Policy Backgrounder

Tariffs: Not Yet but Still a Threat

While tariffs did not feature as part of the President's Day 1 actions, the new Administration has signaled that they will likely be imposed shortly. This includes tariffs on Canada and Mexico, while the trade practices of other jurisdictions, including China and the EU, will be studied more closely before a decision to impose tariffs on them.

Key Insights

- The President has broad authority to impose tariffs and by a Presidential Memorandum on "America First Trade Policy" requested a study of US trade policy and unfair foreign trade barriers, due April 1.
- He said that tariffs of up to 25% could be imposed on Canada and Mexico, the US' first and second largest trading partners in goods, by February 1.
- The President also threatened tariffs on the European Union because of its trade surplus with the US.
- With respect to China, the rhetoric was more muted, leading to speculation about a possible deal, although the US study will also review China's compliance with the 2020 trade deal.
- Tariffs currently account for only about 3% of Federal revenues. The President has proposed a new "External Revenue Service" to receive revenues from tariffs and other payments by foreign parties; it is unclear whether the new agency would take over powers currently held by Customs and Border Protection in the Department of Homeland Security and the Internal Revenue Service.

Presidential Tariff Authority

During the campaign, the President proposed a "universal" tariff of 10% (later doubled to 20%) and tariffs of 60% or more on goods from China, saying that "[o]ther countries are going to, finally, after 75 years, pay us back for all that we've done for the world." The President also threatened tariffs of 25% on Mexico and Canada, the US' first and second largest trading partners in goods (China is third).

While the President did not impose new tariffs on Inauguration Day, he did call for an "overhaul of our trade system," which will include at least the threat of broadly-imposed tariffs. In particular, the President signed a Presidential Directive (a document instructing members of the Administration to take certain actions, which does not have the force of law) to study the causes of the US trade deficit; evaluate relations with Mexico, Canada, and China; and identify unfair trade practices of other countries. The response is due to the President on April 1.

Several US laws give the President broad authority to impose (or reduce) tariffs. For instance, Section 232 of the Trade Expansion Act of 1962 gives the President authority to raise tariffs in cases where imports threaten national security (this was the authority Trump used for the steel and aluminum tariffs in 2018). Section 232 formally requires an investigation by the Commerce Department before its provisions can be invoked, but the President can act without consulting Congress.

Section 301 of the Trade Act of 1974 gives the President authority to impose retaliatory tariffs if "an act, policy, or practice of a foreign country . . . violates or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under any trade agreement [or] is unjustifiable and burdens or restricts United States commerce [.]" (This was the authority for the general tariffs on China under the Biden Administration) The law requires an investigation by USTR and consultations with the relevant foreign government before tariffs can be imposed. The International Economic Emergency Powers Act is the broadest statute, which gives the President to block all transactions with a designated entity (for instance Cuba, North Korea or Iraq during the Gulf War) upon designation of a national emergency that constitutes an "unusual and extraordinary threat."

This broad grant of Presidential power lends credibility to the view that the Administration will seek to impose tariffs on many imports entering the US. Affected parties could easily seek to have these actions overturned in court as overly broad and beyond Congress' intent, but unless the court stayed the tariffs while the lawsuit is pending, this could lead to uncertainty for importers (and exporters facing the potential threat of retaliatory tariffs by other countries). It is unclear how a court could rule – a Federal court approved President Nixon's temporary 10% tariff in 1971, which he imposed as part of closing the "gold window" and the US balance of payments crisis, but that tariff was imposed as a temporary measure in response to an emergency. It is unclear how a court might rule now on a universal tariff, particularly if the tariff were similarly designated as "temporary"; a court could be skeptical that Congress intended such broad powers for the President.

Canada and Mexico

As part of the study, the President also ordered the Secretaries of Commerce and Treasury as well as the US Trade Representative to examine the impact of the USMCA trade agreement on US workers. (The first Trump Administration negotiated the USMCA to replace the former North American Free Trade Agreement.) While USMCA is scheduled for review in 2026, the review could push renegotiation of the agreement or changes to it forward.

The President threatened Mexico and Canada with tariffs while charging them with allowing "mass numbers of people to come in and fentanyl to come in [.]" While Mexico is a chief source of fentanyl imports to the US, the US and Mexico (and China) have increased cooperation against the fentanyl trade in recent years.

Canada's verbal response was measured, but Canada is clearly considering retaliatory action if the US imposes tariffs. Prime Minister Justin Trudeau said that there was "always going to be a certain amount of unpredictability and rhetoric coming out from this Administration" but that the US could count on Canada as a "safe, secure, and reliable partner in an uncertain world," pointing to Canadian energy and minerals as key inputs for US economic growth. But Foreign Minister Melanie Joly noted that imposing tariffs could lead to the "biggest trade war between Canada and the US in decades," and former Finance Minister Chrystia Freeland – likely a candidate to succeed Trudeau in the forthcoming Liberal Party leadership election – argued in a Washington *Post* opinion piece that "America has flourished in large part because of the security that comes from having a stable, friendly and prosperous neighbor along its vast northern border. Imagine how different the American century would have been if you'd needed to spend time and money protecting yourself against a threat from the north."

