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Tariffs as Geo-Economic Statecraft: Revenue, Reindustrialization, Dollar Strength, and Strategic Competition in the First Phase of the Modern U.S. Tariff Regime

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Abstract

Tariffs are now again a key part of U.S. economic policy. They are used to fix trade deficits, help American businesses, and give the U.S. more power in international disputes. The 2025 tariff program was a big change from earlier, smaller ones since it raised customs duties to levels not seen in almost a century. Advocates say that tariffs can raise money for the government, protect U.S. businesses, make the dollar stronger around the world, and give the U.S. more power in negotiations. However, these possible benefits come with some big problems, such as higher pricing for consumers, problems with the supply chain, retaliatory actions against U.S. exports, slower development and investment, and more people trying to avoid tariffs. This assessment looks at fiscal data, industry trends, and economic studies in a methodical way to figure out how tariffs fit into U.S. economic policy. The analysis uses official government data and scholarly literature to look at things like tariff revenue, trade deficit dynamics, effects on manufacturing and jobs, currency changes, and foreign responses like retaliation and evasion. The assessment also looks at how tariffs can be used to protect the supply chain, fight drug trafficking, and protect the country. Tariffs can bring in money and provide businesses and consumers short-term power, but most of the evidence shows that U.S. consumers and businesses pay most of the costs, especially in industries that rely on imported goods. The long-term effects will depend on how well the law is followed, other policies in the country, and changes in the economy as a whole. The time period being looked at is the first part of the contemporary U.S. tariff cycle. During this time, policy changed from specific trade actions to a broader tool with effects on the economy, industry, and strategy. The U.S. Supreme Court's ruling in early 2026 that parts of the 2025 tariff scheme were not lawful caused legal ambiguity and made trade authorities rethink their roles. This change gives us a good reason to look at the first part of the tariff cycle. It shows how tariffs are being used more strategically and the risks they pose to alliances, legal stability, and the credibility of policies.

Keywords: Customs revenue; economic leverage; economic security; geo-economic statecraft; national interest analysis; reindustrialization; strategic competition; strategic trade policy; supply-chain resilience; trade and national security; trade deficits; trade diversion and evasion; U.S. tariff policy

1 Introduction

For a long time, the U.S. trade policy focused on lowering tariffs and making the world economy more connected. After the tariff actions of 2018–2020, this orientation changed, and it grew a lot with the full tariff measures that were put in place in 2025. The 2025 program put broad tariffs on many trading partners and policy areas, unlike earlier trade remedies that only affected certain sectors or countries. Tariffs were used not only to fix trade imbalances but also to help American businesses, bring in money for the federal government, and make the US stronger in international negotiations.

This change means that tariffs are being redefined in a bigger way in economic policy. Tariffs are no longer just used to protect trade; they are also used more and more as tools of geo-economic statecraft. In this case, trade policy overlaps with fiscal policy, industrial strategy, and goals for national security. Tariffs affect government income, the strength of supply chains, diplomatic negotiations, prices, investment, and the economy of the world. This paper examines the initial phase of the contemporary U.S. tariff cycle, from the initial increase in 2018 to

the extensive rise in tariffs in 2025 and the subsequent legal developments in early 2026. During this time, tariffs changed from being specific trade measures to a more general policy tool with effects on the economy, industry, and strategy. The phase ended when the U.S. Supreme Court ruled that some parts of the 2025 tariff program went beyond the legal authority that was used to put them into effect. This caused legal uncertainty and made people rethink trade policy tools.

The study examines the impact of tariffs during this period across various aspects of economic policy. It looks at the effects of tariffs on government revenue and the economy, changes in the trade deficit and trade patterns between countries, the effects of tariffs on manufacturing and investment, the effects of tariffs on currency and inflation, and how tariffs affect diplomatic negotiations and strategic policy coordination. The analysis also looks at problems with enforcement, like avoiding tariffs and making changes to the supply chain, as well as the institutional limits that judicial review has pointed out.

This initial phase of the tariff cycle offers significant understanding of the functioning of tariffs within the overarching framework of U.S. economic governance. This time shows both how useful tariffs can be strategically and how institutional limits can make them less durable. Policymakers need to know how these things work in order to figure out how trade policy affects national economic security and international economic relations.

2 Literature Review

Current economic studies have extensively analyzed tariffs as tools for trade protection, welfare redistribution, and political economy, particularly emphasizing the U.S.-China trade conflict from 2018 to 2020. Prior research predominantly focuses on price pass-through, consumer welfare, and sectoral employment, often characterizing tariffs as static trade shocks instead of dynamic policy instruments. Recent academic work has started to look into trade policy uncertainty and changes in the exchange rate, but usually without considering fiscal and geostrategic goals. This study enhances the literature by concurrently assessing tariffs as fiscal instruments, industrial policy tools, and sources of geostrategic leverage, thereby integrating these dimensions within a cohesive analytical framework.

Prior investigations into sanctions, industrial policy, and executive trade authority have predominantly been executed in isolation. This review combines these different parts into a single framework and looks at tariffs as tools of geo-economic statecraft that affect how much money the government makes, industrial policy, monetary conditions, and geostrategic bargaining. This method is especially useful for institutional decision-makers who are looking at tariffs and trade policy while also having to deal with national security, budget, and legal issues at the same time. This analysis contextualizes the 2025-2026 tariff regime within prior developments, scrutinizing economic outcomes and the circumstances under which tariffs serve as leverage in national security and foreign policy.

A substantial body of empirical research indicates that contemporary U.S. tariffs are primarily transmitted to domestic prices rather than being absorbed by foreign exporters. Micro-price data show that tariffs put in place between 2018 and 2019 raised U.S. import prices almost exactly, which meant that U.S. businesses and consumers had to pay most of the costs (Amiti, Redding, and Weinstein, 2019).

Additional research quantifies welfare losses and reveals minimal evidence of foreign price concessions (Fajgelbaum et al., 2020). If there are no changes in how invoices are sent or how much power the market has, the tariff revenue in 2025 should be seen as a payment from U.S. buyers to the Treasury, not as a cost to foreign governments.

