Tariffs' Use in a Trade War Sept. 2019

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In a previous paper I described how the effect of tariffs upon consumers and suppliers depends to a great extent upon the elasticity of supply and demand for a good both in the short-run and in the long-run-- recognizing that elasticities of both supply and demand tend to increase over time. Elasticities of demand depend upon the availability of substitutable goods or alternative sources of a good. Alternative supplies of a good tend to increase over time as other suppliers of a good become available and other suppliers increase their production capacity in response to an increase in demand (and., potentially, prices) of the good in question. This process will be enhanced by the development of alternative supply chains. These considerations are all germane in a trade “war.”

In a war the objective of each side is to inflict sufficient pain upon the other side so they will capitulate. In that case the use of tariffs goes beyond merely trying to raise domestic revenues or protect domestic producers. The strategy is to inflict hardship upon the other sides' producers and consumers while minimizing harm to one’s own producers and consumers. This implies various strategies may be employed in the current trade dispute between the U.S. and China.

If China wished to hurt the U.S. It would impose tariffs upon products that the U.S. producers that could be readily obtained from other sources at little incremental cost. That includes most agricultural products, but it does not include most products employing various advanced technologies that cannot be easily duplicated—such as various high-tech medical or electronic equipment. While many agricultural products can be obtained from many sources, the U.S. is frequently the low-cost producer, so Chinese consumers are likely to experience some increase in food consumption costs or quality declines until other producers are able to improve their production capabilities. Once they do so, however, in the long run total world agricultural production will increase –which will continue to pressure agricultural prices in a downward direction., even after the trade war subsides. However, in some goods (soybeans) China has little choice but to buy some from the U.S. in the short run since total world production outside the U.S. is less than China consumes each year.

The U.S., in a trade “war”, might find that it had the greatest effect upon Chinese producers by imposing tariffs upon toys, clothes, and other products for which substitutes were widely available for little incremental cost. They also might impose tariffs upon goods that other producers could readily supply within a relatively short period of time given an increase in demand by American producers altering their supply chains. Potential shifts of supply chains away from China over time would likely be irreversible and would continue to pressure Chinese producers even after a trade war subsided. Thus, the affected Chinese producers, like American agricultural producers, would suffer more in the event of a protracted trade war. However, in any trade war, the U.S. would not want to impose tariffs upon items, such as rare earth minerals, where China was the major supplier and few alternative sources or substitutes were available. In fact, because rare earth elements are critical to the production of many high tech products, the U.S. should attempt to find or develop alternative supplies if it expected the trade war to last for any long period of time—as China could damage the U.S. economy greatly by cutting off supplies of rare earths.

Thus, overall, because each side could do damage to the other that would increase as the trade war continued, both could gain by attempting to settle their trade dispute relatively quickly.