Victoria Capital Management, Inc.

Market Missive

Another Perspective on Tariffs

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Tariffs (the imposition of a charge on selected imports) have moved to the center stage in the investment community as the primary factor undermining equity markets. One reason is that many economists define a tariff as a “tax.” There is more to that story than a one-word explanation. If we remember correctly, tariffs are designed to price imported goods higher so domestic industries and companies can flourish. What can happen when a tariff is imposed on foreign entities that compete with domestic counterparts is that U.S. companies raise prices to improve profitability. As a result, consumers are forced to pay higher prices for domestic and imported goods. Before implementing the income tax in the US in 1862 under President Lincoln, duties provided the bulk of revenue that financed the federal government.

Today, there is less motivation to implement tariffs in the U.S. because we are not an emerging economy. We are the world’s leading economy, so why do we need such duties to protect competitive industries? We don’t! However, countries have been charging the US tariffs for many years to support their domestic industries, so why don’t we implement tariffs to level the playing field? We don’t because consumers will bear the brunt of the cost. Foreign tariffs on U.S. goods have increased taxes on consumers. Similarly, reciprocal tariffs by other countries are having the same effect, lowering the ability of their consumers to afford higher-priced products.

History tells us domestic corporations raise prices when tariffs are imposed on foreign competition. According to the Tax Foundation, the tariffs introduced by President Trump that protected the aluminum and steel industries during his first term cost 142,000 full-time jobs and reduced GDP by 0.2%. The president’s pending tariffs are estimated to reduce GDP by 0.4% and substantially increase the number of workers who will lose their jobs before the effects of retaliation. Each time a tariff is raised that impacts consumers' prices, they also punish consumers through other taxes such as state sales taxes!

A rational approach among the world’s major trading partners should be to reduce or eliminate tariffs. Such a decision could reward consumers with lower prices and reduce inflation levels. Countries that maintain tariffs are penalizing most citizens, who should demand that tariffs be reduced or eliminated and not increased. For Third World countries, there should be some negotiations to help domestic industries become more competitive rather than putting them in a position where they remain a Third World country. In the coming weeks and months, the whole tariff debate will produce an outcome that will either reward or penalize equity markets and consumers.

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