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Tariffs and their Impact on Global Trade and Local Economies

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Introduction

In order to create sustainable societies, countries follow the well-known principles of supply and demand of goods that are involved in international trade. Due to the current importance of this trade, some important regulations have been implemented to maintain order in this flow that takes place beyond national borders. These regulations can be exemplified by the different tariffs that regulate the global market. According to Merriam-Webster dictionary, a tariff is "a schedule of duties imposed by a government on imported or in some countries exported goods." Nowadays, tariffs are an important concept in International Business, for it involves other topics as the difference in cultures, economic trends, and international politics.

Since tariffs can be a barrier for international trade, some countries have joined in order to minimize the effect of regulations. On January 1, 1995, the World Trade Organization (WTO) was established to set the rules of trade. Also, according to Alan Rugman, the WTO "acts as a dispute-settlement mechanism." In addition to the roles played by the WTO, some countries have established trade agreements in order to reduce possible limitations for trading. Two decades ago, the North American Free Trade Agreement (NAFTA) was established by Canada, the United States, and Mexico. This agreement has helped in the development of a strong economic integration in the last years, and has served as a model for other agreements. (Rugman)

Despite the differences among countries, international trade agreements can break the national frontiers; thus, it provides benefits to global economy. The major outcomes of these agreements, as well as the impact of tariffs on economy will be discussed further in this article. Different regions will be compared and contrasted in order to get final conclusions about them. The reader will also relate the much-debated tariffs to economic models, since they can be a barrier for trade, but, paradoxically, at the same time can be a strong incentive to strengthen national economies.

TARIFFS: A HISTORIC DEBATE

Originally, according to us-history's webpage, tariffs had as a general purpose "to supply revenue to the government and protect domestic producers from foreign competition." Tariffs were formally implemented by the 1st United States Congress in the 1789 Tariff Act. During the 1800`s, tariffs were one of the greatest sources of wealth, since they were responsible for more than 50% of the federal budget. However, this situation has changed as the government focused on lower tariff rates and did not mean to use them as a major source of income. Contemporary Presidents as Reagan and H.W. Bush looked forward to reduce tariffs and aimed towards better economic integration instead. Taking into consideration that the US served as a model for many economies and the dominance of the American system in the Western hemisphere, tariffs in the USA began an important tendency in other countries. ("Tariffs")

Since setting tariffs may be a synonym of artificial inflation on imported goods, some consumers may argue about its real purpose. As investopedia implies, it seems that tariffs "tend to be pro-producer and anti-consumer." Plus, tariffs increase the government's wealth, while the people's pockets are negatively affected, apparently. Nevertheless, high tariffs may protect people from medically dangerous products, as cigarettes and alcohol. This can lead to a healthier society in which the consumption of addictive products is regulated. In addition to this, tariffs may help developing countries to form strong markets for some domestically produced goods in a specific industry it wants to develop. This occurs after the consumers increase demand for low-priced domestic goods. (Radcliffe)

Due to its effects on the demand and supply curves, tariffs are regulated by the WTO in order to maintain stable conditions in the market, forcing governments to look for other alternatives. Tariffs' economic outcomes can be summarized into three points: increased domestic production, reduced imports, and higher consumer prices. This occurs after consumers purchase fewer goods due to the increased price and domestic suppliers produce even more after the consumption of their products is increased. The WTO has reduced the negative effects of these trends on normal equilibrium conditions. As a result of this global regulation, countries look forward to set non-tariff barriers. Licenses are granted to a firm by the government, for example. The company can act as an importer of a certain product. Other examples are import quotas and voluntary export restraints (VER). The first one is a restriction on a specific amount of an imported good, while the later is imposed by the exporting country rather than the importing one. VER's are usually accompanied by a reciprocal partner, as a request by the destination country to protect domestic markets, as tariffs do. (Radcliffe)

OTHER TYPES OF TARIFFS

Currently, some countries are working together and setting free-trade agreements in order to reduce tariffs. Besides tariffs on international business, some countries have established tariffs on natural resources and energetic providers. In fact, countries use these tariffs as a domestic, regulatory tool. As previously discussed, there are different types of products which tariffs can be applied to, such as electricity, alcohol, and even water. According to authors Hugh Sibly and Richard Tooth, water is regulated in countries as Australia by setting Increasing Block Tariffs (IBT). IBT's avoid scarcity and increase cost recovery. However, these authors imply that "IBT's are neither fair nor efficient, "and that the government must look for another alternative. (Sibly, Tooth)

The Republic of Panama has established some of these tariffs as well, especially for the consumption of alcohol and the use of electricity. In this particular case, a rise of 25% on the tariff rate was applied since January 2015 for households consuming over 750 kW/hour. Other rates of consumption were increased as well, depending on consumer's income. (Lopez) Two months later, President Varela established a tariff for alcoholic beverages. This economic strategy, supervised by the Ministry of Finance and Economics, was done in order to increase the subsidies for retired workers, the Mental Health Institute, and the Social Security. The tariffs on alcoholic beverages were seen as a great and unexpected support for the President's popularity, for he is responsible of Varela Hermanos, S.A, the country's largest alcohol producer. (Moreno)

FROM TARIFFS TO TRADE AGREEMENTS

As previously stated, trade agreements have been established among regions in order to overcome the barriers of trade. A few years after the Canada-United States Free Trade Agreement (NAFTA's predecessor), the governments of Brazil and Argentina looked forward to have a better economic integration, and to join forces in order to form a stronger economy. The result of this idea was Mercosur, which began a new era in South American trade. Even though both agreements began with two countries, NAFTA was joined by Mexico, and Mercosur by Uruguay, Paraguay, and Venezuela, respectively. Nowadays, NAFTA and Mercosur are the two major trade agreements in the Americas. ("Canal Mercosur")

Even though these trade agreements were a totally new path to get involved in international business, they are not limited to the Western hemisphere. Other countries looked forward to join to regional organisms to reduce barriers for trade. For this reason, the modern European Union was formed by the 1993 Treaty of Maastricht. The European Union is a political-economic entity that "manages and implements European policies and budget, and negotiates trade agreements between Europe and other countries." In a similar way, Asian countries formed ASEAN, an entity formed by Indonesia, Malaysia, Philippines, Singapore, and Thailand. This has aided the economic growth of South Asia and Singapore; forming one of the world's fastest growing economies, and cut tariffs on more than 8,000 items. A third union that was formed is the Arab League, an organization formed by Egypt, Syria, Jordan, Iraq, Lebanon, and Saudi Arabia. The formation of the Arab League was supported by the factor endowments and cultural history that this geographic region has in common.

Besides these well-defined organizations, regions such as Central America have followed this tendency. Central America may not be a large region as its northern and southern counterparts, but it has followed the recent models of economic integration. The Central American Common Market originated decades before NAFTA and Mercosur, back in June of 1961. It was established by the governments of Guatemala, El Salvador, and Nicaragua; Costa Rica, and Honduras, which joined it two years later. These five countries once belonged to the same national state, and other countries belonging to the same geographic region were not included for cultural purposes. Nevertheless, the Central American Integration System was founded by the previous five countries and Panama. The main objective of this system is to achieve economic integration in the current financial environment. Belize joined in 2000, and the Dominican Republic did so in 2013. Besides this integration system, the Central American Parliament is a political union formed by former presidents of the zone. (Sanahuja)

ARE TARIFFS & TRADE AGREEMENTS INFLUENCED BY SOCIAL DIFFERENCES?

These organizations may have some elements of economic integration in common, but they have different methods and angles to achieve this goal. While the EU and NAFTA focus mainly on trade and policies to eliminate tariff and non-tariff barriers, ASEAN aims towards "social, cultural, technological, and educational cooperation," as well as "the promotion of peace." In fact, Mercosur and the Arab League have this socio-cultural approach as well, with the later considering "extradition of criminals" as an important aspect. This is a tendency that is strongly defined by the financial status of the member countries and the characterization of some of its members as emerging economies. ("Charter of Arab League")

Since NAFTA and the EU have members that belong to the prosperous triad region, their comparison is an important contribution to any economic analysis. According to Lawteacher, both of these organizations "liberalize their members from trade ruling" and set tariffs for non-member countries. Moreover, tariffs are reduced in products that are traded among members, and casual political moves may enhance the trading system. This allows a certain exchange of factor endowments among its countries, which will generally lead to a strong regional progress in the long run. For this reasons, the bounty of North America and the European Union over other regions is supported by focusing on trade solely, rather than on the solution to unfortunate social problems. ("Advantages, Disadvantages, and Comparisons EU and NAFTA")

In spite of these similarities, there are some aspects in which NAFTA and the European Union differ. Unlike the European Union, NAFTA does not have supranational institutions, as a commission and a court of justice that regulates internal political situations. Other remarkable differences affect the monetary system and social background behind each entity. A very important contrast is NAFTA's conservation of each country's currency. In the other hand, the European Union established a single currency, the Euro. This has been subject of much debate, taking into consideration the modest European growth and its currency's devaluation in recent years. NAFTA has been helped by the current strength of the US dollar, and the trade with the Mexican peso and the Canadian dollar has not represented any difficulties. ("Difference between NAFTA and EU")

