

13.6: Tariffs and Global Pricing

Learning Objectives

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

1. explain the effects of a tariff on global prices

As we learned in Chapter 2 (Section 2.3: Understanding Tariffs), a tariff is any tax or fee collected by a government. Two of the price effects of a tariff are worthy of emphasis. First, although a tariff represents a tax placed solely on imported goods, the domestic price of both imported and domestically produced goods will rise. In other words, a tariff will cause local producers of the product to raise their prices. Why?

When the price of imported goods rises due to the tariff, consumers will shift their demand from foreign to domestic suppliers. The extra demand will allow domestic producers an opportunity to raise output and prices to clear the market. In so doing, they will also raise their profit. Thus as long as domestic goods are substitutable for imports and as long as the domestic firms are profit seekers, the price of the domestically produced goods will rise along with the import price.

The average consumer may not recognize this rather obvious point. For example, suppose the United States places a tariff on imported automobiles. Consumers of U.S.-made automobiles may fail to realize that they are likely to be affected. After all, they might reason, the tax is placed only on imported automobiles. Surely this would raise the imports' prices and hurt consumers of foreign cars, but why would that affect the price of U.S. cars? The reason, of course, is that the import car market and the domestic car market are interconnected. Indeed, the only way U.S.-made car prices would not be affected by the tariff is if consumers were completely unwilling to substitute U.S. cars for imported cars *or* if U.S. automakers were unwilling to take advantage of a profit-raising possibility. These conditions are probably unlikely in most markets around the world.

The second interesting price effect arises because the importing country is large. When a large importing country places a tariff on an imported product, it will cause *the foreign price to fall*. The reason? The tariff will reduce imports into the domestic country, and since its imports represent a sizeable proportion of the world market, world demand for the product will fall. The reduction in demand will force profit-seeking firms in the rest of the world to lower output and price in order to clear the market.

The effect on the foreign price is sometimes called the terms of trade effect. The terms of trade is sometimes defined as the price of a country's *export goods* divided by the price of its *import goods*. Here, since the importing country's import good will fall in price, the country's terms of trade will rise. Thus a tariff implemented by a large country will cause an improvement in the country's terms of trade.

Source

This page is licensed under a Creative Commons Attribution Non-Commercial Share-Alike License ([Links to an external site](#)) [Links to an external site](#) and contains content from a variety of sources published under a variety of open licenses, including:

- The book "International Trade: Theory and Policy" v. 1.0 published by Saylor Academy under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License without attribution as requested by the work's original creator or licensor.

This page titled [13.6: Tariffs and Global Pricing](#) is shared under a [CC BY-NC-SA 4.0](#) license and was authored, remixed, and/or curated by [Babu John-Mariadoss](#) via [source content](#) that was edited to the style and standards of the LibreTexts platform.

- [12.6: Tariffs and Global Pricing](#) by [Babu John-Mariadoss](#) is licensed [CC BY-NC-SA 4.0](#). Original source: <https://opentext.wsu.edu/cpim/>.