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RESEARCH ARTICLE

TARIFF AND ITS IMPACT ON THE WELFARE OF THE UNITED STATES OF AMERICA

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ABSTRACT

Protecting domestic producers of the import-competing goods, thus saving jobs in the sector is the key motive of tariff imposition though political pressure often leads to protectionism. Tariffs imposed by Trump administration which was effective from August 2025, (eventually struck down by US Supreme Court on February 2026) on imports of different countries aimed at revenue generation and import reduction for correcting unfavourable balance of payments. A higher rate of tariff though improves Terms of Trade of the tariff imposing country; it distorts trade by encouraging production in the inefficient import-competing sector and lowers consumption of tariff-imposed good thereby reducing the welfare of the tariff-imposing country.

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INTRODUCTION

A tariff is a tax levied when a good is imported and is paid by the importer to its home country's government. Most common types of tariffs are ad valorem. During the eighteenth and at the beginning of the nineteenth century, tariffs were used mainly to generate government revenue and protect domestic industries. This oldest form of taxing of imports is probably the easiest means to acquire income by a government. In the early nineteenth century, UK used tariffs (well-known Corn Laws) to protect her agriculture from foreign competition. In the late nineteenth century, both Germany and United States protected their nascent industries by imposing tariffs on imports of manufactured goods. However, in the 1840s, income taxes were introduced in England, dismantling protection of agriculture (Corn Laws were repealed). England, Germany and France continued to be free trading nations till late 1860s while USA stood as a fairly protectionist nation. US maintained high tariffs for decades, until income taxes replaced tariffs as the most important source of revenue in the 1930s. After second world war, tariffs continued to decline as US and European countries emphasised on trade expansion as a base of their global strategy. Protectionism is not however dead. Majority of post-war tariff existed between developed countries, mainly on manufactured goods. There are also non-tariff barriers to trade. The developing countries continue facing barriers to trade with the developed ones, in the guise of "managed trade" as in textiles, leather products, etc. The motives of modern governments in restricting imports are manifold. Protecting domestic producers of the import-competing good, thus saving jobs in the sector is the key motive though political pressure often leads to protectionism.Revenue generation and import reduction for correcting unfavourable balance ofpayments are other important causes of protectionist steps. US President Donald Trump taking office for the second time had sanctioned a growing list of tariffs on different countries and commodities to protect American interests. Like he announceda 30% tariff on EU, to tame the growing trade deficit with the bloc and declared 50% tariffs on Brazilian exports. Reciprocal tariff of 25% on almost all goods that India exports to the USA and an additional 25% tariff as a penalty for India's crude oil imports from Russia are imposed. Trump also declared 30% tariffs against Mexico. Significant escalation of the conflict between US and China in 2025 led USA to impose a 145% tariff on Chinese goods and China retaliated by imposing 125% tariff on American goods. For decades, United States and other countries abided by the tariff rates set through a series of complex negotiations known as the Uruguay Round. Countries are free to set their own tariffs – but under the "most favoured nation (MFN)' clause, they couldn't charge one country more than they charged another. To US, tariffs meant better-paying American jobs and are instruments of increasing revenue. The tariff according to Trump is an effective instrument to reduce the US trade deficit with different countries of the world. In the paper, we try to investigate whether US will gain from the imposition of tariff on the importsfrom India and how India strategies to overcome this external shock. The paper is structured as follows- India -US economic and political relation in the recent past and the immediate cause of the imposition of the tariff are considered in section 2. In section 3

the the theoretical framework of the effects of tariffs on the domestic economy of a large country vis -a-vis the exporting country are presented. Section 4 concludes the paper. The paper ends with the list of references.

India-US Political and EconomicRelations in the Recent Past: Backdrop of the Imposition of Tariffon India: India–United States political relations improved significantly by 2016 during the premiership of Narendra Modi. They share an extensive diplomatic and economic relationship overcoming the age-old strained relation—caused by previous adversarial US foreign policies. Both the countries camecloser to tame an increasingly assertive China,combat terrorism and to leverage the deteriorating US-Pakistan ties.Closer ties developed between the two, especially in the ICT, engineering and medical sectors etc.followed by easing of export controls over dual-use goods & technologies (99% of licenses applied so far, upto 2016, were approved) and reversal of the then American opposition to India's strategic program.

In the meantime, growing financial power of the affluent Indian Americans reflected in their increasing contribution in US GDP raised their political influence. India-US relationship remained more or less amicable during first term of President Donald Trump barringa few incidents. Although there were certain differences over the Russian invasion of Ukraine, US and India strengthened cooperation in defence, semiconductors, critical minerals, space, climate, education, healthcare and other fields during the Joe Biden Presidency. The countries came closer further in 2023, for concerted action against UN-identified terrorist organisations. But India-USA diplomatic relation got strained after Donald Trump took office for the second time when India rejected twice, Trump's offer of US mediation to pacify Indo-China border tensions. Bilateral tensions resurfaced over conflicting claims by Trump administration regarding the May ceasefire—after India announced halting of Operation Sindoor. US administration and several media reports credited American diplomacy for facilitating the truce which Indian officials outrightly rejected.Finally on July 30, 2025, President Trump announced 25% reciprocal tariffs on all the goods that India exports to USA and an additional 25% punitive tariff due to India's purchase of crude oil from Russia to retort New Delhi's constant emphasis on strategic autonomy and her rejection of third-party mediation to negotiate a peace deal with Pakistan. Before we go to analyse whether USA benefits from the imposition of tariffs vis-à-vis India, we consider in brief economic effects of tariff for the importing country**.**

Economic effects of an import tariff imposed by a large country: For a large country which shares a considerable volume of world trade, imposing a tariff has two opposite effects. Firstly, positive terms of trade effect (TOT) as the tariff reduces her demand for imports lowering the world price of the imported good. She buys imports at a cheaper price relative to her exports, hence improving her TOT. This increases national welfare. Secondly, there is distortion effect caused by a higher rate of tariff. One is production distortion because domestic producers produce inefficiently more of the import-competing good and the other consumption distortion as consumers buy less of the good due to higher price. These distortions reduce welfare. When tariff increases from say 25% to 50 %(as in the cases of major export items from India to USA including textiles and apparel, gems and jewellery, leather products, organic chemicals etc.) the distortion losses increase sharply and the TOT improvement increases only slightly after some point. If TOT effect dominates the trade distortion effect tariff is welfare enhancing. We illustrate these possibilities in the following section. Weexamine the welfare effect in the tariff imposing large country using neo-classical trade model illustrating the gains from trade in the general equilibrium framework. We consider first the welfare decreasing effect of tariff in a large country.The trade-off between the production of exportable and import-competing goods and implications of resource allocations across these sectors for gains from trade can be explained through the production possibility curve (PPC) and thesocial indifference curves (SIC).PPC represents the different combinations of two goods that an economy can produce with its resources and given technology and defines the limit on the consumption possibility of the economy. Its absolute slope is the opportunity cost of producing an additional unit of good X (say) by forgoing the number of units of good Y or the marginal rate of transformation (MRT) of Y into X. After opening up of trade a large country can transform good X into Y or vice versa either through reallocating resources within the economy (MRT in production) or through trade (MRT in trade).The opportunity cost of producing an extra unit of X is measured by the ratio of private marginal costs of producing X and Y in the absence of externality. Thus, for any point on PPC, the corresponding slope reflects the relative supply price of X (P_X/P_Y) because of marginal –cost-pricing under perfectly competitive conditions. The MRT increases with successive additional units of X being produced giving strictly concave PPC. SICis the locus of different combinations of consumption of X and Y for which the country attains the same welfare level. It has similar properties as an indifference curve except that SICs can intersect making ranking of SICs in terms of social welfare difficult. Under identical and homothetic tastes of consumers this problem can be avoided. We, consider a large country trading with another country (not so large in terms of her share in world trade) and two tradeable commodities X and Y. Since the former has a considerable share of international trade her domestic price ratio is identical to the international price ratio. Let, $(P_X/P_Y)_L$ is the relative price ratio prevailing in the large country that coincides with the $(P_X/P_Y)_f$,the international price ratio. Thus, before trade,