The literature on the tariffs of 2018-2019 points out two main ways that protection can help: it can boost demand for domestic producers, but it can also lower output in downstream industries by raising input costs and causing retaliation (Flaaen and Pierce, 2019). Overall, the earlier wave of tariffs caused a small drop in U.S. manufacturing jobs because gains in some sectors didn't make up for losses in industries that depend on inputs. Regression analysis revealed a notable transition in U.S. imports from China to Vietnam subsequent to the increase in tariffs. Later studies show that some trade flows are reclassified instead of actually moved (Choi and Nguyen, 2023). This difference is important for making sure that laws are followed and that money is safe. Wider tariff coverage makes traditional diversion less likely, but it also makes transshipment and misclassification more likely.

A calibrated model shows that changes in exchange rates can partially offset tariffs. This is because countries that are affected may let their currencies lose value (Jeanne and Son, 2024). This change makes things easier for exporters and shifts costs back to U.S. buyers. Currency responses make it harder to say that tariffs only make businesses more competitive by lowering prices. The effect of exchange rates is influenced by monetary policy, capital movements, and the perceived permanence of tariffs.

Research shows that uncertainty about trade policy keeps people from investing, regardless of what the tariffs actually are (Caldara et al., 2020). Legal obstacles and policy instability can hinder capital formation, even in the presence of tariffs. These findings show that uncertainty can be an economic barrier and may work against the investment incentives that tariff protection is supposed to create.

3 Methodology And Data Sources

The Analysis Looks At U.S. Tariff Actions From 2018 To 2020 And From 2025 To 2026 To See How They Changed To More General Measures And How They Grew In Terms Of Policy And Money. We Don't Take Into Account Comments That Are Speculative Or Don't Have A Source. A Hierarchical Approach Guided The Selection Of Sources, With Official U.S. Government Data And Policy Documents Coming First, Followed By Peer-Reviewed Economic Research And Institutional Analyses That Were Relevant To Trade, Industrial Policy, And National Security. Executive Fact Sheets And Press Releases Are Seen As Statements Of Policy Intent And Negotiated Commitments, Not As Proof Of Causal Outcomes. Figures Are Included For Context And Show The Data That Was Reported At The Time Of Publication; They Are Not Predictions Or Independent Quantitative Estimates.

Counterfactual Estimation Is Not Performed, And Outcomes Are Not Solely Ascribed To Tariffs In The Presence Of Simultaneous Macroeconomic And Geostrategic Shocks. The Analysis Is Designed To Evaluate Tariffs As Multifaceted Policy Tools Rather Than As Singular Trade Measures.

There Are A Few Problems With This Analysis. First, Using Government Data And Official Policy Statements That Are Available To The Public Shows What The Law Meant And What Happened, But It Doesn't Fully Separate The Effects Of Macroeconomic, Monetary, And Geostrategic Developments That Are Happening At The Same Time. Second, Tariff Measures And Related Policy Signaling Continue To Evolve, Especially In Early 2026. Discussions About The Future Are Seen As Indicative Rather Than Predictive, And They Don't Assume That They Will Happen Without Formal Legal Instruments. Third, The Analysis Focuses On U.S. National Interests And Does Not Try To Give A Full Picture Of The Welfare Of All Trading Partners. The Results Should Not Be Construed As Quantitative Assessments Of Trade Leverage Or Market-Access Results. Finally, Although Peer-Reviewed Research And Official Statistics Are Incorporated, No Novel Econometric Estimates Or Counterfactual Simulations Are Developed; Rather, Existing Evidence Is Amalgamated To Assess Policy Trade-Offs. These Limitations Represent Intentional Methodological Decisions Aimed At Emphasizing Transparency, Institutional Legitimacy, And Policy Significance Rather Than Conjectural Inference.

This review synthesizes:

- U.S. Treasury customs revenue data
- BEA trade balance and bilateral trade statistics
- BLS employment and wage data
- Federal Reserve monetary policy statements and inflation indicators
- Peer-reviewed economic research and official institutional publications

4 Results

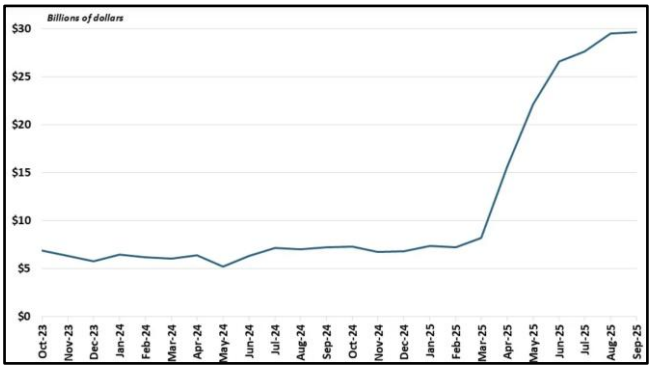
Given the recent implementation of the 2025-2026 tariff regime, most observed effects are best characterized as short-term or transitional rather than established structural outcomes. Trade flows, investment decisions,

exchange-rate dynamics, and diplomatic alignments typically evolve over several years. The longer-term impacts will depend on policy durability, enforcement rigor, and prevailing macroeconomic conditions.

Soaring Customs Revenue and Fiscal Effects

The most immediate and measurable outcome of the 2025 tariff regime was a sharp increase in U.S. customs revenue. As reported in the Monthly Treasury Statement (MTS) dataset of the U.S. Department of the Treasury, after remaining relatively stable at approximately $6-7 billion per month through late 2023 and most of 2024, tariff collections rose abruptly following the 2025 tariff implementation, exceeding $25 billion per month in the second half of the year, with total customs duties for FY2025 amounting to $195 billion, more than 2.5 times the FY2024 level, according to the Monthly Treasury Statement (Oct 2025). All revenue figures are reported directly from Treasury Monthly Statements and are not author-derived aggregates.

Figure 1: Monthly Customs Duties Rise to ~$30 billion (as of Oct 2025)



Source: U.S. Department of the Treasury, CRFB.

