



By Thomas Wash

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The Trade Trilemma *Revisited*

In February 2026, the United States Supreme Court struck down the import tariffs imposed by the Trump administration in April 2025 under the International Emergency Economic Powers Act (IEEPA), eliminating the import charges that had been applied to specific countries but leaving in place those imposed on certain products. While the White House is now working to replace those tariffs to ensure that countries follow through on the trade deal commitments they made over the last year, the time that these tariffs have been in place has helped shed light on their overall impact.

In 2025, we wrote a report called “[The Tariff Trilemma](#),” in which we focused on three types of tariffs — reciprocal, revenue, and restrictive — and their respective trade-offs and purposes. Now that these tariffs have been in place for over a year, we have actual data to assess how the administration’s trade policies have affected the economy and what they may mean going forward, even after the Supreme Court ruled the IEEPA tariffs unconstitutional.

This report briefly reviews the three different types of tariffs and what sets them apart. We then focus on how these tariffs have changed trade flows, investment spending, and domestic inflation. We also discuss the impact of trade on financial markets, including domestic and international equity markets, global currencies, and interest rates.

The Three Rs of Tariffs

In his book, [Clashing Over Commerce](#), author [Douglas Irwin](#) simplifies the complex world of trade policy by outlining three types of tariffs, which he designates as the “Three Rs”: *reciprocal*, *revenue*, and *restrictive*. Each serves a different purpose and comes with its own unique set of pros and cons (see Table 1 on the next page).

In Irwin’s classification scheme, *reciprocal tariffs* generally have the lowest rates and typically function as a bargaining chip. Also known as “tit-for-tat” tariffs, their aim is to persuade other countries to lower their trade barriers in exchange for similar concessions, opening foreign markets to domestic businesses. The primary benefits include a broader consumer base for domestic firms, access to a greater supply of foreign goods that helps lower prices, and increased trade certainty that improves business planning.

However, these tariffs carry significant risks. If set too low, they can lead to a greater dependency on foreign supply chains, making the economy susceptible to supply shocks. Furthermore, the incentive for firms to use lower trade barriers to outsource labor can lead to job dislocation in vulnerable sectors. This was most visibly seen in the US manufacturing sector during the low-tariff era of globalization, where the factory sector’s share of jobs shrank from nearly 40% of payrolls in the 1940s to less than 10% today.

According to Irwin, *revenue tariffs* are considered the “Goldilocks” of trade policy as they are supposed to be set neither too high to choke off imports nor too low to be fiscally insignificant. Their main purpose is to generate government revenue, which can help service the national debt. By design, they keep trade flowing and give the government a vested interest in protecting global commerce to ensure a steady stream of import duties. The main drawback of revenue tariffs is that government finances can be adversely affected if consumers reduce their purchases of imports. Finding the ideal tariff rate for each country can also require constant and complex negotiations in order to maintain optimal revenue levels.

Finally, Irwin’s *restrictive tariffs* are the highest and most protectionist. Their explicit goal is to limit the flow of imports to shield and promote domestic industries. The potential upsides include the development of new domestic industries and greater supply chain resilience by reducing dependence on foreign nations for critical resources. However, the negatives are often immediate and severe. Restrictive tariffs can cause short-term supply chain disruptions as firms scramble for suitable domestic substitutes, which can lead to shortages and price instability during times of high demand. Critically, this aggressive approach is the most likely to provoke retaliatory tariffs from other countries, risking a broader trade war.

Table 1

The Three Rs: Types of Tariffs			
Source: <i>Clashing over Commerce</i> , by Douglas Irwin			
	Reciprocal	Revenue	Restrictive
Primary Goal	Open foreign markets for domestic companies	Generate income for the government	Protect domestic industries from competition
Economic Impact on Trade	Promotes free trade and expands export opportunities	Moderately impacts trade; not primarily designed to restrict it	Restricts imports, can lead to trade wars, higher prices
Typical Tariff Structure	Lowest tariffs	Moderate tariff rates	Highest tariffs (Protective)

Which R is Driving Policy?

While the tariffs imposed by the US since early 2025 exhibit elements of all three types mentioned above, their most notable impacts reflect a combination of revenue-driven and restrictive tendencies. This characterization stems from the fact that although these trade measures have resulted

in broader agreements between the US and many of its allies, they have neither significantly boosted overall trade nor led to a lasting reduction in trade barriers. That said, the tariffs have helped increase federal revenue (as seen in tariff income) while effectively restricting imports in strategically important industries.

Reciprocal

Despite the president branding his 2025 tariffs as reciprocal, they were not designed solely to increase US trade activity. On the contrary, the reciprocity was intended as payback for what the White House viewed as the rest of the world taking advantage of the US. Consequently, much of the administration's negotiations with other countries were one-sided in nature and extended well beyond lowering trade barriers — encompassing policy changes, trade commitments, and investment pledges as well.

