Diagram 1: demand curve essay sample

Business, Customers

Import Tariffs

Introduction

Sloman and Wards (2007, p23) define tariffs as the taxes imposed by the government on the imported goods. In most nations of the world, the tariffs on the imported goods have always been hiked in favor of the locally manufactured goods. When the imported goods get to be highly taxed by the native government, their prices are increased to counteract the high cost of importation. This has always left the domestic goods relatively cheaper and thus high demand from the customers. The imported goods on the hand suffer at this expense; their cost lowers their demand. The government is at the centre of benefit. The revenues collected from the import duties are usually converted to incentives for the local industries that enjoy the protected monopoly. Below is a simple diagram illustrating how price and demand correlates.

Price domestic supply

pt

pt*

Domestic demand

DD*

Quantity

Increase in price lowers the demand and supply of a commodity. Decrease in price raises the demand and supply. Therefore increase in the prices of the imported goods will certainly lower the demand. This closes the doors of

markets to such goods. The consumers are also affected by the increase in the prices Weber (2000, p56).

According to Griffth and Wall (2006, p345) different countries of the world have different minimum wages. Countries with very high population of jobless men and women will certainly provide a very quick and cheap manpower to the industries. Some countries can easily access the raw materials for a certain product while others will use a lot of money to obtain the same materials. This creates the difference in the market prices of the same commodities which have dissimilar origins. The high import tariffs have been a deliberate measure by the government to protect its economy by promoting the local industries. Low tax on the imports would see the local goods lack market as that would pose a very stiff competition. The imports duties also serve to protect the local agriculture. If a government allows the importation of cheap farm products then its agriculture may come to a halt. However, the taxation on such goods has always depended on the country of origin and also the type of the goods. If a government wants to promote a mutual business with another country, it will tend to lessen the import tax on the goods from that country. This is a form of a custom union. For example, the import duties are not charged on products traded between the European Union member states. This is usually aimed at promoting the bilateral trade among such states. It opens up a wide market for the member state goods. In essence, the amount of imports in a country will depend on the level of protection. The World Trade Organization, WTO, however advocates for less trade barriers among all the nations. According to the WTO (2003, p21),

complete removal of the custom tariffs will benefit all the consumers. The demand will rise and the supply increase.

Tariff models and analysis

In this analysis of the import duties, the following points shall be considered:

- Tariffs benefit the domestic industries at the expense of the foreign industries

- Removal of the tariffs benefits both the domestic and the foreign industries

- A custom union without the lowest cost producers may not always benefit its consumers

Here is a look at the partial equilibrium model:

Diagram 2: Equilibrium model

Domestic supply

Price

P1

World supply

A B

Quantity

The thick line is for the domestic country and ‘ A’ is the amount of the goods it supplies while ‘ B’ is the amount consumed with the country. To get the total amount of the import in the above country, one has to get the difference between B and A. P1 is the price per unit of the commodities paid with the country. ‘ A’ and B are the amounts of these commodities. At this stage, no tariff has been introduced yet. The domestic goods decrease in both demand and supply of the goods. At the common price p1, the

domestic supply is at A while the foreign supply is B. The reason to this is that, since there is still no tariff, import goods increase in native country Begg (2007, p21). After the exposure to tariff, here is how the diagram looks:

Diagram 3: Demand curves with the tariff

Domestic supply

Price

P2

P1

World supply

A C K B

Quality

The amount of supply by the local producer is the ‘ C’ while ‘ K’ is the size of the goods consumed in the country. The difference between ‘ K’ and ‘ C’ is the total size of the importation. With the introduction of the tariffs, new prices are set. There is a shift from p1 to p2. This in turn affects both the demand and supply of the goods. The domestic businesses are beginning to peak as the foreign companies start to lose ground. At the new price p2, the demand of the local commodities increases from A to C while the demand of the foreign goods reduces from B to K. The probable reason to this could be that the imported goods have suddenly become more expensive than the domestic goods. Since the government has imposed heavy tax on the importation, the foreign companies must transfer the cost to the consumers hence a hike in prices of such commodities. Customers react by ditching such goods and seek for alternatives, which are the locally manufactured

goods.

