

MACROCOSM

## They Called His Bluff on Tariffs

Sunday, February 2, 2025

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They still may not happen. But if they do, it's a \$256 billion tax hike someone will pay.

Our position on tariffs in the Trump administration has been “wait and see” (see, among several, [“Predictions for 2025: Tariffs”](#) January 3, 2025). We didn't have to wait long. We are beginning to see, with [the announcement Saturday](#) of tariffs on Canada, Mexico and China effective Tuesday. As of this writing, the White House website has published [an actual executive order](#) only with respect to Canada.

- *The Trump administration has called for a 25% tariff on all imports from Canada and Mexico, and 10% on all imports from China – on top of any other tariffs that exist today. The only exception is energy imports from Canada, which will be tariffed at 10%.*
- *Tariffs are taxes.* Holding all else equal and setting aside who effectively pays (as of this writing, the US dollar is sharply stronger, so...), *these tariffs are a tax hike of \$256 billion per year.* To give you some idea of what this magnitude means, *that's about two-thirds the value of extending the expiring provisions of the 2017 Tax Cuts and Jobs Act, according to the Congressional Budget Office.*
- *Tax hikes are anti-growth. This is not good, and it doesn't take a genius to expect volatility in markets while this plays out.* As of this writing Sunday night, US stock futures are sharply lower, but above the January lows of just two weeks ago.
- This doesn't make Trump look like a winner at the moment. *It would seem that the leaders of Canada, Mexico and China have called his bluff.* All that's left to save face is to go ahead and do the tariffs that he threatened – which, at the simplest level, amount to the imposition of a \$256 billion tax hike on ourselves. It's important for the economy for Trump to look like a winner – perhaps the best thing he can do is excite the grass roots of the economy by being an effective cheerleader (see [“The Trump Effect”](#) December 11, 2024). So far he's done a great job – until this.

But there is still an important element of “wait and see.” *The tariffs don't take effect until Tuesday, so there remains time for negotiations* that could avoid them. Even if they become effective on Tuesday, subsequent negotiations could remove them. On the face of it, their purpose is to force cooperation with interdiction of fentanyl and other drugs (rather than to resolve imbalances in trade relations), so one would think that Canada, Mexico and China could come up with something.

### Update to strategic view

**US MACRO:** The White House has announced tariffs of 25% on Canada and Mexico and 10% on China (and Canadian energy exports). This amounts to a \$256 billion per annum tax hike and upsets the US's two largest trade relationships. The tariffs had been threatened to force Canada, Mexico and China to work harder to interdict drug traffic, but it appears their leaders have called Trump's bluff. All he could do to save face is impose the tariffs. They are not effective until Tuesday, so his taking this step may amount to raising the stakes and forcing the other players to fold. The International Emergency Economic Powers Act has been used for sanctions and seizures, but never tariffs, and Trump did not consult Congress as it requires. Courts may well block these tariffs. The US trade relationship with Canada and Mexico is largely tariff-free, so imposing such large ones is a destabilizing risk. Obviously, there will be volatility while this plays out.

[\[Strategy dashboard\]](#)

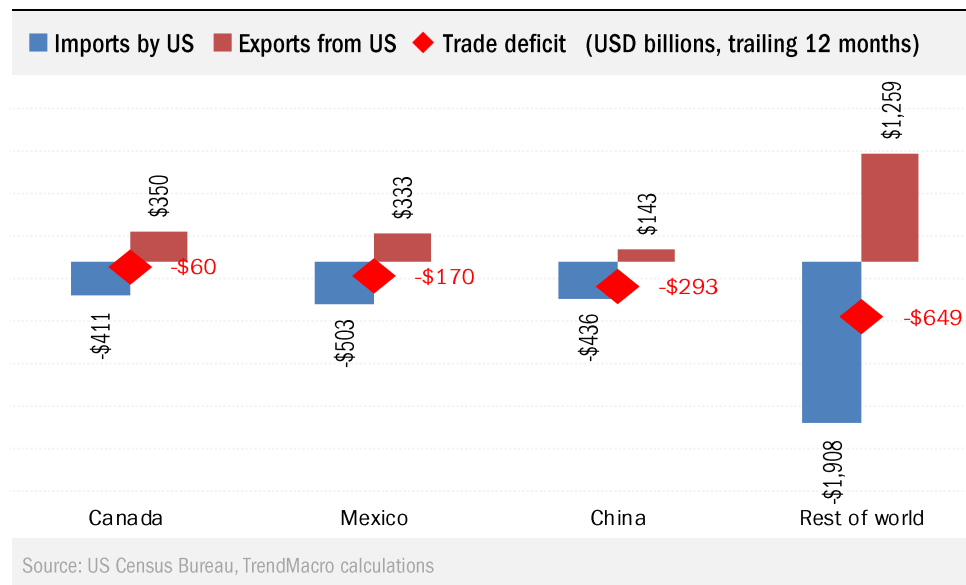
- The reality is that while we can say sensibly that it looks like Trump lost this hand of geopolitical poker, perhaps it will turn out that imposing the tariffs will operate as a form of raising the stakes, and the other players will end up having to fold. It's impossible to tell from the outside. Media accounts are worthless. It's probably impossible to tell from the inside, too.

