HOW CAN BIG BUSINESS MAKE MONEY FROM TARIFFS?

United States History: Focus on Economics, Lesson 7

Lesson Description

INTRODUCTION
History The period from 1880 to 1920 was a time of growth in business. As businesses grew in size, some of them attempted to reduce competition in their markets. The late 1800s was also a time when federal legislation protected domestic businesses from foreign competitors, usually by imposing high tariffs on imported products. Tariff revenues were the main source of revenue to the federal government at this time; they were used to pay government expenses and to protect businesses from foreign competition. Among the industries protected by tariff legislation were steel, iron, sugar, glass, furniture, leather, paper, coal, woolen goods and silk, and tinplate. The McKinley tariff of 1890 and the Dingley tariff of 1897 raised tariff rates to levels higher than any since the Civil War. Many businesses profited as a result of this policy of limiting foreign competition. Protection also contributed to the emergence of large enterprises - cartels, pools, trusts, holding companies, and monopolies - all forms of enterprise which could influence prices by limiting production.

Economic Reasoning
The development of business concentration (monopolies and trusts) during this time has usually been explained as a result of the natural functioning of a market economy. This reasoning suggests that competition will eventually drive out all but a few producers in every market. Now, however, economic historians believe that government policy is responsible at least in part for business concentration during this time. By setting high, protective tariffs, government officials reduced competition and encouraged the development of trusts. Protective legislation generates substantial individual benefits to a small minority while imposing a large cost on others, but the large cost is often spread widely over many individuals so that each individual bears only a small added cost. Therefore, the public may have little knowledge about, or incentive to prevent, protective legislation. In public-choice theory, this sort of government action is called "the special interest effect."

LESSON DESCRIPTION
Students investigate the impact of tariffs on businesses and consumers during the 1880s by looking at a political cartoon, solving a short math problem, and comparing protectionism in the 1980s to protectionism in the 1880s. They then generalize about the impact incentives have on encouraging special interest legislation in a democratic government.

Grade Levels

Grades 9-12

Economic Concepts

- Incentives
- Tariffs
- Special interest groups

Content Standards and Benchmarks

Despite the benefits of international trade, many nations restrict the free flow of goods and services through a variety of devices known as trade barriers, including tariffs and quotas.

Public policies affecting foreign trade impose costs and benefits on different groups of people; decisions on those policies reflect economic and political interests and forces.

National Standard Number: 4
People respond predictably to positive and negative incentives.

National Standard Number: 17
Costs of government policies sometimes exceed benefits because of incentives facing voters, government officials, and government employees, actions by special interest groups, or pursuing social goals other than economic efficiency.

Objectives

Students will:

- Interpret the main idea conveyed by a political cartoon
- Use supply-and-demand analysis to judge the impact of tariffs on domestic markets.
- Apply understanding of incentives to explain why protectionist legislation supported by special interest groups is often passed by Congress even when it is not in the common interest.

Materials (see Activities and Visuals below)

- Visual 1 Tariffs: A Definition
- Visual 2: Panning for Gold
- Visual 3: Protectionism in the 1980s
- Visual 4: Why Politicians Like Protectionism
- Activity 1: Big Business and Government in the Late1880s
- Activity 2: Impact of Tariffs on Business and Consumers

Time Required

Two class periods

Procedure

1. Explain that this lesson involves an examination the rise of big business in the United States. Not everyone was fond of big business, and some cartoonists thought it was given preferential treatment by the U.S. government. Your task is to decide if the cartoonist's economic analysis was accurate.

2. Display Visual 1. Explain that most nations impose tariffs on many imported products. The tariff must be paid by the foreign company to the importing government for each product imported to and sold in the country in question. Ask the students to respond to the questions.

QUESTIONS AND ANSWERS FOR VISUAL 1

1. Which company must pay the tariff? *(Beebock.)*
2. How much will the tariff cost the company? *(100,000 x $100 = $10,000,000 total revenue; $10,000,000 x 10% = $1,000,000 in tariff payments.)*
3. Who receives the revenues generated by the tariffs? *(The United States Treasury.)*
4. Does Bike benefit from this tariff? *(Yes. Beebock has to adjust its prices to cover the costs of the tariffs which Bike doesn't have to pay.)*

3. Display Visual 2. Ask the students to answer the questions at the bottom of the cartoon.

QUESTIONS AND ANSWERS FOR VISUAL 2

1. Whom does the miner represent? *(Trusts and big business.)*

2. Where are the gold nuggets coming from? *(The river labeled Dingley tariff.)*

3. What is the source of the river? *(The Capitol in Washington, D.C.)*

4. Does the cartoon show how business can make money from a tariff? *(No.)*

4. Ask what seems to be the cartoonist's message? (The point seems to be that the Dingley tariff was a river from the Capitol which brought gold nuggets to large business trusts.)
5. Pose the question: Why would business owners, of all people, want to see more dollars flow into the United States Treasury? How can business make money from tariffs? (Let the students come up with any conclusion here. The question will be asked again at the end of the lesson, and they will have a better idea then.)
6. Distribute Activity 1. Ask students to read it and answer the questions. Discuss the answers with the class after students complete their work.

QUESTIONS AND ANSWERS FOR ACTIVITY 1

1. Why was business expanding in the late 1880s? *(Transportation and communication made it easier to serve more customers. Population growth was very rapid at this time. Businesses expanded so they could sell more products to larger numbers of people.)*
2. What types of business organizations were used to gain some control of prices and competition? *(Pools, trusts, holding companies.)*
3. How did the federal government influence the success or failure of business enterprises in the late 1800s? *(By changing tariff laws.)*
4. Did Henry O. Havemeyer and Bryon W. Holt agree on the impact of tariffs on U.S. business? *(Yes. They believed tariffs encouraged businesses to combine into trusts.)*

5. Do you think Havemeyer and Holt would have agreed on keeping tariff rates high to protect U.S. business from foreign competition? *(No. Havemeyer was the head of the sugar trust, and he wanted it to be protected from foreign competition. Holt was associated with the New England Free Trade League, and he probably wanted tariffs abolished to bring more competition into the marketplace.)*

Distribute Activity 2. Ask students to complete it in small groups. Ask them to answer the following question when they are done with the problem: "How do tariffs influence business, and why might tariffs be viewed as giving money to business?"

1. How much sugar was sold per month before the tariff was passed? *(1 million lbs.)*
2. How much sugar was sold per month after the tariff was passed? *(750,000 lbs.)*
3. How did the price of sugar change after the tariff was passed? (*It increased from $2 to $3.)*
4. How much total revenue did the Fictionland sugar producers receive before the new tariff was passed? *($2 times 500,000 lbs. = $1 million per month.)*
5. How much total revenue did the Fictionland sugar producers receive after the new tariff went into effect? *($3 times 500,000 lbs. = $1.5 million per month.)*
6. How much additional revenue do Fictionland sugar producers receive each year as a result of the new tariff rules? *($1.5 million minus $1 million = $500,000 times 12 months = $6 million.)*
7. What does the average Fictionland sugar producer make per year as extra revenue asa result of the new tariff law? *($6 million divided by 10 producers = $600,000 per producer.)*
8. How much extra money must consumers pay to receive the 500,000 lbs. of Fictionland sugar made by Fictionland producers? (*$3 minus $2 = 1 extra dollar times 500,000 lbs.= $500,000 per month times 12 months = $6 million - that is, the same as the additional revenues gained by the producers.)*
9. What is the average cost to Fictionland consumers per year to buy the Fictionland sugar? *($6 million divided by 100 million consumers = $6 per person.)*
10. If you were a Fictionland producer would you be willing to pay $50,000 a year to help pay a government lobbyist to work with political leaders to keep this tariff high? *(Given the assumption that you expect to be successful in your lobbying effort, the answer is yes. The potential gain is $600,000 per year, while the cost is $50,000, so your net gain is $550,000 per year.)*
11. If you were a Fictionland consumer would you be willing to pay $50,000 a year to help pay a government lobbyist to work with political leaders to abolish this tariff? *(Given the assumption that you expect to be successful in your lobbying effort, the answer is no. The potential gain is $6 per year, while the cost is $50,000, so your net gain is minus $49,994.)*
12. Given this information, do you think this new tariff will be abolished soon in Fictionland? Explain your answer. *(No. The incentives are very strong for political leaders and businesses to work hard to keep this tariff in place. On the other hand, consumers do have to pay more for sugar, but the additional cost per individual is so low that individual consumers have little incentive to be interested or to fight this political decision.)*
13. How do tariffs influence the revenues of domestic business firms that are protected by the tariffs? Why might tariffs be viewed as giving money to domestic business firms? *(Tariffs increase the costs of foreign producers but not those of domestic producers. The increased costs reduce competition in the market. The decline in supply combined with stable demand results in higher prices. Domestic firms can now charge higher prices and improve their profits.)*