Note that the government introduces the tariff p2 – p1 to protect the domestic producers. Through this, it is able to generate revenues and may offer more incentives to the local industries. As the gap between p2 and p1 expands, foreign producers tend to lose more customers and the supply also diminishes. The customers on the other hand will have to buy the very goods at higher prices than the previous ones. The domestic producers now start to gain monopoly.

Sometimes a government may decide to join a customs union and thus abolish the protective tariffs. This analysis will try to establish who benefits and who loses in such a case, in an attempt to prove that the domestic businesses actually benefit at the expense of the foreign businesses. Below is the ideal diagram of demand and supply while the tariffs are still in place. When the tariff is dropped, the four regions of the diagram have different significance on both the producers and the consumers.

Diagram 4: Demand curves after the Tariff

Domestic supply

Price

P2 1 2 3 4

P1

World supply

A C KB

Quantity

These four regions are marked by figure 1, 2, 3 and 4 as shown above. Let us analyze each region separately:

- This is the area which has been lost by the producers after elimination of the tariff. As discussed before, both the producers were selling their goods at relatively higher prices when the tariff still existed. The price had hiked from p1 to p2. The consumers are the gainers of this very area. The foreign producers will likely to restore their previous cheaper prices and the domestic producers must also try to offer competitive prices in response. The greatest loser here seems to be the domestic producer. Its commodities are at risk of losing the market again due to dumping by the many foreign producers.
- It is the consumers again who the gainers in this region are. This is the region where the importation of the cheaper goods comes to play again. This area is also referred to as the welfare gain area.
- In the area 3, the government loses its revenue. These were the revenue obtained from the tariffs. Even though their government suffers a loss, the consumers do not seem to be much bothered since they will now have much money in their own pockets by paying less money for the goods. However, the government may no longer offer the incentives and the subsidies as it used to.
- This is referred to as the welfare gain area. This is because of the gain from the lowered prices of the goods. Therefore, both region 2 and 4 are considered as welfare gains.

This is a clear evidence that with the protective tariffs on, the domestic producers from the custom duties at the expense of the domestic consumers. But who really matters to the government? Is it the domestic

consumer or the domestic producers? That triggers another challenging decision to be made by the government: joining the custom union with all the countries.

Custom union has both welfare gain and the lowest cost producer benefits. The welfare gains shall benefit the member state countries. If the custom union has no lowest cost producers, the consumers of the member states are not likely to benefit from such a union. The custom unions are only beneficial where they are indeed complementary. It should not be politicized but should be purely economical. If the initial custom duties were higher on the import member states, the custom union is more likely to increase the welfare of the economy in the involved states. The production effects of a custom union will be of more benefits if the tariffs to other non-member states are also lowered. Lastly, a custom union shall raise welfare more if the quantity and consumption of the world production is larger.

The above goals are what are sought by the WTO today. The WTO is another custom union on its own. It has over past years seen the European Union achieve some the goals. The EU forms a very large market for the member states thus breeds more profit for the research and development.

Conclusion

The import tariffs have their benefits but also have their disadvantages. The benefits only favor the native government. The businesses that trade on the importation of the foreign goods are subjected to high taxation. This is clear evidence that the tariffs on the imports only benefit the domestic industries.

Recommendation

The abolishment of the import tariffs clearly has a common welfare gain; both to the government and to the consumers. This will certainly benefit the businesses that deal in the imports as well. Therefore every nation should consider a total abolishment of the tariffs and open up the free markets as demands the World Trade Organization. Very low or no import tariffs at all will definitely improve a country's economy through the attraction of more foreign investors.

Reference list:

Begg, D et al 2008, Economics

Greg, R & Joe, W 2000, Economics in the 21st Century

Griffth, A & Wall, S 2006, Economics fro Business Management

McDowell, M et al, 2006, Principles of Economics

Sloman &Wards 2007, Essentials of Economics

World Trade Organization 2000, Custom Unions

Charles, W 2013. The Global Economy Journal: International Trade Retrieved from www. degruyter. com/view/j/gej

Esther, D 2012, American Economic Journal: Applied Economic Retrieved from www. aeaweb. org/aej

Wander, K 2011, Economics: Import Tariffs in the United States of America

World Trade Organization, 2010, The European Union Economic Strategies