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Covarrubias: The Uncertainty Cost: How Tariff Threats Disrupt Markets Before Implementation




Our research identified over 4.3 million jobs across 15 states that could face exposure if tariffs on goods from Mexico and Canada take effect, writes TAMIU's Daniel Covarrubias.

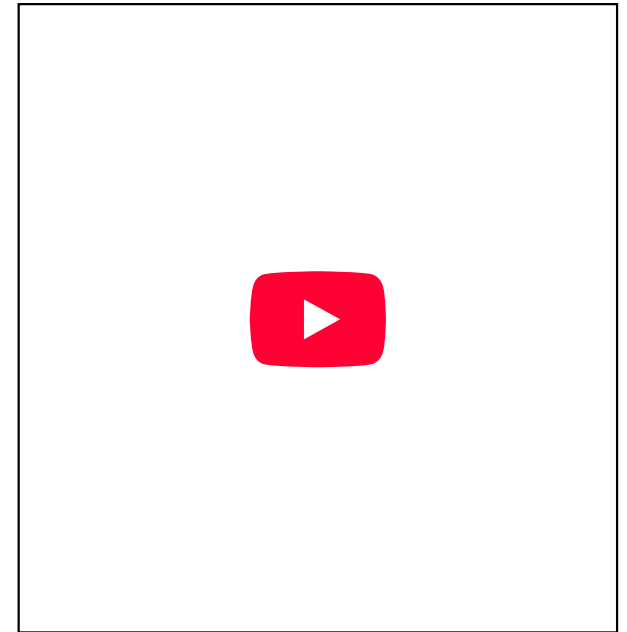
BY DANIEL COVARRUBIAS • [BORDER BUSINESS, GUEST COLUMN](#) • MARCH 3, 2025



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Dr. Daniel Covarrubias, Ph.D., director of Texas A&M International University's A.R. Sanchez, Jr. School of Business' Texas Center for Economic and Enterprise Development.

The weeks-long anticipation of U.S. tariff implementation on Mexican and Canadian imports has revealed an economic phenomenon: significant market disruptions occurring well before duties take effect, creating what economists call an 'uncertainty cost.' With the March 4

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deadline for 25% tariffs approaching, North American businesses already bear costs that rarely appear in traditional policy analyses.

Three critical findings have emerged from this situation: First, the mere threat of tariffs imposes actual economic costs through business uncertainty. Second, these uncertainty costs often exceed traditional policy estimates because they trigger inefficient adaptations across entire supply chains. Third, the impact is already manifesting in measurable ways across the North American economy, from increased inventory holdings to investment delays.

Unlike traditional tariffs that generate revenue, this ‘uncertainty cost’ represents pure economic waste, expenses absorbed by businesses and consumers without benefiting anyone. While conventional tariffs at least direct funds to government coffers, uncertainty costs dissipate as inefficiencies throughout the economy.

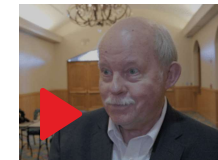
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Recent economic data reveals concrete costs from heightened trade policy uncertainty. These include measurable declines in business investment, reduced stock market valuations for exposed sectors, and growing supply chain inefficiencies as companies engage in anticipatory hedging behaviors.

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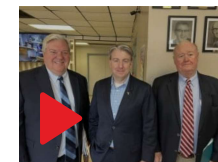
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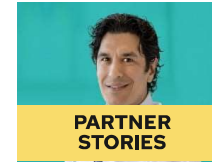
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The economic stakes are substantial. Economists project U.S. GDP growth could be reduced by 0.25 to 0.40 percentage points due to tariff uncertainty alone. This translates to potential economic output losses of approximately \$45 billion from the 25% tariffs on imports from Canada and Mexico, which could rise to \$75 billion if retaliatory measures are implemented.

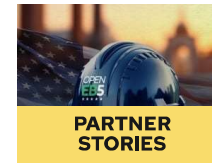
The human impact is equally significant. Our research at Texas A&M International University's Sanchez School of Business Texas Center for Border Economic and Enterprise Development identified over 4.3 million jobs across fifteen states that could face exposure if these tariffs take effect.

Companies in border states report substantial increases in inventory holdings as manufacturers adapt to potential disruptions, with automotive suppliers maintaining 28-35% higher safety stock levels and Texas grain elevators operating at 93% capacity versus 78% last January, while cross-border commercial activity has shown modest fluctuations. The Port of Los Angeles moved more containers last month than in any previous January as importers rushed to bring in goods before anticipated tariff implementation.

