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Course

Date

Title of the Article: "U.S., Indo-Pacific countries launch trade talks shunning tariff cuts"
Source of the Article: https://www.reuters.com/world/asia-pacific/us-indo-pacific-countries-launch-new-generation-trade-talks-shunning-tariff-cuts-2022-09-08/
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Section of Syllabus to which the Commentary Relates: Interventions

Commentary:

The article is about a move by the US Government to take part in trade talks with Indo-Pacific countries while ruling out any possibility of tariff cuts. The trade talks were seen as a reaction to an early free trade agreement with China that saw the cutting of tariffs with countries of the region. There is a group advocating against a tariff reduction because it sees it as interference of corporates with trade policies. Further, the group questioned whether not having the tariff cuts would be beneficial to workers.

Figure 1: The US market with trade tariffs

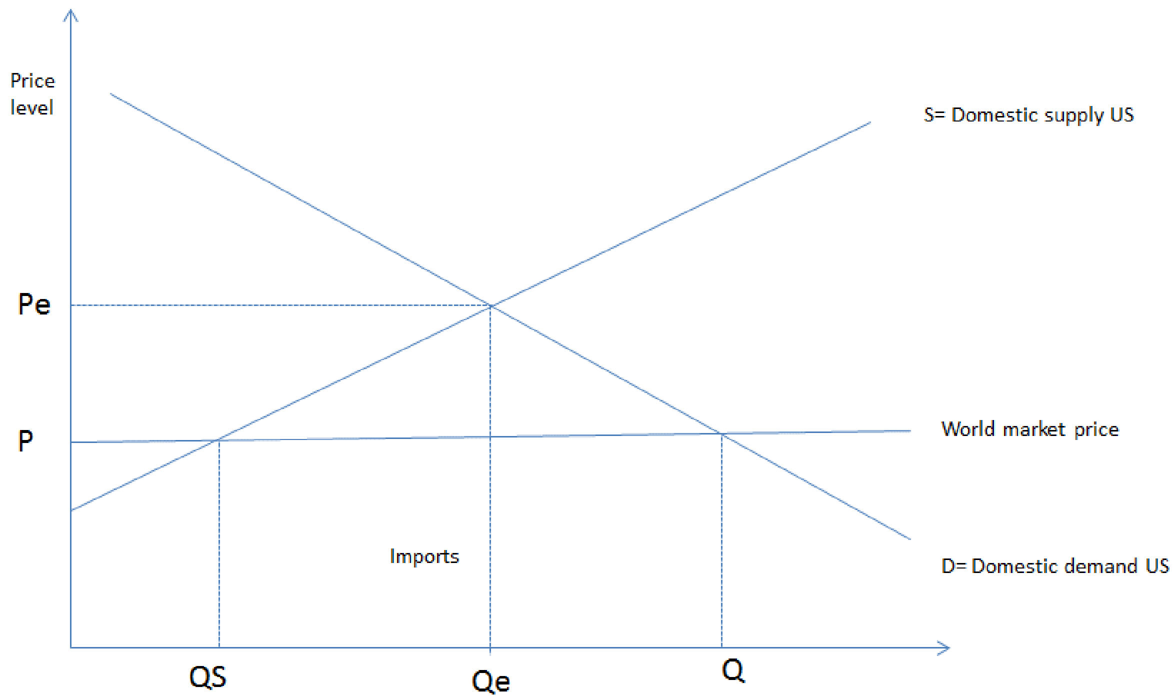

Figure 1

Figure 1 shows the US market before a reduction in tariffs. The price is dictated by the world market and set at P. Local producers are supplying the market at quantity QS which is not sufficient to meet the local demand levels. To meet the demand, the difference between Q and QS in the market is supplied by external suppliers by imports. Despite the local producers supplying the market, they are still operating below full capacity as there is a need for imports to meet the demand in the market.