Despite the surge in customs duty revenue, the fiscal impact remains limited in structural terms when compared to the January 2026 12-month rolling deficit of $1.6 trillion. Tariff receipts offset only a modest portion of U.S. fiscal imbalances, confirming that tariffs do not materially alter long-run deficit dynamics, which are primarily driven by entitlement growth, interest costs, and demographic trends.

Figure 2: January 2026 12-Month Rolling Deficit of $1.6 Trillion

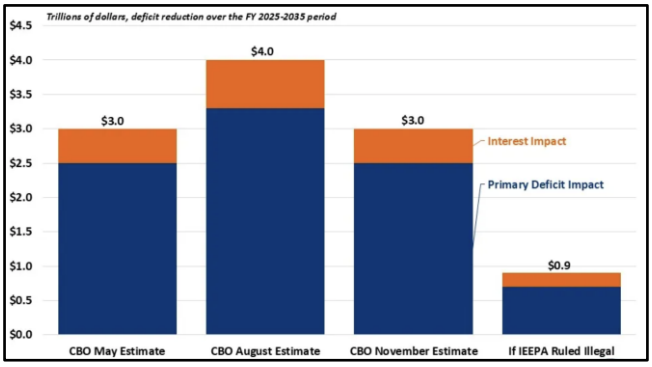
Source: U.S. Department of the Treasury, Congressional Budget Office, CRFB.

Peer-reviewed research cautions against interpreting tariff revenue as a net transfer from foreign producers. Empirical studies demonstrate near-complete pass-through of tariffs to domestic prices, indicating that U.S. importers and consumers bear most of the economic burden. Welfare analyses suggest that efficiency losses associated with tariffs may exceed the gross revenue collected, especially as higher rates suppress trade volumes and encourage evasion. Economic modeling further finds diminishing net revenue returns at elevated tariff levels, once slower growth, retaliation, and avoidance behaviors are taken into account.

Finally, the fiscal outlook is subject to legal uncertainty. The 2025 tariff program was implemented largely under emergency authorities, and early 2026 court rulings placed portions of the regime at risk. If ultimately invalidated, the federal government could be required to refund the collected duties, potentially reversing much of the short-term revenue gain.

In summary, the 2025 tariff data indicate a substantial increase in customs revenue but only modest mitigation of the fiscal deficit. These figures represent gross collections and do not account for indirect economic offsets, behavioral adaptations, or potential legal reversals. Consequently, tariff revenues should be viewed as conditional and contingent on policy context, rather than as a stable or structural fiscal resource.

Figure 3: Tariff Forecasts Remain Volatile (as of Nov 2025)



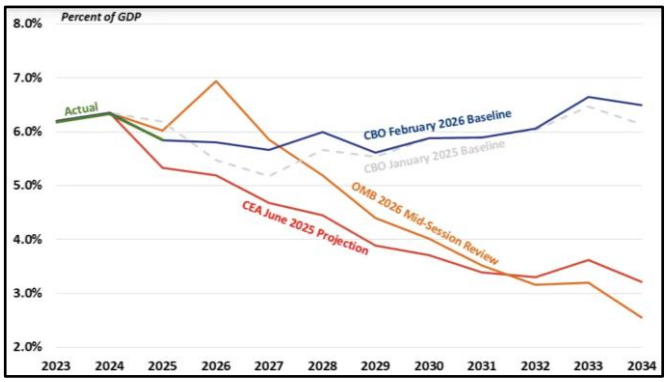
Source: CBOA and CRFB Estimates - Figures are included solely to contextualize scale and volatility, not to forecast or infer future outcomes.

* Estimates for "If IEEPA Rule Illegal" are crude, rounded, and meant to convey an order of magnitude rather than precision.

Trade Deficit Dynamics

A central objective of the 2025 tariff regime was to reduce the U.S. trade deficit by suppressing imports and improving export competitiveness. In practice, the tariffs generated significant short-term volatility rather than a smooth adjustment. In advance of implementation, firms engaged in widespread import front-loading to avoid higher duties, producing a temporary surge in imports. As a result, the U.S. trade deficit reached an unprecedented monthly high in January 2025, denoting a timing shift rather than a structural change in trade demand.

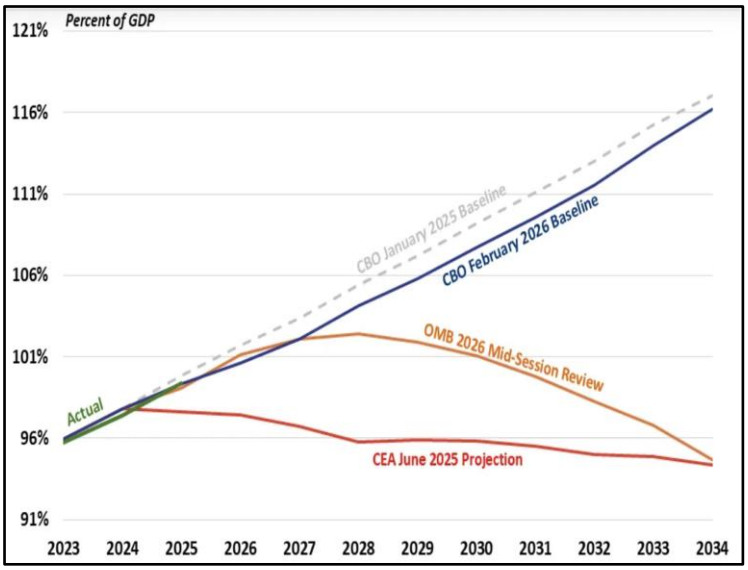
Figure 4: Deficit (% of GDP) Forecasts (as of Early 2026)



Source: Council of Economic Advisers (CEA), Office of Management and Budget (OMB), Congressional Budget Office (CBO), and CRFB estimates.

After the implementation of tariffs in April 2025, import volumes contracted sharply. During mid- and late-2025, reduced import spending and modest export adjustments contributed to a rapid narrowing of the monthly trade deficit. However, on a cumulative basis, the U.S. trade deficit for most of 2025 remained elevated compared to 2024 due to the early-year surge. This pattern suggests that much of the observed improvement reflected one-off inventory unwinding and demand cooling rather than durable rebalancing.

