How to Raise Tariffs '*WTO Legally*'– a Backgrounder

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First, what is a tariff schedule?

- **Tariff schedules** have been around since ancient Babylon. They list every conceivable thing that could show up to a port, and apply a tax to that product.
- Up until 1930, American tariff schedules were written into actual statutes. Every single good, listed in alphabetical order, along with a corresponding tariff rate, was written into law. The Tariff Act of 1930, aka the Smoot-Hawley tariff, was the last time Congress legislated a complete tariff schedule.
- From 1934 until 1947, we entered into thirty bilateral free trade agreements. They were done on a "Most Favored Nation" (MFN) basis, which meant that when we promised 0% tariffs on shrimp to Mexico in 1943, *every other country we had a trade deal with got 0% tariffs on shrimp*, even though they weren't part of the bilateral deal. From this point on, the United States began operating, in essence, two tariff schedules:
  - Our "**MFN" tariff schedule**, which covered every country we had a trade deal with; and
  - Our **1930 Tariff Act tariff schedule**, which applies tariffs to countries we do *not* have a trade deal with. The 1930 tariff act schedule is still in effect, but applies only to merchandise from Cuba and North Korea.
- In 1947, along with UK and others, we elevated all the bilateral deals into a giant 'multilateral' trade agreement, called the GATT. The GATT is still in effect, and has 164 countries signed-on. The WTO overseas the GATT. After the GATT went into effect, ***we began referring to our MFN tariff schedule as our "Normal Trade Relations" (NTR) tariff schedule***.

- There are over 30,000 individual lines in the U.S. tariff schedule, covering every imaginable 'thing' that could show up in our ports, for both the NTR and 1930 schedules.
- Our tariff schedules are no longer in statute. They are a publication of the U.S. International Trade Commission. Click on a chapter for a category of goods, and a PDF will open. You will see a column of goods covered by that chapter, and in adjacent columns, the applicable tariff rates for that good. MFN/NTR tariffs are in Column 1, and 1930 tariffs in Column 2.

How are the tariffs assessed? Key points and terminology.

- Always look to the merchandise's country-of-origin, not where it was shipped from. If a Made-in-China microwave is imported into the U.S. from Mexico, the fact that it shipped from Mexico is irrelevant. Because the merchandise originated in China, our tariff applicable to microwaves from China will be applied when that microwave shows up in port.
- *But you just said we apply our MFN/NTR tariffs to every country except Cuba and North Korea?*
    - That's correct. But additional tariffs can apply on top of the tariff in a tariff schedule if there is a trade remedy order (e.g., anti-dumping or countervailing duty order, or others) in effect. Every country does this, and the use of trade remedy orders is allowed (subject to strict rules) under the GATT if the necessary facts are applicable.
    - For this reason, every shipment must include a **bill of lading**, which indicates the country of origin of the merchandise in the shipment (among other things).
- Tariffs can be '***specific tariffs***': **e.g., $1/kg** (a specific $ amount based on quantity); OR
- Tariffs can be '***ad valorem***': **e.g., 10%,** like a sales tax (a specific % based on the value of the shipment).
- How is the value of a shipment determined for assessing an ad valorem tariff?
    - Answer: in addition to the bill of lading, the shipper must supply a **commercial invoice** showing how much they paid for it. This document is in addition to the bill of lading, every shipment must have both documents. Of course, supplying a fraudulent invoice showing a lower amount paid to achieve a lower ad valorem tariff is a common problem.[1] As many invoices will be in foreign currencies, customs officers use exchange rate sheets maintained by the Federal Reserve Bank in New York.

How Trade Agreements Deal with Tariffs

(including the mother of them all, the General Agreement on Tariffs and Trade, or "GATT", which operates similar to a regular, bilateral trade agreement, but with 163 other countries):

- **Schedule of Concessions** - Schedules are the legal means by which tariff commitments are recorded. Think of them like "promise sheets". In Geneva, stapled to the GATT, are 164 Schedule of Concessions, one for every WTO member. It is over 22,500 pages long.[2]

[1] This problem is as old as the United States. James Madison authored the first tariff schedule of the United States, which he helped pass as Speaker of the House on July 4, 1789. To deal with problems of undervaluation in our *ad valorem* tariffs, then-President Madison introduced "Minimum Valuation Provisions" in the Tariff Act of 1816.

