

1. Background: Can Tariffs Fund the Government?

- Historically, in the 19th century, many countries relied on tariffs as a primary source of government revenue.
 - Recently, figures like Peter Navarro from the Trump administration (as of 2025) have claimed that raising tariffs could generate significant revenue (e.g., \$600 billion annually) to reduce other taxes, like income tax, while funding the government.
 - This paper examines whether such claims are realistic.
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2. The Laffer Curve Concept

- The paper uses the "Laffer Curve," an economic concept that describes the relationship between tax rates and tax revenue:
 - At a 0% tax rate, revenue is zero.
 - At a 100% tax rate, economic activity (in this case, trade) stops, so revenue is also zero.
 - Somewhere in between, there's a "peak" where revenue is maximized.
 - Since tariffs are a form of tax, raising them too high could reduce imports and, consequently, tariff revenue.
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3. Analysis: The Limits of Tariff Revenue

- The authors use the cModel, a global economic simulation, to analyze the impact of tariff increases on trade and revenue.
 - They account for scenarios where tariff revenue reduces the U.S. trade deficit (a goal of the Trump administration).
 - Findings:
 - In the most optimistic scenario (where \$1 of tariffs reduces the trade deficit by only \$0.25), additional tariff revenue peaks at \$500 billion.
 - In a more realistic scenario (where \$1 of tariffs reduces the trade deficit by \$0.50 or more), revenue is \$300 billion or less.
 - Compared to U.S. federal spending in 2024 (\$6.75 trillion), \$300 billion covers about 2 weeks of expenses, and \$500 billion covers about 4 weeks.
 - Thus, tariffs alone cannot realistically fund the government, which heavily relies on income taxes (\$2.43 trillion in 2024).
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4. Side Effects of Tariffs

- Higher tariffs increase the cost of imported goods, burdening U.S. businesses and consumers, especially those reliant on imported inputs, food, or clothing.

- Excessive tariffs reduce trade volume, lower economic efficiency, and harm growth.
 - The paper suggests that high tariffs could push the economy into the "downward" part of the Laffer Curve, where revenue decreases due to reduced trade.
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5. Conclusion and Policy Implications

- Tariffs cannot replace other taxes to fund the government. Current tariff revenue (\$86 billion) covers just 4 days of federal spending.
 - Overly high tariffs may reduce the trade deficit but will shrink economic activity and fail to generate expected revenue.
 - The Trump administration's reliance on tariffs could lead to economic costs like higher prices and supply chain disruptions, with limited fiscal benefits.
 - Historically, tariffs funded governments in the 19th century (e.g., the McKinley era) because government spending was smaller and income taxes didn't exist. This model doesn't work for modern, large-scale budgets.
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6. Simple Analogy

- Think of tariffs as a "special fee" at a restaurant:
 - A small fee might not deter customers (imports), but a high fee could drive them away, reducing revenue (tariff income).
 - The government's budget is like running a massive restaurant—tariffs alone can't cover the costs because the "customer base" (trade volume) is limited.
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7. Why This Paper Matters

- The Trump administration's tariff policies could significantly impact the global economy in 2025, potentially causing trade contraction and price increases (as noted in other CEPR articles).
 - This paper provides a data-driven perspective, cautioning against over-reliance on tariffs and contributing to informed policy discussions.
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References

- The full paper is available at CEPR (<https://cepr.org/voxeu/columns/tariffs-cannot-fund-government-evidence-tariff-laffer-curves>) or Global Trade Alert.
- The Laffer Curve concept is explained in detail on Wikipedia (https://en.wikipedia.org/wiki/Laffer_curve).

Let me know if you have further questions or need clarification on specific points!