$$(P_X/P_Y)_L = (P_X/P_Y)_f$$

The large country can be said to lack comparative cost advantage in world market. Still, it can trade with the other country to buy commodity Y (in which the other has comparative advantage in production) because of its large home demand. We assume perfect competition with flexible factor prices, in both the sectors. Free-trade production and the consumption point for the large country be P and C respectively on the price line LL' (the national budget line) as illustrated in figure (1). In the absence of any externality in production and factor price differential, at P the absolute slope of production possibility curve, RS or opportunity cost of producing X (MRT) equals the absolute slope of the line LL' also reflecting the free-trade international price-ratio. At C the absolute slope of SIC orthe marginal rate of substitution in consumption equals the slope of LL', reflecting the fact that the country is consuming within her national budget line. Thus, at free-trade equilibrium:

$$MRS(C) = (P_X/P_Y)_L = (P_X/P_Y)_f = MRT(P),$$

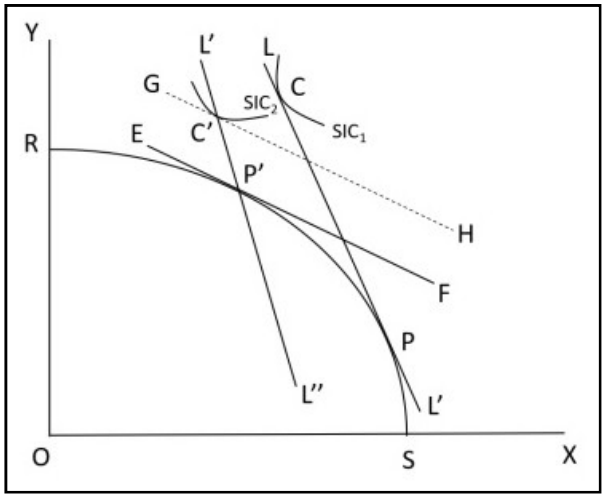

Fig.1.Welfare Loss due to Imposition of tariff

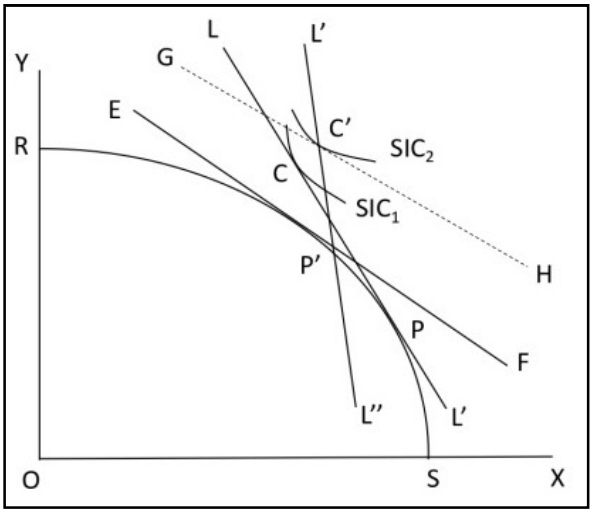

Fig. 2. Welfare Gain due to Imposition of Tariff

After the imposition of tariff on the commodity Y, the tariff-ridden domestic price ratio becomes p_t ($P_X/P_Y(1+t)$,t ad valorem tariff) which is less than the international price ratio p_f (P_X/P_Y). Thus, domestic relative price of Y, given by the reciprocal of the absolute slope of the price line EF (reflecting the price ratio p_t) rises. Higher relative price of Y causes domestic producers to produce inefficiently more of the import-competing goodwhile falling relative price of X contracts theefficient production sector. Production point thus shifts from P to P' where the price line EFis tangent to RS satisfying the condition MRT (P') = $1/p_t$.The rise in the domestic price of imports lowers its consumption which for a large country will drive the world price of that good down, while the reduction in her supply of exports pushes up its world price improving the TOT.But the trade distortion effect dominates the TOT effect when the tariff is high. The imposition of tariff raises the domestic price ratio ($P_Y(1+t)/P_X$), decreasing the MRT in production (now equal to $P_X/P_{Y(1+t)}$) which is less than MRT through trade.The consumption bundle shifts from C to C', where SIC_2 is tangent to the broken line GHsatisfying the condition MRS (C') = $1/p_t$, parallel to the changed price line (or national budget line)EF. Trade will be carried out at the new international TOT or L'L" and C' must lie on this line. Thus, at tariff-ridden equilibrium

MRS (C') =$1/p_t$=MRT (P')

Higher the rate of tariff, flatter will be the line EH and larger the divergence between EH and L'L". The new consumption point is on a lower indifference curve than C implying a fall in welfare of the large country. In the presence of monopoly in the import-competing sector of the large country, free trade removes the monopoly -created price distortion and the country specialise in the good in which she has comparative advantage. When foreign supply of imports is perfectly competitive, an import tariff though allows the monopolist to survive, but breaks its monopoly power. On the other hand, in the case of few large suppliers of imports, imposition of tariff lowers the supply of the imported good and raises its price. Consumers as under perfectly competitive condition pay a higher price and consume less. Figure 2 illustrates the welfare raising effect of a tariff which is not very high. Here the TOT effect is large and dominates the trade distorting effect of thetariff. After tariff is imposed production moves from P to P' as relative price of Y increases, the import-competing sector expanding while export promoting industry contracting.

The price line EF giving the new domestic price ratio is steeper than that in the case of large tariff. Trade will be carried out at the new international TOT line or L'L" and consumption takes place at C' on this line, where the social indifference curve with slope equal to EF meets L'L". In this case C' lies on a higher SIC than C, and the tariff has increased the welfare of the tariff imposing country. A small tariff increases the welfare of a large country while a large tariff can do the opposite. This can also be examined in a general equilibrium setting using offer and trade indifference curves. In a general equilibrium framework, the TOT effect of an import tariff can be explained through offer curve showing a country's willingness to trade its exports for imports at different TOT. It is the locus of the points of tangencies between the TOT (showing international price ratio of the traded commodities) and the trade indifference curve (combinations of traded goods providing equal level of welfare to a country). Imposition of tariff (or increase in the existing rates) can shift the offer curves. As already stated, in a large tariff-imposing country, tariff changes its volume of trade and TOT. A tariff unambiguously lowers the import demand under the implicit assumption that the tariff revenue is redistributed among domestic consumers in a lump-sum manner.

A tariff raises the domestic relative price of imports and lowers the import demand by the absolute value of the import demand elasticity (e). Redistribution of tariff revenue on the other hand raises the income of the consumers, increasing their demand for imports by the value of marginal propensity to consume (m). Thus, a tariff changes the demand for imports by (m-e). Now, a rise in the relative price of imports has substitution and income effects and these effects outweigh the income redistribution effect and lower the demand for imports. For a large country the fall in her import demand being substantial in relation to the volume of world trade, the relative price of Y falls internationally. Thus, the TOT will generally improve in favour of the large country. This is illustrated in figure (3) with OA and OB the free trade offer curves of the large country and her trading partner respectively intersecting at E to determine the free trade market equilibrium. Let the large country imposes an ad valorem tariffof 50% (say) on her imports Y. Then world market price of Y is two-third of its domestic price. This implies that the large country's offer curve should decline to two-third of its height after the imposition of the tariff since a lower volume of exports can support her smaller

import demand. OA' is the tariff-ridden offer curve of the large country and the international equilibrium shifts to E'.

Fig. 3.

The TOT improves for the large country as indicated by the slope of OE'. How much a country will be able to influence the TOT in her favour depends upon the elasticity of the foreign offer curve. In fact, a large country faces a less than perfectly elastic offer curve.By restricting her purchase and sale she can buy imports cheaper and sale exports dearer, thereby gaining an improvement in the TOT. To take advantage of this power a large country will levy an optimal tariff which permits her to reach the highest possible trade indifference curve. The existence of such a tariff is due to two opposing forces that are at work as the tariff rate is increased successively. The TOT turn more and more in favour of the country levying the tariff while counter to TOT improvement, volume of import as well as export tend to be curtailed with increasing tariff rate (shown in figure 3). At smaller rates, the decline in trade volume is small and the welfare gain is due to stronger TOT effect. With increasing tariff rate trade volume declines by greater magnitudes leading to successive welfare losses. But the country cannot go on increasing its tariff rate because an optimum position is reached when the gain due to TOT improvement exceeds the loss from decline in trade volume by the greatest possible margin. Beyond this optimum, improvements in TOT are still possible, but are accompanied by a decline in the volume of trade which more than offset the TOT effect.

