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What's the Tariff Endgame?

The April 2 "reciprocal" tariff announcement has introduced a considerable amount of uncertainty and confusion about the path ahead and the end game for President Trump. While the path ahead has more questions than answers at this point, in this note we outline what we view as the options for the path ahead, potential endgames for the Trump administration, and discuss the bull case for the market from a policy perspective that could emerge in coming weeks.

Path forward. We see three potential paths forward for tariffs:

1. Trump starts cutting deals and tariffs are reduced.
2. Courts or Congress block the tariffs; and/or
3. Trump stays the course, and this is a historic realignment of global trade.

The market is hoping for a combination of 1 and 2, with growing concerns about the possibility and uncertainty of the third path. President Trump has sole authority over paths 1 and 3, making this harder to gauge.

For option 2, a court challenge should be closely watched. Our trade contacts have highlighted that Congress passed The Trade Act of 1974 following the use of emergency authority by President Nixon in 1971 to impose a global 10% tariff. Section 122 of the Trade Act of 1974 authorizes the president to impose up a tariff of up to 15% for 150 days when there is a balance of payments/trade imbalance between another country and the U.S. President Trump has highlighted the trade imbalance as a key driver of his use of emergency powers. We expect a case to be brought arguing that Congress passed a law specifically to address trade imbalances, seeking to reign in presidential emergency powers used by President Nixon to impose a global tariff. A key hurdle for these court cases is a general reluctance by courts to challenge the emergency declarations of a president, and they could point to the Congressional powers under the National Emergencies Act of 1976, which gives Congress a role in overruling a presidentially declared emergency.

At this time, we are skeptical that Congress would be willing to prevent the tariffs from going into effect, but pressure will build if Trump sticks with the current rates and/or the economic and market impacts deteriorate. Under the National Emergencies Act, Congress has the authority to cancel an emergency declared by the president; however, they will need a veto proof majority to overcome a likely veto. The Senate voted last week 51-48 to overturn the Canadian tariffs, but the House has prevented a vote, and 51 votes is far short of the 2/3 needed to overcome a veto. We would note that this is the latest in the fight over the "power of the purse." Decisions on taxes and tariffs are granted by the Constitution to Congress, but Congress has delegated this authority to the president in various bills – opening up the question of whether these laws are constitutional? (The Supreme Court last week held oral arguments in another case related to delegated authority on taxes that could help answer this question).

Endgame. What is the endgame for tariffs? Is it to create a new revenue source to provide a political permission structure for Republicans to pass tax cuts? Is this an effort to protect national security-related industries? Is President Trump seeking policy changes in other countries? Are there other factors that we need to consider?

- **Obtain a new source of revenue.** A national sales tax/border adjustment tax has been a longtime goal of many Republicans. Former Speaker Ryan tried a border adjustment tax in 2017 to pay for the TCJA but was forced to abandon the idea. Republicans need a new revenue source to accomplish their tax goals. Should we view this as fulfilling a longtime policy goal of the Republican party? We continue to view the revenues collected by the global 10% tariff as stickier than appreciated, and they will be used to "pay for" the tax cuts being debated in Congress.

- **Protect national security-related industries.** President Trump has highlighted the national security needs of various industries. We have long highlighted the theme of "technology as a national security asset" leading to tech restrictions on semiconductors and the tools for manufacturing. Expanding on this theme, the national security imperatives to have a baseline of industrial production and protection certain industries are a key theme of the sector-specific tariffs. We view the tariffs on automobiles, steel, aluminum, and the soon-to-be announced tariffs on semiconductors and pharmaceuticals as key national security-related industries. As such, these will be the stickiest of the tariffs.

- **Force policy changes.** We have repeatedly been told that President Trump is seeking to use the economic force of the United States to force policy changes in other countries, pushing countries to remove tariff and non-tariff barriers. A problem for President Trump is that he has not set out a clear matrix that he is trying to achieve, and world leaders are unsure if he is someone they can negotiate with/are concerned that his constant moving of the goal posts could lead to political embarrassment. Some of the policies we have heard that President Trump would like to achieve include: new trade deals, expanding access for U.S. goods and services globally; new energy deals, especially for natural gas; increased defense spending by NATO allies; access to critical and rare earth minerals; seeking countries to side with the U.S. vs. China; and the potential for a grand bargain "Mar-a-Lago Accord."

The "force policy change" dimension is the area with the most volatility, given that Trump is the sole decider of success, retaliatory risk is high (we are particularly concerned about the embargo on rare earth metals from China and its impact on U.S. industrial production), and trust in "Trump as a negotiator" is currently low, especially in Europe and China. One thing that is worth following is that the only thing excluded from tariffs are USMCA compliant goods. That is a deal that Trump negotiated. It is an example of Trump somewhat keeping his word – and Trump trying to signal that deals can be struck and followed?

Bull Case. Whenever markets sell off as much as they have, we get questions seeking to outline the so-called "bull case," as to avoid being overly negative. In the coming weeks, from a policy perspective, we expect to see an increased focus on Congress passing tax cuts and their potential stimulative effects. If this is achieved, in tandem with trade deals, an increased focus on deregulation, and potential cuts/easing by the Federal Reserve, the current market narrative would shift dramatically. It is hard to call this a base case yet, but the tax cuts have a very high probability of passage in the coming months (with the need to raise the debt limit as a catalyst to get it done).

Over the weekend, the Senate passed a budget resolution that seeks to make the 2017 Tax Cuts and Jobs Act (TCJA) permanent by using creative scoring, arguing that the current policy should score at $0, should Congress vote to extend the law. The House will need to pass the same resolution before Congress can begin work on the actual bill to extend and expand the TCJA. The goal is to accomplish this in the coming weeks.

The Senate bill would authorize more than $5 trillion in tax cuts and would include as much as $325 billion for defense and border security. If passed, the dollar amount of this legislation would be the largest in U.S. history (dwarfing bills such as the American Rescue Plan ($1.9 trillion) in 2021 or the CARES Act ($2.2 trillion) in 2020). The total dollar amount may be reduced by spending cuts, but the details, amount, and timing of the cuts remain unclear. Will the near-term impact be more stimulus as cuts could be back-end loaded?

Will the tax bill be viewed as fiscal stimulus? These are very rough numbers, but we could see **$500 billion to almost $1 trillion** in extra stimulus through the tax code in the next year or two, depending on how various provisions are crafted, including:

- **Renewal of business provisions**: 2025 & 2026 – $200-300 billion (retroactive provision & using former TCJA score)
- **No tax on tips, OT, Social Security**: $50-$100 billion annually (area of the greatest variability)
- **Child Tax Credit changes**: $75 billion annually
- **Changes to SALT**: $25 billion annually (assuming increase to $20,000)
- **Increased spending on defense and immigration**:$300 billion

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