Another dynamic is the fragility of having imposed the tariffs under the authority of 1977's [International Emergency Economic Powers Act](#). *The Act has been used to impose sanctions and seize assets. But it has never been used to impose tariffs – which are effectively sanctions on your own citizens – and it's not clear from the text that it can be.* The Act calls for consultation with Congress, which did not take place.

- President Donald J. Trump used other statutory authorities across 2018 and 2019 for various rounds of tariffs. Although he did cite the Act in 2019 as authority for his threat to tariff Mexico, the tariffs were not put in place because Mexico satisfactorily capitulated.
- *So there has never been a legal test. If Trump moves on the tariffs Tuesday, we should look for an intervention by the courts similar to the one last week* in response to Trump's order to cut off various forms of federal aid. Trump dropped the initiative.
- If the order is blocked, Trump will regret saying in it, "I ...specifically find that action under other authority to impose tariffs is inadequate to address this unusual and extraordinary threat." *That will make it difficult to resurrect the tariffs if blocked*, the way Joseph R. Biden found new authorities to work around the Supreme Court itself and continue to forgive student debt.

In the meantime, while we "wait and see," here are some fun facts about our trading relationship with Canada, Mexico and China.

- Mexico is the US's number one trading partner, with \$836 billion in



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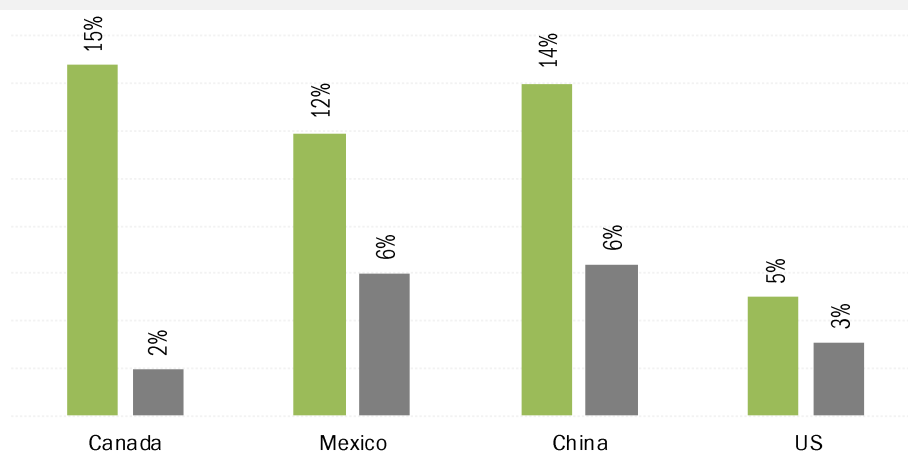
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Remember – AI can be funky. This is still experimental. Check it out and let us know what you think.

total trade over the trailing twelve months (please see the chart on the previous page). Canada is second with \$762 billion, and China third with \$578 billion. Together, the three make up 41% of US foreign trade.

- Trade with Canada is the most balanced, with the US running a trade deficit of \$60 billion, only 8% of total trade (again, please see the chart on the previous page). Trade with Mexico is less balanced with a 20% deficit (the same as the rest of the world), and far less balanced with China with a 51% trade deficit.
- The US imposes lower most-favored-nation tariffs than Canada, Mexico or China. All four nations impose higher tariffs on agricultural goods than on non-agricultural goods (please see the chart below).

