U.S. Tariffs Unlikely to be Beneficial
By Byron A. Ellis – March 27, 2018

A tax on an imported good is a tariff. Businesses losing market share due to imports often petition their government to impose a tariff on imports. A tariff, however, raises the relative domestic price above the relative world price by the amount of the tariff, making the good more profitable for the inefficient businesses and costlier to domestic consumers. When the domestic relative price of the good is higher than the relative world price, the industry production process is inefficient.

The effect of the tariff on the country that incurs it depends on the quantity of the targeted commodity exported to the country applying the tariff, its elasticity and the demand for the commodity in the world market. That is, the effect depends on whether the country imposing the tariff consumes a lot of the targeted commodity. If the amount consumed is small, the tariff is unlikely to influence world prices or the targeted country.

However, if the country imposing the tariff consumes large quantities of that commodity and the exporting country has no other viable markets, the relative world price and the quantity exported by the targeted country would fall, adversely affecting the exporting country. But, if the exporting country has other markets or the amount exported is small, the relative world price and exported quantities would not be significantly affected, only the relative domestic price in the country imposing the tariff would rise.

If the country or countries that the tariff is applied against retaliate by imposing tariffs of their own on high export products of the country that first imposed the tariff, their actions would reduce demand and world prices for those goods, as well as for all the inputs that contribute to the production of the retaliated goods. For instance, China buys significant amount agricultural and meat products from the United States; if they retaliate against U.S. tariffs by imposing tariffs on high volume goods that the U.S. exports to China, the loss to American farmers and farming supply chain could be significant. Moreover, the relative domestic and world prices for the targeted U.S. products are likely to fall, adversely affecting the income of U.S. agricultural producers and their support chain.

China is unlikely to suffer any domestic pricing consequences from imposing agricultural tariffs on the U.S. and might even benefit from lower relative world prices, since South American countries can supply them with agricultural products.

Tariffs lead to inefficient production and consumption, since domestic prices rise relative to world prices. Layard and Walters (1978) argued that if the tariffed commodity is labor-intensive, any rise in the relative price makes capital worse off and labor better off. But, they noted that even making labor better off would not constitute an argument for tariffs. They also noted that some governments will argue that tariffs are needed for national defense, but even in the case of national defense, tariffs cannot be justified if alternative instruments are politically feasible.