Free trade equilibrium occurs at the point of tangency of TIC_1 and OE as shown in figure 3. Post-tariff equilibrium and the welfare of the large country is shown by the trade indifference curve TIC_2 passing through E' and TIC_2 indicates a higher level of welfare than TIC_1.With the assumption that TICs are non-intersecting with each other like CICs then for any tariff rate that displaces the home offer curve along the elastic portion of the foreign offer curve the corresponding TIC will be strictly higher than free trade TIC. All such tariff rates raise the home country's welfare above the free trade level. For tariff rates even larger, trade distortion effect dominates the TOT effect thereby lowering the welfare of the tariff-imposing large country. Thus, according to standard trade theory tariffs imposed by a country has the consequence of reducing welfare by hurting economic efficiency and consumer well-being. While they boost government revenue and support specific producers, tariffs commonly cause higher prices for consumers, increased costs for firms relying on imports, and reduced competitiveness, ultimately leading to higher unemployment. Overall, there is evidence, consistent with economic theory, that tariffs have led to higher prices in the US economy. During 2025 through December Personal Consumption Expenditure, (PCE) of core goods except few rose by 2% against -0.0% over the same period in 2023. For PCE durable goods, prices rose 2.1% against -2.2% over the same period in 2023. Though tariffs raised an additional revenue ($194.8 bn above 2022-24 average) but after the US Supreme Court judgement curtailing the President's authority to use the IEEPA to impose tariffs, all IEEPA-based tariffs will be stroke down, implying all of the IEEPA revenue collected so far may be returned to the importers. There is less clear evidence about the impacts of tariffs on the wider economy: for example, employment in tariff-exposed industries is not appreciably lower or higher than what would have been expected. It is too early and the effects of tariffs may evolve and change overtime as consumers, firms and policymakers respond gradually. Also, these macro-variables are reflection of the present economic condition and is difficult to disentangle what changed due to tariffs versus the other economic changes over the past years.

CONCLUSION

India is steering the post-tariff economic situation through a strategy of "multi-alignment," combining proactive diplomatic negotiations with key economic powers, targeted retaliation, and rapid trade diversification. India's diplomatic maneuvering includes strategic trade diversification aiming at reducing overdependence on US and China. Recently India finalised a landmark free trade agreement with the European Union in January 2026, creating a major alternative market to the US, covering sectors like textiles, marine products, and pharmaceuticals. She has concluded trade deals with UK, Oman, New Zealand to reduce overdependence on the U.S. market. India expanded bilateral diplomacy with Brazil, France, Israel, and Japan to secure trade and investment agreements, strengthening her "multi-alignment" activity. Despite harsh tariffs, India has adopted a balanced rather than confrontational approach, focusing on bilateral trade negotiations to secure exemptions, and finalise a fair agreement by early 2026. India has proactively slashed duties on certain US products, including motorcycles and whisky, to create goodwill and signal commitment to a mutually beneficial deal. The government is focusing on strengthening domestic manufacturing, particularly in labour-intensive sectors like textiles and electronics to combat tariff-induced disadvantages. India is preparing special financial packages, including interest subsidies and investment credit, to assist sectors directly hit by U.S. tariff increases. The Reserve Bank of India has utilised the undervalued rupee to blunt the competitive loss from high U.S. tariffs. India has shown increased willingness to ease restrictions on Chinese technology and investment to secure vital industrial inputs, balancing her economic needs with ongoing structural competition. India's strategy is currently seen as "not negotiating from weakness," instead using the threat of tariffs to forge a more resilient diversified, and "pro-India" trade ecosystem.

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