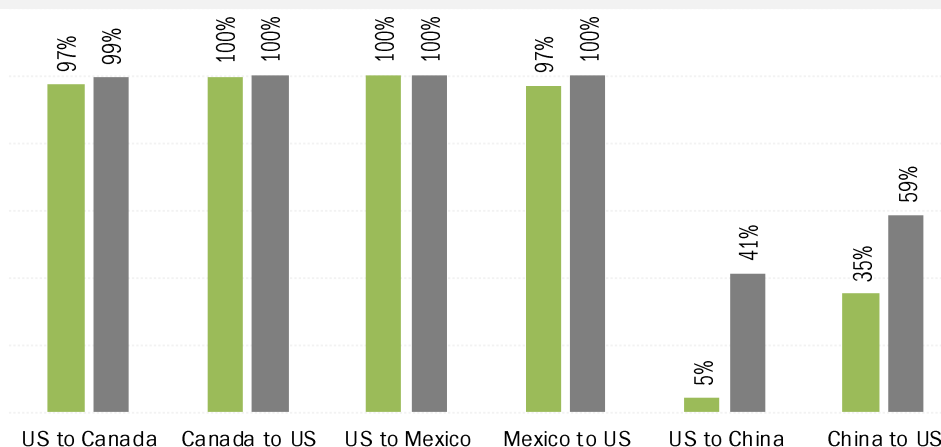
Tariff rates ■ Agricultural goods ■ Non-agricultural goods (2023, MFN, trade-weighted)



Source: World Trade Organization, TrendMacro calculations

- Almost all goods traded by the US with Canada and Mexico move tariff-free (please see the chart below). A significantly smaller share of US trade with China moves tariff-free.

Share traded tariff-free ■ Agricultural goods ■ Non-agricultural goods (2023, MFN)



Source: World Trade Organization, TrendMacro calculations

- Don't get the false impression that there aren't already some important tariffs between the US, Canada and Mexico. The heavily tariffed things don't trade, so they don't show up in the chart above. For example, Canada imposes a 200%-plus tariff on dairy products (hard to believe their farmers are so incompetent to need that and influential enough to get that).
- Be that as it may, imposing large tariffs on Canada and Mexico is to make very large and dark marks on a substantially clean sheet of paper. Thinking of it as a tax-hike is just the beginning – that tax hike will drive all kinds of adaptive responses. The consequences are unpredictable, but it's hard to see how they would be good.
- The US tariffs on China have been imposed since 2018, while the US trading relationship with Canada and Mexico has been broadly static under, first, the North American Free Trade Agreement and then the successor United States-Mexico-Canada Agreement. A lot has happened since 2018, including a global pandemic, a global depression, a global inflation and a global boom. So we can't tell if tariffs really matter (see ["How Much Do Tariffs Matter?"](#) January 28, 2025). But it's worth noting that since 2018 US trade with China has fallen 5%, while trade with Canada has risen 24% and with Mexico 35%. These are nominal figures, and inflation explains all of the growth with Canada and two thirds of the growth with Mexico. But it makes the contraction of trade with China all the worse. Maybe the tariffs ended up mattering.
- We still urge patience. But chance favors the prepared mind, so be prepared. What we "wait and see" could be really, really important.

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### Bottom line

The White House has announced tariffs of 25% on Canada and Mexico and 10% on China (and Canadian energy exports). This amounts to a \$256 billion per annum tax hike and upsets the US's two largest trade relationships. The tariffs had been threatened to force Canada, Mexico and China to work harder to interdict drug traffic, but it appears their leaders have called Trump's bluff. All he could do to save face is impose the tariffs. They are not effective until Tuesday, so his taking this step may amount to raising the stakes and forcing the other players to fold. The International Emergency Economic Powers Act has been used for sanctions and seizures, but never tariffs, and Trump did not consult Congress as it requires. Courts may well block these tariffs. The US trade relationship with Canada and Mexico is largely tariff-free, so imposing such large ones is a destabilizing risk. Obviously, there will be volatility while this plays out.