14. Which of the following groups do you think would pay for a lobbyist to work for them in Washington, D.C., in 1880 - sugar consumers, sugar producers? *(Sugar producers. Their potential benefits are greater than their potential cost.)*
15. Which of the following groups would be likely to make a campaign contribution to a political campaign - sugar consumers or sugar producers? *(Sugar producers. Their potential benefits are greater than their potential cost.)*
16. Which of the following groups would be likely to work hard to get voters to the polls to vote for their preferred candidate - sugar producers or sugar consumers? *(Sugar producers. Their potential benefits are greater than their potential cost.)*
17. Who has the strongest financial incentive to influence legislation on tariffs? *(Sugar producers. Their potential benefits are greater than their potential cost.)*
18. Who has the least financial incentive to influence legislation on tariffs? (Sugar consumers. Their potential benefits are very small relative to their potential costs.)
19. Under these circumstances, which group does the political candidate have the greatest incentive to please - sugar producers or sugar consumers? *(Sugar producers.)*
20. Will the tariffs improve the total production of the Fictionland economy? *(No. There is no increase in sugar production. Higher sugar prices reduce consumer purchasing power for other products. The sugar tariffs will have a small negative impact on the economy's production.)*
21. Is the political leader likely to gain from voting for protective tariffs? *(Yes. Campaign contributors from business will be pleased and continue to support this officeholder. Other voters will not be upset because they may not know what caused the price increase and its small impact on their budgets makes it an issue unlikely to influence their vote.)*
22. Display Visual 3. Explain that tariffs still exist. One hundred years later, in the 1980s, quotas and tariffs were used to protect various industries from foreign competition. Discuss the questions on Visual 3.

    1. QUESTIONS AND ANSWERS FOR VISUAL 3
        1. Who gains from import quotas on automobiles? *(Auto producers and workers in the U.S. automobile industry, who receive greater profits and more jobs.)*
        2. Who loses as a result of import quotas? *(U.S. automobile buyers, who pay higher prices for their cars.)*
        3. There are many more auto buyers than auto producers. Why would the U.S. government negotiate a deal with Japan to reduce the purchasing power of the U.S. consumer? *(Government officials have strong incentives to serve lobbyists and the auto industry. They face weak incentives to protect consumers.)*
2. Display Visual 2 again. Can businesses (trusts) pan gold nuggets from protective tariffs? *(Yes, by reducing competition and raising prices.)*

Closure

Display Visual 4. Ask how this quotation is consistent with what they have learned about trusts and protective tariffs in the 1880s. *(Tariffs reduce competition; supply is reduced, so higher prices can be charged by the remaining firms. The higher prices lead to increased profits for a small number of people in the protected industry. Meanwhile, a large number of people pay higher costs; but each individual may pay only a small amount, so there is little opposition to the protectionist laws.)*

Visual 1

TARIFFS: A DEFINITION

DEFINITION: A tariff is a tax on imported products or ser vices. In the case of tariffs imposed by the United States, the business that imports or produces the foreign product must pay the taxto the U.S. government. The tariff revenue goes directly to the U.S. Treasury.

EXAMPLE: Suppose two different companies, Beebock and Bike, sell athletic shoes in the United States. Beebock is located in Brazil. Bike is located in Or tonville, Minnesota. A tariff mustbe paid on all shoes made outside the United States and sold in the United States. The tariff is 10 percent of all total sales revenues. Both companies sell 100,000 pairs of shoes per month at a price of $100 per pair .

1. Which company must pay the tariff?

2. How much will the tariff cost the company?

3. Who receives the revenues generated by the tariffs?

4. Does Bike benefit from this tariff?

Visual 2

Panning for Gold

Directions: Look at the cartoon and answer the following questions.

1. Whom does the miner represent?
2. Where are the gold nuggets coming from?
3. What is the source of the river"
4. Does the cartoon show how business can make moey from a tariff?

Visual 3

PROTECTIONISM IN THE 1980s

From 1981 to 1985, the U.S. automobile industry was shielded from Japanese competition by "voluntar y import restraints." During that time the following changes took place:

- Average price of a Japanese car sold in the United States rose by $2,500.
- Average price of a United States car sold in the United States rose by $1,000.
- Extra costs of car purchases for U.S. consumers in 1984 were approximately $13 billion.
- Trade pr otection in 31 other industries cost U.S. consumers in 1984 $53 billion.

QUESTIONS FOR DISCUSSION

1. Who gains from import quotas on automobiles?
2. Who loses as a result of import quotas?
3. There are many more auto buyers than auto producers. Why would the U.S. government negotiate a deal with Japan to reduce the purchasing power of the U.S. consumer?

Information taken from A. Blinder, Hard Heads, Soft Hearts (Reading, Mass.: Addison-Wesley, 1987), pp. 11618.

Visual 4

Why Politicians Like Protectionism

Protectionism is a politician's delight because it delivers visible benefits to the protected parties while imposing the costs as a hidden tax on the public.

Activity 1

NAME______________________________

BIG BUSINESS AND GOVERNMENT IN THE LATE 1880'S

AN OVERVIEW[1]

During the late 1880s, business firms in the United States faced few regulations from the federal government. This "hands-off" relationship did not change until the creation of the Interstate Commerce Commission in 1887 and the Sherman Antitrust Act in 1890. Even after these laws were passed things did not change immediately because the Supreme Court issued a series of very narrow interpretations of the laws' intent, thus restricting their effect on business practices.