[2] https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm2_e.htm#con

- A Schedule of Concessions does not try to force a particular tariff rate; i.e., it doesn't say that a country *will* charge 10% on microwaves. Rather it just sets a maximum tariff rate ('ceiling') for which a country promises not to exceed. I.e., the country will not charge *more than* 10%.

  Essentially, a Schedule of Concessions is an entire 'promise' tariff schedule that is stapled to a trade agreement. It lists tariff rates for every product like a country's national tariff schedule, but the rates in the Schedule are promises, not necessarily what's being applied on a given day at the ports. The ports will look to the country's national tariff schedule.

- **"Bound vs. Unbound":** When a country has made a promise in its Schedule for Concessions for a particular good, then that good's tariff line is said to be "**Bound**".
  - In the GATT, most developed countries have 'bound' every single tariff line. Many developing countries, however, have not even made any promise/commitment for many goods, and so these are said to be "**Unbound**" tariff lines.
  - There is no GATT/WTO obligation to 'bound' every product in its Schedule of Concessions.
- "**Ceiling vs. Applied**": The tariff currently applied is not necessarily the bound rate. A country can bind its tariff at 20% for a good (aka, the good's tariff **ceiling**) in its Schedule of Concessions and yet choose to **apply** the tariff at 10% at their ports, because this number is lower than their ceiling. Later on, the country is still free to raise its applied rate to 20% anytime it wants, because it hasn't violated its promise of a 20% bound rate. ('Bound' and 'ceiling' are essentially synonyms).
- The Applied tariff rate is the level that is actually collected under a country's **National tariff schedule**. The U.S. National Tariff Schedule is the document maintained by the USITC, referenced in the previous section, called the "**Harmonized Tariff Schedule of the United States**" (**HTSUS**)
  - Many Latin American countries have traditionally had applied rates significantly lower than their ceiling rates. The space between a country's applied tariff for a good, and it's bound/ceiling rate for that good, is called "**tariff water**". Tariff water is a valuable tool for governments to use as leverage when seeking to extract concessions from foreign suppliers. India is a prolific user.
  - While the United States' Schedule of Concessions to the GATT has a bound tariff rate average of 3.4%, the same averaging of our Column 1 (MFN/NTR) tariff schedule shows an average of 2.5%. This indicates that there are goods where we have unilaterally chosen to collect lower tariffs, thus providing us with a small modicum of tariff water in those instances. But of course, 1% or 2% is not sufficient to provide any meaningful leverage. At least half of all industrial goods enter the United States at 0% tariff under our MFN/NTR tariff schedule.[3]

[3] https://ustr.gov/issue-areas/industry-manufacturing/industrial-tariffs

- Our National tariff schedule, the HTSUS, does not list our bound/ceiling rates, it only lists applied rates. To discover our bound/ceiling rates, you must look to our Schedule of Concessions, which is maintained in Geneva (available on WTO website).

Process for Modifying Bound Tariff Rates in the GATT

- GATT Article II makes countries Schedule of Concessions a legal part of the GATT:
  - Art. II Para. 1(a): Reiterates Article I's MFN obligation, every GATT member shall apply treatment "no less favorable" to every other GATT member. There are three exceptions, where governments are allowed to collect revenue at ports without counting as a breach of a bound/ceiling rate:
    1. Clarifies that certain domestic taxes can be collected at the border, and that these are separate from tariffs. Classic example is domestic excise taxes on beverage alcohol (centuries old). These are taxes collected from domestic producers *at the time of production*. So obviously, they cannot be collected on foreign producers whose product has not yet even entered into the USA. Thus, they are collected at the time of importation to ensure equal treatment.
    2. Trade remedy orders executed in accordance with GATT Article VI (e.g., anti-dumping and countervailing duties assessed in accordance with GATT rules).
    3. Certain customs fees (e.g., U.S. Merchandise Processing Fee).
- **GATT Article XXVIII, titled "Modification of Schedules**", sets out a detailed process for modifying bound tariff rates.
- **Summary:** Art. XXVIII is complex, but in summary, it sets rules to ensure that tariff negotiations *can* happen, and that there is no requirement to negotiate with every single other WTO/GATT member. For example, say the U.S. wants to revise its tariff on steel. It does NOT have to sit down and negotiate with all 163 other WTO members. Rather, Art. XXVIII says the U.S. must negotiate with three 'categories' of other country-counterparties:
  1. First is the country that has the so-called "**Initial Negotiating Right (INR)**". The INR country is the country with which the U.S. first negotiated that particular tariff commitment with respect to the product. For most products, the United States' INR counterparty would most likely be a country that was an original GATT signatory and also a developed country. *This means Europe or Canada should likely be our INR counterparty for most products*.
  2. The second category is the country with the "**Principal Supplying Interest**"; which is the country that at that moment in time is the major exporter of that product. *Based on current import sources, our Principal Supplier counterparty is most likely to be Canada, Mexico, or China, who together count for more than half of our imports*. **Because we already have a preferential tariff agreement with Canada and Mexico (USMCA), raising our bound rates in our WTO/GATT Schedule of Concessions would not affect them in practice. With regard to China, we (and they) have already abandoned our MFN commitments, ever since the Section 301 trade remedies.**
  3. The above two categories of country, along with the country seeking to modify its schedule of concessions, are referred to as the "contracting parties primarily

