

Discussion of Bianchi-Coulibaly

The Optimal Monetary Policy Response to Tariffs

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Overview

- There has been much discussion (to say the least!) about how monetary policy ought to respond to tariffs on imports.
- Two existing perspectives:
 - ▶ 'Look through': Tariffs should only have a temporary effect on inflation, so policy should not respond.
 - ▶ 'Fight inflation': Fighting inflation should be a priority.

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- Two existing perspectives:
 - ▶ 'Look through': Tariffs should only have a temporary effect on inflation, so policy should not respond.
 - ▶ 'Fight inflation': Fighting inflation should be a priority.
- This paper opposes *both* perspectives:
 - ▶ Argues monetary policy should be aggressively *expansionary* in response to a rise in tariffs.

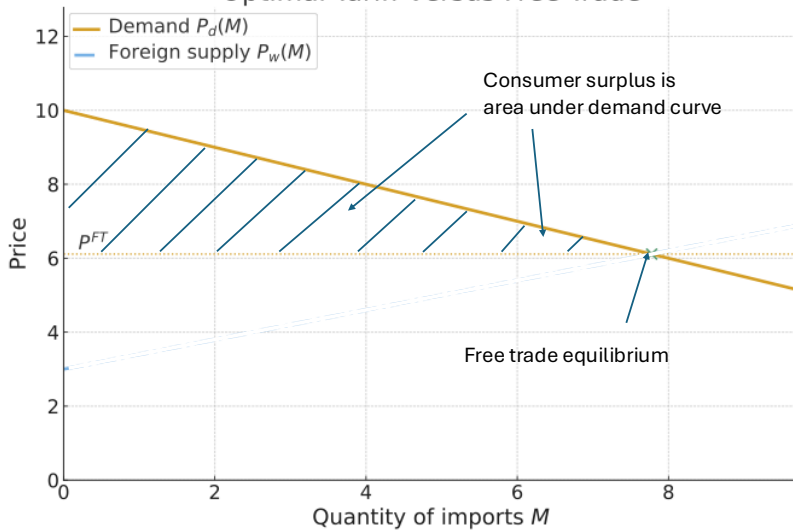
Comments

- Provide some intuition for B-C's view that monetary policy should be expansionary when prices rise due to imposition of a tariff.
- In my conclusion I'll argue for the 'Fight inflation' perspective.

Why Should Monetary Policy Be Expansionary After Tariff Hike?

- Small open and competitive economy, with fixed terms of trade, P_w .
- Domestic households collectively have a downward-sloped demand curve in P_w .

Optimal Tariff versus Free Trade



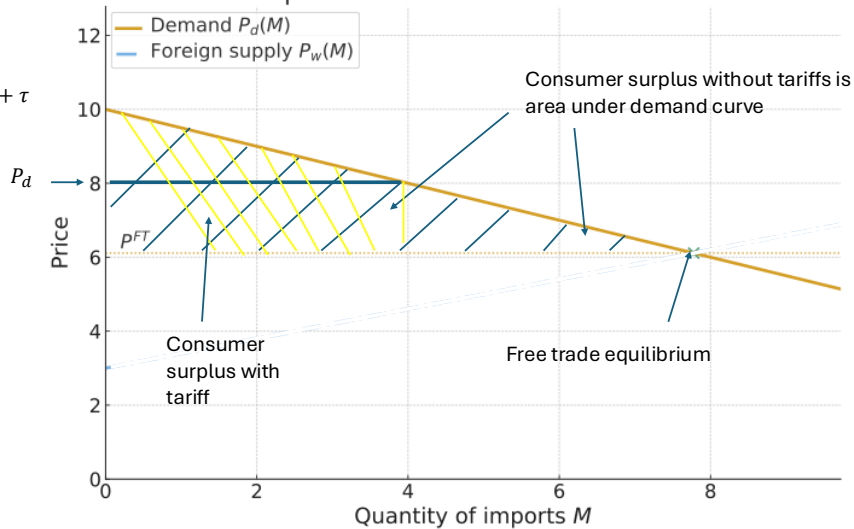
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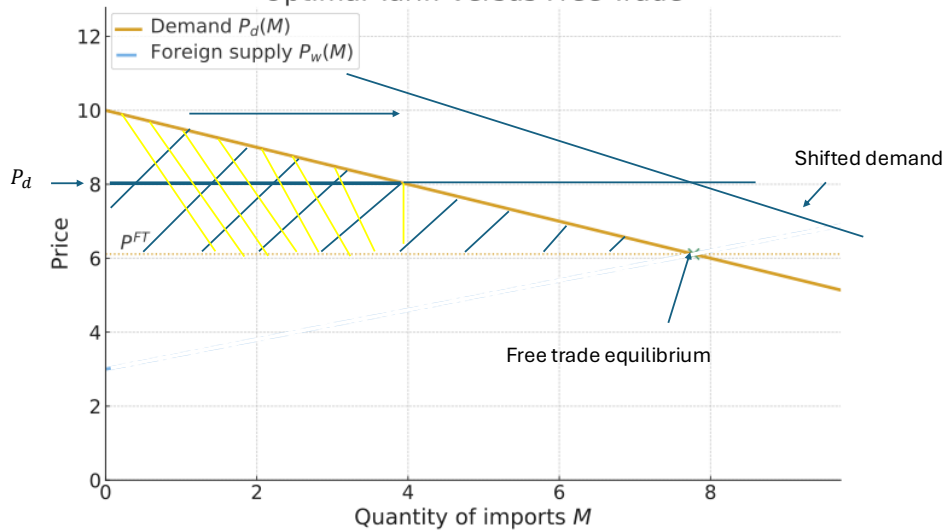
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Tariff Reduces Consumer Surplus

- Use expansionary monetary policy to shift demand curve to the right, to reclaim some of that surplus.

