What Are Tariffs?

Wondering what tariffs are and how they work? Read on!

What is a tariff?

A tariff is **a tax on goods and services crossing national borders.**

What kinds of tariffs are there?

An **import tariff** is a tax on goods and services entering a country. It's the most common type of tariff. An **export tariff** is a tax on goods and services leaving a country.

Who sets tariffs?

Tariffs are imposed by **governments**.

Who pays tariffs?

Import tariffs are paid by **importers**. Export tariffs are paid by **exporters**.

Why do governments impose tariffs?

Governments impose tariffs for a number of reasons. Most commonly, they use them to **protect domestic industries** by making imports more expensive.

Do tariffs lower prices for consumers?

No. They usually result in higher prices.

How do tariffs work in practice?

Let's assume the US imposes a 25% tariff on imports from Canada.

Under this tariff, any American company that imports Canadian goods into the United States will have to pay the US government a 25% tax on those goods.

Say you own a manufacturing company in Canada and an American client regularly buys a $100 part from you. Before the tariff, your client would simply pay you $100 for the part and import it to the US tax-free.

With the new 25% tariff, your client has to pay you $100 for the part AND pay the US government $25 for the tariff. Here's the math:

$100 part x 25% = $25 tariff
Total cost to import your part
Before the tariff: $100
After the tariff: $125

Will your client just absorb this additional cost and live with lower profits? Probably not. That leaves them with some choices.

They could pass along the cost of the tariff to their customers, but they won't be happy paying more.

Or they could look for another supplier who can provide the part more cheaply. If they find one, you'll either lose your client or be forced to match or beat the new supplier's price.

If your client can't find another supplier and they have to keep buying parts from you, they'll likely want to negotiate a lower price to offset the cost of the tariff.

If you agree to lower your prices, you'll probably want to cut costs elsewhere to protect your profit margin. You may do this by cutting worker pay or worker hours, or even laying off workers altogether. Or you may invest in technology to replace some of your human workers.

How do tariffs affect consumer prices?

In North America, **supply chains are highly integrated**. That means parts and components often cross national borders several times before they're installed in an end product. If tariffs are applied every time a part crosses the border, the price of the end product will go up. And if a country responds to tariffs with tariffs of their own—with what are called **retaliatory tariffs**—consumer costs can go up even more.

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Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics