The Impact of Tariffs on Different Dimensions of Global Economy: An Overview

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Abstract

In recent years, the global trade environment has witnessed a significant growth in protectionism, with tariffs emerging as a key policy tool. This tendency has been spearheaded by Donald Trump's administration in the US, which has imposed tariffs on all nations, including China and India. This paper aims to explore the history of tariffs, opportunities and challenges of tariffs, reasons to impose tariffs by US to the rest of the world and the impact of tariff imposed by US on world share market. By analyzing the world share market trends over the last three months, this paper seeks to provide insights into the short-term effects of tariffs.

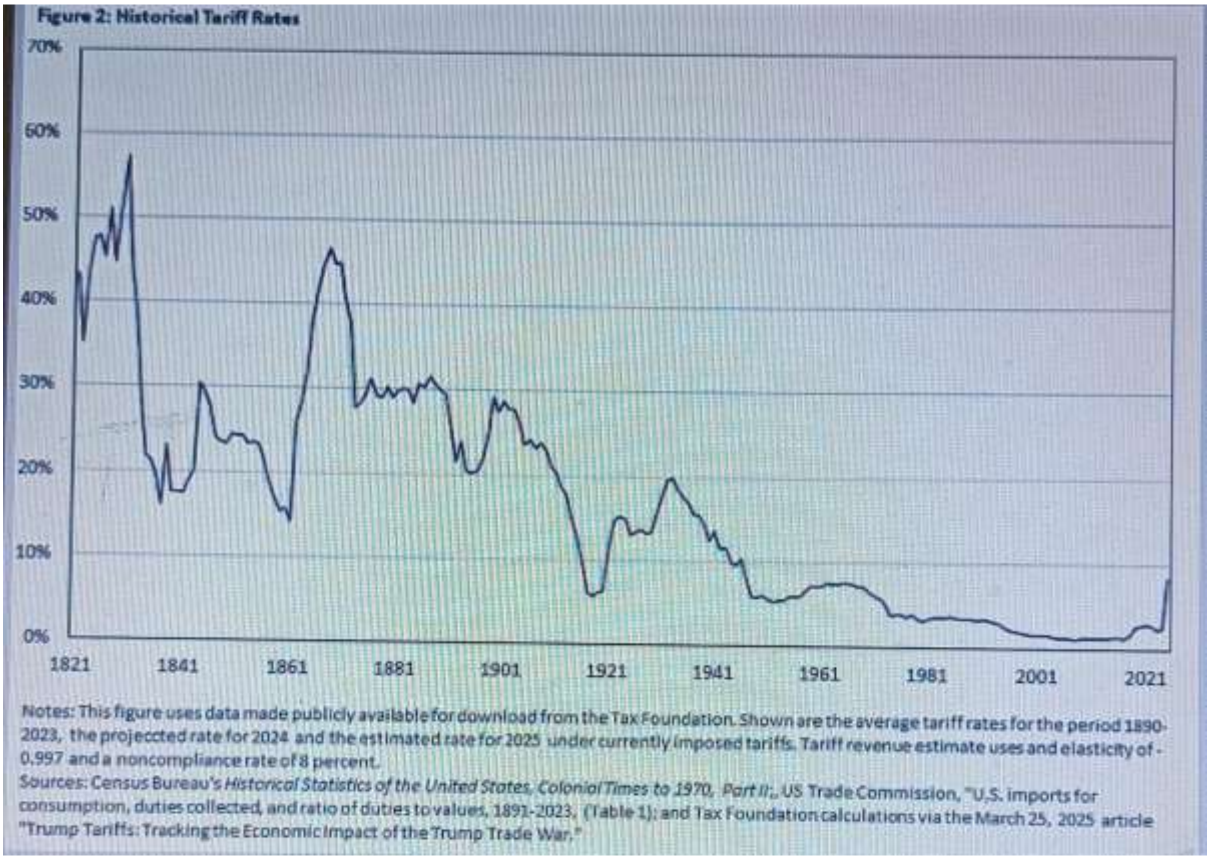
Keywords: Protectionism, Trade War, Global Share Market, Volatility, Standard Deviation