Optimal Tariff versus Free Trade



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- Why not just use the tariff revenues to subsidize imports?
 - ▶ This would completely negate the negative effects of the tariff.

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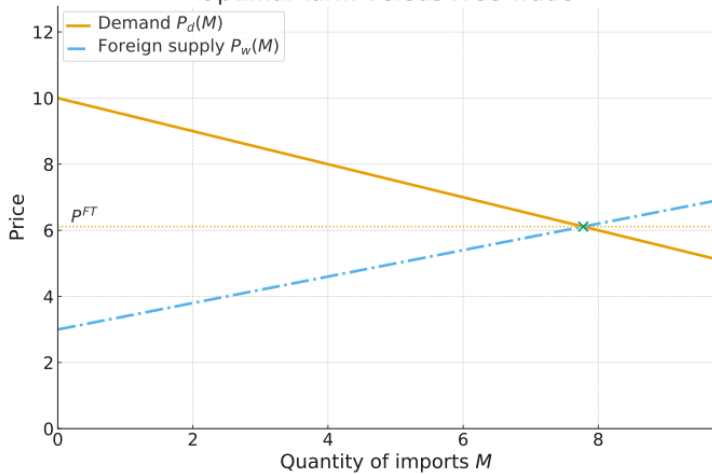
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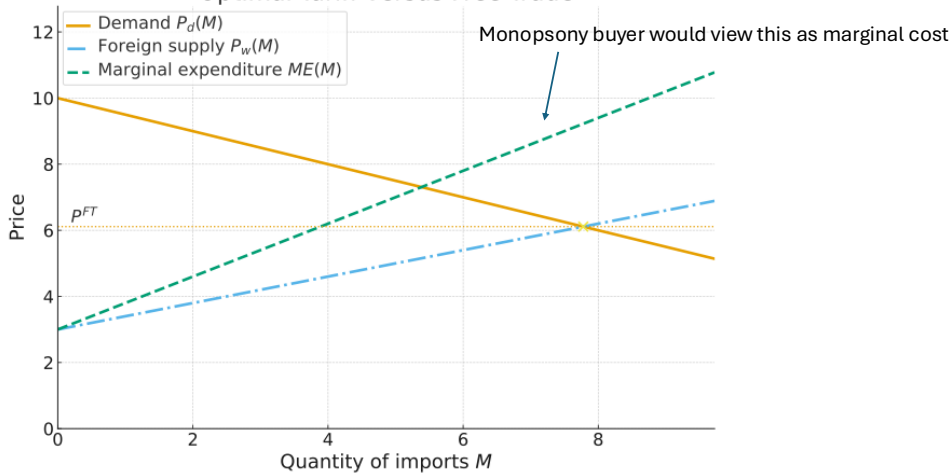
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 - ▶ (Important that foreigners don't retaliate),

Optimal Tariff versus Free Trade



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Introducing a Tariff

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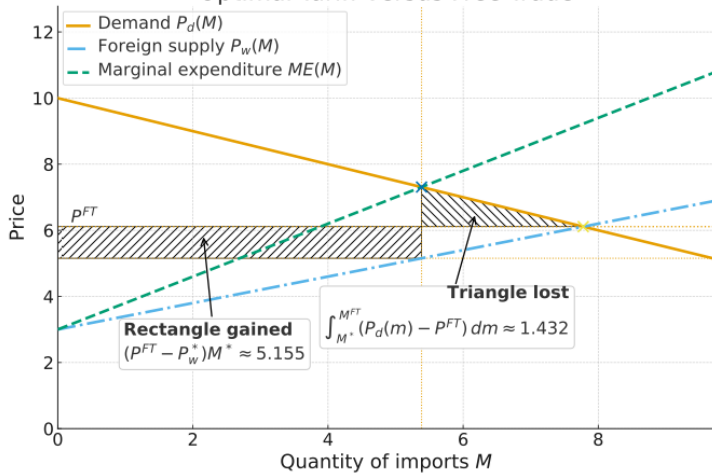
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- A benevolent government that goes to the border and buys goods does internalize that marginal cost is steeper than the supply curve.
- A government that cares only about its citizens gets them to internalize the higher marginal cost by setting a positive tariff.

Optimal Tariff versus Free Trade



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 - ▶ Again, the remedy is expansionary monetary policy to fix effects of the excessive tariff.
 - ▶ A better remedy would be to use the surplus to subsidize the purchase of imports.
- Previous discussion assumes no retaliation.
 - ▶ After Smoot-Hawley & Trump #1, there was retaliation, in which case everyone loses.

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- A shock can lead to persistent inflation only if the Central Bank accommodates.
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- The post-Covid inflation reduced Central Bank credibility and there is a greater risk that high inflation expectations become entrenched.
 - ▶ Well understood by policymakers, but only just now beginning to be incorporated into academic models.
 - ▶ An excellent example is the work of [Cristofell and Farkas \(2025\)](#).