Pro-Growth Tariff Reform

Tariffs can bring domestic production back to the United States. This is assured given our nation's vast internal market. However, as long as it remains more profitable to import, reshoring production will be stymied.

Reshoring production should not require giving up workplace safety and environmental protections so as to be ʽcompetitive ʼwith workers in low-wage countries. Tariffs are the needed offset to preserve the society we built.

And significantly, tariffs can offset purely domestic taxes. For example, the additional tariffs on Chinese imports instituted in 2018 brought in approximately $48 billion per year after most waivers expired in 2021. This is roughly the same revenue as all the federal income tax remitted by the bottom fifty percent of American taxpayers, as well as all the federal gas tax paid by motorists over the course of a year.

The Coalition for a Prosperous America (CPA) has proposed a model that uses a simple, four-level structure of global tariffs at 0%, 15%, 35% and 55% (explained more in this document). CPA projects that this tariff would create 10 million new producer jobs, increasing real household incomes by 10%, grow the economy by 7% and generate $603 billion in new revenue. This revenue is more than sufficient to eliminate income taxes on the large majority of American wage earners.

On a historical note, from 1789 to 1930, Congress regularly passed new tariff schedules. That process unfortunately atrophied after 1934, when Congress delegated most tariff powers to the President. CPAʼs proposed model of pro-growth tariff reform can serve as a basis for the resumption of Congress' constitutional duty to legislate tariffs.

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By the Coalition for a Prosperous America

Introduction

So long as it is more profitable to produce overseas when supplying goods to the United States market, reshoring of domestic manufacturing will be stymied. Government incentives alone cannot compete with conditions in poor countries, nor should Americans be expected to give up labor and environmental protections so as to be ‘competitive ’with workers in poor countries.

In order to re-shore, the cost advantages enjoyed by manufacturers in subsidized and low-wage countries must be offset. From the founding of the United States, under the Tariff Act of 1789, Congress used tariffs for precisely this reason. Unfortunately, over the last 70 years, the United States has eliminated most of its tariffs, allowing virtually tariff-free access for producers around the world. America’s average applied tariff rate is now just 1.6%, and most manufactured goods are eligible to enter the United States duty-free, even from countries without free trade agreements.

CPA’s economic modeling shows that tariff reform as described below would create 10 million new producer jobs, increase real household incomes by 10%, grow the economy by 7% and generate $603 billion in new revenue. This revenue is more than sufficient to eliminate income taxes on the large majority of American wage earners. Tariffs can be phased-in gradually, to give private sector capital the necessary time to make productive investments under such new terms of trade.

FIRST CONGRESS. SESS. I. CH. 2. 1789.

CHAP. II.—*An Act for laying a Duty on Goods, Wares, and Merchandises imported into the United States.*(*a*)

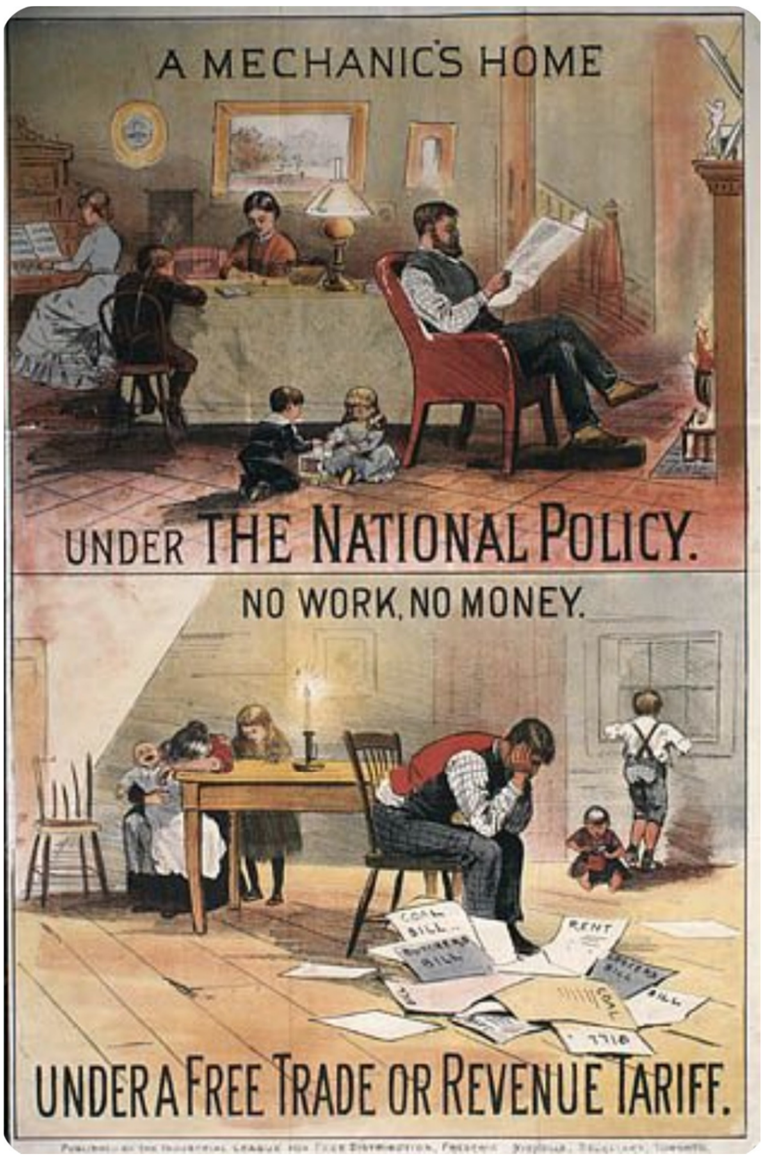
SEC. 1. Whereas it is necessary for the support of government, for the discharge of the debts of the United States, and the encouragement and protection of manufactures, that duties be laid on goods, wares and merchandises imported: (*b*)

