FREQUENTLY ASKED QUESTIONS ON TARIFFS

What is a tariff?

A tariff is a tax on goods imported into a country. Like other federal taxes, it is collected by the importing government and goes into the general revenue account at the U.S. Treasury.

Who pays for tariffs?

Tariffs are paid by the importing firm. The exporting country government does not pay the tariff.

Why do countries use tariffs?

In general, tariffs are set to protect domestic producers from competition with imports. By making imports more expensive, domestic producers may gain a competitive advantage over imported goods by being able to offer lower prices.

Countries may also set tariffs to shelter new industries from competition as they develop. For example, as part of its industrialization program, South Korea set high tariffs on imports of many industrial goods until the government determined that its companies were ready to compete on global markets. The United States and other developed countries pursued similar strategies earlier in their history.

Canada's use of dairy tariffs provides another example of how tariffs can be used to support domestic industry. In this case, the use of tariffs supports the administration of a supply management program which balance supply and demand at prices that support farmers' livelihoods as well as fair prices to consumers.

Tariffs can also be used to level the playing field between developed and developing countries. Currently, a coalition of developing countries is arguing for the right to establish a Special Safeguard Mechanism at the World Trade Organization (WTO) to achieve food security and sustainable development and to enhance rural livelihoods. This would take the form of a variable tariff on key agricultural goods that would protect local producers from sudden drops in prices or floods of imports. The U.S. has vigorously opposed that idea since the 1990s.

How do importer country firms make up for the cost of paying tariffs?

It's possible that exporting companies would temporarily lower their prices to compensate for the price impact of tariffs. Otherwise the cost of the tariff will be passed along to others in the importers supply chain, potentially including consumers.

If the tariff successfully stimulates local production to replace imports, local jobs and other economic benefits can arise.

How are tariffs usually set?

Tariffs are set by the importing country government and can be set as a percentage of the value of an item or by its volume or weight. Countries may also set quotas (restricting the volume of imports of a good) or Tariff Rate Quotas, in which tariffs are set up to a certain volume of imports, usually with higher tariffs charged when the volume exceeds the quota. The U.S. imposes Tariff Rate Quotas on imports of sugar, which sets a maximum volume of imports from eligible countries each year.

Another example is a recent agreement with the EU, in which Europe will allow the U.S. to export up to 35,000 tons per year of hormone-free beef to Europe **without** tariffs, but once that limit is exceeded very high tariffs (up to 100%) would raise the cost of additional imports significantly. In this example, Europe is setting a quota on tariff-free beef to limit the amount of hormone-free beef entering the EU, thus protecting its own domestic market.

Trade agreements place limitations on the imposition of tariffs. Under rules at the World Trade Organization (WTO), *bound* rates are the maximum tariff a government can set on each item. The *applied* rate is what they actually charge in practice. Developing countries have tended to maintain higher bound rates, although in practice, many charge low applied rates. For example, Mexico's bound rate for corn is 37 percent, so it has the right to charge up to 37 percent on imports. The rate it uses in practice—the applied rate—however, is four percent. As of 2017, the U.S. trade weighted average tariff on agricultural imports was 3.9 percent, and 2.2 percent on industrial goods.

WTO members also agree to Most Favored Nation status, which means that lower tariffs or other trade benefits offered to one country must be extended to other WTO members. If a country enters into a separate free trade agreement with one or more countries, it can only agree to tariffs at or below the limits agreed to at the WTO, and the agreement must cover substantially all trade.

Free Trade Agreements like the North American Free Trade Agreement (NAFTA) generally aim to eliminate tariffs (as well as setting rules on many other areas of economic activity) among member countries, with certain exceptions. In the case of NAFTA, for example, Mexico agreed to phase out its tariffs on corn over 15 years. Canada eliminated tariffs on agricultural goods imported from the U.S., with a few exceptions such as dairy products, which range from 200 to 300 percent at rates over an established quota.

So how can the United States charge higher tariffs for steel or other goods?

Rules at the WTO and other free trade agreements include an exception when a country's national security is threatened. The idea is that, for example, during a time of war, a country might need to reduce its reliance on imported goods and build up local capacity. That justification is a kind of wild card that suspends the rules at the WTO or other trade agreements.

In the U.S., Section 232 of the Trade Expansion Act of 1962 establishes a process to assess the national security impacts of imports. In 2018, using Section 232, the U.S. Commerce Department decided that global overproduction of steel resulted in low prices that threatened U.S. steel production. Furthermore, they deemed U.S. steel production as essential to national security. President Trump imposed 25 percent tariffs on imports of steel and 10 percent on aluminum. His administration is considering also designating automobiles as essential to national security, potentially setting new tariffs on them as well.

Many of the exporting countries affected by those tariffs have rejected this use of the national security exemption. They question the fact that it has been applied selectively (bolstered by statements such as President Trump's own tweet asserting that the steel tariffs were a response to Canadian dairy tariffs). Several are charging retaliatory tariffs on U.S. exports. Seven countries have raised formal challenges at the WTO's Dispute Settlement Body.

Can the President legally set tariffs?

The U.S. Constitution gives Congress the authority to set tariffs and other taxes and to regulate international commerce. It authorizes the president to negotiate treaties. Congress has delegated its authority to the President to change tariffs under certain circumstances in various laws. The International Emergency Economic Powers Act of 1977, for example, gives the president authority to set tariffs on another country during a "national emergency." President Trump used that justification to threaten Mexico with rising tariffs if it did not curtail flows of immigrants. Section 301 of the Trade Act of 1974, which permits tariffs in cases of discriminatory or unjustifiable practices by a trading partner is being used to justify tariffs on China. Congress could pass new laws to take back that authority, starting with putting limits on the amount and duration of tariffs and pushing for new efforts to work with other countries to press for reforms of unfair trade practices.