concerned". However, Art. XXVIII also contemplates a third category, who are "substantial suppliers", and get to be consulted by the primarily concerned parties.

- **What happens if negotiations fail? What happens if the U.S. just says to counterparties, "We're raising our bound tariff rates in our GATT Schedule of Concessions to 200% across the board, because we'd rather do deals bilaterally."?** Well, in that case, Art. XXVIII, paragraph 3.(a) says that the three categories of countries above will be free to withdraw "substantially equivalent concessions initially negotiated with the applicant contracting party." If the U.S. were still concerned about a foreign parties' bound rate in its GATT Schedule of Concessions, this would be a difficult process, as disagreement about the monetary value of tariff concessions is highly likely. However, if the U.S. places little value on a foreign country's GATT Schedule of Concession, either because we already have a bilateral free trade agreement with that country, or because a country has successfully used non-tariff barriers to make their Schedule of Concessions worthless (e.g., China), then going through the Art. XXVIII process is a mere formality on the way to legally raising our WTO Bound Tariff Rates.
- Note: Europe accounts for 16% of U.S. exports[4], and U.S. exporters do depend on the EU's GATT Schedule of Concessions as we do not have a free trade agreement with Europe. This also applies to UK (3.5% of exports) and Taiwan (2.1% of exports).[5] It is reasonable that, parallel to effectively eliminating our GATT bound rate commitments, 'placeholder' bilateral free trade agreements are executed with Europe and Taiwan. As we have major trade deficits with these economies, we maintain all the leverage.
- Brazil and India account for 2.7% and 2.3% of U.S. goods exports respectively.[6] While we do not have a free trade agreement with them, there is nonetheless little value in their Schedules of Concessions, as their bound rates are very high as seen in adjacent chart. They only allow our exports in areas where it suits them. Furthermore, Brazil is covered by our Generalized System of Preferences (GSP) which unilaterally waives our tariffs. India has historically been covered too and is attempting to rejoin. If we raised our bound rates in our Schedule of Concessions, we would have infinitely more leverage in GSP.

WTO Bound Tariff Rates	
All Products, (S.A.%, 2021 UNCTAD)	
USA	3.4%
Japan	4.5%
European Union	4.9%
United Kingdom	6.0%
Canada	6.6%
Taiwan	6.8%
Switzerland	7.7%
Singapore	9.4%
Australia	9.7%
China	10.0%
Saudi Arabia	11.2%
UAE	14.6%
Korea	16.5%
Norway	20.1%
Israel	22.7%
Chile	25.2%
Philippines	25.7%
Thailand	28.0%
Turkey	28.9%
Peru	29.5%
Brazil	31.4%
Argentina	31.8%
Mexico	36.2%
Indonesia	37.1%
India	48.5%
Pakistan	60.90%

[4] https://ustr.gov/countries-regions/europe-middle-east/europe/european-union
[5] https://www.census.gov/foreign-trade/statistics/highlights/toppartners.html#exports
[6] https://www.census.gov/foreign-trade/statistics/highlights/toppartners.html#exports