

2.4: Understanding Tariffs

Learning Objectives

After reading this section, students should be able to ...

1. Learn the different methods used to assess a tariff.
2. Measure, interpret, and compare average tariffs around the world.

The most common way to protect one's economy from import competition is to implement a tariff: a tax on imports. Generally speaking, a tariff is any tax or fee collected by a government. Sometimes the term "tariff" is used in a nontrade context, as in railroad tariffs. However, the term is much more commonly used to refer to a tax on imported goods.

Tariffs have been applied by countries for centuries and have been one of the most common methods used to collect revenue for governments. Largely this is because it is relatively simple to place customs officials at the border of a country and collect a fee on goods that enter. Administratively, a tariff is probably one of the easiest taxes to collect. (Of course, high tariffs may induce smuggling of goods through nontraditional entry points, but we will ignore that problem here.)

Tariffs represent the primary way in which countries either liberalize trade or protect their economies. It isn't the only way, though, since countries also implement subsidies, quotas, and other types of regulations that can affect trade flows between countries. When people talk about trade liberalization, they generally mean reducing the tariffs on imported goods, thereby allowing the products to enter at a lower cost. Since lowering the cost of trade makes it more profitable, it will make trade freer. Complete elimination of tariffs and other barriers to trade is what economists and others mean by free trade. In contrast, any increase in tariffs is referred to as protection or protectionism. Because tariffs raise the cost of importing products from abroad but not from domestic firms, they have the effect of protecting the domestic firms that compete with imported products. These domestic firms are called import competitors.

There are two basic ways in which tariffs may be levied: specific tariffs and ad valorem tariffs. A specific tariff is levied as a fixed charge per unit of imports. For example, the U.S. government levies a \$0.51 specific tariff on every wristwatch imported into the United States. Thus, if one thousand watches are imported, the U.S. government collects \$510 in tariff revenue. In this case, \$510 is collected whether the watch is a \$40 Swatch or a \$5,000 Rolex.

An ad valorem tariff is levied as a fixed percentage of the value of the commodity imported. "Ad valorem" is Latin for "on value" or "in proportion to the value." The United States currently levies a 2.5 percent ad valorem tariff on imported automobiles. Thus, if \$100,000 worth of automobiles is imported, the U.S. government collects \$2,500 in tariff revenue. In this case, \$2,500 is collected whether two \$50,000 BMWs or ten \$10,000 Hyundais are imported.

Occasionally, both a specific and an ad valorem tariff are levied on the same product simultaneously. This is known as a two-part tariff. For example, wristwatches imported into the United States face the \$0.51 specific tariff as well as a 6.25 percent ad valorem tariff on the case and the strap and a 5.3 percent ad valorem tariff on the battery. Perhaps this should be called a three-part tariff!

As the above examples suggest, different tariffs are generally applied to different commodities. Governments rarely apply the same tariff to all goods and services imported into the country. Several countries prove the exception, though. For example, Chile levies a 6 percent tariff on every imported good, regardless of the category. Similarly, the United Arab Emirates sets a 5 percent tariff on almost all items, while Bolivia levies tariffs either at 0 percent, 2.5 percent, 5 percent, 7.5 percent, or 10 percent. Nonetheless, simple and constant tariffs such as these are uncommon.

Thus, instead of one tariff rate, countries have a tariff schedule that specifies the tariff collected on every particular good and service. In the United States, the tariff schedule is called the Harmonized Tariff Schedule (HTS) of the United States. The commodity classifications are based on the international Harmonized Commodity Coding and Classification System (or the Harmonized System) established by the World Customs Organization.

Measuring Protectionism: Average Tariff Rates around the World

One method used to measure the degree of protectionism within an economy is the average tariff rate. Since tariffs generally reduce imports of foreign products, the higher the tariff, the greater the protection afforded to the country's import-competing industries. At one time, tariffs were perhaps the most commonly applied trade policy. Many countries used tariffs as a primary source of funds

for their government budgets. However, as trade liberalization advanced in the second half of the twentieth century, many other types of nontariff barriers became more prominent.

Table 2.4.1 “Average Tariffs in Selected Countries (2009)” provides a list of average tariff rates in selected countries around the world. These rates were calculated as the simple average tariff across more than five thousand product categories in each country’s applied tariff schedule located on the World Trade Organization (WTO) Web site. The countries are ordered by highest to lowest per capita income.