Figure 5: Debt (% of GDP) Held by the Public Forecasts (as of Early 2026)



Source: Council of Economic Advisers (CEA), Office of Management and Budget (OMB), Congressional Budget Office (CBO), and CRFB estimates.

Consistent with economic theory and prior empirical research, these effects are transitory. Studies indicate that exchange-rate adjustments, macroeconomic feedbacks, and global demand cycles typically erode tariff-induced deficit reductions over time. Evidence from late 2025 suggests that extreme tariffs may compress the deficit in the short term; however, the persistence of this effect into 2026 is uncertain.

Shifts in Bilateral Trade Flows

The tariff measures that went into effect in 2025 changed trade relationships between the United States and its most important trading partners in a big way. The tariff framework applied to a lot of things, but its effects weren't the same for all of them. Results were different depending on things like how well the supply chain was integrated, how well countries worked together politically, and how much they were affected by tariffs. The policy didn't just cut down on imports; it mostly changed the flow of trade between countries.

The biggest change happened in trade between the US and China. China had the highest total tariff burden because it was the United States' biggest deficit partner. This included the new universal tariffs, the existing Section 301 duties, and other product-specific measures. As a result, the U.S. bought a lot less from China in 2025. This was because prices went up and companies tried to make their supply chains more diverse. China responded with tariffs and other restrictions that weren't tariffs. In the end, talks led to a temporary drop in tensions, but trade between the two countries did not go back to what it was like before the tariffs.

Countries that had previously benefited from diversifying their supply chains had mixed results. Mexico and Vietnam are two examples of this difference. As companies stopped buying from China, Mexico got a bigger share of U.S. imports. Because it was close by and very connected to the USMCA, it was in a good position to take in some of this redirected production, even with high tariffs on some goods. Vietnam had benefited from trade diversion during the U.S.-China trade dispute, but the new tariff framework put new limits on the country.

The expanded tariff structure made it harder for Vietnam to fully replace Chinese production in the U.S. market because many of its exports depend on Chinese intermediate inputs.

For advanced industrial allies like the European Union, Japan, South Korea, and Taiwan, the result was mostly negotiation instead of escalation. At first, these economies had to deal with baseline tariffs and some measures that only affected certain sectors. However, diplomatic efforts often led to changes in tariff rates, exemptions, or commitments that were the same on both sides. For example, European pharmaceutical exports were first hit with tariffs, but negotiations helped stabilize trade between Europe and the United States. Japan and South Korea got some help through managed trade agreements that included more access to U.S. markets for exports and working together to keep the supply chain safe. Because Taiwan is important for making semiconductors, the situation there didn't get too bad. Instead, the U.S. encouraged Taiwan to invest more in U.S. production.

India's path was a little different. At the beginning of the tariff cycle, it had some of the highest tariff exposure of any major U.S. partner. This raised concerns about alignment pressures and led to the search for other trade partners. But talks finally led to a temporary trade framework in early 2026. As part of this deal, U.S. tariffs on Indian exports went down to about 18 percent. In return, India agreed to buy more U.S. goods and lower some trade barriers.

All of these changes show that the 2025 tariff regime changed the way trade works around the world, not just cut down on imports. Imports from China to the U.S. went down, but imports from other suppliers went up as companies changed where they got their goods. In this way, tariffs changed the structure and direction of trade and gave negotiators more power. However, they did not lead to a long-term decrease in the trade deficit without bigger changes in the economy as a whole.

Industrial Revival Efforts: Reindustrialization, Jobs, and Investment

Evidence from 2025 indicates that tariffs correlated with modest increases in domestic manufacturing output and a significant uptick in investment announcements, especially in capital-intensive sectors deemed strategically vital. Still, the overall picture of employment was much less clear.

The Bureau of Economic Analysis says that manufacturing output went up slightly over the year, even though the tariff measures caused input costs to go up. Indicators from the Federal Reserve also show small increases in real manufacturing value added and industrial production. As tariffs went up, the prices of competing imports went up, which led to stronger demand in industries like steel, machinery, chemicals, and household appliances. In this way, tariffs seemed to help protect producers in the country. But these gains did not lead to a similar increase in jobs. In 2025, the total number of manufacturing jobs in the United States stayed mostly the same. This was because job growth in protected sectors was canceled out by job losses in sectors that rely heavily on imported goods or are at risk of retaliation from other countries.

This result is in line with what previous research on tariffs has found. Studies frequently emphasize two conflicting effects: tariffs can enhance domestic demand by protecting local producers, yet they simultaneously increase production costs and may provoke retaliatory trade actions. In many cases, the costs that downstream industries have to pay outweigh the benefits of protection. Research analyzing the 2018–2019 tariff episode arrived at a comparable conclusion, indicating that escalating input costs often surpassed the benefits derived from heightened domestic demand (Flaaen and Pierce, 2019). More evidence from firms shows that rising output and prices don't always lead to a lot of new jobs, especially in industries that rely heavily on automation (Flaaen, Hortaçsu, and Tintelnot, 2020).

At the end of 2025, labor market indicators showed this mixed picture. The ISM manufacturing employment index and other measures stayed close to neutral, which means that hiring in the sector is not picking up much. At the same time, the overall unemployment rate went up a little bit as the economy started to slow down. These trends all point to the same thing: that tariffs may help some industries, but they don't always have a big impact on overall employment.

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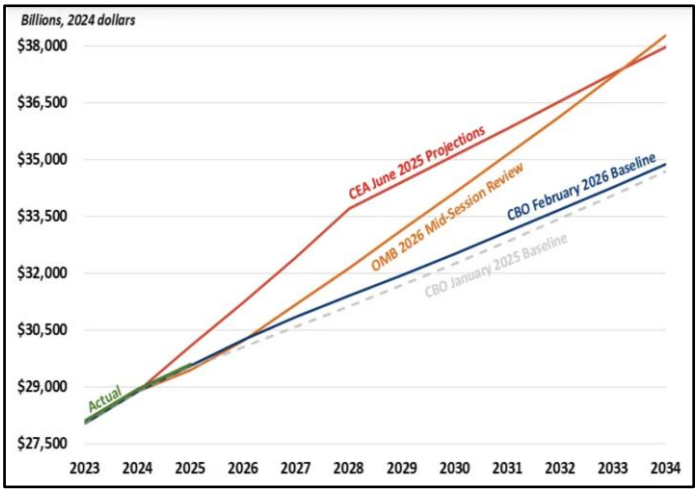
Figure 6: Real GDP Forecasts (as of Early 2026)



Source: Council of Economic Advisers (CEA), Office of Management and Budget (OMB), Congressional Budget Office (CBO), and CRFB estimates.