Introduction

A Tariff is a text imposed on imported goods by a country. Tariffs can be used to protect domestic industries, raise revenue or regulate trade. In fact, tariffs have been a part of the national economic policy for years. They were originally instituted to safeguard domestic industries, ensure revenue to the state and affect trade. They were considered instruments of protectionism at first- that is, protection against competition from outside for local business-but such larger implications are being scrutinized from all over the world, especially with the presence of a global economy. For the country that levies them today, in an interdependent world economy, tariffs carry meanings beyond the global implications on supply chains, foreign markets, and foreign relations. This paper analyzes the conversion of tariffs from being instruments of protectionism to adopting far-reaching global implications. It seeks to understand how tariffs transformed in their real effects on the global economic patterns by historical contexts, existing trade conflicts. In this paper, historical data from 15 January 2025 to 15 April 2025 have taken to calculate the daily returns and volatility using standard deviation.

History of tariffs

Tariff history begins with ancient civilizations, where goods were taxed to raise revenue and control trade. Tariffs existed in ancient Egypt, Mesopotamia, and the Roman Empire as a major source of state revenue, being prevalent at ports and trade routes. The Mauryan Empire in India, under Kautilya's leadership, introduced a systematic system of taxation, including tariffs on imports and exports. In the mercantilist period (16th to 18th centuries), European nations levied high tariffs to stimulate domestic production and preserve trade surpluses, resulting in colonial monopolies on trade and protective laws such as England's Navigation Acts. The Industrial Revolution witnessed intensified protectionism as countries, particularly the United States and Germany, employed tariffs to protect their expanding industries. Britain, though, turned to free trade with the repeal of the Corn Laws in 1846.



These war years were characterized by protectionism, particularly with the U.S. Smoot-Hawley Tariff Act in 1930, and it deepened the Great Depression as it cut overseas trade. In the post-World War II period, the formation of the General Agreement on Tariffs and Trade (GATT) in 1947 was a transition towards reducing tariffs and multilateral trade cooperation, further aided by the World Trade Organization (WTO) in 1995. In the 21st century, though globalization has risen, tariffs are still a tool of strategy, like in events such as the U.S.–China trade war, where tariffs were employed to showcase economic strength. Existing trade policy is also pitted against tariff use and regional agreement and non-tariff trade, and it accommodates the dynamic nature of geopolitics and international economics.

Advantages of Tariffs

1. Domestic Industry Protection: Tariffs helps protects domestic business from international rivalry since it increases competition for imports. This gives international companies a chance to expand and develop.
2. Revenue For The Government: Particularly in less developed countries, tariffs are a handy way to generate income since there are few alternative sources of revenue.
3. Job Preservation: Protecting local industries, tariffs can be utilized to save jobs in domestically competitive industries vulnerable to lower-cost foreign imports.
4. Encourages Local Production: Local produced goods becomes more attractive for purchase, this motivates the domestic production.

5. Useful in Trade Bargaining: Makes the country's overseas trading approachable as negotiable for expectable change of action from the other country.

Disadvantages of Tariffs

1. Consumer Spending: high priced import goods slowing the pace of living.
2. Reprisal and Trade Conflict: Prompting other nations to introduce reprisal tariffs that spiral trade conflicts. All affected economies suffer from this.
3. Less Competitive Market: Tariffs eliminate free trade and can cause a relatively inefficient allocation.

Literature review

Early discussions on import protection date back to the era when Britain introduced tariffs following the collapse of the gold standard during the Great Depression. The rationale was that restricting imports could help alleviate domestic unemployment (Cripps & Godley, 1978). Supporting this perspective, some research indicated that countries which adopted protectionist policies experienced faster growth during the 19th century (O'Rourke, 2000). Eichengreen (1981) contributed further by differentiating between short-term and long-term impacts, arguing that while tariffs may boost output and employment temporarily, they can ultimately hinder production over time.

