AFTER "LIBERATION DAY": WHAT CAN TARIFFS ACCOMPLISH, AND WHEN?

On April 2, 2025, President Trump announced a new tariff regime that surprised most observers with its severity, and many risk assets have responded with significant losses and volatility. The risk asset downturn reflects, at least in part, the increased probability of a recession, reduced corporate profits, and higher inflation from tariff-driven price increases.

Given the political nature of the tariffs and their dependence on decisions made by the President and other global leaders, it is extremely difficult to predict what happens next. The fact that this is an internally created issue rather than a response to an external shock like the COVID-19 pandemic contributes to the sense of uncertainty and market stress.

A useful way to think about potential outcomes may be to think through what goals could be pursued with tariffs, how likely they are to succeed—and, perhaps more importantly, how quickly they could be resolved.

We believe that the most positive potential outcome is the successful negotiation of concessions from other countries, followed by reduction or elimination of some or all tariffs. Given the uncertainty and difficulty of predicting even near-future developments, we recommend that clients stay the course of their strategic asset allocation. Market volatility has occurred across return-seeking assets and countries (US and non-US stocks, high yield bonds, etc.), and any future negative economic outcomes are likely to be international in nature. Right now, the best focus is on the long term.

Potential Tariff Goals

GOAL	ACHIEVABILITY	SPEED
Lasting reduction in US trade deficits	Trade deficit reduction likely requires the US to save more, consume and borrow less.	It would take years, and the political situation / policy could change in the meantime. Such reduction requires political and cultural change.

GOAL	ACHIEVABILITY	SPEED
Restore US manufacturing	Restoring US manufacturing is possible but requires a shift in the full-employment economy from service to factory jobs in the face of increasing automation.	It would take years, and the political situation / policy could change in the meantime.
Raise revenue / pay down national debt	Even high tariffs would raise much less than income tax and reducing the trade deficit would reduce revenue.	Tariffs raise revenue immediately.
Help negotiate lower trade barriers and other concessions	New negotiations already are in progress to a degree with Canada and Mexico. The chance of success with other countries is harder to gauge and depends on objectives.	Concessions could happen quickly. Some countries have signaled a willingness to negotiate, while some have aggressively countered.

Lasting reduction in US trade deficits

The US shifted from a position of consistent trade surplus (export more than import) to consistent trade deficits (import more than export) in 1971, when the US dollar became the global currency after the collapse of the gold standard and fixed exchange rates. A strong, globally demanded US dollar has made imports cheaper. Trade deficits—buying more goods and services from other countries than we sell them—are funded by US national debt (borrowing from other countries) and driven by US citizens' lower savings rates and greater consumption rates.

President Trump has been a consistent, long-term opponent of US trade deficits (and a fan of tariffs.) But returning to persistent trade surpluses would likely require the US and its citizens to save more, consume less and borrow less. These changes would be politically unpopular and require cultural change in the case of consumption.

Tariffs are unlikely to achieve significant, lasting reductions in trade deficits on their own. And a country's balance of trade (trade deficit or surplus) is not particularly related to its economic strength, with some rich countries with trade deficits (US, UK, France among others) and poor countries with surpluses (Iraq, Bangladesh, Angola among others).

US Trade Balance as a Percentage of Gross Domestic Product

Source: Federal Reserve Bank of St. Louis, Bureau of Economic Analysis, World Trade Historical Database, Measuring Worth