Throughout 2025, the [US reached a series of framework agreements with multiple countries to establish new trade relationships](#). While the primary objective was to address trade barriers against the US, these deals also sought to secure commitments for purchases of key US goods, including energy, advanced semiconductors, and aircraft. In addition, provisions were included to encourage partner countries to invest in US manufacturing, supporting broader reshoring efforts. Many of these arrangements also incorporated measures to strengthen supply chain resilience, with the goal of reducing dependence on China.

These tariffs mark a departure from traditional US trade policy. While previous reciprocal rates aimed to integrate the US into the global economy by incentivizing market openness, the current strategy focuses on domestic insulation. Data suggests this decoupling is already visible; excluding the surge in data processing equipment (see Figure 1), broad-based goods imports have shown little growth relative to their pre-tariff baseline.

Revenue

Revenue is one of the most straightforward areas in which these tariffs have been effective. When they were introduced, they were framed as a way to diversify government revenue sources by increasing tax receipts. As noted in our previous report, the White House sought to advance this objective by implementing broad-based tariffs under IEEPA authorities.

In general, tariff policy aims to set rates high enough to generate meaningful revenue while still allowing trade flows to continue, but not so high that imports collapse. We estimate that, over the past year, effective tariff rates have generally been set in the 10–15% range, with most partner countries landing toward the lower end following the new trade agreements.

These tariffs have been quite successful in boosting government revenues, generating roughly \$360 billion, or about 6% of total tax receipts (see Figure 2, next page). By comparison, tariff revenues prior to these measures were roughly one-third of that level. This increase underscores how the White House has been able to capture additional fiscal resources from countries running trade surpluses with the US.

Figure 1

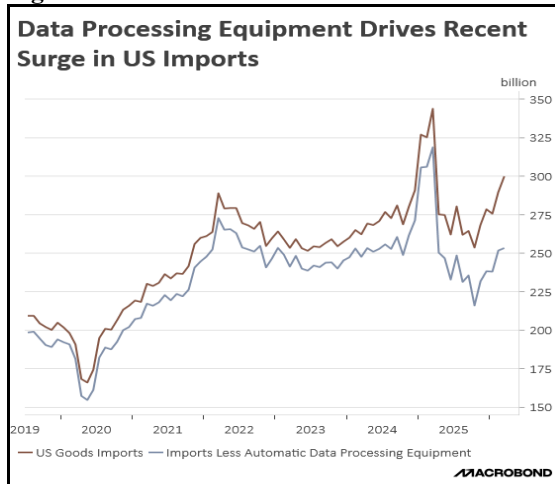
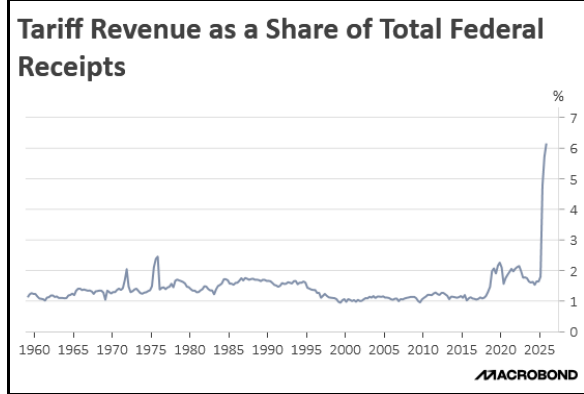


Figure 2



Restrictive

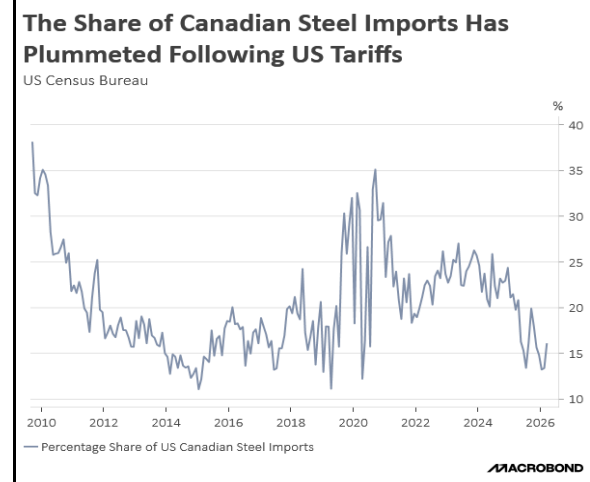
Given the disruptive nature of tariffs, the White House has implemented several restrictive measures while incorporating notable loopholes to limit the drag on the broader economy. Unlike revenue-focused tariffs aimed broadly at trading partners, these measures have been applied at the sector and product level, with the explicit goal of shielding specific industries. To date, they have been particularly concentrated in industrial and commodity sectors, with indications that future actions may increasingly extend to pharmaceuticals and semiconductors.