Table 2.4.1 Average Tariffs in Selected Countries (2009)

Country	Average Tariff Rates (%)
United States	3.6
Canada	3.6
European Community (EC)	4.3
Japan	3.1
South Korea	11.3
Mexico	12.5
Chile	6.0 (uniform)
Argentina	11.2
Brazil	13.6
Thailand	9.1
China	9.95
Egypt	17.0
Philippines	6.3
India	15.0
Kenya	12.7
Ghana	13.1

Generally speaking, average tariff rates are less than 20 percent in most countries, although they are often quite a bit higher for agricultural commodities. In the most developed countries, average tariffs are less than 10 percent and often less than 5 percent. On average, less-developed countries maintain higher tariff barriers, but many countries that have recently joined the WTO have reduced their tariffs substantially to gain entry.

Problems Using Average Tariffs as a Measure of Protection

The first problem with using average tariffs as a measure of protection in a country is that there are several different ways to calculate an average tariff rate, and each method can give a very different impression about the level of protection.

The tariffs in Table 2.4.1 “Average Tariffs in Selected Countries (2009)” are calculated as a simple average. To calculate this rate, one simply adds up all the tariff rates and divides by the number of import categories. One problem with this method arises if a country has most of its trade in a few categories with zero tariffs but has high tariffs in many categories it would never find advantageous to import. In this case, the average tariff may overstate the degree of protection in the economy.

This problem can be avoided, to a certain extent, if one calculates the trade-weighted average tariff. This measure weighs each tariff by the share of total imports in that import category. Thus, if a country has most of its imports in a category with very low tariffs but has many import categories with high tariffs and virtually no imports, then the trade-weighted average tariff would indicate a low level of protection. The simple way to calculate a trade-weighted average tariff rate is to divide the total tariff revenue by the total value of imports. Since these data are regularly reported by many countries, this is a common way to report

average tariffs. To illustrate the difference, the United States is listed in Table 2.4.1 “Average Tariffs in Selected Countries (2009)” with a simple average tariff of 3.6 percent. However, in 2008 the U.S. tariff revenue collected came to \$29.2 billion from imports of goods totaling \$2,126 billion, meaning that the U.S. trade-weighted average tariff was a mere 1.4 percent.

Nonetheless, the trade-weighted average tariff is not without flaws. For example, suppose a country has relatively little trade because it has prohibitive tariffs (i.e., tariffs set so high as to eliminate imports) in many import categories. If it has some trade in a few import categories with relatively low tariffs, then the trade-weighted average tariff would be relatively low. After all, there would be no tariff revenue in the categories with prohibitive tariffs. In this case, a low average tariff could be reported for a highly protectionist country. Also, in this case, the simple average tariff would register as a higher average tariff and might be a better indicator of the level of protection in the economy.

Of course, the best way to overstate the degree of protection is to use the average tariff rate on *dutiable* imports. This alternative measure, which is sometimes reported, only considers categories in which a tariff is actually levied and ignores all categories in which the tariff is set to zero. Since many countries today have many categories of goods with zero tariffs applied, this measure would give a higher estimate of average tariffs than most of the other measures.

The second major problem with using average tariff rates to measure the degree of protection is that tariffs are not the only trade policy used by countries. Countries also implement quotas, import licenses, voluntary export restraints, export taxes, export subsidies, government procurement policies, domestic content rules, and much more. In addition, there are a variety of domestic regulations that, for large economies at least, can and do have an impact on trade flows. None of these regulations, restrictions, or impediments to trade, affecting both imports and exports, would be captured using any of the average tariff measures. Nevertheless, these nontariff barriers can have a much greater effect on trade flows than tariffs themselves.

? Key Takeaways

- Specific tariffs are assessed as a money charge per unit of the imported good.
- Ad valorem tariffs are assessed as a percentage of the value of the imported good.
- Average tariffs can be measured as a simple average across product categories or can be weighted by the level of imports.
- Although average tariffs are used to measure the degree of protection or openness of a country, neither measure is best because each measure has unique problems.
- In general, average tariffs are higher in developing countries and lower in developed countries.

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