Investment responses were generally more favorable but remained contingent on policy stability. Announcements of reshoring and foreign direct investment increased compared to pre-2018 levels, particularly in sectors such as semiconductors, electric vehicles, batteries, pharmaceuticals, and critical minerals, all of which align with national security interests. Multiple governments and multinational firms announced expanded U.S.-based investments or procurement commitments during tariff negotiations, often linked to discussions of tariff caps or exemptions. These announcements serve as illustrative examples rather than a comprehensive dataset. Although attribution is ambiguous, available evidence indicates that tariffs acted less as a primary investment driver and more as a bargaining tool alongside subsidies, regulatory access, and defense cooperation.

The 2025 tariffs provided partial protection to selected industries and coincided with increased investment announcements in several sectors, supporting long-term supply-chain resilience. These commitments are best interpreted as negotiated signals rather than definitive investment outcomes, and their long-term durability remains uncertain. Aggregate manufacturing employment gains were limited, and output growth was modest. These findings suggest that while tariffs may offer temporary leverage for the domestic industry, sustained industrial revitalization depends on complementary policies such as workforce development, innovation, and investment stability, rather than reliance on protectionist measures alone.

Dollar Strength, Inflation, and Monetary Policy Interactions

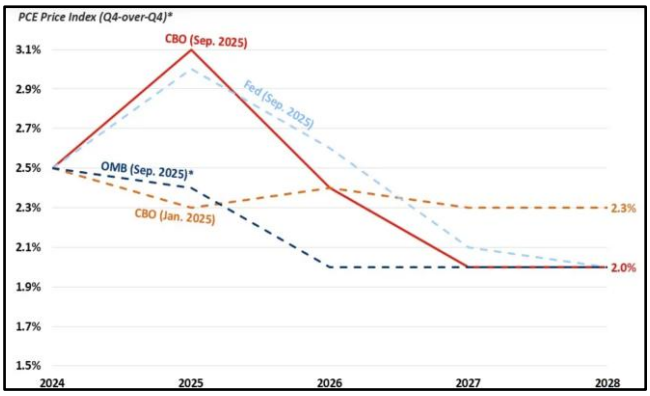
Tariffs also had complicated effects on currency markets and monetary policy, with some effects canceling each other out. Theoretically, a decrease in import demand should bolster the U.S. dollar, as fewer dollars are dispatched overseas for foreign goods. In real life, though, this relationship turned out to be less stable. Exporting countries can change their exchange rates to make up for some of the cost of tariffs. Data from 2025 shows that currency changes made some of the price effects of the tariffs less strong.

After the tariffs were put in place, the value of the currency of several important U.S. trading partners fell. China let the renminbi lose value in 2025, which helped its exporters deal with the higher tariffs that the US put on them. When trade tensions or tariff announcements got worse, other export-oriented economies, like Canada and Mexico, also had times when their currencies were weak. These changes effectively moved some of the tariff burden back to U.S. consumers through changes in exchange rates. On the other hand, some important U.S. allies, like Japan, Taiwan, and parts of the euro area, didn't use deliberate currency depreciation. Instead, they dealt with the policy changes by focusing on negotiation and trade agreements. The Federal Reserve's broad trade-weighted

dollar index was about the same at the end of the year as it was at the end of 2024. This suggests that the tariffs did not cause the dollar to rise in value over time.

Tariffs mostly caused prices of goods to go up, especially in categories that are heavily reliant on imports. This pattern fits with earlier studies that found that tariffs often have a big effect on consumer prices. At the same time, bigger economic factors kept the overall inflationary effect from getting too strong. By the end of 2025, core inflation was closer to the Federal Reserve's target. This was because demand at home was falling, commodity prices were falling, and the effects of earlier monetary tightening were still working their way through the economy.

Figure 7: Projected Annual Inflation (as of Sep 2025)



Source: Congressional Budget Office, Office of Management and Budget, Federal Reserve, CRFB.

* OMB reports PCE inflation data year-over-year

The Federal Reserve responded to these cross-currents by shifting toward policy easing. Tariffs initially raised fears about inflation persistence, but decelerating growth and a loosening labor market led the Fed to cut interest rates in late 2025. This monetary response partially offset the contractionary effects of tariffs on demand, but also limited any tariff-driven appreciation of the dollar.

The 2025 tariffs did not result in a sustained strengthening of the U.S. dollar and generated only modest, temporary inflationary pressures. Exchange-rate adjustments and monetary easing partially offset the intended effects of the tariffs. These outcomes indicate that trade policy effectiveness is highly contingent on currency movements and central bank interventions.

Strategic Leverage and Foreign Policy Outcomes

The 2025 tariff system was a big change in U.S. trade policy. It changed the way tariffs were used from being used as tools to fix trade problems to being used as tools of geo-economic leverage. Tariffs were clearly tied to larger policy goals, such as protecting national security, controlling drug use, enforcing immigration laws, and working with important partners on strategic issues. Reported security and enforcement outcomes during this period primarily mirror concurrent statements from U.S. government agencies and should thus be regarded as correlated policy developments rather than independently verified causal effects of tariff policy.

China quickly and broadly retaliated against the U.S. actions. U.S. goods were hit with counter-tariffs, and there were also non-tariff measures like stricter rules on American companies doing business in China and export controls on important minerals. After a period of rising tensions, both governments started talking to each other. This led to a temporary tariff truce and a partial rollback of retaliatory measures. China's later involvement, especially its help with regulating fentanyl precursor chemicals, shows that the tariff pressure gave the US more power in negotiations. However, a full trade agreement was still out of reach because of ongoing legal disputes at the World Trade Organization.

