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What are tariffs and are they good or bad?

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The word tariff (the most beautiful word in the dictionary according to the US President Elect) relates to a tax or duty imposed by a government on imported or exported goods. They are typically used to regulate trade, protect domestic industries, and generate government revenue. Tariffs can either increase the price of foreign goods, making them less competitive compared to local products, or provide an incentive for domestic production by discouraging imports. Tariffs can vary based on the type of product and the trading relationship between countries. They are one of the key tools used in international trade policy.

Looking back, the average global tariff rate was around 30% in the early 1970s, with the number of trade tariffs varying significantly by region and industry. Over time, international trade agreements like the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO) have worked to reduce tariffs globally to increase cross-border trade and reduce prices globally. Today, the average global tariff rate is much lower at around 7-10%.

In practice, tariffs come with both visible and hidden effects, which can benefit or harm economies and consumers in various ways. The benefits include:

1. Protecting Local Businesses:

One of the main advantages of tariffs is that they help protect domestic industries from foreign competition. By making imported goods more expensive, tariffs encourage consumers to buy local products. This can benefit emerging industries and preserve jobs in key sectors, such as manufacturing and agriculture.

2. Revenue for Governments:

Tariffs are also a way for governments to raise money. In some countries, especially those with limited tax systems, tariffs provide vital income that can fund public services, infrastructure, and social programs.

3. Leverage in Trade Talks:

Tariffs can also be used as a tool in international trade negotiations. When a country imposes a tariff on a particular good, it can push other countries to reduce their own trade barriers or to make other concessions in exchange for tariff reductions.

There are significant negative implications of imposing tariffs on your trading partners, however. The primary drawback is that they lead to higher prices for consumers as imported goods become more expensive, and they can cause domestic producers to raise their prices as well, raising domestic inflation.

Other negative implications include tit-for-tat retaliation by other countries (more commonly referred to as a trade war) which can hurt businesses that rely on exporting to international markets. While tariffs protect domestic industries in the short term, they can also reduce competition. When companies don't face foreign competition, they may have less incentive to innovate, improve quality, or reduce prices. Over time, this can harm the overall economy by slowing down progress and reducing productivity.

In reality, tariffs can help protect local industries and generate government revenue, but the net impact of tariffs, both positive and negative, depends on the specific industries targeted and the broader economic environment, making it important to carefully weigh the pros and cons before implementing or responding to them.

In a world which desperately needs higher growth with stable and controlled inflation after a decade of below trend growth and falling productivity, increased tariffs are not a welcome development.

The US may benefit from increased tariffs against its peers in the short term, however, in the longer run, the global economy will be smaller. This will likely lead to higher prices than would have otherwise been the case for us all. In response, other countries will need to find ways to stimulate their economies to offset the lost trade over the coming four years or risk another decade of poor growth outcomes for their populations.