These tariffs have been used as a tool to support reshoring by making it more expensive for firms to source from foreign competitors. In our previous report, we noted that tariff rates above 20% typically signal an effort by the US government to actively protect a given industry. In response, many companies have reconfigured their supply chains, seeking workarounds and alternative arrangements to avoid elevated tariff costs.

While some of these tariffs were deliberately set at prohibitively high levels, the White House has intentionally provided certain sectors with leeway in exchange for demonstrable commitments to rebuilding domestic manufacturing capacity. In other

cases, the restrictive tariffs have successfully redirected trade flows from foreign suppliers back toward US producers. One clear example is Canadian steel, where its share of US imports declined following the implementation of these measures (see Figure 3).

Figure 3



The Next Phase

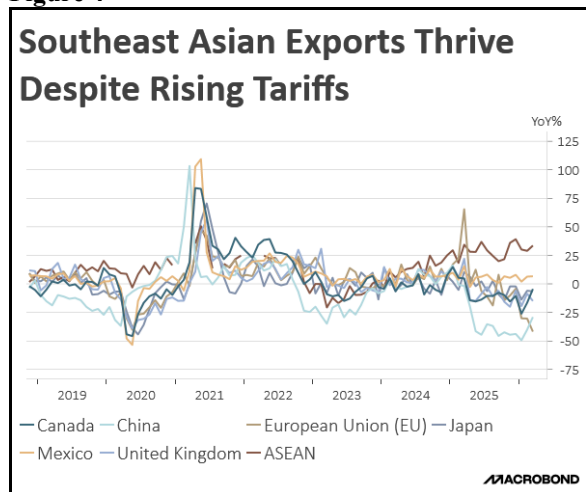
A year after the tariffs were introduced, the White House is now looking to scale back some of the initial safeguards in its trade policy as it seeks to demonstrate more tangible results. This will likely involve converting many of the existing framework arrangements with partner countries into fully fledged trade agreements. At the same time, the administration is expected to increase pressure on domestic industries to shift a larger share of their production back to the US.

The White House is likely to focus much of its efforts on converting various trade frameworks into formal agreements. South America, where the US has sought to deepen ties as part of a modernized Monroe Doctrine approach, has seen the greatest progress so far. By contrast, negotiations in Asia and Europe have been more challenging as Washington has taken a tougher line on policy practices it views as

disadvantaging the US, including currency management and certain food and environmental regulations.

The US is also likely to renew its attention toward the trade relationship with China. Despite multiple rounds of talks over the past year, the two sides have yet to agree on even a basic trade framework. Securing a deal with China would represent the White House's most significant trade victory, given its longstanding view of Beijing as the principal actor exploiting global trade rules to America's detriment. While we do expect a broad agreement to emerge over time, a truly comprehensive deal will likely be gradual, with both sides first addressing the most contentious issues and only later working down to narrower areas of dispute, potentially including aspects of foreign policy.

Figure 4



The US will also seek to ensure that domestic firms follow through on their pledges to reshore manufacturing. There are already signs of this shift, including the president's decision to impose a [tiered tariff system on certain imports](#), such as non-US steel. We also suspect that the White House has privately pressured [large pharmaceutical](#) companies to expand domestic production capacity. At the same time, automakers and

semiconductor manufacturers could face higher input costs if Washington begins targeting countries that export chips and key components on national security grounds, though any such moves are likely to be more gradual given these sectors' importance to the broader economy.

Investment Implications

Now that tariffs have been in place for more than a year, much of the initial shock and surprise has worn off — to the benefit of domestic equity markets. We believe that, while the Supreme Court decision has likely increased uncertainty, firms have largely accepted that tariffs are here to stay. As a result, the overall tariff framework is unlikely to undergo major changes, even if additional measures are introduced over time.

We have already seen a broader normalization of the impact of tariffs on the economy. Although job growth slowed last year, non-tech investment spending has begun to recover as more firms gain clarity on managing these levies. This is one of the key reasons the economy remains structurally sound, despite recent supply shocks.

Turning to international equities, we have also seen clear beneficiaries emerge. Countries that have been able to pass higher prices onto importers have generally enjoyed stronger equity performance, especially those that sit at critical points in the AI supply chain. Several emerging Asian markets, in particular, outperformed the US and most other regions last year (see Figure 4). However, this outperformance could be jeopardized if the White House moves to constrain these trade flows through more restrictive tariffs.

These trade dynamics also have important implications for currencies. We expect the changing US trade policy to remain a headwind for the dollar as other countries continue to diversify their reserve holdings and seek alternative export markets.

In addition, deregulatory elements embedded in recent reciprocity-focused policies could encourage some foreign investors with large US exposures to

repatriate capital, adding further pressure on the dollar. We continue to believe that US markets will remain structurally strong, given their depth and liquidity, but we see growing opportunities abroad as other countries benefit from a secularly weaker dollar and the potential for repatriation flows.

Thomas Wash
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