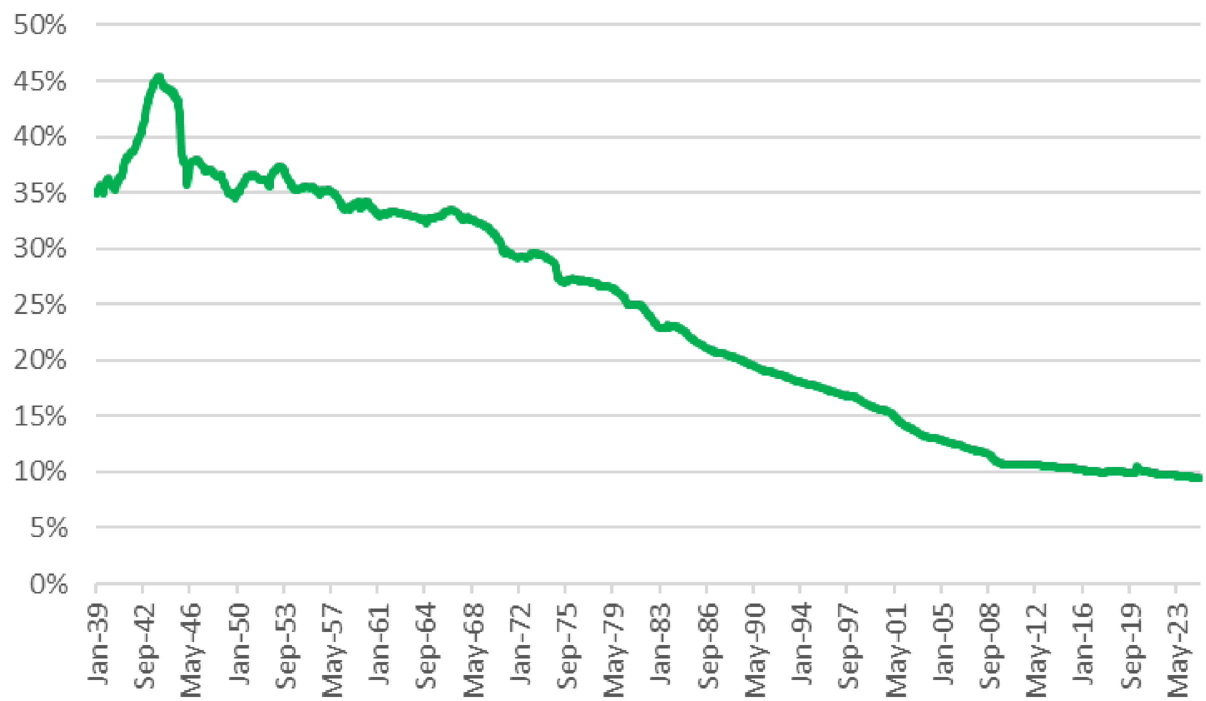
Restore US manufacturing

The share of US workers in manufacturing jobs fell consistently and significantly between the end of World War II and about 2010 (where it stabilized, perhaps at a long-term minimum), driven by automation, globalization, greater imports (trade deficits), and a shift toward a service rather than goods production economy.

Maintaining US domestic production in critical areas, and providing good jobs for US workers, are noble and logical goals. But shifting more manufacturing to the United States is challenging when the US is at near full employment (the workers need to come from other industries) and operates an effective service economy (many workers won't want to switch to factory jobs currently done in China or Vietnam). In fact, the US, while running a trade deficit in goods, has consistently run a trade surplus in services.

Most importantly, any such shift would take time (years), and would expose those companies making the shift to the risk of future policy changes. Lastly, automation may significantly affect how production happens in the medium-term, with efficiency rising and manufacturing employment declining.

Percentage of US private sector employment in manufacturing



Source: Federal Reserve Bank of St. Louis

Raise revenue/pay down national debt

As a tax, tariffs will indeed raise government revenue—perhaps (low) trillions of dollars over a decade, though the likely actual amount is difficult to model. This income can fund government spending or tax cuts, such as (partially) funding an extension of the 2017 tax cuts. Total US federal government revenues, however, are more like $5 trillion per year, or $50 trillion over a decade. Unlike the income tax, tariffs are regressive in nature (people with less money tend to pay more.) And tariffs as a source of revenue conflicts with other goals—the more imports decline because, say, US manufacturing is revived, the less income tariffs would generate.

Help negotiate lower trade barriers and other concessions

Tariffs may be used as a negotiating tool to get lower foreign tariffs and reduce other trade barriers or influence countries' behavior in other ways. Indeed, some countries have signaled that they are willing to negotiate to reduce their trade surplus with the US and other concessions. At the same time, China has responded aggressively. A logical (if painful for the markets) US approach to negotiating would be to show willingness to pursue tariffs even in the face of market volatility and potential economic pain, to demonstrate seriousness.

Gaining desired concessions would be positive for the US, and—unlike any of the other goals—could be achieved quickly. The most positive tariff scenario in terms of the market outlook is the (relatively) quick achievement of concessions and corresponding reduction in tariffs. A simple reversal of the tariff program (if the cost and political risk appears too high) would similarly help end volatility (without additional benefits to the US), but this scenario may be less likely given the political capital invested in the "Liberation Day" announcement. Also, domestic and perhaps international legal challenges to the tariffs are almost certain to arise.

We remain hopeful that the goals of the US tariff program become clear and well-communicated in the near future, and that the US and global trading partners work toward an overall resolution that is beneficial and calming for the global economy and for the investment markets.

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