Flash Economics

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Possible reasons for the increase in US tariffs

Donald Trump has just increased tariffs on US imports by 12.5 percentage points (total tariffs levied by the US are now 15%).

There are several possible reasons for this policy:

- Creating a balance of power favourable to the United States in order to obtain concessions from other countries (additional imports of American products, lower tariffs on imports from the United States, more favourable regulations for American tech companies, access to commodities, etc.);
- Using tariffs to finance a reduction in American taxes; since tax cuts would mainly benefit Americans with high incomes, and higher tariffs would mainly penalise Americans with modest incomes, the result would be a further increase in income inequality;
- Encouraging US and foreign companies to produce more in the United States; one can hardly expect existing value chains to change, but new investment could increasingly target the United States.

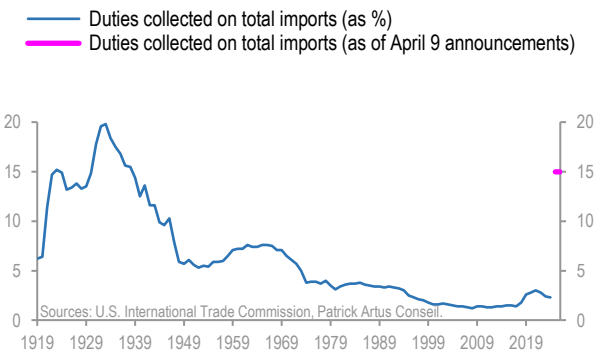
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Announcing a sharp rise in tariffs on US imports

On April 2, 2025, and again on April 9, 2025, Donald Trump announced a sharp rise in US import tariffs: 10% for all countries, 145% for China, and 25% for automobiles, steel and aluminum. The average increase in tariffs is 12.5 points, taking the total on US imports to 15% (Chart 1).

Chart 1
United States: Duties collected on total imports (as %)



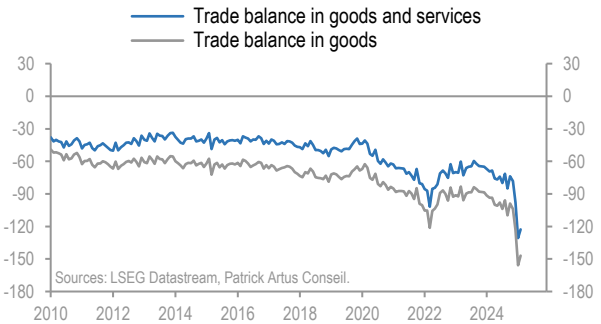
We are questioning the motives behind this increase in tariffs, which will result in pushing up inflation in the United States (according to our estimates, from 2.8% in March 2025 for core inflation, which is to peak in a few months' time, depending on the final decision on tariffs, close to 4%).

A possible main motivation for raising US tariffs: to create a balance of power favourable to the United States

The idea would be that the increase in tariffs in the United States is a starting point for negotiations with other countries on:

- Obtaining an increase in imports by these countries from the United States, thereby reducing the US trade deficit (Chart 2);

Chart 2
United States: Trade balance in goods and services
(monthly data, USD bn)

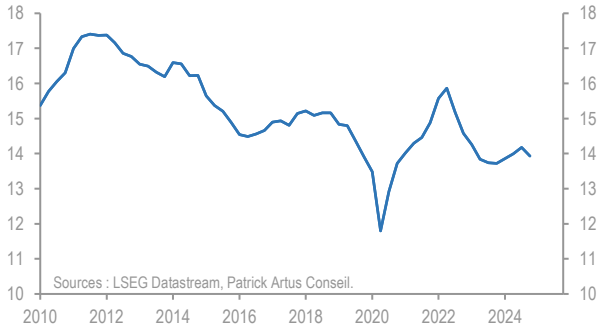


- Lowering the tariffs imposed by these countries on their imports from the United States;
- The regulation targetting major US digital companies outside the United States (particularly in Europe);
- The access to commodities;
- The quantity of imports from the United States (agricultural products, energy, etc.).

Second possible motivation: using tariffs to finance a tax cut

With an average tariff increase of 12.5 points and imports representing 14% of GDP (Chart 3), **the increase in tariffs theoretically amounts to 1.75% of US GDP**.

