TARIFFS

Tariffs, a trade mechanism favored a century ago, are in the news today. Basically, tariffs are being discussed because former President Trump has called himself the "tariff man" and postulated that tariffs bring in so much money from other countries that it could eliminate the need for income taxes. In essence, he argues that tariffs are the answer to fiscal woes and world peace, all at the expense of other countries.

Of course, those claims are false. But we'll start with what Trump specifically claims and then how tariffs work.

TRUMPS TARIFF PROPOSALS:

Some key points about Donald Trump's quotes and proposals for tariffs if he is reelected:

- Universal tariff: Trump has proposed a 10% tariff on all imports.
- China-specific tariff: He wants to impose a 60% tariff on all imports from China.
- Escalating tariffs: Trump has threatened even higher tariffs in some cases, such as a 100% tariff on Mexican-made goods and a 200% tariff on **John Deere** exports from Mexico to the US.
- Mexico specific tariffs: Proposed a Mexican-made goods with 100% tariffs, a move that would risk blowing up a trade deal that Trump's own administration negotiated with Canada and Mexico.
- Tariffs as a cure-all: Trump sees tariffs as a solution for many issues, claiming they will revitalize the US auto industry, make childcare affordable, maintain the dollar's status as the world's reserve currency, and even stop wars.
- Economic impact: Trump believes tariffs will create more factory jobs, shrink the federal deficit, lower food prices, and allow the government to subsidize childcare.
- Tariffs as leverage: He views tariffs as a tool to pressure other countries on various issues, not just trade-related ones.
- Enthusiasm for tariffs: Trump has called tariffs "the greatest thing ever invented" and refers to himself as a "tariff man."
- Ease of implementation: Trump claims he can implement tariffs with just "a phone call."

- Replacing income tax: In June 2024, Trump floated the idea of fully replacing the income tax with tariffs, though economists argue this is not feasible.

Trump insists that tariffs are paid for by foreign countries. In fact, it is importers — American companies — that pay tariffs, and the money goes to U.S. Treasury. Those companies, in turn, typically pass their higher costs on to their customers in the form of higher prices. That's why economists say consumers usually end up footing the bill for tariffs. Economists generally consider tariffs self-defeating. Tariffs raise costs for companies and consumers that rely on imports. They're also likely to provoke retaliation.

Trump Tariffs Would Raise Rates to Great Depression-Era Levels (taxfoundation.org)
Harris calls Trump's tariff proposals a 'sales tax on the American people' (nbcnews.com)
Trump favors huge new tariffs. How do they work? | PBS News
Trump Tariffs Could Cost US $800 per Person Annually Says Top Economist - Newsweek

The Basics of TARIFFS & TRADE WARS:

Definitions:

Some of Trump's proposals can be more accurately described as a Trade War. He aims to pressure specific countries to extract behaviors unrelated to trade. His tariffs target all products from a specific country, rather than specific products to protect American industries such as steel or computer chips. Additionally, some of his proposals contradict trade agreements previously negotiated under his administration. For instance, his proposed tariffs on Mexican and Canadian goods directly run afoul of the trade deals signed by him to replace NAFTA.

A tariff and a trade war are related concepts in international trade, but they have distinct differences.

> **Tariff:** A tariff is a specific type of trade policy or tool. It is a tax imposed on imported goods by a country. Tariffs are typically used to protect domestic industries by making foreign products more expensive. They can be applied selectively to specific products or countries.
>
> **Trade War:** A trade war, on the other hand, is a broader economic conflict. It occurs when countries retaliate against each other by imposing trade barriers, often escalating over time. Trade wars usually involve multiple protectionist measures, not just tariffs. Increased protection causes nations' output compositions to move towards their autarky position. Can escalate to full conflict. Trade wars have historically led to escalated conflicts and significant changes in trade and territorial control.

Key Differences Between the Two:

Scope - a tariff is a single policy tool, while a trade war is a larger economic conflict involving multiple measures.

Economic Impact - While tariffs affect specific industries or products, trade wars can have broader economic consequences, potentially impacting GDP, employment, and international relations.

In essence, tariffs are a tool that can be used in a trade war, but a trade war encompasses a wider range of economic actions and retaliations between countries.

The Basics of Tariffs and Trade Barriers (investopedia.com)
Trade wars, Trump tariffs and protectionism explained (bbc.com)
US trade: Is Trump right about the deficit? (bbc.com)

Who Collects a Tariff?

In simplest terms, a tariff is a tax. It adds to the cost borne by consumers of imported goods and is one of several trade policies that a country can enact. Tariffs are paid to the customs authority of the country imposing the tariff.

