Insight

The Anticompetitive Effects of Tariffs

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Executive Summary

- President Trump has advanced his economic agenda by, on the one hand, directing agencies to reduce anticompetitive regulations and, on the other, imposing broad tariffs, yet these policy initiatives are largely in conflict.
- Tariffs – by design – restrict competition from foreign firms while entrenching the market position of existing dominant firms by erecting barriers for new market entrants, thus providing a countervailing pressure to his efforts to reduce anticompetitive regulations.
- The Trump Administration's desire for market dynamism through deregulation could be largely thwarted by the anticompetitive effects of its tariffs.

Introduction

Among the essential components of President Trump's economic agenda are efforts to reduce anticompetitive regulations through agency rulemakings and the levying of historically high tariffs on most of the world's nations.

On April 2, the president announced country-specific tariff hikes that would raise the cost of imports to the highest level since the Smoot-Hawley tariffs of the 1930s. A week later, on April 9, President Trump signed Executive Order (EO) 14267, entitled "Reducing Anti-Competitive Regulatory Barriers." The EO called for federal agency heads to work with the chairman of the Federal Trade Commission and the United States Attorney General to identify and eliminate anticompetitive regulations.

Yet these two policy initiatives are largely in conflict as tariffs – by design – restrict competition from foreign firms. Moreover, tariffs often entrench the market position of existing firms by erecting barriers for new entrants.

The Trump Administration's deregulatory agenda has the potential to enhance market dynamism, but any success could be impeded by its tariff policies.

Deregulatory Agenda

During his first term, President Trump signed Executive Order (EO) 13771, entitled "Reducing Regulation and Controlling Regulatory Costs," which called for executive departments and agencies to identify at least two existing regulations to be repealed for each new regulation. To begin his second term, Trump upped the ante and signed EO 14192, entitled "Unleashing Prosperity Through Deregulation," which called for 10 existing regulations to repealed for every new regulation.

On April 9, 2025, President Trump signed EO 14267, entitled "Reducing Anti-Competitive Regulatory Barriers," directing agency heads work with the chairman of the Federal Trade Commission and the United States Attorney General to identify and eliminate anticompetitive regulations.

Specifically, the EO ordered a "complete review of all regulations subject to their rulemaking authority and identify those that:

i. Create, or facilitate the creation of, de facto or de jure monopolies;
ii. Create unnecessary barriers to entry for new market participants;
iii. Limit competition between competing entities or have the effect of limiting competition between entities;
iv. Create or facilitate licensure or accreditation requirements that unduly limit competition;
v. Unnecessarily burden the agency's procurement process, thereby limiting companies' ability to compete for procurements; or
vi. Otherwise impose anti-competitive restraints or distortions in the operation of the free market."

Prior American Action Forum research found that increased regulatory burdens are often associated with higher barriers to entry that are negatively associated with firm births, firm deaths, and increased profits among incumbent firms – meaning regulations inhibit new market entrants while cementing the position of existing firms. In other words, regulations hinder competition and reducing them could foster market dynamism.

Trump's Tariff Agenda

Tariffs have become a mainstay of the Trump Administration, which has implemented a host of tariffs on countries, sectors, and products utilizing various tested and untested executive authorities. Trump's tariff agenda, commonly justified as vital to national security and job growth, has shifted from week to week when it comes to size and scope, but it remains an economic tool on which the administration will continue to rely going forward.

A tariff is a tax placed on the value or quantity of imports entering a country for business or consumer purposes. Tariffs are primarily used by a country to protect domestic industries from foreign competition by artificially increasing the cost of foreign products for end consumers, who inevitably pay the import tax or purchase more domestic products. Other use cases include insulating up-and-coming industries, ensuring industries vital to national security maintain a domestic footprint, bargaining or retaliating against other countries' trade barriers, and raising government revenue. In the modern era, this tool has not been used as a significant source of revenue for developed countries and has been well under 4 percent of federal revenue for the past 65 years.

Historically, Congress has passed tariff legislation via the powers provided under Article 1, Section 8 of the Constitution, which directly grants the legislative branch the ability to impose taxes and duties as well as to regulate trade. More recently, the power of imposing, adjusting, and negotiating tariffs was delegated by Congress to the executive branch, and specifically to the president. These changes to tariff authority have allowed the president to make unilateral decisions on trade policy when negotiating trade agreements or responding to international events.

There is no better example of the unilateral imposition of tariffs by the executive branch than President Trump's "Liberation Day" where tariff rates of 10 to 50 percent were announced on nearly every U.S. trade partner. While "Liberation Day" tariffs are currently on hold – and were recently struck down by a three-judge panel of the U.S. Court of International Trade – they were imposed via an executive order that declared the overall U.S. trade deficit a threat to national security. This EO – again, disputed in by the U.S. Court of International Trade – was employed to justify the use of the International Emergency Economic Powers Act (IEEPA), a previously untested authority for the imposition of tariffs.

Effects of Tariffs on Competition

Tariffs are taxes on U.S. importers. Tariffs raise the cost of final goods imported and sold directly to consumers and raise input costs for domestic producers that use intermediate goods purchased from abroad.

The current tariff policy is designed to sufficiently raise the cost of imports to make it comparatively advantageous for firms and consumers to switch to domestically sourced goods, thus encouraging domestic production.

Reduce Foreign Competition

Increased competition is typically associated with lower prices, more choices, and increased innovation.