Chart 3
United States: Imports of goods and services
(as % of nominal GDP)

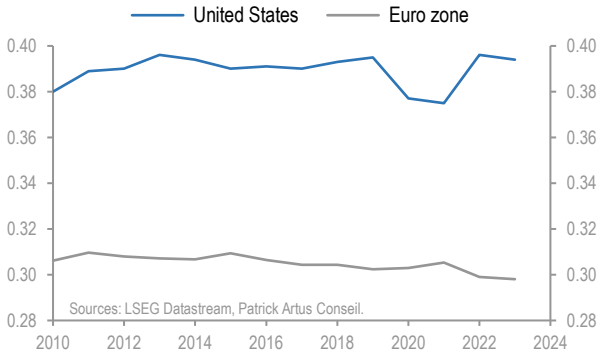


This sum will be reduced by the negative effect on activity, and therefore on tax receipts, of the increase in tariffs. This negative impact on US GDP will come from the decline in household purchasing power and in household consumption (which could cost the US 0.5 points of GDP if the tariff cut decided on 9 April is upheld), resulting in a 0.2 point drop in tax revenues.

The increase in tax receipts due to the rise in tariffs will be sizeable, and Donald Trump **had planned to lower the tax rate on corporate profits and the direct tax rate on households** using the budget leeway afforded by the rise in tariffs.

This would imply a rise in income inequality in the United States (Chart 4), with wealthier households benefiting from the rise in after-tax profits and the lower taxation of their incomes, and poorer households suffering from the higher prices of imported goods.

Chart 4
Gini index of income inequalities (after redistribution)



Third possible motivation: encouraging foreign companies to invest more in the United States

Taxation of imports can be motivated by the need to reindustrialise the United States (Chart 5), by encouraging US and foreign companies to invest more in the United States (Charts 6A/B).

Chart 5
United States: Real value added in manufacturing
(as % of real GDP)

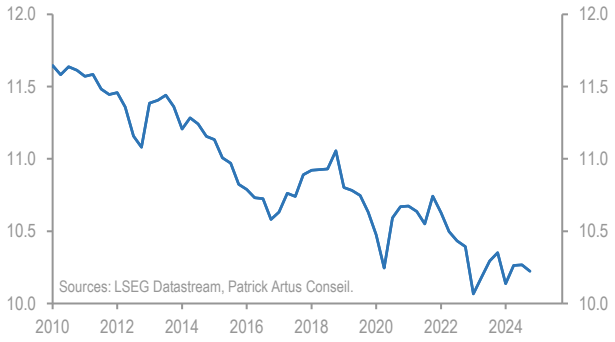


Chart 6A
United States: Investment of corporations
(in value terms, as % of nominal GDP)

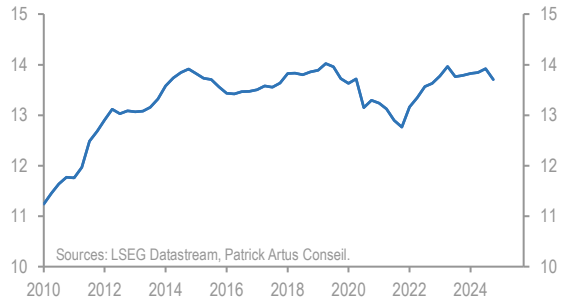
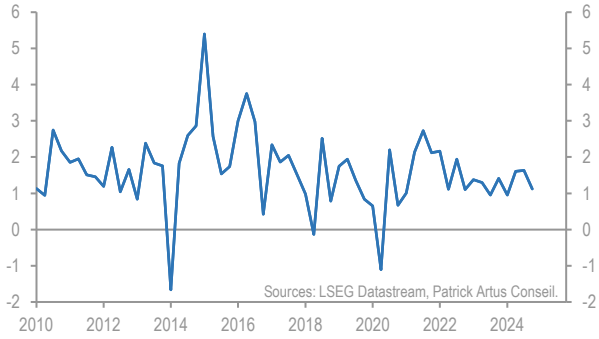


Chart 6B
United States: Direct investment inflows*
(as % of nominal GDP)



(*) Direct investment inflows are capital inflows leading to an increase in liabilities (in this case for the United States) and therefore have a positive sign.

It is unlikely that companies will substantially modify their global value chains, but it is possible that a greater proportion of new investments will be made in the United States.

Summary: what is the overarching motivation?

We have considered three possible motivations for the Trump Administration's introduction of very significant tariffs:

- Creating a strong negotiating position, with tariffs being reduced if advantages are obtained from other countries;
- Financing the tax cuts promised by Donald Trump;
- Encouraging companies to invest more in the United States.

The strong reaction to the drop in stock market indices normally reduces the incentive to invest; the tax cuts still have to be approved by the US Congress; more than likely, the only result of the introduction of tariffs is nowadays the opening of negotiations between the United States and other countries.

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