1: Section 1 of the Tariff Act of 1789, passed on July 4, 1789.

It's important to remember that America was built on a protective tariff. In fact, the importance of using tariffs for promoting domestic manufacturing was recognized in America's first Tariff Act, passed by Congress on July 4, 1789. This is noteworthy, as in 1789, the United States 'economy was heavily dependent on trade with Europe. Tariffs were also the primary revenue source for the new republic. So for that reason, while higher 'protective' tariffs for some products was instituted, much milder 'revenue' tariffs covered most imports, ranging from five to fifteen percent.

These lower revenue tariffs were not enough to establish domestic production. For example, the tariff on imported clothing was 7.5 percent. The United States was a large consumer of cotton goods (Treasury estimated $11 million worth of imports in 1807 – a very large amount), but these cotton goods were overwhelmingly imported from Europe. Subsidies were made available in Massachusetts, Rhode Island, Connecticut and Pennsylvania for cotton mills, but they could not compete with European imports, and the mills failed.

Beginning in 1806, however, trade with Europe was significantly disrupted due to various embargoes resulting from the Napoleonic Wars. U.S. foreign trade deteriorated further with the War of 1812. This in turn convinced the majority in Congress of the need for stronger tariffs so as to incentivize more domestic production and less reliance on imports. What may be dubbed a 'national security' tariff in 1816 increased tariffs. And a fulsome embrace of protective tariffs was enacted with the Tariff Act of 1824, championed by Henry Clay. From 1824 until 1934, the United States mostly maintained highly protective tariffs averaging between forty and fifty percent on imports. These tariff laws also made extensive use of "minimum-valuation provisions"—to prevent under-invoicing by importers that could fraudulently lower the applicable tariff—as well as "specific tariffs" establishing a fixed price per quantity of any imported good.



2 Poster in support of Canada's Pro-Tariff National Policy, seeking to reduce reliance on trade

As a result, the United States prospered, and became the greatest nation in the world, supported by a protective tariff.

In 1934, however, Congress delegated its tariff-setting role to the president. F.D.R.'s Secretary of State, Cordell Hull, slashed U.S. tariffs from an average of over 40% to 14% during his eleven year tenure. At first, this was to encourage more imports, so that foreign nations would have more U.S. dollars with which to repay debts to the U.S. government. Some presidential tariff cuts also happened in order to advance international security concerns.

In the last several years, fortunately, the United States has again started using broad-based tariffs to limit the nation's exposure to imports from adversarial regimes. For trade with China, this was done by presidential action under Section 301 of the Trade Act of 1974. For trade with Russia, this was accomplished by Congress shifting Russia's status from Column 1 to Column 2 of the Harmonized Tariff Schedule. Currently, America's China tariffs have a broad scope covering almost 40% of imports from the People's Republic, but are relatively modest, ranging from 7.5% to 25%. These tariffs raised more than $130 billion for the U.S. Treasury through the end of 2021. Notably, these tariffs have not caused any meaningful price increases for tariffed Chinese goods. This is all the more remarkable, considering that non-tariffed items such as real estate have begun seeing rapid price increases in the same time period.

Both the China and Russia trade actions have proven highly beneficial. But ultimately, ***America will be better served if Congress can once again legislate a new tariff act***, something it did regularly between 1789 and 1930.

CPA has put forward a ‘Model Tariff ’that Congress should consider as a starting point for pro-growth tariff reform.

What is a model tariff?

Policy groups often develop ‘model policies’ to serve as draft legislative text for lawmakers’ consideration. Proposing draft legislation invites helpful scrutiny and feedback through public debate.

The model tariff is CPA’s version of that. It serves as a starting point for Congress’ consideration of a new Tariff Act.

Tariff Acts legislation typically consists of rules known as ‘tariff schedules’. Tariff schedules list every conceivable physical good that can arrive in a port, and establish a tax for such goods. These taxes can be either ‘*ad valorem*’—applied as a percentage to an importer's shipment invoice, similar to a sales tax—or ‘specific’ in establishing a fixed-dollar amount per unit of measure.

How did CPA design its model tariff?

As explained above, this is a two part question: (1) the question of setting tariff rates; and (2) what rules apply.

<u>Setting tariff rates in the model tariff</u>

The current U.S. tariff schedule contains over 30,000 codes, accommodating unparalleled policy-making precision. This level of depth is a feature, but it also presents a challenge, considering that tackling over 30,000 product import taxes can seem overwhelming.