Yet the current tariff policy has significant anticompetitive effects that could undermine the benefits of increased competition. Most obvious is that tariffs – by design – insulate domestic industries from foreign competitors. Sufficiently high tariffs can eliminate the competition domestic firms face from foreign firms.

This result would conflict with the directive from Trump's EO that seeks to eliminate regulations that "limit competition between competing entities or have the effect of limiting competition between entities."

Increased Prices, Fewer Choices, and Decreased Innovation

Sufficiently high tariffs would force firms to switch from cheaper foreign suppliers – with whom they conducted business before the imposition of tariffs – to often more costly domestic suppliers. Another option, and perhaps equally inefficient, is for firms to base their supply chain decisions on tariff rates rather than investing capital in the most productive manner and leave firms with a permanently lower return on investment. Alternatively, the whipsaw nature of the current tariff regime could simply leave firms paralyzed and induce them to forgo investment while waiting for more clarity. None of these options is an efficient use of capital and could threaten the benefits of competitive markets.

As tariffs increase the cost of goods sold, firms will often respond by passing these costs on to consumers. Firms facing more elastic demand – meaning that a small change in price could lead to a large reduction in the quantity demanded – may be unable to pass the increased costs to consumers. In this case, these firms could simply forgo supplying the product and leave consumers with fewer choices that would likely put upward pressure on prices.

Foreign competition also incentivizes firms to innovate. Foreign firms competing for domestic market access do so not just by offering lower prices but new products Limiting the access of foreign firms in the domestic market through tariffs reduces any incentive domestic producers have to develop new products, knowing there will be fewer options for consumers that are comparatively more expensive. Similarly, if a tariffed country responds in kind, therefore shrinking the potential market for domestic exports, the expected return on research and development for new products would decline. The decline in expected returns disincentivizes the development of new products for consumers. What is left is a downward shift in the global level of research and development.

Increased Barriers to Entry

Part of President Trump's pro-competitive EO called upon agencies to identify regulations that "create unnecessary barriers to entry for new market participants." Tariffs undermine this directive by increasing the cost of production and limiting the number of firms able to profitably operate in a market. Smaller firms with less capital lack the ability to build domestic facilities to avoid increased tariffs. This leaves small firms with little choice but to accept lower margins or raise prices for consumers, making them less competitive compared to larger firms.

Rent Seeking

Furthermore, tariffs not only impede new firm entry, but they could also entrench the position of dominant firms through regulatory rent seeking. In other words, firms could leverage their position in the market to lobby for tariff exemptions, for tariffs to be applied, or for tariffs to remain in place depending on their position in the supply chain.

This regulatory capture was a concern during the first Trump Administration. In October 2019, Assistant Inspector General for Audit and Evaluation Carol Rice issued an alert "regarding the lack of transparency that contributes to the appearance of improper influence in decision-making for tariff exclusion requests." The perception was that large incumbent firms were able to leverage their political influence to gain a competitive advantage by being granted exemptions.

The most recent wave of tariffs raises the same concerns. Large incumbent firms, often more publicly visible with a greater number of employees, have greater capacity and leverage to lobby the Trump Administration for tariff exemptions for their products while smaller firms with fewer resources will likely find themselves unable to obtain similar treatment.

It could also be the case that firms ask the Trump Administration for an exemption for a specific input while leaving tariffs on similar products in place. This would lower the cost of production for one specific firm while raising the costs of their competitors. Domestic producers could also find it advantageous to ask the administration for tariffs on the foreign supply of competing goods. Such tariffs, if sufficiently high, could insulate them from foreign competition, allowing them to raise prices or reduce output.

This dynamic replaces competition with a game of regulatory capture in which the government picks winners and losers as a limited number of firms gain a competitive advantage through regulatory capture, a direct contradiction of the EO's stated purpose.

Supply Chains as a Form of Competition

Firms spend years, if not decades, building efficient, cost-effective, and often global supply chains to satisfy consumer demand. Supply chains themselves are a form of competition.

During the height of the COVID-19 pandemic, firms with the most resilient supply chains were best able to continue production, while firms that were heavily dependent on supply from China were unable to keep up with increased demand.

The lessons learned from the pandemic caused many firms to shift production outside of China to countries deemed less risky. Countries such as Vietnam and India were winners in the post-pandemic supply chain realignment. Mexico and Canada also benefited from efforts by American firms to nearshore their production. In other words, firms brought production geographically closer to the final customer rather than relying on production from longer distances to reduce supply chain risk and improve agility amid disruption. Furthermore, firms that relied on just-in-time inventory operations also changed course to ensure available supply amid prolonged disruptions to supply chains.

Tariff policy threatens to upend much of this market-driven supply chain rearrangement and replace it with a government-directed scheme that emphasizes domestic supply chains. This would reestablish heavily concentrated supply chains that could be similarly vulnerable to disruption in the same way many companies were caught flat-footed during the pandemic.

Conclusion

President Donald Trump's agenda to reduce anticompetitive regulations largely conflicts with his imposition of tariffs and directly contradicts many of the directives of his EO. Tariffs are taxes that would likely raise the price of inputs to production or final goods and are borne by the consumer. Moreover, the exemption process could lead to a game of regulatory capture wherein firms can lobby the federal government – depending on their position in the supply chain, either for exemptions or the implementation of tariffs – that would give them a competitive advantage over their competition.

Ultimately, tariffs threaten to foil the benefits of deregulation while entrenching the market position of existing dominant firms.