Numerous studies have reported minimal or no adverse effects of tariffs on economic performance. Reitz and Slopek (2005) argue that there is no definitive theoretical prediction regarding the impact of tariffs on output. Their findings emphasize that the effects depend on various factors, including the timing and expected duration of the tariff shock, the response of real wages and exchange rates, the values of key elastic-cities, and institutional conditions such as the exchange rate regime and the level of capital mobility. Consistent with their theoretical assessment, their empirical analysis—based on five datasets and a non-structural VAR approach—shows no significant influence of tariff changes on the real exchange rate, trade balance, or real output, either domestically or internationally.

Later discussions during the 1990s and 2000s shifted toward examining the broader relationship between trade, trade policy, and economic growth. These studies expanded the focus beyond tariffs to include various trade-restrictive measures. A generally positive link between trade openness and growth was found (Dollar, 1992; Feyrer, 2009; Billmeier & Nannicini, 2013), although debates persisted over methodological issues and the accurate measurement of trade openness (Rodriguez & Rodrik, 2001; Temple, 2000). In parallel, research evolved to investigate the effects of trade policy using micro-level industry data (Grossman & Rogoff, 1995; Topalova & Khandelwal, 2011).

Another possibility—discussed in Amiti, Redding, and Weinstein (2019)—is that in response to the tariffs, domestic producers raise their prices to retailers on goods that compete with the imports.

Our estimated asymmetry in the pass-through rates of exchange rates and tariffs is consistent with the results in Fitzgerald and Haller (2018) and may reflect the role of imported intermediate inputs in production and the perceived difference in the persistence of tariffs versus exchange rate changes.

With the recent resurgence of interest in tariff-related issues, a growing body of research has emerged. However, much of this work relies on narrowly focused, disaggregated sectoral data and centers primarily on a few countries, particularly the United States (Amiti, Redding, & Weinstein, 2019; Fajgelbaum, Goldberg, Kennedy, & Khandelwal, 2019). Although these studies generally indicate welfare losses due to tariffs, their findings have limited applicability because of their narrow sectoral scope and limited geographic coverage. This leaves open the broader question: what macroeconomic evidence exists regarding the impact of tariffs on output?

Furceri et al. (2019) suggest that the adverse effects of tariffs largely stem from increased costs of imported inputs, which in turn affect overall production. In a related study (Furceri et al., 2019), the authors also find that tariff hikes tend to cause real exchange rate appreciation, while their influence on the trade balance is generally small and statistically insignificant.

Another mechanism, as explored by Amiti, Redding, and Weinstein (2019), is that domestic firms may respond to tariffs by raising prices on goods that directly compete with imports. The observed asymmetry in the pass-through effects of exchange rate fluctuations versus tariffs aligns with the findings of Fitzgerald and Haller (2018), likely reflecting the critical role of imported intermediate goods in production and the differing expectations regarding the longevity of tariffs compared to exchange rate shifts.

Research gap

Although much has been studied in regard to tariffs, we still do not have a complete understanding of the historical background, opportunities, and obstacles of tariff policies and how they affect international stock markets. Numerous studies have examined particular aspects of tariffs, for example, the effect on individual industries or between two nations, but few of them have investigated the overall effects of tariffs between multiple nations and markets. This deficiency in an overarching study does not allow the reader to properly understand the long-term development of tariffs, opportunities offered by tariffs for economic expansion, and impediments they are creating for worldwide financial stability. This research would fill this information vacuum by considering the history, prospects, and difficulties of tariffs and their performance in stock markets in large economies such as China, the USA, Japan, and India. In so doing, we aim to present a richer picture of how tariffs influence the global trade and financial markets.