For this reason, CPA recommends beginning with four levels of tariff to prioritize simplicity: 0%, 15%, 35%, and 55%. This was not uncommon historically. The 0% threshold was known as ‘the free list in older tariffs, while other goods were placed on their own schedule under a handful of tariff rates.

CPA recommends defaulting to a 15% tariff on non-manufactured goods and 35% on manufactured goods.

A 15% tariff is accepted by economists as a ‘revenue tariff’ as opposed to a protective tariff—since 15% is too low to stave off most import transactions. Significantly, though, the increased federal revenue from a 15% tariff would allow the reduction of other domestic taxes, in turn making domestic production more viable.

From that point, CPA recommends adjusting a particular product’s tariff based certain criteria. For example:

1. 0% tariff: inability to produce at all. E.g., for reasons of geography. Or if the U.S. has granted 'Geographical Indication' protection to a foreign agricultural product.

2. 55% tariff: critical industries: Industries that the U.S. must maintain domestically, and where a 35% tariff proves insufficient to promote domestic reshoring. Determination as to what goods must be maintained domestically to maintain critical industries would be left to presidential determination.

Helpfully, the nation has already seen the beginnings of this type of tariff reset in the actions of both the Trump and Biden administrations, for trade with China and Russia respectively.

Implementation and rules for model tariff

- Phase-in: a five-year phase-in of the tariffs is suggested, to give private capital time to make investments and ramp up domestic capacity in anticipation of the tariff, without causing any immediate price effects. If a domestic producer asserts they can meet domestic capacity at market prices ahead of that period, they could petition to accelerate the timeline.

- Use of Tariff Rate Quotas (TRQs): TRQs are already used in America's current tariff schedule. TRQs are the mechanism whereby a lower tariff will be extended to a specific quantity of an imported good over the course of a finite time period (usually, half a year or a year). TRQs are a recommended mechanism in the Model Tariff to limit the chances that phasing-in the new tariffs would lead to possible price shocks. They are also useful to address any temporary domestic production shortcomings (e.g. in the event of natural disaster). President Trump successfully used a 50% tariff on washing machines, with a limited 20% tariff TRQ for 1 million washing machine imports, to convince Samsung and LG to shift their washing machine production to the United States from abroad.

- Minimum Valuations: because ad valorem tariffs rely on the declared value of invoices from foreign vendors, they are very susceptible to fraud, since shippers can undervalue the goods on the invoices they submit to customs. As early as the Tariff Act of 1816, this was addressed with 'minimum valuation provisions,' which assign minimum value prices to specific goods. WTO rules currently prohibit minimum valuation provisions, but this should be ignored, much as the U.S. continues to ignore the WTO's ruling against recent China tariffs.

- No tariff lowering. Even with America's current, extremely low tariffs, there are some items—for example sugar and peanuts—where quite high tariffs are imposed and managed through TRQs. These TRQs are considered to work quite well, and for this reason, CPA recommends they be left as is.

What are the benefits of Congress passing a tariff like the model tariff code?

There are many benefits to Congress passing a tariff along the lines of a model tariff:

1. <u>Major Source of Revenue.</u> Added tariff revenue can fund the reduction of other domestic taxes for a net-neutral revenue result while shifting taxation toward imports and away from domestic taxpayers. The United States remains the world's largest consumer market, and can count on private capital, both domestic and foreign, to make productive investments, so long as they have relative certainty.

2. <u>Considering tariffs holistically</u>. America's tariff schedule is the product of 90 years' worth of ad-hoc piecemeal cuts, leaving little coherence in the current tariff schedule. For example, the U.S. allows tractors to be imported tariff-free, but charges tariffs on certain tractor components. These types of situations are sometimes referred to as 'inverted tariffs.' WTO-legal tools to protect industry, like Anti-Dumping and Countervailing Duty (AD/CVD) orders, amplify this problem, because they're narrowly focused on ultra-specific tariff lines against imports from a sole foreign business (AD) or country (CVD), and are used most frequently on intermediate goods. This leads to the situation with prices on metals that are substantially higher than prices in other markets, but the U.S. still allows the tariff-free importation of vehicles and appliances made from those same metals. This leads to domestic OEMs getting undercut by foreign competitors who have cheaper inputs.

   By passing a new tariff schedule in its entirety, Congress can undo tariff inversion and ensure a level of rationality.

3. <u>Can implement with, or without, current FTAs</u>. The United States' current tariff schedule has three columns: "Column 1", which is the standard, 'default' tariff; "Column 1-Special", which indicates preferential tariff rates for FTA countries and countries with tariff preference programs, like GSP, and "Column 2", which imposes tariffs for Russia, Cuba, and North Korea.

   Congress could elect to pass the Model Tariff as a replacement for just Column 1, leaving FTAs intact, or as a replacement for both Column 1 and Column 1-Special, which would eliminate FTAs.

   Even if Congress elects to only replace Column 1, it would be prudent to immediately revisit America's current FTAs, since the nation would now have infinitely more leverage in tariff negotiations.