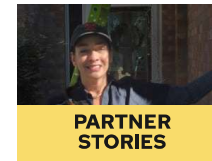


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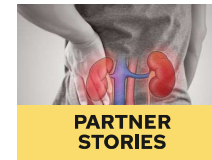
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At Port Laredo, North America's top port of entry, commercial truck traffic has shown the following slight declines: 0.3% in November, 1.7% in December, and 0.9% in January (year-over-year) despite no implemented tariffs. These patterns illustrate how the uncertainty cost functions essentially as an invisible tariff on cross-border operations, adding financial burden to supply chains even before any formal duties are collected.

Businesses face significant administrative hurdles beyond the headline tariff rates that compound trade disruption. Payment systems for international transactions require advance preparation, with financial qualification processes potentially taking weeks to establish. Importers must also secure increased customs bonds, often requiring two to three times greater coverage, to guarantee tariff payments to federal authorities. These financial requirements create a secondary barrier to trade that extends beyond the tariff percentage itself, potentially forcing smaller importers to prepay duties or seek additional capital to continue operations. This administrative complexity represents a hidden cost rarely captured in conventional policy discussions, one that disproportionately impacts smaller businesses with less financial flexibility.

Measuring Uncertainty's Impact

Today's trade uncertainty has reached an unprecedented scale. To understand this objectively, we can look at the Federal Reserve's Economic Policy Uncertainty Index, a measure that tracks mentions of uncertainty in news articles and corporate earnings calls. Higher values on this index indicate greater economic uncertainty. During the 2018-2019 US-China trade tensions and the first round of Mexico tariffs, this index peaked at 386 points in August 2019. The comparison with today is striking.

Recent data show significant volatility, with readings averaging 251 in the most recent three months, nearly triple the average observed during the initial 2018 tariff implementation period (90 points). This represents a 178% increase over the 2018 baseline when steel and aluminum tariffs were first implemented, indicating that today's business environment faces substantially higher policy volatility.

Research shows this index correlates with manufacturing purchasing manager indicators, capital market risk premiums, and lagged effects on business fixed investment. Typically, each 100-point increase in uncertainty corresponds to a 0.5-0.7% reduction in GDP growth over subsequent quarters.

The 2018–2020 U.S.–China trade tensions and the first round of reciprocal tariffs between the U.S. and Mexico provide instructive historical precedent, yet the current North American situation differs in three fundamental ways. First, today’s supply chains leverage sophisticated AI-driven risk modeling that amplifies precautionary responses. Second, the geopolitical context means tariff decisions now touch on complex security considerations that extend beyond economic calculations. Third, financial markets have developed more sophisticated hedging mechanisms that distribute policy uncertainty across broader economic sectors.

For businesses with cross-border operations, adaptation strategies are already impacting daily operations. Companies are implementing what we might call an ‘uncertainty hedge’ – maintaining expanded inventory buffers while accelerating border crossings to prepare for potential disruptions.

The automotive sector is particularly vulnerable due to its deeply integrated tri-national supply chain. A single transmission component might cross borders multiple times during production, with each crossing potentially subject to the proposed 25% tariff. With approximately \$1.6 trillion in goods moving between the U.S. and its neighbors last year, manufacturers are actively exploring alternative sourcing options. This

shift toward redundant supply arrangements creates additional costs but provides insurance against policy volatility.

Retail and distribution networks display similar defensive adaptations. To manage uncertainty, major distributors report a 28% increase in bonded warehouse leases, while time-sensitive components are increasingly shipped by air rather than sea at a striking 14:1 ratio.

Financial responses have grown more sophisticated as well. Major manufacturers now allocate nearly 7% of revenues to trade compliance, up from 4.2% in 2020. Currency hedging to protect against Mexican peso and Canadian dollar volatility has expanded dramatically, while expanded supplier financing programs help reduce cash flow vulnerabilities.

The sectoral impact of trade policy uncertainty reveals important patterns. Automotive components are hit hardest when uncertainty rises. For every unit increase in uncertainty, investment is estimated to drop by 1.4%, much more than in other sectors like industrial machinery, consumer electronics, and agricultural processing.

Jobs follow a similar pattern: when trade uncertainty increases slightly, hiring in the automotive sector drops by nearly 1%. Perhaps most

tellingly, inventory buffers have expanded dramatically, with automotive companies now stockpiling parts for an additional 48 days compared to normal times, a clear sign that businesses are preparing for disruption.

The Multiplier Effect of Uncertainty

Economic research identifies what can be called an 'uncertainty multiplier effect,' showing cascading impacts through multiple channels. This uncertainty multiplier works like dominos in the economy. When a parts supplier delays expansion due to trade uncertainty, their customer might postpone a production line upgrade, whose employees might defer major purchases, and so on. One cautious decision triggers many others, multiplying the economic impact far beyond the original hesitation. Consider a typical auto parts supplier: When facing trade uncertainty, they might delay expanding their supplier network, shift to shorter three-month contracts instead of annual agreements, and postpone productivity-enhancing equipment upgrades.

