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WASHINGTON POLICY STRATEGY

Potomac Perspective

Brian Gardner
Chief Washington Policy Strategist
bgardner@stifel.com



This week investors should get some clarity on tariffs. President Trump has declared Wednesday, April 2, as “Liberation Day.” Regardless of what the administration announces, investors might view it as “Clarity Day.” We caution, however, that any relief rally should be taken with a grain of salt. We expect the tariff announcement will probably be more about a restructuring of the American economy than some sort of negotiating tactic.

Congress is in a two-week sprint before the Easter and Passover break. Senate Republicans want to pass a budget resolution before they leave town and take another step towards extending the Trump tax cuts. We explain some of the hurdles that need to be cleared this week and discuss some policy decisions that await Congress, including potentially higher taxes for wealthier taxpayers.

Special elections in Florida today could also impact the upcoming tax debate. We think Republicans will keep both seats being contested, but margins matter.

- **Liberation Day** – President Donald Trump has set April 2, a day that he is calling “Liberation Day,” as the date he will announce new tariffs. The actual details of who and what will be subjected to tariffs remain elusive. This has contributed to volatility in the financial markets. Regardless of the content of Wednesday’s announcement, there could be a relief rally in equities.
 - As we noted a few weeks ago, investors seem to have focused on “tariffs as a negotiating tool” as the primary justification for new tariffs. We think, however, that is a misinterpretation of the administration’s intent. Instead, we believe the administration plans to use tariffs as a way to restructure the American economy. This is among the reasons we think it has not reacted to the recent selloff in the equity markets. This may also be why Treasury Secretary Scott Bessent uses the term “detox” when talking about the administration’s economic agenda.
 - Although the specifics are not yet known, we expect the administration will announce a series of reciprocal tariffs on countries that impose tariffs on goods at higher rates than the U.S. imposes on their imports. We think the biggest unknown is whether the administration will include value-added taxes in its calculations.
 - It is also possible the U.S might propose tariffs on imports from countries that that have trade surpluses with the U.S. (i.e., with whom the U.S. runs a trade deficit). Based on data from the Commerce Department’s Bureau of Economic Analysis, the administration might announce additional tariffs on imports from Canada, China, France, Germany, India, Israel, Italy, Japan, South Korea, Malaysia, Mexico, Switzerland, Taiwan, the United Kingdom, and Vietnam. The following countries have trade deficits with the U.S. (i.e., with whom the U.S. runs a trade surplus) and might be spared under this type of tariff: Australia, Belgium, Brazil, Hong Kong, and the Netherlands.
- **Budget Resolution and Tax Legislation**– Senate Majority Leader John Thune (R-South Dakota) is planning to hold a vote on the Senate budget resolution this week. If successful, it would allow the House to vote on the Senate’s version (which is different than the budget resolution passed by the House a month ago) before Congress breaks for the Easter and

Passover holidays. That, in turn, could keep a glimmer of hope that Congress might pass a reconciliation bill before Memorial Day. There are, however, significant hurdles to clear, and we continue to believe the reconciliation process could last into the summer or beyond.

- **Baseline Decisions** – The budget resolution Senate Republicans are considering has two features that could slow down the legislative process. First, they want to use the “current policy,” which means the baseline of the budget resolution would not have to consider the additional debt extending the Tax Cuts and Jobs Act of 2017 (TCJA) would incur. Budget resolutions historically have used “current law” as the baseline under which the budget resolution would include the additional debt caused by extending JCTA. The Senate Parliamentarian needs to decide whether “current policy” is permissible under reconciliation rules. The timing of her decision could impact the timing of a vote in the Senate on the budget resolution (which then sets off a series of dominoes on subsequent votes) and would have ramifications for the substance of the reconciliation bill. A “current law” baseline would restrict what Republicans can accomplish in the tax bill.
- **Tax the Rich** – On Friday, Axios published an article in which it reported that Republicans might allow the top individual income tax rate to reset after 2025 while keeping other tax rates low. This should not be surprising for several reasons. First, regardless of which baseline is adopted by the budget resolution, Republicans will face some constraints on the budget math as they seek to not only extend JCTA but also provide relief from the cap on the State and Local Tax deduction. There is also interest in exempting income from tips, overtime, and Social Security from federal taxes. Offsets will have to come from somewhere, and there are limited options. Also, the optics of cutting Medicaid spending while also voting to keep lower tax rates for the wealthy are not good. The Republican base has become more working class, and there are fewer Republican voters who would prioritize tax cuts for wealthier workers. Decisions have yet to be made regarding the top tax bracket, but allowing the top rate to reset has long been an underappreciated option.
- **Special Elections** – Florida will hold a pair of special elections today to fill the vacant seats previously held by former Representatives Mike Waltz (R) and Matt Gaetz (R). The two Republicans won their seats in November 2024 by 33 points and 32 points, respectively. Republicans have been somewhat panicked about the race to replace Mr. Waltz. Polls have shown a surprisingly close race, and many think the Republican candidate has run a weak campaign. We expect Republicans will win both races, but we will be interested in the margins.
 - In several special elections to fill vacancies in state legislatures, there have been notable shifts towards Democrats and away from Republicans. This should not be surprising since Democrats have regularly performed well in special elections over the past few years. We attribute this to the makeup of the two parties. The Republican base now includes many “low-propensity” voters who vote only in presidential elections and less frequently in off-year elections (i.e., special elections). At the same time, the Democratic base has a larger group of “high-propensity” voters who vote regularly even in off-year and special elections. Democrats have a built-in advantage in special elections.
 - We expect Republican lawmakers will take note of the results and of the margins as they try to interpret what this week’s vote could portend for them in the 2026 midterm elections and how they need to position themselves going into those races. The Florida special elections could also impact how some Republicans handle the upcoming reconciliation debate even if Republicans hold both seats, as we expect.

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