The Daily Dish

Some Dietary Math

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As reported by *The New York Times*:

> *Doug McMillon, the chief executive, said on Walmart's latest earnings call last week that it probably would not be able to "absorb all the pressure" from the president's tariffs for much longer.*
>
> *In response, the president demanded in a post on social media on Saturday that Walmart "EAT THE TARIFFS," rather than pass any new costs on to customers.*

The exchange has raised a few interesting issues. To begin, it is President Trump's first public acknowledgment that the burden of tariffs will be on U.S. citizens and businesses. Until now, he has doggedly stuck to the fantasy that the tariffs will be paid for by other countries. Let's count that as a small victory for reality-based thinking.

It does, however, raise the question as to whether the president can plausibly position himself as the populist warrior taking on big business over the costs of…his policy. Hmmm. Eakinomics will get back to you on that one.

The really big question to Eakinomics, however, is the dietary math. Not the calories; the numerical exposure to tariffs that would make it simply impossible to "eat" the tariffs. The intuition is pretty simple. If you import none of your intermediate goods, then the costs of getting your goods to sale is unchanged and "eating" the tariffs is a non-event. But if all of your costs are imported from China, then your costs have just gone up by 30 percent. Eating the tariffs (for any length of time) and staying in business is just as likely as defying gravity. Somewhere between zero costs and 100 percent of costs is the cutoff point at which eating the tariffs would drop profit to zero, but not below.

<Spoiler alert: Math follows. If you are allergic, close your eyes and hum for 10 seconds.>

Suppose the net profit margin (as a percent of revenues) in the absence of tariffs is m, revenues are R, and costs are C. Finally, let s be the share of costs imported and t the rate of tariff. Then the firm will continue to run a profit after eating the tariff only if:

$R - C - (s \times t \times C) > 0$

A little re-arranging yields:

$s < m / ((1-m) \times t)$

Simple enough, and welcome back hummers.

What does this mean in the real world? Using data provided by Aswath Damodaran, it means that for retail grocery and food, where the margin is 1.97 percent, less than 6.7 percent of costs can be imported from China. Otherwise, eating the tariff means taking a loss. If we look simply at the universal tariff of 10 percent, the required cutoff is 20.1 percent of costs.

As it turns out, margins range widely, so the capacity to eat a tariff diet does as well. For the market as a whole (which helpfully includes some services), the margin is estimated to be 8.67 percent. This corresponds to a cutoff of 31.7 percent for importing from China, and 95 percent for the universal tariff. At the extreme, semiconductors and their 20-percent margin translate to 83 percent of import costs from China (and a whopping 249 percent imported at the universal tariff rate).

What are the lessons? First, it is silly to think that having companies "eat the tariff" relieves Americans of the burden. It will simply be translated to profits and shareholders, and further down the line to the pensions of police, firefighters, and other ordinary citizens. The tariff is inescapable in any deep economic sense.

Second, telling every firm to eat the tariffs is simply infeasible for low-margin firms. For firms with large margins, it might make sense to bear the costs in the short-run (thus dodging the president's ire) but over the longer term, the reduced profitability will still have implications for the ability to attract capital.

It just turns out that tariffs are a bad diet.