Clayton W. Caldwell

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Policy in a Global Economy

Pipe Dream or Callous Waste of Capital? The Impacts of Tariffs on Global Economics

The Trump administration’s strong tariff policies received considerable political and economic attention, and with good reason. The complexity of modern global supply chains means that US tariff policies could greatly influence the world economy. Trump regularly claimed his tariff stance was to protect American workers, but do tariffs really help domestic workers or industries? An analysis of the impacts of the Trump administration’s tariff policies show that tariffs may benefit specific domestic producers but certainly hurt domestic consumers and leave the global economy worse.

In theory, a tariff could benefit the US if the US is sufficiently large to force importers to reduce their prices by the amount of the tariff. This prevents consumers from absorbing the full costs of the tariff.[[1]](#endnote-1) In this scenario, foreign exporters lower prices to stay in the US market and their producer surplus falls. Meanwhile, domestic producers see increased producer surplus due to a lack of competition via reduced imports.[[2]](#endnote-2) Consumer surplus falls due to having reduced access to import varieties and paying higher domestic prices.[[3]](#endnote-3) However, if the government is able to allocate funding to social welfare benefits equal to the total cost of the tariffs, then consumers will benefit from the tariff and US welfare will increase overall.[[4]](#endnote-4)

Tariff costs to US producers and consumers are particularly high for intermediary products. As Mary E. Lovely puts it, the products subject to the Trump administration’s tariff policies are mostly inputs used in American production.[[5]](#endnote-5) When intermediate products imported to the US are subject to a tariff, the cost of this tariff acts as a tax to domestic producers.[[6]](#endnote-6) This drives down both producer and consumer surplus because prices for those goods rise to accommodate the price of the tariff. The importer increases prices by roughly the amount of the tariff, which means domestic consumers pay more for the same product and consume less of it.[[7]](#endnote-7)

Exporters today are increasingly reliant on international supply chains to remain competitive.[[8]](#endnote-8) When those supply chains are disrupted by a tariff, their production is handicapped because the tariff is added to their own production costs. This pressure can force US firms offshore to avoid raising their own export prices and reducing their competitiveness. One example of this would be Harley Davidson, which moved motorcycle production to Thailand to avoid these costs when selling to European markets.[[9]](#endnote-9) In addition to driving producers out of the US, this creates enormous supply shifts in global supply chains and this can cause significant economic losses. An additional impact comes from retaliatory tariff policies which would be placed on additional US exporters. While these do not seem to influence US export prices, the impact of the tariff falls onto foreign consumers just as the cost of American tariffs fall onto the shoulders of American consumers. The end result is a reduction in global consumption.[[10]](#endnote-10)

The theoretical benefits of imposing a tariff rely on the ability to force foreign exporters to reduce their prices to accommodate the tariff.[[11]](#endnote-11) By driving down imports, domestic producers can sell at higher prices while consumers are forced to pay higher prices for these goods. If the US government can invest the revenues gained from the tariff into social welfare programs, consumers will be effectively paying higher prices in exchange for greater welfare benefits. However, this is only possible in a market which is sufficiently price inelastic. If prices are too elastic, then foreign producers can simply raise their prices in response to the tariff or sell their goods elsewhere.[[12]](#endnote-12) Finally, crucial to the benefits of tariffs is that the exporting nation does not retaliate as retaliatory trade policies can eliminate any potential tariff benefits.

Most of the market was surprised at Trump’s presidential victory, expecting Hillary to win and banking on her economic policies instead.[[13]](#endnote-13) Because of this, it is likely that his tariff policies were an unpleasant surprise in many industries. The United Steelworkers Union, for instance, complained that “the Administration’s trade policies have led to confusion, higher trade deficits and no real success in changing the practices of our trading partners.”[[14]](#endnote-14) The lack of confidence in the US market and continued tariffs between the US and China mean that entering the Chinese market is harder for domestic producers and exporting to the US less desirable for many firms worldwide. The economic impact in this regard is difficult to measure but is likely to have impacts for years to come.[[15]](#endnote-15)

Trump’s tariffs have negatively impacted US overall wellbeing because they failed to meet the numerous conditions necessary to produce clear tariff benefits. Import prices in affected industries have mostly risen by tariff amounts and this suggests tariff costs were passed down to domestic consumers.[[16]](#endnote-16) Given that exporter prices meanwhile stayed largely constant, it suggests that the price elasticity of the affected goods was much too high for the tariffs to raise sufficient revenues to benefit US consumers.[[17]](#endnote-17) In some cases, such as tariffs on imported washing machines, the revenues raised were far and away exceeded by the costs of the tariff borne by consumers.[[18]](#endnote-18) This is further shown by the rise of imports in other nations while US imports declined, further suggesting that the market was elastic enough for foreign exporters to simply do business elsewhere.[[19]](#endnote-19) Data also show that China’s retaliatory tariffs cost US exporters about $2.4 billion per month in lost exports in 2018.[[20]](#endnote-20) Meanwhile, the cost to consumers amounted to roughly $12.3 billion in 2018 and was accompanied by an additional deadweight loss of $6.9 billion. However hopeful the Trump administration may have been when enacting such harsh tariff policies, the inability of the US economy to meet the steep requirements necessary to see any real benefit from tariffs has caused them to do much more harm than good.

**Notes**

1. Amiti, M., Redding, S., and Weinstein, D. “The Impact of the 2018 Trade War on U.S. Prices and Welfare.” (2019). *National Bureau of Economic Research.* Pg. 9. [↑](#endnote-ref-1)
2. Ibid, pg. 20. [↑](#endnote-ref-2)
3. Ibid, pg. 16 [↑](#endnote-ref-3)
4. Ibid, pg. 13. [↑](#endnote-ref-4)
5. Lovely, M. and Liang, Y. “Trump Tariffs Primarily Hit Multinational Supply Chains.” (2018). *Peterson Institute for International Economics.* Pg. 2. [↑](#endnote-ref-5)
6. Ibid, pg. 7. [↑](#endnote-ref-6)
7. Amiti, Pg. 6. [↑](#endnote-ref-7)
8. Lovely, pg. 8. [↑](#endnote-ref-8)
9. Bown, C. “There Is Little Dignity in Trump’s Trade Policy.” (2020). *Foreign Affairs*. [↑](#endnote-ref-9)
10. Amiti, pg. 15. [↑](#endnote-ref-10)
11. Ibid, pg. 9. [↑](#endnote-ref-11)
12. Ibid, pg. 10. [↑](#endnote-ref-12)
13. Ibid, pg. 2. [↑](#endnote-ref-13)
14. Bown, 2020. [↑](#endnote-ref-14)
15. Bown, 2020. [↑](#endnote-ref-15)
16. Amiti, pg. 6. [↑](#endnote-ref-16)
17. Ibid. [↑](#endnote-ref-17)
18. Flaaen, A., Hortaçsu, A., Tintelnot, F. “The Production Relocation and Price Effects of U.S. Trade Policy: The Case of Washing Machines.” (2019). *National Bureau for Economic Research.* Pg. 4 [↑](#endnote-ref-18)
19. Ibid, pg. 7. [↑](#endnote-ref-19)
20. Ibid, pg. 14. [↑](#endnote-ref-20)