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Macro Memo

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TARIFFS 101: A PRIMER

Tariffs, federal levies on the value of imported foreign goods, at their core, are tools; they are neither good nor bad. Rather, they are either appropriate for the intended result, or not. Let's consider the simple hammer — a great choice for the task of driving nails into a board, but very ineffective for mowing the lawn. In this context it is helpful to understand the nature of tariffs and the results they might deliver. They can be used as an economic tool providing both revenue to the treasury and protection to domestic industry. They can also be used as a tool of foreign policy.

As an economic tool tariffs are dual edged. They simultaneously discourage consumption and encourage production. When a country imposes a tariff, the targeted good(s) becomes more expensive. This could incent consumers to consider domestically produced alternatives or possibly to forgo the purchase altogether. At the same time, the tariff amounts to a subsidy for domestic producers by making imports less competitive. This understanding gives a basis from which to evaluate the historical use and effectiveness of tariffs.

The media has recently given much attention to the Smoot-Hawley tariff act of 1930. That act, now considered a contributing factor to the Great Depression, has led to a current-day overall skeptical attitude towards tariffs in general. In 1930, much of Europe was still rebuilding from the devastation of World War 1. As a result, the US accounted for roughly half of global GDP, we were running a very large trade surplus. The flip side of that same coin is that the US was under-consuming relative to its production. Our economy was out-of-balance. As such, a policy prescription that further encouraged production and discouraged consumption was, to say the least, ill-judged. The ensuing buildup of inventories and lack of buyers led to substantial price cuts which eventually turned into outright deflation.

Fast forward 95 years to 2025 and the US has a very different set of economic conditions. We have the world's largest trade deficit – by factors; we have offshored critical manufacturing industries (and the

associated jobs); consumer debt is close to all time highs. In short, we over-consume and underproduce. For an economy/nation to be truly independent it must produce what it needs. In this situation a policy prescription that discourages additional consumption and encourages domestic production might be appropriate.

The US dollar became the global reserve currency after World War 2. That means most global trade occurs in dollars, which simultaneously makes US Treasuries[1] the global reserve asset[2]. A way the US gets dollars into the global trading system is by opening its consumer markets to global trade. As issuer of the global reserve currency, the US must act as the consumer of last resort. Consuming is a role to which Americans have grown quite adept[3] . In fact, we have performed the role of consuming so well for so long that much of the world has become dependent upon US markets. Because President Trump's primary instincts come from business rather than politics, he sees access to US markets as a highly valuable asset which can be used in negotiation. In the first two months of his second term as president we have seen the threat of tariffs wielded if countries choose not to cooperate with his policy objectives. We have also seen those threats rescinded when the targeted nation relents to the president's demands.

President Trump's proposal of reciprocal tariffs suggests he is primarily interested in tariffs as a policy negotiation tool, with economic benefits as a derivative of policy success. He stated in a March 9 interview that if a foreign corporation chooses to build their products in America there will be no tariff applied to its value[4]. The derivative benefits to that policy accomplishment would include the construction jobs to build factories as well as the more persistent jobs created to operate those factories. Through the application of reciprocal tariffs, it appears trading partners of the US will be able to choose their preferred tariff level – again suggesting President Trump is more interested in the policy application of tariffs as a tool.

Over a century ago then President Teddy Roosevelt famously said, "speak softly and carry a big stick." It appears President Trump has chosen tariffs to serve as his big stick.

[1] Treasury Bills, Notes, and Bonds – all of which are debt obligations of the US Treasury Department
[2] The global reserve asset is a savings instrument for nations with foreign trade surpluses. Treasuries are the preferred savings instrument because they are readily converted into dollars, which are needed to settle global trade.
[3] Hence the near record levels of consumer debt
[4] https://rollcall.com/factbase/trump/transcript/donald-trump-interview-maria-bartiromo-fox-news-sunday-futures-march-9-2025/

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