Figure 2: The US market with a reduction in trade tariffs

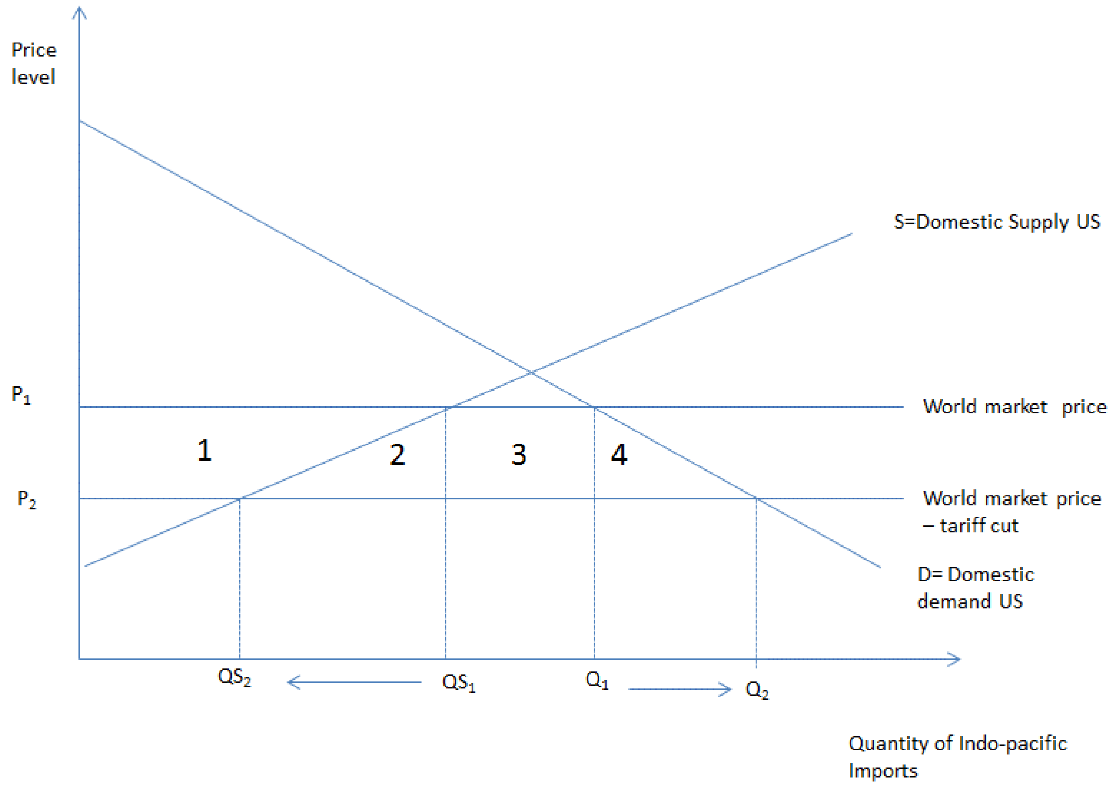

Figure 2

Figure 2 shows the US market after a reduction of tariffs. Before the cut of tariffs, the price of goods was set at P_1. At this price level, the domestic demand for imported goods is at Q_1, and the domestic supply is at QS_1. The domestic supply at this point is high because every country focuses on producing goods where it has a competitive advantage. Despite this, there is excess demand the size of $Q_1 – QS_1$ which will be filled by Indo- Pacific imports. When the US government intervenes in the market by cutting tariffs, the price of goods drops to P_2 from P_1. The price will be the world market price minus the tariff cut. Based on the law of demand and supply, a price decrease will be followed by an increase in demand and an increase in supply. Consequently, the quantity demanded in the market moves from Q_1 to Q_2.

On the supply side, local supply will reduce from QS_1 to $QS_{2.}$ This creates excess demand in the market marked by the region Q_2 –$QS_{2.}$ The cut in tariffs creates an opportunity for Indo-Pacific countries to supply more to the US market. Therefore, the cut in tariffs will increase imports from Q_1 – QS_1 to Q2 –QS2 as per figure 2.

While the objective of cutting tariffs is to increase trade with the Indo-Pacific countries, the local producers are set to suffer because of increased competition. The tariffs will see a dropped in local production as the manufacturers will not be willing to produce at the price in the market. This reduction in production is likely to lead to the desire by the local producers to cut the costs of production. Essentially, the companies will have to lay off some employees to remain competitive in the market and preserve their bottom line. However, the US producers might see the tariff cuts as a short-term intervention strategy and may continue supplying more.

Due to the tariff cuts, consumer prices will reduce, resulting in a consumer surplus equal to the area marked 1+2+3+4 in the graph. The local producer will reduce their supply to mitigate against losses; hence they will lose a producer surplus equal to the region marked 1 in figure 2. The tariff reduction will not mean the country will not collect taxes, the country will collect taxes equal to the region marked 2+3+4 in figure 2. Consequently, the US will gain a social surplus equal to the area marked 1+2+3+4. The Indo-Pacific countries will gain income due to their expansion into the US market.

Imports from Indo-Pacific countries will increase in the short run while prices of goods dependent on imports from those countries reduce. This will see an increase in consumer demand in the local market. However, the tariff cuts will flood the domestic market with imports. The local producers will lose their competitive advantage over their competition. In the long run, there will be a loss in local production which will negatively affect the well-being of the US economy.

However, a reduction in tariffs might be beneficial to the US as the country can export products to these Indo-Pacific countries where it has a competitive advantage. Therefore, the tariff cuts might help the country to specialize in its production. The tariff reduction intervention will effectively lower the price of Indo- Pacific imports. The US will gain a social surplus while the Indo-Pacific countries will open a new market which will see them increase their income. Therefore, the tariff reduction will be mutually beneficial.