The European Union took a different approach. The EU mostly avoided immediate retaliation after saying it was worried about the legality of the U.S. tariff authority. Instead, it focused on negotiating. This method eventually led to a negotiated tariff cap and promises of equal access to each other's markets, which helped keep a larger trade war from breaking out across the Atlantic. The agreement helped stabilize trade flows in the short term, but it also led to discussions within the EU about how to rely less on the U.S. market and make supply chains within Europe stronger.

India's experience shows how dangerous it can be to put high tariffs on strategic partners. At the beginning of the tariff cycle, India had some of the highest tariff exposure of any major U.S. trading partner. The policy caused problems in diplomacy and pushed India to look for other trade partners, even though quiet talks were still going on behind the scenes. But by early 2026, talks between the two countries had led to the framework for a temporary trade agreement between the U.S. and India. With this deal, tariffs on Indian exports went down to about 18%, and India promised to buy more American goods and lower some trade barriers.

Even though they thought the tariffs were against the United States–Mexico–Canada Agreement (USMCA), Canada and Mexico chose not to retaliate directly and instead looked for diplomatic solutions. Mexico got the extra tariffs put on hold by agreeing to work together more on managing migration and enforcing drug laws. Canada got exemptions for important energy exports. In both cases, keeping the bigger picture of North American economic integration was more important than making the disagreement worse.

Japan, South Korea, the United Kingdom, Australia, and Brazil were also U.S. allies that wanted to find negotiated solutions. Many got partial tariff relief or caps in return for concessions in specific sectors, more access to markets, or strategic cooperation. As time went on, the tariff system became more like a flexible and negotiated framework. It was strict with geopolitical rivals but could be changed for partners who were willing to work with them diplomatically.

This conditional approach is very clear in the case of South Korea. A deal between the two countries announced in mid-2025 lowered U.S. tariffs on South Korean goods from 25% to about 15%. In return, South Korea promised to make big investments in U.S. industries and give U.S. companies more access to South Korean markets. But later, U.S. officials warned that tariffs could go back to their original level if the South Korean legislature didn't follow through on important parts of the agreement (White House, 2026). This episode shows that during this policy cycle, tariff levels were often linked to negotiated commitments and legislative follow-through instead of staying the same over time.

The tariffs were used as tools of diplomacy and security, as well as having economic effects. U.S. policymakers made a clear link between tariff policy and cooperation in areas like stopping drug trafficking, controlling immigration, stopping illegal financial activity, and working together on larger strategic issues.

Tariff threats and increased Mexican enforcement efforts happened at the same time in the areas of fentanyl trafficking and migration enforcement. These included more aggressive efforts to stop fentanyl from getting into the country, sending in security forces, sending cartel leaders back to their home countries, and keeping a closer eye on chemical precursors. U.S. officials often blamed these changes on economic pressure, but the cause-and-effect relationship is still up for debate because they happened at the same time as Mexico's domestic policy changes and increased cooperation between the two countries.

Tariffs also got in the way of efforts to fix the fentanyl precursor supply chain. Before China agreed to limit the export of some precursor chemicals to North America, it put targeted tariffs on chemical imports. China promised to put in place export controls and enforcement actions in exchange for some tariff relief. The Department of Justice, the Drug Enforcement Administration, and the Office of the U.S. Trade Representative all said that tariff leverage helped get these promises.

The 2025 tariff cycle sped up changes in the global trading system that were already happening in a more general sense. To protect themselves from U.S. tariffs, some countries made their regional trade agreements stronger. At the same time, the U.S. focused more on bilateral agreements and looked into tariff preferences based on alliances. As countries tried to reduce their exposure to tariff risks and diversify their economic partnerships, initiatives like the Indo-Pacific Economic Framework gained traction. All of these changes point to a slow move toward a trading

system that is more controlled and focused on alliances. Tariffs will no longer be seen as universal barriers, but as tools for shaping important economic relationships.

In general, the tariffs seem to have given the country some diplomatic power, which has led to security-related concessions and new talks with important partners. The policy, on the other hand, put pressure on some alliances and pushed some countries to look for other economic ties. The evidence indicates that tariffs can serve as an effective tool in foreign policy when applied selectively and accompanied by credible negotiation avenues. But putting too much faith in these kinds of measures could speed up the breakdown of global trade and slowly weaken the U.S.'s power in the global economy.

Tariff Evasion and Enforcement Dynamics

High tariff differentials under the 2025 regime created strong incentives for evasion, producing sustained enforcement challenges for U.S. authorities. As tariff rates increased, firms adapted by altering supply chains, reclassifying goods, or exploiting procedural gaps. Research distinguishes between legal trade diversion—shifting production to new suppliers—and evasion practices such as misclassification or false origin reporting that directly undermine tariff enforcement.

Transshipment and Re-routing: A common tactic is to route goods through intermediary countries to obscure their origin. Chinese goods were frequently shipped through Southeast Asia or free-trade zones before entering the United States under altered country-of-origin declarations. These patterns prompted investigations, additional inspections, and diplomatic engagement with transit economies, though complex supply chains limited the effectiveness of complete prevention.

Undervaluation and Duty Misclassification: High ad valorem tariffs increased incentives to underreport shipment values or classify products under lower-tariff categories. U.S. Customs and Border Protection expanded audits and data analytics to identify suspicious declarations and pursued enforcement actions against several fraud schemes. Despite these efforts, large tariff differentials continued to create incentives for misreporting.

De Minimis Threshold Exploitation: The duty-free de minimis threshold became a major avoidance channel as sellers divided shipments into smaller parcels or shipped goods directly to consumers. The mid-2025 restriction of de minimis eligibility for selected countries reduced this practice and recovered tariff revenue, although some firms redirected shipments through third countries.

Non-Resident Importer and Re-shipping Schemes: Foreign exporters occasionally utilized shell importers or third-party logistics providers to conceal the identity of the importer of record. U.S. authorities responded by tightening verification requirements and restricting access to specific exemptions, thereby reducing but not fully eliminating this strategy.