Research objectives

- History of Tariff
- Opportunities and challenges of tariffs
- Reasons to impose tariffs by US to the rest of the world
- Impact of tariff imposed by US on world share market
- Advantages and Disadvantages of Tariffs

Opportunities and Challenges of Tariffs

There are a number of benefits of tariffs to a nation's economic development and management. One of the main benefits is protection of local industries from global competition, especially in developing nations where local businesses might not have been in a position to compete with established foreign businesses. Tariffs can spur consumers to purchase locally made products by raising the cost of imported products, thereby encouraging local manufacturing, employment, and entrepreneurship. Moreover, tariffs can be utilized as a source of funding for government activities, particularly in developing countries with inefficient tax authorities. Tariffs can also serve as a negotiating strategy in trade talks, allowing nations to push back against discriminatory trade practices or gain more favorable terms. Tariffs are of strategic benefit and protection, but at the same time, they also have a lot of severe downsides. One of the main concerns is the danger of trade wars, where affected countries impose tariffs in retaliation, escalating tensions and cutting world commerce. International supply chains could be damaged, and producers and consumers harmed. Increased costs of imported goods are one typical effect of tariffs, with consumers paying and potentially increasing inflation. Over the long run, this might reduce economic efficiency and overall purchasing power.

Reasons to impose tariffs by US to the rest of the world

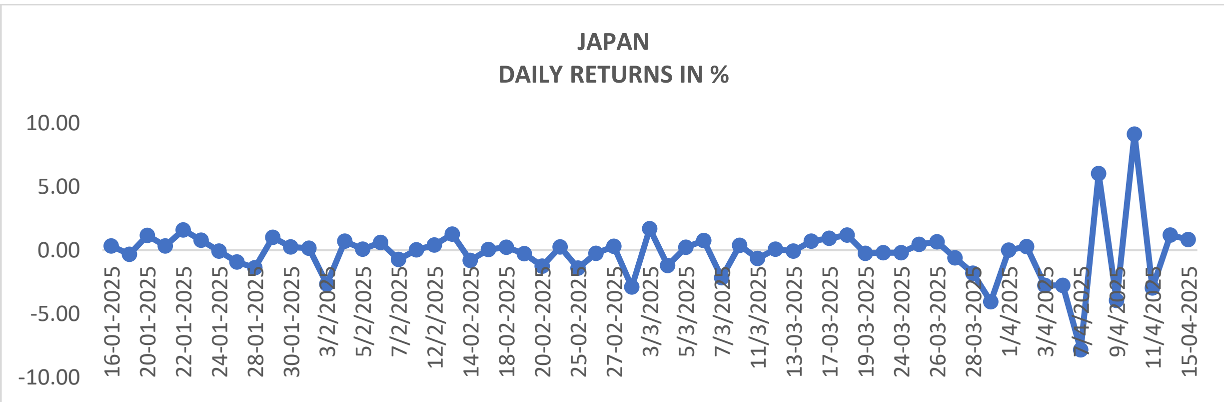
- The United states imposes tariffs on imported goods and services to achieve various economic and strategic objectives. Tariffs are taxes levied on imported products, which can increase their prices in the US market and make them less competitive compared to domestic products.
- The US imposes tariffs to make America strong again by protecting its industries, creating jobs and boosting the economy. The "America First" approach prioritizes American interest and aims to address trade imbalances and unfair practices. By doing this, US seeks to reclaim its position as a global economic leader and promote domestic growth.
- Tariffscan change trade balances, empower the dollar, and make it more expensive for other nations to pay debts or purchase necessities.