Tariffs on imports coming into the United States, for example, are collected by Customs and Border Protection, acting on behalf of the Commerce Department.

It is important to recognize that the taxes owed on imports are paid by domestic consumers and not imposed directly on the foreign country's exports. The effect is nonetheless to make foreign products relatively more expensive for consumers, but if manufacturers rely on imported components or other inputs in their production process, they will also pass the increased cost on to consumers.

The Basics of Tariffs and Trade Barriers (investopedia.com)

Tariffs' Impact on Consumer Prices:

Tariffs have a significant impact on consumer prices, generally leading to higher costs for goods. Here's how tariffs affect consumer prices:

Direct Price Increases

- Tariffs are taxes imposed on imported goods, which directly increases their cost

- These increased costs are often passed on to consumers in the form of higher retail prices.
- For example, when tariffs were imposed on washing machines, prices increased by $86 per unit.

Domestic Price Effects

- Even domestically produced goods can become more expensive due to tariffs
- When imported goods face tariffs, domestic producers may raise their prices as well, taking advantage of reduced competition
- This effect can be seen across entire industries, such as when U.S. steel producers raised prices following tariffs on imported steel.

Broader Economic Impact

- Tariffs can lead to inflation by increasing prices across multiple sectors.
- The overall effect can be significant – one study estimated that Trump-era tariffs increased annual costs for U.S. households by $200 to $300 on average
- Another analysis suggested that tariffs could raise the inflation rate by about 3/4 percentage point relative to the baseline.

Consumer Choice and Substitution

- Higher prices due to tariffs may force consumers to switch to less desirable alternatives or reduce consumption.
- This can result in a loss of consumer choice and potentially lower quality goods being purchased.

Long-term Effects

- Over time, tariffs can reduce economic efficiency and productivity, potentially leading to job losses and further economic impacts that affect consumer purchasing power.
- They can also inhibit innovation, which may result in fewer new products and technologies reaching consumers.

In summary, tariffs typically result in higher prices for consumers, both directly through increased costs of imported goods and indirectly by allowing domestic producers to raise prices. These effects can be widespread, impacting not just the targeted products but entire industries and the broader economy.

Tariffs Are Great – If You Like Raising Prices, Undermining Jobs, and Inhibiting Innovation | George W. Bush Presidential Center (bushcenter.org)
What Are Tariffs? | Council on Foreign Relations (cfr.org)
The Basics of Tariffs and Trade Barriers (investopedia.com)

Are Tariffs Against Countries an Effective Positive Tool?

Tariffs are generally not considered an effective positive tool for economic growth or job creation in the long run. While tariffs may provide some short-term benefits to specific protected industries, their overall economic impact tends to be negative:

- Higher consumer prices: Tariffs typically lead to increased prices for imported goods and allow domestic producers to raise prices, reducing consumer purchasing power.
- Job losses in other sectors: While tariffs may create some jobs in protected industries, they often lead to more job losses in industries that use tariffed goods as inputs. For example, tariffs on steel and aluminum were estimated to create 1,000 jobs in steel production but result in 75,000 fewer jobs in steel-using industries.
- Reduced economic growth: Many economists argue that tariffs act as an economic drag. A Tax Foundation analysis estimated that Trump-era tariffs would reduce long-run GDP by 0.2% and result in 142,000 fewer full-time equivalent jobs.
- Decreased productivity and innovation: Tariffs can reduce competition, leading to complacency among protected industries and decreased incentives to innovate.
- Retaliation and trade wars: Imposing tariffs often leads to retaliatory measures from other countries, harming export-dependent industries and potentially escalating into broader trade conflicts.
- Inefficient resource allocation: Tariffs can distort market signals, leading to inefficient allocation of resources as businesses adjust to artificial price changes rather than true market conditions.

While some argue that tariffs can help protect infant industries or address unfair trade practices, most economists believe that the overall costs outweigh the benefits. Alternative policies, such as investing in education, infrastructure, and research and development, are generally considered more effective for improving economic competitiveness and creating jobs.

It's worth noting that there is some debate on this issue, with some economists and policymakers arguing for strategic use of tariffs in certain situations. However, the predominant view among economists is that free trade and lower tariffs are more beneficial for overall economic growth and prosperity in the long run.

