NLC NATIONAL LEAGUE OF CITIES

Member Fact Sheet on Tariffs for Municipal Leaders

This fact sheet provides an overview of how tariffs impact local governments.

Executive Summary

Tariffs put pressure on local governments by raising operating costs and lowering tax revenues.

Tariffs are a tax on imports, and they have been shown to raise the cost of imported goods and materials. This affects consumers, businesses, and local governments that buy things made abroad. But higher prices aren't the only way local governments are affected.

Municipal governments primarily rely on sales, income, and/or property taxes to raise money, and all three of these revenue sources can be reduced by tariffs. As prices rise, consumers buy less, which reduces sales tax revenue. Research has shown tariffs reduce household income as well, meaning consumers have less to spend while also reducing income taxes. And with less money, willingness and ability to pay for housing declines, which hurts property tax revenue. Business taxes are similarly affected as they sell less and reduce payroll through pay cuts and/or layoffs, which ultimately reduce income taxes as well.

What is a Tariff?

A tariff is a tax on physical goods (products, components, and raw materials) that cross a border. Almost always, as is the case with the United States right now, tariffs are placed on imports (and not exports – from here on out we'll be talking primarily about tariffs on imported goods). Tariffs are usually targeted in some way:

- by geography (e.g., on goods from a specific country),
- by type of good (e.g., imported steel), or
- both (e.g., a tariff on steel from a specific country).

While tariffs generate federal government revenue, they create downsides in the form of trade barriers and higher prices.

What Should Cities be Thinking About?

Here are some questions that may be helpful as you consider how tariffs could impact your city's finances and broader community:

How will tariffs impact your residents and businesses?

- Are there key industries that will be affected by increased production needs or increased cost of goods?
- Are there groups of residents that will be especially affected by increased prices or decreased supply of goods?
- Is a meaningful change in your local job market likely, and if so, in which direction?

What is the city purchasing?

- How will the impacts on residents and businesses affect the need for your government programs and projects?
- Are there active or upcoming projects (e.g., infrastructure) that rely on imported materials that could be subject to increased costs?
- Is there enough price flexibility incorporated into procurement language to account for price surges or alternative sourcing?
- How will regular operations be affected?

How could changes impact municipal revenue?

- How will the impacts on residents and businesses (and their corresponding changes in purchasing and hiring) affect your tax revenues?
- How might you adjust your municipal budget to potential changes in local tax revenues?

What Do Tariffs Achieve?

Targeted tariffs can sometimes be a useful tool for correcting a market failure, addressing anticompetitive (unfair) practices from another country, or protecting an important domestic industry from foreign competition (in cases where banning international sourcing isn't desirable). Tariffs are sometimes used to raise revenue, though globally this is not a popular option due to the many negative side effects.

One common tariff goal is to protect and grow an important industry. For example, if there is excess production capacity for tin, a country could use tin tariffs to increase domestic production and sales as local buyers switch from foreign to domestic suppliers.

Who Pays for a Tariff?

Regardless of how the tariff is actually collected, **the cost burden is often shared across all parties in a supply chain, and it's usually the tariff-imposing government's businesses and consumers who pay the most.**

For example, hypothetically, if you usually buy a $10 box of tea from Country A, and suddenly your government puts a 50% tariff on imports from that country, the seller is likely to raise the price of the tea (perhaps to $15, i.e., $10 plus 50% of $10). In that case, even if the tea seller is the one giving money to the government, it's you, the consumer, who would be paying the cost in the form of higher prices.

The seller may absorb some of the cost themselves, especially if they're selling something where demand is very elastic (for example, a non-essential good that consumers can more easily do without) or where there are very good substitutes.

Continuing the example, that tea seller from Country A might worry that American customers will simply drink less tea, but they also might worry about losing customers to sellers from Country B who don't face the tariff. In that case, they might lower their prices so that the full force of the tariff isn't felt by the end consumer.

But keep in mind: companies that export to the United States are rational enough to not do business at a loss. If that tea seller was only making $2 per sale, there's no way they'd absorb a $5 cost per sale. They'd lose money until they went out of business doing that. So the higher the tariff, the more of it has to be passed through to the end consumer for the transaction to even be feasible.

The evidence we have on tariffs aligns well with this simple model. In [this interview] with several experts from the University of Chicago, Rodrigo Adão (an associate professor of economics) says "If we go back to the trade war in 2018, there is a body of research showing that most of the impact of these tariffs was borne by consumers and firms inside the United States." Steven Durlauf, a professor of public policy, gives some examples: "Consumers are directly affected by having to pay more for goods…approximately 60% of U.S. vegetable consumption comes from Mexico, and 25% of crude oil processed by U.S. refineries comes from Canada. Even 80% of U.S. toys originate in China. Those, and many other products, will all cost Americans more."

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What Impacts Do Tariffs Tend to Have Broadly?

First and foremost, tariffs raise prices and generate some revenue for the levying government. The second-order effects can be wider-ranging. One analysis of 54 countries found that tariffs hurt household incomes. An even larger study, spanning 151 counties and half a century, found that tariffs lead to "economically and statistically significant declines in domestic output and productivity" while also hurting employment and increasing economic inequality.

The international response to tariffs must also be considered; countries may retaliate with unfavorable policy changes that often start with retaliatory tariffs of their own. The United States' 2018 tariffs provoked just such a response, and economists found that "import tariffs on foreign goods neither raised nor lowered US employment in newly-protected sectors," but "retaliatory tariffs had clear negative employment impacts," resulting in a net loss of jobs for the United States.

Research also tells us that costs are even higher when you account for the inefficiencies and uncertainty involved in managing responses to changing policy in the real world. One study, for example, found that challenges like remaking and renegotiating supply chains contributed substantially to tariff-driven GDP losses.

What Impact Will Tariffs Have on Local Governments?

Tariffs impact local governments in several ways. A tariff intentionally designed to protect a local industry from foreign competition may help protect employment in that sector, which could boost communities dependent on that industry.

However, tariffs that are large and/or untargeted tend to have a variety of negative impacts:

- **Rising costs** can significantly impact local governments, which must buy everything from fuel and uniforms to construction materials.
- As residents buy less and make less money, **local tax revenues fall** in the long run.
- Since the revenue generated by tariffs is collected entirely by the Federal government, the trade-off may be thought of as **transferring tax revenue** from state and local governments to the Federal government.
- When large tariffs are imposed very suddenly, **local governments may also find themselves unable to afford to complete projects** they've already started, resulting in further losses to the community.

Footnote: How Tariffs Can Address Unfair Economic Practices

Tariffs are also used to address unfair practices such as "dumping," which involves selling goods for less than the prevailing price (sometimes even at a loss) to undercut and harm competitors. If one country's steel industry had deep pockets or the financial support of their government, they could theoretically sell enough cheap steel to the United States to drive domestic production out of business completely. Then, with no means to make steel itself, the US economy would be beholden to foreign suppliers who would then be free to significantly increase the prices. Putting a tariff on the subsidized foreign competition could be a good way to still import some steel (so as not to create a shortage that stalls progress and increases prices) while not allowing the domestic industry to be sabotaged.

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