ADVISOR INVESTING

What Are Trade Tariffs And How Do They Work?

Audited & Verified: Jul 8, 2025, 10:45am

Written By Prashant Mehra
Senior Staff Writer

& 1 other

Editorial note: Forbes Advisor Australia may earn revenue from this story in the manner disclosed here. Read our advice disclaimer here.

Table of Contents

On April 2, 2025, US President Donald Trump unveiled sweeping new taxes—dubbed "Liberation Day" tariffs—targeting imports from nearly every country around the world. The move sent shockwaves through the global trade system and triggered a sharp downturn in international financial markets.

revised framework, and financial markets are bracing for renewed volatility.

So what are trade tariffs, why do governments use them, and how do they affect the costs of goods and services?

Featured Partner Offers

Subscribe

Provider Available Devices Filter Sort: Default

3 of 3 results

	AU Trading Fee	US Trading Fee	Available products
eToro	US$2	US$2	ASX shares, Global shares, US shares, ETFs
Moomoo Share Trading	$3	US$0.99	ASX shares, Global shares, Options trading, US shares, ETFs
Webull	$1.00	US$1.00	ASX shares, Global shares, Options trading, US shares, ETFs, Cryptocurrencies

eToro — GO TO SITE

Trade stocks, commodities and currencies from the one account and get access to social trading.

Moomoo Share Trading — GO TO SITE

Trade US, Asian and CHESS-sponsored ASX stocks and get access to social trading.

Webull — GO TO SITE

Trade over 3,300 Australian and US ETFs with $0 brokerage.

LOAD MORE

1 - 3 of 3

What Are Tariffs and How Do They Work?

internal_user ×

applies to goods—typically physical goods—when they cross a border.

Tariffs are paid by the importing business to the customs authority of the country levying the tariff, and the cost is eventually passed on to consumers, in full or in part. In simple terms, tariffs are a tax that increases the price of goods and services purchased from another country, making them less attractive to domestic consumers.

There are commonly two forms of tariffs:

- **Specific Tariffs** where a fixed amount is levied on every unit of an imported good, with the tax varying according to the type of good. For example, a $300 tariff on each computer imported, or a two cent tariff on every kilogram of sugar imported.
- **Ad Valorem Tariffs** where the tariff is levied as a fixed percentage of that good's value. For example, a 15% tariff levied on imports of US or Chinese cars will usually increase the price of the car by 15% for domestic consumers—unless of course the manufacturer chooses to absorb the price increase.

Why Do Countries Impose Tariffs?

Historically, tariffs have been an important source of revenue for governments. Prior to the 19th century, they were considered a great way to collect tax, because it was easy to track something when it crossed a border. A state could place agents at ports or common places where ships passed and collect taxes at that point.

As commerce and technology got more sophisticated, most governments moved on from tariffs to other forms of taxes, such as an income tax, business taxes, and sales or value-added tax. These taxes are considered more efficient because they use a broader base to collect revenue, while also minimising distortions in economic activity.

Tariffs have also been traditionally seen as a tool for trade policy, and are often used as a form of protectionism. Typically, countries impose tariffs either to protect some domestic industry or consumer or to exert leverage over other countries they trade with:

- **To protect domestic industries:** Governments use tariffs to stave off increased competition from cheaper imported goods that could threaten domestic industries and risk less secure supplies and higher unemployment. This sort of strategy is often used by developing nations to protect their less mature industries from foreign competition.
- **To protect domestic consumers:** Governments also levy a tariff on products that they feel could harm its citizens. For example, tariffs on imported beef which may contain hormones.
- **To further national interests:** Tariffs are also often used as an extension of foreign policy or to protect certain sectors deemed strategically important, such as defence or certain farm products. For example, earlier this year Trump placed 25% tariffs on imports from Canada and Mexico, and 10% tariffs on imports from China to force these

Other Trade Barriers

Tariffs are just one form of trade barrier. In addition, governments use several other types of restrictions to limit trade with or exert pressure on other countries. These include requiring licences for imports in certain industries, imposing import quotas on certain types of goods, mandating a minimum percentage of local content for products, or scaling up administrative requirements such as satisfaction of local regulations, or the volume of paperwork required.