Prime Minister Trudeau supports counter-tariffs on "the principle of dollar-for-dollar matching tariffs." This would clearly be a significant trade war if it were to get to that point, given the volume of US and Canada trade reached $923 billion in 2023. Trudeau convened a meeting of the provincial and territorial premiers to seek a common response to any US tariffs; all agreed except for Alberta Premier Danielle Smith, who had earlier visited the President-Elect in Florida, who would not agree to tariffs on energy exports to the US. Canada clearly has other trade options as well. Progressive Conservative Party leader Pierre Poilievre would not commit to supporting Trudeau on the question of tariffs on energy exports but called for construction of additional pipelines and export terminals for oil and gas "to send our energy to the rest of the world without relying on the Americans."

Mexican President Claudia Sheinbaum did not specifically threaten retaliatory tariffs but said she would defend Mexico's sovereignty; immigration policy will be a highly sensitive area for Mexico.

European Union

With respect to the European Union, the President's rhetoric was equally harsh: "They don't take our cars, they don't take our farm products, they don't take our farm products, they don't take almost anything. And yet, we take their cars and we take their farm products, we take a lot from them. So we'll figure that out with either tariffs or they have to buy our oil. The one thing they can go, our oil and gas, the one thing they can do to catch up quickly: Buy our oil and gas, and they should do that."

The EU's trade surplus with the US could reach $230 billion for 2024 (final numbers should be available in early February). In 2023, US exports to the EU were $368.76 billion, up from $350.79 billion in 2022, while the US imported $576.98 billion in 2023, up from $553.27 billion in 2022. Oil and gas do figure strongly in US-EU trade: the top three EU imports from the US are petroleum oils and crude oil, pharmaceutical products and natural gas; the top three US imports from the EU are medicines, motor vehicles, and medicinal and pharmaceutical products

China

With respect to China, the President's language was more muted than the campaign rhetoric might have predicted, saying that "[w]e're going to have meetings and calls with President Xi" and adding that he had been invited to visit China (Chinese Vice President Han Zheng attended the Inauguration and met with Vice President Vance.) Specifically, the Presidential Memorandum Presidential Directive asks for an investigation of whether China has complied with the trade deal negotiated in 2020 in the first Trump Administration.

On that question, the likely answer seems clear: Chinese purchases of US goods have missed the targets. An analysis in 2022 from Bloomberg, using Chinese customs data, suggests that China bought only about 63% ($237 billion) of goods contemplated under the agreement. A similar analysis from the Peterson Institute of International Economics was even more critical, suggesting that China purchased only 58% of the promised exports, even as it highlighted several changes in Chinese trade policies required under the deal.

Now, the question is what type of deal might be required to avoid new and punitive tariffs on China such as the President promised during the campaign. One possible element in a deal is the question of whether China will agree to the steps necessary for a divestiture of Tik-Tok sufficient to avoid a ban in the US (the ban went into effect January 19 after the Supreme Court upheld Congress' law on the subject), but the President has directed the Justice Department not to enforce the ban for 90 days. This could provide a narrow window in April to negotiate a deal after the report on unfair trade practices is due to the President but before the end of the 90-day hold on the Tik-Tok ban. The President suggested that the US could impose "tariffs of 25, 30, 40, 50 percent, even 100 percent" if China did not yield on Tik-Tok, heightening the stakes for that negotiation but also leaving open the question of what other matters, in particular relating to the trade deficit, would be necessary for a deal with China.

Tariffs as a Source of Revenue?

The President also promised to establish an External Revenue Service "to collect all tariffs, duties, and revenues," which he suggests will result in "massive amounts of money pouring into our Treasury from foreign sources." Currently, the US receives only about $85 billion in tariff revenue, less than 3% of the cost of Federal operations. Imposing tariffs could raise that figure (the President said "we're going to make a lot of money from tariffs"), but higher prices for goods would presumably discourage their import and consumption, at least to some degree.

Energy: A Way Out?

Revenues from tariffs would also not rise if tariffs can be avoided. As the President's comments about the EU and oil strongly imply, purchases of US energy supplies could be one way for exporter countries to reduce their trade deficits with the US quickly. One observer of the energy industry noted that tariffs, or the threat of them, will likely play an increasing role: liquefied natural gas (LNG) "could be that trade lever for many of the countries under examination for tariffs, including Canada and Mexico." However, both Canada and Mexico produce and export natural gas – notably, in Canada's case, to the US, leading to the disagreement between Prime Minister Trudeau and Premier Smith, although Mexican imports of US LNG have been rising in the past few years. Increased EU purchases of US LNG seem, therefore, clearly on the horizon, particularly for the EU and perhaps also for other countries.

Conclusion

Despite not having imposed tariffs on Inauguration Day, for the cautiously-minded it is perhaps best to think of the current situation as a delay in policy rather than a fundamental shift in policy. As noted above, two provisions of US law require a formal study before tariffs may be imposed. It seems difficult to imagine that the requested study of US trade policy would conclude that the US faces few unfair foreign trade practices, and the threat of tariffs raises uncertainties for both importers and exporters. More broadly, even if the threat of high tariffs is a negotiation tactic, the strategy has dangers as well: as former Finance Minister Freeland wrote, "[y]ou've chosen to humiliate your friends before moving on to tackle your true adversaries" – a strategy that has both risks and potential costs whether or not tariffs are ultimately imposed.

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