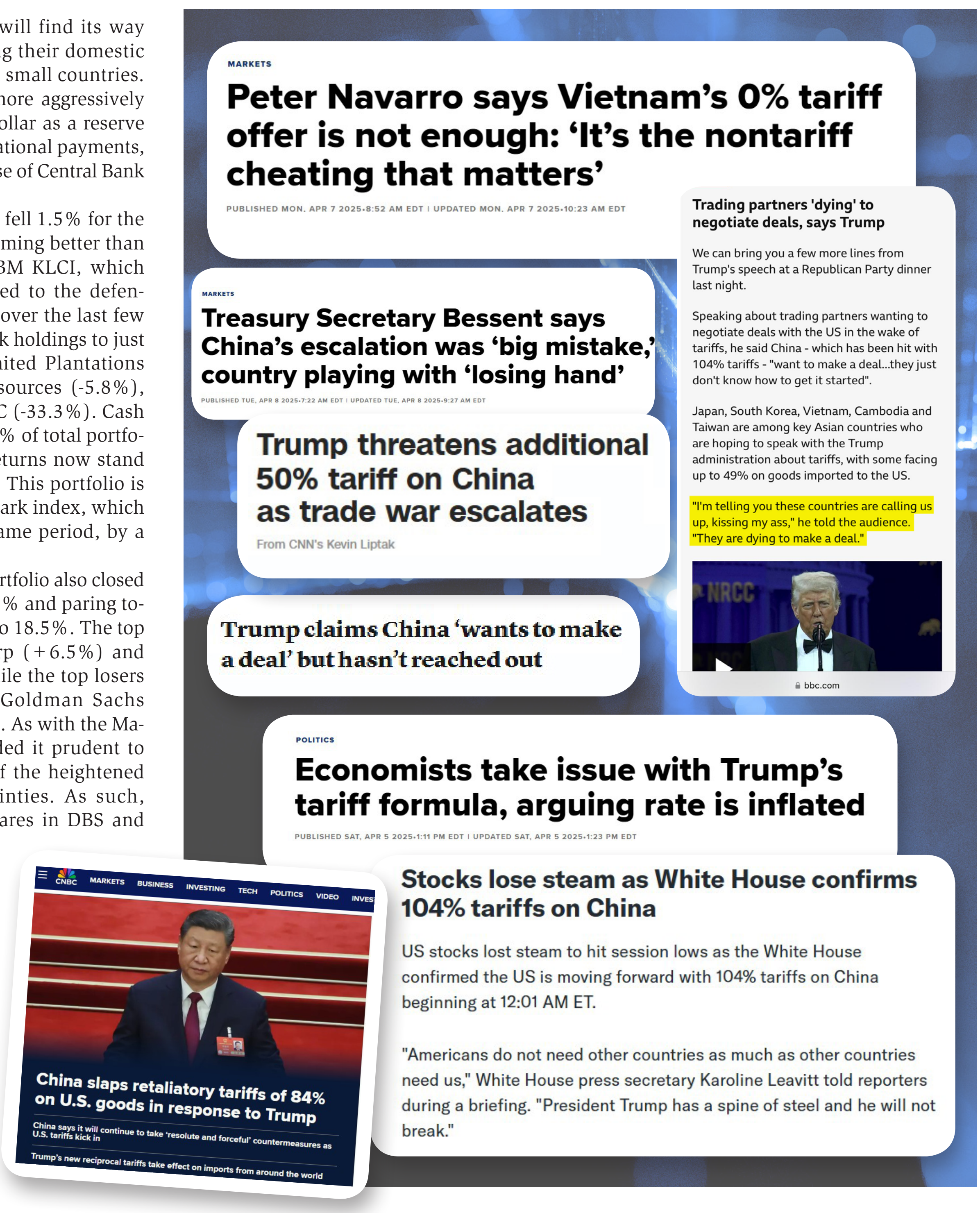
The Absolute Returns Portfolio also closed lower last week, down by 5% and paring total returns since inception to 18.5%. The top gainers were US Steel Corp (+6.5%) and CrowdStrike (+1.8%), while the top losers were Tencent (-12.2%), Goldman Sachs (-8.2%) and Nucor (-6.1%). As with the Malaysian Portfolio, we decided it prudent to raise more cash in view of the heightened global economic uncertainties. As such, we disposed of all our shares in DBS and OCBC, increasing cash to just over 30% of total portfolio value. ∎

Malaysian Portfolio

	QUANTITY	AVERAGE COST (RM)	COST OF INVESTMENT (RM)	CURRENT PRICE (RM)	CURRENT VALUE (RM)	GAIN/(LOSS) (RM)	GAIN/(LOSS) (%)
SHARES HELD							
Insas Bhd - Warrants C	134,800	0.417	56,205.0	0.040	5,392.0	(50,813.0)	(90.4)
United Plantations Bhd	2,850	16.920	48,222.0	20.820	59,337.0	11,115.0	23.0
Kim Loong Resources Bhd	20,400	2.346	47,850.0	2.130	43,452.0	(4,398.0)	(9.2)
Total			**152,277.0**		**108,181.0**	**(44,096.0)**	**(29.0)**
Cash balance (as a % of portfolio)					452,911.4		80.7
Realised profits/(losses)					405,188.4		
CHANGE SINCE LAST UPDATE							
Portfolio							(1.5)
FBM KLCI							(8.2)
Portfolio returns since inception			**200,000.0**		**561,092.4**	**361,092.4**	**180.5**
Portfolio returns (annualised)							**17.2**
Portfolio beta							**0.5**
Risk-adjusted returns since inception							**349**

PERFORMANCE COMPARISON	AT PORTFOLIO START	CURRENT	CHANGE (%)	RELATIVE PORTFOLIO OUTPERFORMANCE (%)
FBM KLCI	1,829.7	1,400.6	(23.5)	204.0
FBM EMAS	12,700.4	10,343.8	(18.6)	199.1

Footnote:
Current price is as at April 9, 2025
Portfolio started on Oct 10, 2014, with RM200,000
Data sourced from Bloomberg



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