These effects ripple through the economy when thousands of companies make similar decisions; recent economic modeling suggests that the impact on GDP from policy uncertainty alone could affect hundreds of billions in economic activity, even before any tariff is

implemented. These ripple effects constitute a significant financial drag that traditional economic models often fail to quantify. The impact extends to consumer sentiment as well, with recent surveys showing the largest monthly decline in consumer confidence since 2021 and shifting consumption patterns as households respond to economic uncertainty.

Perhaps most concerning is how shifting implementation timelines create self-reinforcing uncertainty cycles. When trade policy announcements are made, market impacts typically take two weeks to stabilize, according to Federal Reserve data. Meanwhile, companies struggle to navigate unclear regulatory boundaries, leading to a 22% increase in improper use of exemptions for low-value shipments.

The current trade policy environment has forced businesses to develop entirely new strategic frameworks. Many now maintain increased liquidity buffers for potential tariff shocks, deploy real-time customs classification systems, and reconfigure supply networks with multiple node redundancy. Companies that had already begun diversifying from China to Mexico now find themselves caught in a cross-border dilemma, forced to navigate multiple supply chain disruptions simultaneously and make painful internal adjustments.

Manufacturers across the U.S. that invested in Mexican production facilities to diversify from earlier trade tensions now face the potential for tariffs on multiple fronts, the very scenario their strategic planning had sought to avoid. This predicament illustrates how even prudent business planning becomes challenged in rapidly shifting policy environments.

Strategic Responses to Policy Uncertainty

Companies caught in this position may be forced to consider complex operational adjustments, potentially including benefit modifications, marketing reductions, price increases, or facility consolidations, all in anticipation of tariffs that haven't yet materialized. Some businesses might even contemplate redirecting sales efforts toward foreign markets rather than focusing on domestic customers. This demonstrates how trade policy uncertainty can inadvertently redirect economic activity away from U.S. growth.

Addressing the economic impacts of trade policy uncertainty requires differentiated approaches from various stakeholders. For businesses operating in this environment, strategic frameworks must evolve beyond simple contingency planning. Forward-thinking companies are

developing modular supply chains with embedded optionality, maintaining core North American integration while building selective redundancies in critical components. This approach acknowledges the continued advantages of regional integration while creating strategic flexibility. Companies have demonstrated this by maintaining Mexican production facilities while establishing parallel sourcing relationships in lower-risk jurisdictions for critical inputs, allowing rapid adjustment without abandoning efficient North American networks.

For policymakers, reducing uncertainty does not necessarily mean abandoning policy objectives but implementing them with clearer frameworks. Design principles that could minimize economic disruption include establishing longer implementation timelines with specific milestones, creating standardized exemption processes that provide predictable pathways for compliance, and developing reliable communication channels for affected industries.

Historical precedent from previous trade adjustments suggests that certainty about the process can be nearly as valuable as certainty about outcomes, allowing businesses to make informed decisions even amid policy changes.

Regional stakeholders, particularly state governments and border communities, can develop institutional mechanisms that create stability amid federal policy uncertainty. Border states might establish cross-border coordination offices that track policy developments and provide real-time intelligence to affected businesses. Regional economic development agencies could create targeted programs to assist smaller suppliers with compliance challenges, preventing cascading disruptions through supply chains. Most significantly, border communities could build information-sharing networks to rapidly disseminate best practices as uncertainty unfolds.

The ultimate cost resides less in implemented tariffs than in what economists increasingly recognize as an 'uncertainty cost,' a substantial drain from paralyzed investment and suboptimal sourcing decisions. This represents a permanent efficiency loss that undermines the very economic competitiveness that tariff policies often aim to enhance. Unlike actual tariffs that at least generate public revenue, these uncertainty costs create economic friction without benefiting any stakeholder.

North American economic integration has created a complex, interdependent system where policy uncertainty generates ripple effects far beyond the targeted sectors. The challenge ahead requires evaluating the impact of specific tariff rates and understanding how

policy predictability functions as a crucial economic variable. In our integrated continental market, \$1.6 trillion in annual trade means \$3.5 million crosses borders every minute, roughly equivalent to the value of a suburban neighborhood changing hands hourly. This deep integration explains why even small disruptions can have outsized impacts and why the economics of uncertainty may ultimately prove more consequential than the tariffs themselves.

Editor's Note: The above guest column was penned by Dr. Daniel Covarrubias, director of Texas A&M International University's A.R. Sanchez, Jr. School of Business Texas Center for Border Economic and Enterprise Development. The column appears in the Rio Grande Guardian International News Service with permission of the author. Covarrubias can be reached by email via: dcova@tamiu.edu

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