In response to these challenges, U.S. enforcement agencies increased inspections, established specialized task forces, and enhanced cooperation with foreign customs authorities. Although these measures raised compliance costs and improved revenue collection, they did not eliminate incentives for tariff arbitrage. Consequently, the effectiveness of tariffs as policy instruments depends not only on statutory rates but also on sustained investment in enforcement capacity, data integration, and international collaboration.

By late 2025, legal challenges to the statutory authority underpinning aspects of the tariff regime introduced further uncertainty. Businesses and investors increasingly factored this uncertainty into supply-chain planning. This pattern supports findings in the literature that policy volatility can influence economic behavior independently of tariff levels.

The 2025 experience indicates that the effectiveness of tariffs depends on both policy design and the institutional capacity necessary for effective enforcement.

Emerging Developments in 2026

The developments in this section represent executive policy signaling, not formally enacted trade measures. These examples serve to document emerging policy patterns that could shape future tariff policy.

In early 2026, the United States indicated a potential expansion of its tariff policy by announcing that countries conducting business with Iran could be subject to an additional 25 percent tariff on U.S. imports. Although no formal legal instruments or implementation timelines had been published at the time of writing, this announcement reflects a growing willingness to employ tariffs as secondary coercive instruments aligned with geopolitical objectives rather than traditional trade disputes. Affected countries may respond through partial compliance, trade re-routing, diplomatic engagement, or strategic resistance involving retaliation or bloc coordination. The effectiveness of these measures depends on each country's exposure to the U.S. market and its capacity to withstand economic fragmentation.

Concurrent policy signaling in early 2026 indicated that tariff leverage could also be utilized in negotiations with allied economies. Public statements and contemporaneous reporting revealed that the United States considered imposing additional tariffs on certain European NATO members as part of broader geopolitical negotiations involving Denmark and Greenland. Although the scope, legal authority, and implementation schedule remained uncertain, this episode demonstrates the increasing use of tariffs as instruments of geopolitical bargaining, including among alliance partners.

Another development during this period involved negotiations between the United States and India. In early 2026, the two governments announced a framework for an interim trade arrangement, reducing U.S. tariffs on Indian exports to approximately 18 percent, while India agreed to expand imports of U.S. goods and lower specific trade barriers. This adjustment underscores the negotiated and dynamic character of the tariff framework, where tariff levels frequently change through bilateral bargaining rather than remaining static.

If these developments persist, they may signal a broader evolution in tariff policy, shifting from tools primarily addressing trade imbalances to instruments of geopolitical leverage. The sustainability of this approach depends on legal viability, alliance tolerance for economic pressure, and the extent to which short-term leverage yields longer-term strategic outcomes.

Judicial Review and the Termination of Phase I of the Tariff Regime

In early 2026, the U.S. Supreme Court issued a decision addressing the statutory authority to implement certain elements of the 2025 tariff regime. In a 6-3 ruling, the Court determined that portions of the tariff program exceeded the scope of the emergency authorities invoked by the executive branch. The decision effectively invalidated the legal basis for certain tariffs imposed under those authorities and introduced uncertainty regarding the status of previously collected duties.

The ruling produced immediate administrative and legal consequences. Importers filed claims for refunds of duties collected under the invalidated authority, while federal agencies began reviews to determine the appropriate response. Estimates indicated that a substantial portion of tariff revenue collected during the affected period could be subject to refund claims, although the final monetary impact depends on ongoing court proceedings and administrative decisions.

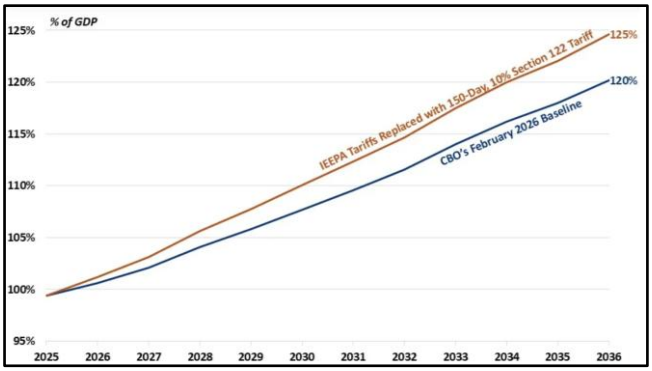
From a policy perspective, this decision marks a logical endpoint for the first phase of the modern U.S. tariff cycle examined in this study. This episode illustrates that tariff policy functions within a broader institutional framework, in which statutory authority, judicial review, and administrative procedures determine the durability of economic policy instruments.

Administrative Response and Alternative Trade Authorities

In the aftermath of the Supreme Court decision, federal policymakers evaluated alternative statutory mechanisms within existing trade law. An immediate response was the use of Section 122 of the Trade Act of 1974, which authorizes the temporary imposition of tariffs of up to 15 percent for 150 days to address balance-of-payments concerns. This provision enables the executive branch to implement temporary trade measures while conducting the investigations necessary for longer-term policy actions.

Additional statutory authorities are available under U.S. trade law. Section 301 of the Trade Act of 1974 authorizes tariffs in response to unfair foreign trade practices following an administrative investigation, while Section 338 of the Tariff Act permits duties against countries that discriminate against U.S. commerce. Although these authorities require more extensive administrative procedures, they offer a clearer statutory basis than emergency powers.

Figure 8: Debt Projection Under Section 122 Tariff Scenario (as of Early 2026)



Source: CRFB estimates based on Congressional Budget Office estimates and CRFB Modeling.

Beyond tariff authorities, the federal government possesses several related policy tools that influence trade and industrial outcomes. These instruments include export controls, targeted sanctions, domestic industrial incentives, government procurement policies, and regulatory frameworks affecting foreign investment. In practice, contemporary economic policy often relies on a combination of these measures rather than tariffs alone.

The post-decision environment signifies a transition between legal frameworks rather than a complete cessation of tariff policy. The adoption of further tariff measures will depend on administrative investigations, statutory interpretation, and broader institutional coordination.