In a similar way, the historic past of the European Union can be considered another disadvantage. While NAFTA's countries have been involved in trading and commercial activities for many years before the formation of NAFTA itself, the European Union's members were involved in World Wars and other political conflicts. This is a disadvantage for doing international business, for there is a socio-political tension in different parts of the European Union. The possible independence of Catalonia from Spain, the Russian/Ukrainian conflict, the Scottish independence, and the social tensions in Greece are examples of this condition. North America's recent superiority over Europe may be traced back to the previous contrasts between them. NAFTA is looking forward to keep the growth of its huge GDP. In the other hand, the European Union's members must look towards the future and try to avoid other conflicts.

APPLYING TARIFFS AND TRADE TO SOCIAL AND ECONOMIC MODELS

It is known that the concept of “tariffs” in international business is more complex than believed. Its history involves a great amount of aspects, which can be applied to the economic and social models that aid the understanding of this field. Regarding the social aspects, NAFTA’s success can be traced back to Canada’s and USA’s high individualism index. This principle is one of the four cultural dimensions described by Geert Hofstede. In the other hand, more collective countries as Indonesia and Mercosur’s members have their society’s protection as a main goal, not an individual perspective of things. These governments seek to protect their domestic producers and tend to behave different than other regions. Several models can illustrate the cultural differences behind trade agreements and organizations, for countries can be perceived as large businesses. In other words, Hofstede theories can influence the company to company interaction, which is described in the cross-cultural business context model. (Rugman)

Apart from the geographic bonds that are a common factor to the previously described regions, the trade that occurs among them follows the Hecksher-Olin theory. This theory implies that countries export goods that are produced intensively by factor endowments. In the European Union, for example, Germany is a greater exporter of technology-related goods. The other members of the union import these goods; this trade follows Hecksher-Olin theory. A similar condition occurs in ASEAN, where the export of rice occurs mostly in Vietnam, while the production of palm oil takes place mostly in Malaysia and Indonesia. Countries may set trade agreements and organizations, but their main exports are in close relationship with the particular factor endowments of a country.

Another model that is used in international business is Porter's Model of the determinants of national competitive advantage. Porter suggests that there are four determinants: factor conditions, firm structure, demand conditions, and supporting industries. Moreover, he indicates that there are two external factors that influence these determinants: chance and the government. In other words, tariffs are external forces set by the government, and can play a major role in national competitive advantage. Even though a country can be successful in an industry, such as Brazil in the ethanol industry, its determinants are altered by the presence or absence of tariffs. Porter's determinants could be strong and positive, but this success would not have been possible without low tariffs to trade members. Without this external force, trade would have been difficult with a hypothetically low demand.

Another model that can be used to understand this concept is Porter's five forces model, which can be illustrated by Coca Cola's situation in France. France, a member of the European Union, has a very attractive and stable market for almost any firm, including Coca Cola. Coca-Cola's five forces are well-developed, but an external tariff surrounding this diamond can become a major influence on the firm's performance. The French government imposed a tariff on Coca-Cola, in order to lower the obesity rate in the country. In fact, this tariff was imposed on other sugary drinks. Clearly, companies should consider this external force that surrounds most models; otherwise, their predicted numbers will face a big discrepancy. (Abdullah)

Conclusion

Tariffs and trade agreements are an important element in nowadays international business field, as previously shown. The Trans-Pacific Partnership represents the current situation of tariffs. While some countries have lowered their tariffs on imports through trade agreements, other governments maintain their position that tariffs are an important tool to protect domestic markets and labor. Japan tariffs "16-32 percent on US oranges, 38.5 percent on US beef, and an eye-popping 778 percent on US rice above an annual quota," indicates author Simon Johnson. This shows that there is a wide range of numbers and strategies used in tariffs globally.

International business is influenced by different forces of economy, and their unique combination can determine how and which tariffs to enforce. Even though there and more and more countries involved in trade agreements, tariffs are still a very effective tool, depending on the context. Global economy has change a lot since 2005, and it is totally different from last century's. It can be very difficult to predict whether tariffs will remain in some countries or not. However, thanks to the applications of some models, people can have an idea of how the panorama will remain. How much are these models and international trade going to change in the future? The answer of this question is a complete paradox, for it totally depends on the present economic behavior. Society and countries will change: tariffs and economy will adapt to these potential changes.

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