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## How the Trump tariffs affect UK firms

*How should UK exporters react to the tariffs imposed by President Trump? Some manufacturers may decide to increase production in the US, but those with loyal US consumers who are relatively insensitive to price changes may prefer to stay in the UK. In any case, **Catherine Thomas** writes that firms' first step to managing the damage to their bottom line is finding the right initial price response.*

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Firms in the UK sold goods and services worth £183 billion to the United States in the 12 months to the end of the third quarter of 2024. This makes the US the UK's largest single export destination, at around 22 per cent of all exports. Firms selling physical goods accounted for £59 billion, or 32 per cent of this total, an amount equivalent to around £900 per person in the UK. The Trump tariffs announced on 2 April will directly affect these exporters. When the tariffs come into force, buyers in the US will have to pay a tax to the US government whenever they make a purchase, to the value of 10 per cent of the total amount that they pay to the UK firm.

Although Trump has announced a one-month delay in implementing the tariffs, each UK firm selling in the US must plan ahead and decide how to respond once they come into effect. The most urgent decision should be to reconsider what price it charges its US buyers in the short term.

For the vast majority of goods exporting firms, maintaining the same unit price for US buyers would be a mistake. The optimal pricing strategy will differ for each firm, depending critically on how sensitive US buyers are to its price (the *firm-specific elasticity of US demand*). The unit price a US buyer will have to pay is 110 per cent of the unit revenues the UK firm will receive. Because of that, firms will find it optimal to pass on only a share of the full tariff rate to them. This means UK firms will generate lower revenues per unit, at between 91 per cent and 100 per cent of current levels. Since the price to US buyers will increase to between 100 per cent and 110 per cent of their current price, UK firms will also sell lower quantities.

The percentage quantity reduction from US buyers after a price increase tells the firm how much of the tariff it should pass through. The UK firms include plants that produce cars (15 per cent of total UK goods exports to the US), pharmaceutical and medicinal products (11 per cent of the total), mechanical power generators (eight per cent) and scientific instruments (four per cent). For some of the products these firms sell, US buyers will absorb an increase in the price they have to pay without reducing the quantity they buy by much. These are products for which it's hard to find any reasonably priced alternative. At the other extreme, some products' US demand may fall off by large amount in response to any tariff pass through to prices.

As an aside, the price elasticity and tariff pass-through rate showed up in the formula the Trump administration used to calculate the 2 April country-specific tariff rates. They are represented by the  $\epsilon$  and  $\phi$  symbols, respectively. When the administration used the formula, they plugged in the same values for all countries.

However, for a UK firm choosing its post-tariff price, it is important to consider its own firm-level demand from US buyers. The elasticity measure used in the tariff formula assumed that a price increase of 10 per cent would lead to a 40 per cent decrease in quantities bought and that firms would pass one quarter of the tariff rate through to consumer prices.

Estimating elasticity of demand is challenging for any firm at the best of times. In uncertain times like these, to understand how demand will respond to any price change, a firm first needs to forecast various market factors that shift overall demand.

First, all non-UK firms exporting goods to the US are also likely to change their prices in response to their tariffs, which impacts demand for what UK firms sell. However, the countries facing the highest tariff rates tend to export a basket of goods that is different from what the UK exports to the US, so it's unlikely that a large share of their US customers will easily switch to UK suppliers.

Second, under any tariff pass-through, US buyers will be paying more for less. This effect serves as a recessionary force that will reduce demand levels in general. Third, even for the firms with long-term relationships with trusted trading partners, these ties will now be put to the test as buyers reassess all their supply chain logistics.

Once a UK firm has a good sense of its overall US market under the new set of global tariffs, it should choose a post-tariff price so that its own unit revenues optimise the trade-off on the margin between passing through the tariff and limiting the quantity decline. For the firms selling products with few available substitutes, such as specialised scientific instruments, their US demand is likely to remain relatively resilient to higher post-tariff price. For other small manufacturing firms that would otherwise have grown via exporting, it will now be harder to find US buyers for their products at higher price levels. In other words, the tariffs are expected to constrain growth in the UK economy.

When the dust starts to settle a little, firms should move to the next stage of their tariff response and revisit how they organise production across country borders. The UK producers hit by tariffs are often manufacturers that produce relatively high-end products within their global sector. For example, Jaguar Land Rover (JLR) accounts for more than two thirds of all the car exports to the US. While it has a research and development (R&D) centre in Oregon, it does not currently assemble vehicles there. The Indian firm that owns JLR, Tata Motors, may choose to shift more stages of production within US borders.

Similarly, while BMW Mini currently manufactures all the cars it sells in the US in its UK production facilities, its parent firm, BMW, does make other car models in plants in South Carolina. In contrast, the several Japanese car manufacturers in the UK export from the UK only to EU markets. These comparisons suggest that serving export markets from the UK now makes sense, cost-wise, only for relatively premium car segments. These products may fare better under the new tariff regime as they are likely to have less elastic demand, and their optimal tariff pass through could be reasonably high.

In many manufacturing exporting sectors, production tends to be located in the UK because it has a relatively skilled research and product-development workforce. This is the case for pharmaceuticals, engineering products and scientific materials. Firms in these sectors include large public companies such as Astra Zeneca as well as many privately-owned smaller firms. These organisations' incentives to "tariff jump" by relocating production to US plants will vary. It is quite possible we are heading for an increase in global merger and acquisition activity as each sector reallocates production assets across firms, matching production locations with destination markets to reflect new costs of trading across country borders.

Capital investments to re-organise global production, either within or across firms, are costly and time consuming, and firms will require more clarity and certainty about the new regime before making any big changes. Uncertainty about the global trading system is contributing to the ongoing volatility in the prices of stocks and other financial securities, as well as in currency exchange rates. Stock prices tumbled globally after the tariff announcement because taxing US imports will dampen demand for all firms, including those not directly involved in goods trade.

Adam Butlin gives [more detail](#) on the range of possible indirect effects on the UK economy. Meanwhile, for any individual exporting firm, finding the right price response given its current production footprint is the first step to managing the new tariffs' damage to its bottom line.

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