The Tariff

Part 4: Resurrections

Movie sequels are rarely as good as the originals. Arguably the same can not be said about tariffs, be they on imports or exports. Originating as a concept – believe it or not – in the Middle East, tariffs have been around for millennia. However, in the recent past (say, 50 years) the prevailing economic consensus has been that tariffs are bad, and free trade is good for global economic development and wealth creation. As a result, and driven by an increasingly open global trading landscape, governments around the world have been slashing tariffs and seen remarkable growth in return.

However, more recently this consensus and trend has come to an abrupt halt and even seen reversal. It is not for this publication to discuss the relative political and economic arguments for and against the imposition of tariffs. Instead, we'd like to focus on the implications of movements in tariffs and what companies should be prepared for, either to manage or lobby.

For that, it is important to first understand why tariffs are imposed. A wide variety of reasons exists, each of which comes with its own implications for effective management or response. More or less, they can be categorised into the following four groups:

1) Revenue generation

Clearly the imposition of tariffs helps fill governments' coffers. Most customs authorities will have specific revenue collection targets, typically set by the Ministry of Trade (or equivalent). Applied tariff rates are bound by the commitments that World Trade Organization (WTO) members have made under the General Agreement on Tariffs and Trade (GATT) in 1948. Tariff rates applied in practice are usually well below these "bounds". Moreover, a significant part of international trade is conducted under the provisions of free trade agreements, meaning that actual tariff rates paid are even lower or zero.

Consequently, in the vast majority of territories, customs duty revenues are a small if not negligible component of government revenues. Although many governments are legally entitled to raise tariffs to their bound rates in order to raise revenues, even doing this would likely have a small impact on tariff revenues collected.

In short, tariff increases aimed at growing the revenue base are unlikely to be something that should concern importers. If they do occur, shifting supplies to sources that are entitled to preferential trade rates, or simply accepting the rate increases and either on-charging them to customers or funding them out of supply chain profits are the most common and logical actions companies can take.

2) Protection of domestic companies or industries

Another traditional reason for the imposition of tariffs is to protect vulnerable industries or companies in the domestic market from overseas competition. Although this is still a common concern and priority for governments, over time, and because of GATT commitments, it has become more popular to impose non-tariff measures, such as quotas or licenses, to achieve this goal.

Tariffs used to discourage overseas entities to target a market only affect a relatively small number of players, usually in specific industries. The use of preferential trade is often not an option, as the protection tends to extend to Free Trade Agreement provisions, either by excluding affected products from tariff rate reductions or by making qualification for lower rates hard to achieve (for example through local content requirements). Hence there are few good options for importers to avoid such tariffs.

In addition to standard tariffs, protection of domestic companies is also often achieved through the imposition of anti-dumping duties or countervailing duties. There has been a marked increase in the number of such measures imposed in the recent past in many territories around the world. Although there are specific globally acceptable standards on when and how such duties may be imposed, especially in relation to demonstrating "injury" to a domestic industry, the complexity of business and supply chains provides ample opportunity for governments to argue that they are appropriate. To avoid this kind of tariff to have a (significant) impact, the seller would need to provide detailed and convincing argumentation that they are not selling at an unreasonably low price, or have benefited from government subsidies in the territory of manufacture. Doing so is a time consuming and complex exercise, without guarantee of success. Sometimes it may be possible to reduce the level of anti-dumping or countervailing duties, rather than eliminating them altogether.

Finally, governments may see the need to protect domestic companies or industries that are of "strategic interest". One way of doing this is by imposing prohibitively high duty rates on products made by such industries or companies. As an example, the US has applied this basis for the imposition of punitive tariffs extensively during the Trump administration, but there are many more examples, less publicised, to the same effect. Again, there are global rules on when and how such tariffs may be imposed. Nevertheless, there is significant room for interpretation, allowing governments to be perhaps more liberal in their imposition than the letter of the rules may suggest. Typically, the level of additional tariffs, often in conjunction with non-tariff measures, leave little if any scope for a would-be importer to continue importing affected products.

Although theoretically it is possible to challenge the imposition of additional tariffs through the WTO Dispute Panel, in practice this Panel is hampered by some of the WTO members to the extent that it is not possible for it to rule definitively on any such measures. Consequently, companies are left with few good options. Appeal to another national government, for example in the territory of manufacture, may lead to the imposition of retaliatory tariffs. However, although this may help at a macro-economic level, it usually does little for the companies affected by the additional tariffs in the first place.

3) Encouragement of local investment

Sometimes governments impose additional tariffs in order to make it more attractive for economic operators, at least economically, to set up business in a particular market rather than supplying such market from abroad. Although this is a fairly crude measure and is more often than not combined with other requirements or non-tariff measures, in practice it means that the only viable option for companies to supply such a market is to set up shop there. This may be achieved from scratch, i.e. establishing a greenfield facility. It may be attractive to invest or acquire an existing business. However, this may be subject to strict foreign investment rules (such as CFIUS) that may not always be manageable in practice.

Ultimately, the objective of governments in this instance would be to create employment and economic activity onshore, including the development of valuable intellectual property. Whereas this may be achievable through the establishment of a new business or the acquisition of an existing one, the imposition of tariffs may simply be a preferred way to make it happen. Consequently, an attempt to avoid those tariffs without creating the desired activity onshore will probably result in yet higher tariffs or additional non-tariff restrictions, until the objective is met.

4) Discouragement of overseas growth

A final noteworthy reason for the imposition of tariffs is the aim to stifle production abroad, Although this can be closely linked to the objective of encouraging local investment, this is not necessarily so. Discouragement of overseas growth is often targeted at specific territories, often for strategic reasons. This means that it may well be possible to supply the market in question from other territories, where a company may already have facilities or be in a better position to establish a new facility. Hence the options to avoid tariffs imposed for this reason may be wider, possibly even avoiding them altogether by using appropriate preferential trading options.

Clearly the above is a somewhat crude categorisation of the reasons to impose new tariffs. However, the important message is that understanding the underlying reasons is crucial for any affected organisation in devising an appropriate response. Most companies will have become used to a world of low tariffs and have excluded tariff considerations from important business decisions. That world is fast disappearing, particularly in some industries and geographies. Accepting that reality and spending the time and effort to consider appropriate business responses will separate the commercial wheat from the chaff.