Data Analysis

Graph1. Daily Returns of China [15-Jan-2025 to 15-Apr-2025]

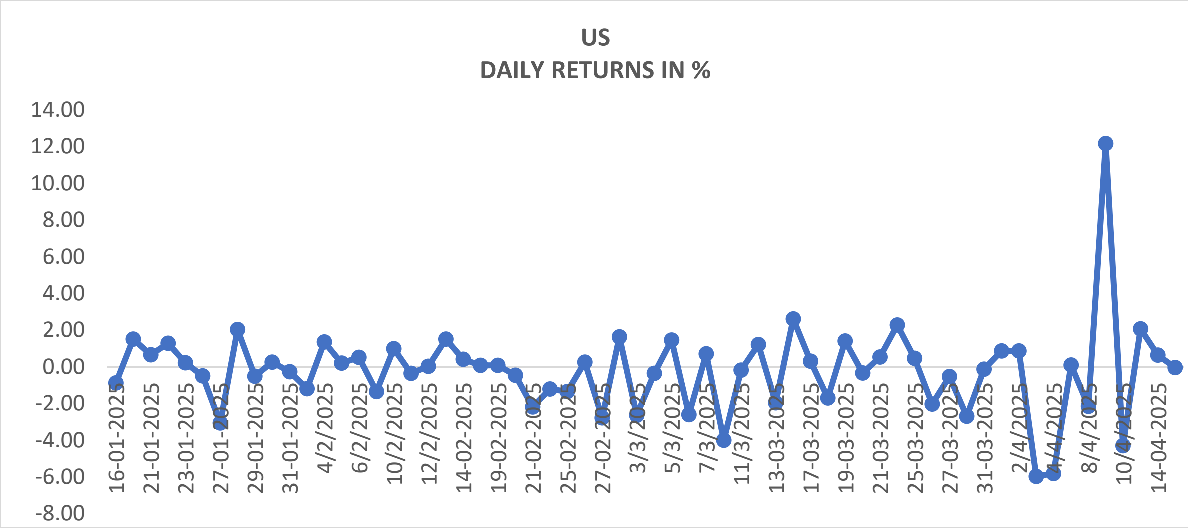
Source: https://in.investing.com/indices/shanghai-composite-historical-data

Graph 2. Daily Returns of Japan [15-Jan-2025 to 15-Apr-2025]



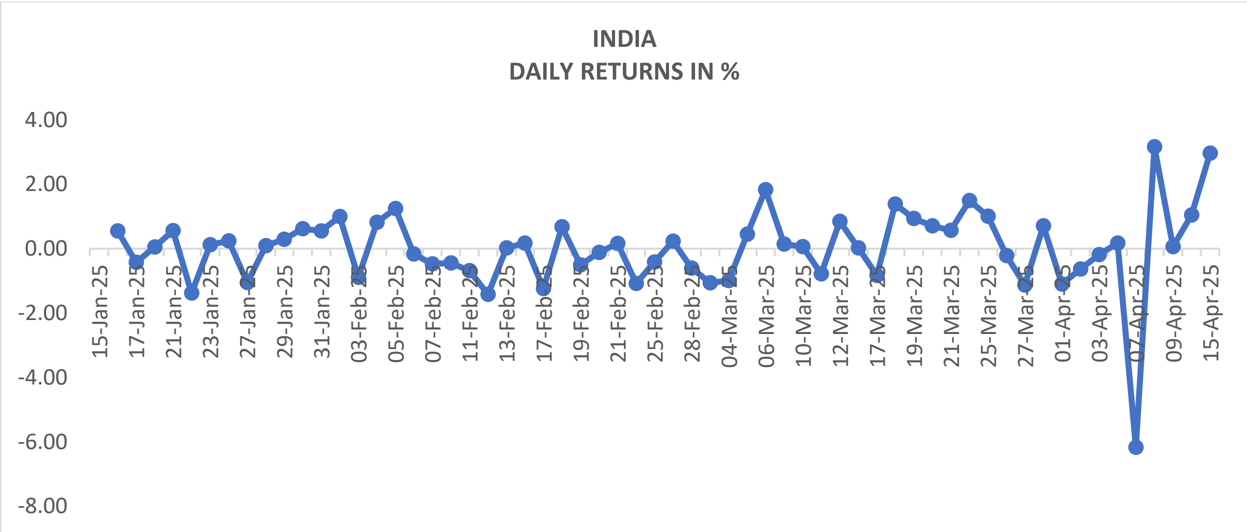
Source: https://in.investing.com/indices/japan-ni225-historical-data