5 Policy Lessons From Phase I Of The Tariff Regime

Empirical outcomes from the 2025 tariff cycle provide several policy lessons concerning the design, enforcement, and institutional durability of tariff-based economic statecraft. The initial phase of the modern U.S. tariff cycle illustrates both the potential strategic utility of tariffs and the institutional constraints that limit their longevity. While the economic effects observed during this period remain subject to debate, several patterns are evident in the available data and policy developments.

Tariffs Functioned Primarily as Negotiation Instruments

A key observation from Phase I is that tariffs frequently served as negotiating instruments rather than as permanent trade barriers. Tariff levels introduced in 2025 were often followed by bilateral negotiations, resulting in revised tariff rates, exemptions, or reciprocal commitments. Adjustments to tariff arrangements with partners such as India, Japan, South Korea, and the European Union illustrate this trend. These outcomes indicate that tariffs can function as bargaining mechanisms to facilitate negotiations over market access, investment commitments, and regulatory cooperation.

At the same time, this evolving structure generated uncertainty for firms and investors, especially when tariff levels were revised during negotiations. The Phase I experience suggests that the effectiveness of tariffs as leverage depends in part on the credibility of both escalation and de-escalation mechanisms. Evidence from the 2025 tariff period indicates that tariffs provided partial protection for specific domestic sectors and coincided with increased investment commitments in strategic industries. However, aggregate employment and output outcomes were mixed. Job gains in protected industries were frequently offset by losses in sectors reliant on imported inputs or export markets. These patterns reinforce prior empirical research, which finds that tariffs may offer temporary demand support but rarely result in sustained industrial expansion without complementary policies. Workforce development, infrastructure investment, technological innovation, and regulatory stability are necessary to ensure that tariff protection translates into durable industrial capacity.

Enforcement Capacity Is Central to Tariff Effectiveness

Phase I also demonstrated that significant tariff differentials created strong incentives for evasion. Practices including transshipment, misclassification, undervaluation, and exploitation of de minimis thresholds emerged as prominent challenges during the implementation of the tariff regime. Enforcement agencies responded by increasing inspections, expanding data analytics, and collaborating with foreign authorities to identify fraudulent trade flows.

These developments suggest that tariff policy must be evaluated in conjunction with enforcement capacity. Without sustained investment in customs enforcement, trade data integration, and international cooperation, tariff measures may incentivize avoidance and undermine their intended policy objectives.

Institutional and Legal Constraints Shape Policy Durability

The court's decision to strike down parts of the 2025 tariff program highlights how important institutional oversight is in shaping U.S. trade policy. Because many of these tariffs were introduced using emergency authorities, they were open to legal challenges, which ultimately exposed weaknesses in their legal foundation. This situation shows that long-term trade measures need clear statutory backing and well-defined administrative procedures if they are to withstand scrutiny and remain in force.

More broadly, the episode illustrates that tariff policy does not operate in isolation. It functions within a wider institutional system that includes congressional legislation, judicial review, and administrative rulemaking. For policymakers who want tariff measures to endure, relying on temporary or loosely defined authorities may not be sufficient. Instead, stronger statutory grounding and, in some cases, explicit legislative support may be necessary to ensure stability and credibility in trade policy.

Tariffs Operate Within a Wider Economic Policy Toolkit

The Phase I experience further demonstrates that tariffs rarely operate in isolation. Trade policy outcomes during this period were shaped by parallel policy instruments such as industrial subsidies, export controls, regulatory incentives, and government negotiations. The interaction between tariffs and these supporting tools influenced many of the economic and geostrategic outcomes observed during the tariff cycle.

Accordingly, tariffs should be regarded as one component within a broader economic policy toolkit, rather than as a standalone mechanism for achieving trade or industrial objectives.

6 Conclusion

There are effects of tariff policy that go beyond trade. It has an effect on government income, household spending, the stability of international partnerships, and institutions' ability to uphold trade rules. Because of this, arguments

about tariffs are closely related to bigger issues of national economic security. The tariff measures that came into effect in 2025 were a big change in U.S. trade policy. They moved away from traditional, narrowly focused trade remedies and toward a broader use of tariffs as tools of economic strategy. The court's decision in early 2026, which struck down parts of the tariff framework, is a good time to look back on the first phase of the modern tariff cycle.

The evidence examined in this study indicates that tariffs can function as instruments of negotiation in international economic relations. In many cases, pressure from tariffs went hand in hand with renegotiated trade agreements and policy coordination with foreign partners. This included working together on issues like drug control and supply-chain security. At the same time, these changes came with significant economic costs and institutional limitations that made the policy less effective overall.

From this first phase, we can see a few patterns. In the short term, tariffs brought in a lot more money for customs, but their overall effect on the federal budget was still pretty small. Some industries in the US saw their output rise and new investments announced, especially in sectors that got direct protection. But the job market was uneven because higher input costs and trade measures taken in response to them canceled out gains in other parts of the manufacturing sector. Imports moved toward different suppliers instead of going down across the board, and trade flows changed locations instead of going down. Meanwhile, problems with enforcement, such as transshipment, undervaluation, and misclassifying products, continued to be a major concern. The legal ambiguity surrounding the tariff program underscores the influence of statutory authority and judicial scrutiny on the enduring stability of trade policy.

These findings suggest that tariffs can provide leverage in negotiations and temporary protection for specific industries; however, their efficacy is significantly influenced by policy formulation and institutional context. Setting clear goals, using trustworthy negotiation frameworks, and working together with other economies usually leads to better results. On the other hand, relying too much on tariffs alone could lead to economic inefficiencies, strained diplomatic ties, and more difficult enforcement.

The Phase I tariff cycle shows that tariffs work best when used with other policy tools, not on their own. Industrial policy initiatives, export controls, investment incentives, and diplomatic engagement all had an impact on the results we saw during this time. So, the main question for policy makers is not just whether or not to use tariffs, but how to use them in a smart and selective way as part of a larger system of economic governance. In this way, the 2025 tariff cycle is a good example of how trade policy is changing in relation to national economic security. Future discussions will probably center on whether tariffs continue to be a primary instrument of economic statecraft or evolve into a component of a more comprehensive strategy that amalgamates trade policy with industrial advancement and international collaboration.

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