Are Tariffs Good or Bad?

There are some arguments why tariffs might be beneficial in specific cases.

The biggest one, which is often used by politicians, is the idea of **unfair trade practices**, where a foreign country heavily subsidises its industry, or sets unreasonably low prices in the importing country's market in order to drive out competition.

This was sometimes seen during the economic rise of China in the early 2000s—which changed the nature of manufacturing and led to factory closures and loss of jobs in some Western countries. Economists generally counter this argument by saying that, if another country wants to spend their money subsidising its industry so that you can buy cheaper products, then it's a gift to you. Most economists agree that the growth of China has been positive for most countries overall, although there were particular industries, geographic areas, and demographics that felt most of the impact.

Another argument, often used by Donald Trump, is that **the other country will pay** for the tariffs. This is only partially true in specific cases because of the "terms of trade effect", whereby if a country imposes a tariff that lowers demand for the foreign country's product, it might push prices down on the global market. As a result, while the total price that domestic consumers pay will go up, it may not go up by as much as the tariff imposed, because the other country has had to lower their prices.

This reasoning is also countered by the fact that such optimal tariffs only work if the country imposing them has a big enough market, and they certainly don't work if the other country decides to retaliate.

"If you impose tariffs on your imports of another country's goods, and they retaliate by putting tariffs on the goods you're exporting to them, then almost always, both countries are going to be worse off than if both countries just have low tariffs to begin with," says Scott French, a Senior Lecturer in Economics at the University of New South Wales (UNSW).

In general, most economists agree that trade barriers of any kind—tariffs, quotas, any other type of restrictions on trade—have a negative economic impact and that lowering them encourages

 th.

optimal place.

“Most trade involves mutually beneficial exchanges, and it tends to be best for everyone. With international trade, there are always going to be winners and losers, but the idea is that the overall economic pie is bigger when there are lower trade barriers,” he says.

“So generally, tariffs are bad.”

What Impact Do Tariffs Have?

Tariffs and trade barriers have a significant impact on consumers and businesses, although this can vary over time.

In the short run, tariffs increase the prices of imported goods while allowing domestic producers to keep prices high amid decreased competition. The net effect is that domestic consumers are left paying higher prices, which may reduce consumption.

Tariffs also reduce efficiencies by allowing less competitive domestic companies to operate. Over the long term, these businesses may see a decline in efficiency due to a lack of competition, or could see profits reduce due to the emergence of alternatives for their products.

For policymakers, widespread tariffs run the risk of economic distortions such as higher inflation and greater demand for subsidies or public services due to less disposable income for their citizens.

Impact of US Tariffs

The Trump tariffs announced in April are the most sweeping trade barriers globally since World War 1, ending decades of trade liberalisation.

The Liberation Day tariffs are considered unusual because of how broad-based they are. Essentially, the tariffs were intended to apply to almost every good from almost every country in the world. While past US administrations have often imposed tariffs on specific industries, the extent of their use this time has sharply lifted the US’ overall tariff rate.

It has left economists struggling to analyse the long-term effects, because they only have data about what happens when tariffs are imposed on particular industries or countries. They don’t have a lot of evidence of what happens when the world’s largest economy proposes massive tariffs on all of its trading partners at the same time.

There is a broad agreement, though, that the proposed taxes and frequent changes involved will result in an uncertain policy environment that will discourage household demand for big ticket items, as well as business investment.

their biggest macroeconomic concern—five times more than the next highest perceived risk. Similarly, more than half of respondents highlighted continued uncertainty in US foreign policy as the greatest geopolitical risk affecting their investment decision-making.

"There are a lot of people just standing on the sidelines waiting to invest and spend money, and that's going to take a long time to really be felt in the global economy," French said.

"The biggest implication is just this chilling effect on investment, meaning that even if we got rid of all the tariffs tomorrow, it might take five years before we're back to where we would have been before everyone put their plans on hold."

Is Free Trade Finished?

Post World War Two, the US and Western European countries set up what was originally called the General Agreement on Tariffs and Trade (GATT), which evolved into the World Trade Organization (WTO) over time.