Graph 3. Daily Returns of US [15-Jan-2025 to 15-Apr-2025]



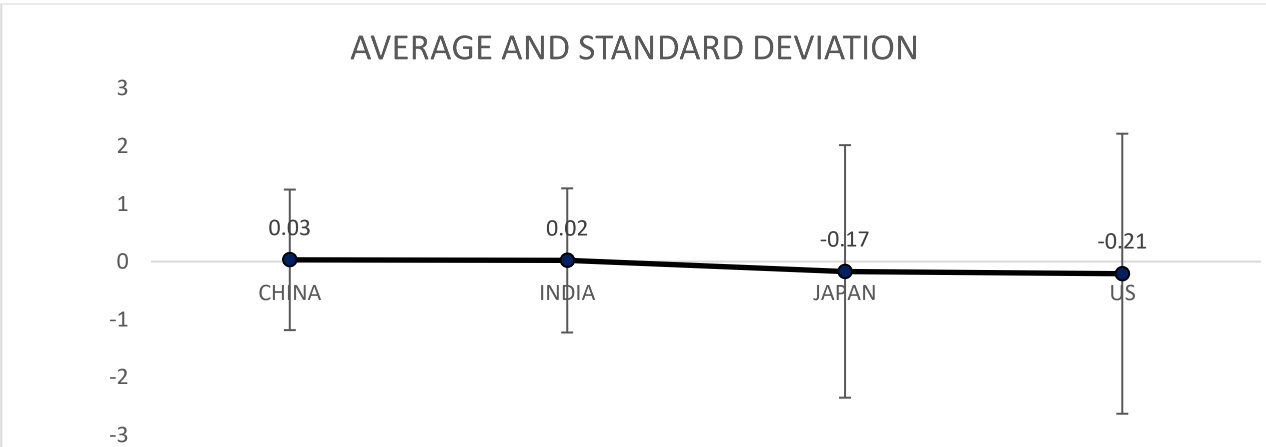
Source: https://www.nasdaq.com/market-activity/index/spx/historical

Graph 4. Daily Returns of India [15-Jan-2025 to 15-Apr-2025]



Source: https://www.nseindia.com/reports-indices-historical-index-data

Graph 5. Average returns and Standard Deviation



Graph 5, showcases the average returns and standard deviations of CHINA, INDIA, JAPAN and US. Japan and US exhibit higher volatility (standard deviation of 2.185 and 2.423 respectively) and negative average returns (-0.17% and -0.21% respectively). In contrast, China and India display lower volatility (standard deviation of 1.216 and 1.247 respectively) and slightly positive average returns (0.03% and 0.02%)

Limitations of the study

This study is limited to period from 15 Jan 2025- 15 Apr 2025. This study focuses solely on the countries including India, Japan, US, China. The analysis is constrained by the availability and quality of data. Data collection was strictly confined to secondary sources. The analysis is based on historical data. The results may not be indicative of future performance.

Conclusion

In conclusion, this paper shows that the tariffs imposed have shaken global markets, leading to increased uncertainty and volatility. Countries like Japan and the US experienced significant market fluctuations. The tariffs were intended to boost domestic industries, but they also have sparked concerns about trade wars and economic slowdown. Tariffs may provide short-term benefits to domestic industries, also lead to trade wars higher consumer prices and global economic slowdown. As protectionist policies continue to shape international trade, it is essential for international investors, policymakers and businesses to understand the implications of these policies. Future research should focus on exploring the long-term consequences of protectionism and identifying effective strategies for promoting sustainable economic growth.

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