This historical period was also an era of business mergers and growth. Businesses now could produce and sell products across the continent. The United States had become the largest single trading zone in the world. Transportation and communication changes allowed firms to reach customers from California to Maine, from Minnesota to Florida. Businesses expanded to serve regional and national markets rather than merely the local area. Often several small businesses would join together as "pools" to set prices and production levels, and to divide territories. Later, these informal arrangements became "trusts" or "holding companies." A trust was formed when stockholders in many competing companies – for example, sugar producers – trusted their shares in the business over to a group of trustees who then ran the entire industry. The trustees attempted to set prices and production levels in a way that would maximize profits. This organizational practice was used to influence the output of kerosene, sugar, whiskey, cottonseed oil, linseed oil, lead, salt, rubber boots, and gloves.

The trusts also sought to influence government legislation which would affect their industry. They sought especially to secure passage of protective tariff legislation to reduce competition from foreign producers.

TARIFFS AND TRUSTS[2]

"The mother of all trusts is the customs tariff bill" (Henry O. Havemeyer, president of the American Sugar Refining Company, head of the Sugar Trust, June 1899).

"That the tariff, by shielding our manufacturers from foreign competition, makes it easy for them to combine, to restrict production, and to fix prices – up to the tariff limit – ought to be evidence to every intelligent man" (Bryon W. Holt, The New England Free Trade League, September 1899).

QUESTIONS FOR DISCUSSION

1. Why were businesses expanding late in the 1880s?
2. What types of business organizations were used to gain some control of prices and competition?
3. How did the federal government influence the success or failure of business enterprises late in the 1800s?
4. Did Henry O. Havemeyer and Bryon W. Holt agree on the impact of tariffs on U.S. Business?
5. Do you think Havemeyer and Holt would have agreed on keeping tariff rates high to protect U.S. business from foreign competition?

1Information taken from Gary Walton and Hugh Rockoff, *History of the American Economy*, 7th ed. (New York: Dryden Press, 1994).

2See "Why Did American Business Get so Big?" by Colleen A. Dunlavy, Associate Professor of History at the University of Wisconsin-Madison, for *Audacity* (Spring 1994), p. 46.

Activity 2
NAME______________________________

IMPACT OF TARIFFS ON BUSINESS AND CONSUMERS

Directions: Read the following information. Then answer the questions which relate to the information.

IMAGINE YOU ARE A NEWSPAPER REPORTER ASSIGNED TO report on a story in a different country. The country's name is Fictionland. It is located near you, and its legislature has just passed a new tariff law to protect jobs and business in the Fictionland sugar industry. While doing your research, you discover the following facts about the sugar industry as it operated before the new tariff was approved.

1. There are 10 sugar producers in Fictionland.
2. They produce 500,000 pounds of sugar each month.
3. At this time the Fictionland sugar producers cannot expand their production.
4. Foreign sugar producers also sold a total of 500,000 pounds of sugar per month in Fictionland.
5. There are 100 million sugar consumers in Fictionland.
6. Consumers bought 1 million pounds of sugar per month at a price of $2 per pound.

ADDITIONAL INFORMATION

Tariff supporters argued that the tariff would raise money for the government to help balance the budget without raising the taxes of Fictionland citizens. It would also help preserve jobs and businesses in a traditional part of the economy – the sugar industry. There was little opposition to the bill, and it passed a vote in the Legislature by a wide margin.

CONSEQUENCES

1. Foreign producers reacted to the higher costs imposed by the tariff by supplying less sugar to Fictionland. They reduced their sales to Fictionland by one half.
2. Prices rose from $2 per pound to $3 per pound. Local economists explained that supply declined while demand for sugar remained stable, so market prices rose to a new equilibrium level.

3. Domestic sugar producers continued to make and sell 500,000 pounds of sugar per month. They now could charge a price of $3 per pound.

You think you may have a story to write – one that has been overlooked by other reporters. Answer the following questions and decide whether the tariff has helped the Fictionland consumer.

1. How much sugar was sold per month before the tariff was passed?
2. How much sugar was sold per month after the tariff was passed?
3. How did the price of sugar change after the tariff was passed?
4. How much total revenue did the Fictionland sugar producers receive before the new tariff was passed?
5. How much total revenue did the Fictionland sugar producers receive after the new tariff rules went into effect?
6. How much additional revenue do Fictionland sugar producers receive each year as a result of the new tariff rules?
7. What does the average Fictionland sugar producer make per year as extra revenue as a result of the new tariff law?
8. How much extra money must consumers pay to receive the 500,000 lbs. of Fictionland sugar made by Fictionland producers?