Over that period until the 1990s, there were a series of rounds of negotiations that led to a broad reduction in tariffs and non-tariff barriers across most countries, starting with the advanced industrial economies, but eventually moving down to the less developed countries. Negotiations stalled in the early 2000s when it came to contentious sectors, especially agricultural tariffs.

But overall, there has been a long-term, general decline in tariffs globally, which has allowed international trade to flourish. That landscape shifted dramatically following the US administration's rollout of its tariffs in April.

Economists and international organisations have expressed concern about the substantial increases, with the WTO warning they could cause global trade volumes to contract by 1% in 2025, if implemented.

Some analysts have raised the potential for the US tariffs to push the world's largest economy into a recession. French says while this may be a possibility, the bigger worry is the reduction of long-term economic growth, not just in the US but across the world because of the reality of complex global supply chains.

"If we only bought final goods from each other, then we could just build more of those products domestically," he says. "But what's more likely to happen is that a business will, all of a sudden, need to source some crucial component from somewhere else, and it just backs up their entire supply chain in the meantime."

It will also lead to trade diversion as the US and China, after imposing steep tariffs on each other, look to increase their trade with other countries. Governments in the Asia Pacific and

From the perspective of Australian businesses, the impact will depend on how they interact with the global supply chains. It could mean that anything manufactured in the US or North America, especially using steel or aluminum components, is going to get more expensive. On the other hand, if they produce something that substitutes for one of these goods, they are likely to benefit.

Frequently Asked Questions (FAQs)

What is a tariff in simple terms?

Are tariffs good for the economy?

Do tariffs cause a recession?

Guides To Investing

How To Buy Stocks And Shares

How To Research Stocks

Best Investment Trading Apps in Australia

Stocks & Shares: Is Now The Time To Buy The Dip?

Best Passive Income Ideas

Investing In ETFs In Australia

How To Survive A Stock Market Crash

What Is Forex Trading?

Best ‘Safe Haven’ Investments for Australians

Best Short-Term Investments for Australians

Best Long-Term Investments

Best Dividend Stocks On The ASX

What is ESG Investing?

n A Brokerage Account in Australia

Subscribe

What Is Compound Interest?

What is a Bond?

Guide To REITs

Buying Guides

How To Buy Tesla (TSLA) Stocks

How To Buy Netflix (NFLX) Stocks

How To Buy Amazon (AMZN) Stocks

How To Buy Twitter (TWTR) Stocks

How To Buy Microsoft (MSFT) Stocks

How To Buy Apple (AAPL) Stocks

How To Buy Facebook (META) Stocks

How To Buy ETFs

How To Buy Bonds In Australia

Investing News

ASX Today

Euro to AUD Forecast

USD to AUD Forecast

AUD To USD Forecast

GBP To AUD Forecast

AUD To PHP Forecast

BTC To AUD Forecast

internal_user ×

Subscribe

More from Advisor

CommSec Review: Features, Pros & Cons

By **Sophie Venz** Former Staff Editor

Our Pick Of The Best Share Trading Platforms For Australians

By **Sophie Venz** Former Staff Editor

How To Buy Microsoft (MSFT) Stocks & Share...

By **Andrew Michael** Former Editor

How To Buy Apple (AAPL) Stocks & Shares In Australia

By **Jo Groves** Former Staff Writer

internal_user ×

Subscribe

What Is A Bond? The Complete Guide

By **Sophie Venz** Former Staff Editor

Term Investing From Australia

By **Sophie Venz** Former Staff Editor

Prashant Mehra
Senior Staff Writer

Prashant Mehra is a Senior Staff Writer for Forbes Advisor Australia based in Sydney. He has more than 20 years of international experience covering financial news, including with Reuters and the Australian Associated Press (AAP). He writes about business, markets, the economy and investing.

Forbes

internal_user ×

AdChoices

Subscribe

Limit the Use of My Sensitive Personal Information

Privacy Preferences

Digital Terms of Sale

Terms of Service

Contact Us

Send Us Feedback

Report a Security Issue

Jobs At Forbes

Reprints & Permissions

Forbes Press Room

Advertise

internal_user ×