What Are Tariffs? | Council on Foreign Relations (cfr.org)
Tariffs: What are they, who pays for them and who do they benefit? (usc.edu)
What Are Tariffs, and How Do They Affect You? (investopedia.com)

Long-Term Effects of Tariffs on Domestic Businesses:

The long-term effects of tariffs on domestic businesses are generally negative, despite some short-term benefits for certain industries. Here's an overview of the key long-term impacts:

Reduced Competitiveness
- Tariffs can lead to complacency among protected domestic industries, reducing their incentive to innovate and improve efficiency.
- Over time, this lack of competition can make domestic businesses less competitive in global markets.

Higher Input Costs
- Many businesses rely on imported materials or components for their production processes.
- Tariffs increase the cost of these inputs, leading to higher production costs and potentially lower profit margins.

Decreased Productivity
- The inefficiencies created by tariffs can result in lower overall productivity in the economy.
- This can slow economic growth and limit opportunities for business expansion.

Loss of Export Markets
- Retaliatory tariffs from other countries can reduce export opportunities for domestic businesses.
- This can lead to decreased sales and market share in international markets.

Reduced Innovation
- Resources that could be used for research and development may instead be diverted to cope with higher costs or reduced revenues.
- This can inhibit the emergence of new products, services, and industries.

Job Losses
- While some industries may initially benefit from tariff protection, the overall effect on employment is often negative.
- The Tax Foundation estimated that Trump-era tariffs would lead to a loss of 142,000 full-time equivalent jobs in the long run.

Supply Chain Disruptions

- Tariffs can force businesses to restructure their supply chains, which can be costly and time-consuming.
- This can lead to inefficiencies and reduced flexibility in responding to market changes.

Reduced Investment

- Uncertainty created by trade tensions can lead to delayed or reduced business investment.
- This can slow economic growth and limit business expansion opportunities.

In summary, while tariffs may provide short-term protection for some industries, their long-term effects on domestic businesses are largely detrimental. They can lead to reduced competitiveness, higher costs, decreased innovation, and overall economic inefficiency, ultimately undermining the very industries they were intended to protect

Tariffs as a Major Revenue Source: Implications for Distribution and Growth | CEA | The White House
Trump Tariffs & Biden Tariffs: Economic Impact of the Trade War (taxfoundation.org)
Tariffs Are Great – If You Like Raising Prices, Undermining Jobs, and Inhibiting Innovation | George W. Bush Presidential Center (bushcenter.org)

Tariffs and Increased Conflict Historically:

While tariffs themselves do not always directly lead to war, they have historically contributed to increased tensions between nations and, in some cases, played a role in escalating conflicts. Tariffs can contribute to economic instability, international tensions, and deteriorating diplomatic relations. These factors, in turn, can increase the risk of broader conflicts. The historical record shows that aggressive protectionist policies often lead to retaliation and escalation, potentially creating conditions that make military conflicts more likely.

Historical examples where tariffs and trade disputes contributed to increased tensions and conflicts between nations:

- The American Revolution: British trade policies and tariffs that restricted American economic growth were a contributing factor to the tensions that led to the American Revolution.
- The American Civil War: Disagreements over tariff policies between Northern and Southern states were one of the factors that heightened tensions leading up to the Civil War.
- The Opium Wars (1839-1860): These conflicts began after China imposed trade restrictions and confiscated British opium, leading to military intervention by Britain.

- German-Polish Customs War (1920s-1930s): The Weimar Republic increased tolls on Polish coal and steel products in an attempt to force Poland to give up territory. Poland retaliated by increasing toll rates on German products, leading to economic tensions.
- The Great Depression and World War II: The Smoot-Hawley Tariff Act of 1930 dramatically increased U.S. tariffs, leading to retaliatory measures from other countries. This tariff war exacerbated the Great Depression, with world trade declining by about 66% between 1929 and 1934. The resulting economic instability and international tensions are often cited as contributing factors to the outbreak of World War II.
- Anglo-Irish Trade War (1932-1938): This trade dispute between the United Kingdom and the Irish Free State involved the imposition of tariffs and other trade restrictions, contributing to tensions between the two nations.
- U.S.-Japan Trade Tensions (1980s-1990s): While not leading to military conflict, trade disputes and tariffs between the U.S. and Japan in the automotive and electronics sectors created significant diplomatic tensions.

These examples illustrate that while tariffs alone rarely directly cause wars, they can contribute to economic instability, international tensions, and deteriorating diplomatic relations. These factors, in turn, can increase the risk of broader conflicts or exacerbate existing geopolitical tensions.

Trade war - Wikipedia
History of tariffs in the United States - Wikipedia
Tariff War: What It Means, Effect, History (investopedia.com)