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TARIFFS AND THEIR FAILINGS: A HIGHER U.S. TARIFF WOULD RAISE PRICES, ERODE U.S. COMPETITIVENESS, AND ENDANGER EXPORTERS

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Mr. Chairman and Members of the Committee:

Thank you for this opportunity to testify on potential increases in U.S. tariff rates. My testimony this afternoon will address four main points: the nature of tariffs and the way they are paid; the people and economic "sectors" who bear their cost; the risks tariff increases pose for American exporting industries; and the unsettling implications of an unlimited presidential power to impose tariffs without Congressional approval. By way of introduction, I am Vice President of the Progressive Policy Institute (PPI) here in Washington, D.C., a 501(c)(3) non-profit research institution established in 1989 and publishing on a wide range of public policy topics. Before joining PPI in 2021, I served at the Office of the U.S. Trade Representative from 2015 to 2021, as Assistant USTR for Policy and Economics, responsible for overseeing agency economic research and use of trade data, chairing the interagency Trade Policy Staff Committee, and administering the Generalized System of Preferences.

Fundamentally, a higher across-the-board tariff rate will leave Americans worse off. It will diminish family living standards by raising store prices. It will make U.S. taxation more regressive for families and less equitable for businesses. It will damage U.S. industries through higher production costs, lost overseas customers, and potential retaliation. And finally, if implemented by presidential decree rather than legislation, it will erode a core Constitutional separation-of-powers principle.

I. WHO PAYS FOR TARIFFS?

To explain these points, let me begin with the basics. A tariff is a tax on purchases of goods bought from overseas, paid by U.S.-based buyers to U.S. Customs and Border Protection when their orders arrive at the border. Such buyers can be individuals ordering goods for their own use; retailers stocking grocery shelves or appliance aisles; small businesses like hair salons or auto repair shops buying supplies; or manufacturers, farmers, and construction companies buying inputs (say, wiring, fertilizer, cement) they use to make cars, raise crops, or build houses.

Mechanically, tariffs work as follows: The buyer of a product from abroad, legally termed the "importer of record," is the U.S.-based individual or business who ordered it and receives it at

the border.[1] This person or company pays the tariff by writing a check to CBP, in an amount determined by the rate assigned to the product in the U.S.' "Harmonized Tariff Schedule" (HTS).[2] If the buyer is an individual consumer, he or she has paid the tariff and assumes the cost. If the buyer is a retailer, the tariff cost is included in the price of the product in the store. If the buyer is an industrial firm such as an appliance maker, the tariff becomes part of its production cost.

Men's cotton shirts are a typical retail example. Consider a container of $100,000 worth of these shirts, hypothetically valued at $10 each, arriving at the Long Beach container port from Vietnam this week for a retailer's Christmas selection. As the cranes move the container from ship to truck, the buyer reports the arrival to CBP and writes the agency a $19,700 check, reflecting the 19.7% tariff assigned to the shirts under HTS line 61051000.

Who bears the cost of this, as we follow the shirts from the ship's deck to the cash register a week later? Clearly, neither the Vietnamese factory producing the shirts nor the shipping company carrying the container has paid CBP any money. The U.S.-based retailer has paid, but this is not the end of the story. The retailer has now paid $100,000 to a factory for the shirts, $19,700 in tariffs to CBP, and about $5,000 to the shipping company for transport. So her 10,000 shirts cost her $124,700 in total. This "landed cost" — $12.47 per shirt, each including $1.97 worth of tariff — is the base from which she calculates a markup sufficient to cover domestic transport, wages and salaries, building maintenance, and other costs, with enough profit per shirt to end the year "in the black."

Markups vary by company, but hypothetically assuming a simple doubling from port to cash register, the shirts would sell for $24.94 each, with the tariff embedded in the price and amplified by markup. So the retailer has paid, and the shopper bears the tariff system's cost — and note that this cost is well above CBP's $1.97 in revenue per shirt. (Of course, if the shirts do not sell, the retailer is simply out the money.) If the government raises the tariff rate, the landed cost will be higher, and therefore, all else equal, the price in the store will be higher.

Of course, retailers are not the only buyers of goods, and consumer goods are not America's only imports. Industrial inputs — paints and wiring bought by construction and manufacturers, or fertilizer by farmers — are large imports, too. For these products, tariffs work the same way, though in some cases, the "incidence" (that is, the burden of paying the tariff) can fall on the U.S. producer as well as the final consumer. American automakers, for example, face intense competition from factories in Canada, Mexico, Germany, Sweden, Japan, Korea, and now China. A higher U.S. tariff on metals, semiconductor chips, and parts would make it more expensive for them to assemble cars in the United States. They will pass some or all of this on to auto-buyers, but as they do, the U.S.-produced vehicle's price will rise relative to the Asian- or European-made alternatives. At some point, the manufacturer may feel it must absorb the tariff cost itself, and compensate by reducing employment and/or wages, scaling back research and development, limiting marketing, or making some other damaging choice.

Finally, two real-world examples — one current, one long past — serve as an illustration. After investigating the tariffs imposed on steel, aluminum, and many Chinese-made goods in 2018 and 2019, (sections of U.S. trade law designed respectively for national security-related measures

and negotiating leverage in trade disputes), the U.S. International Trade Commission concluded unambiguously that "tariffs under sections 232 and 301 passed through fully into U.S. importer prices".[3] Likewise, the United Kingdom's 3 pence-per-pound tea tariff of 1773 was a tax paid by Americans — not somehow by Chinese tea growers or the East India Company. In sum, U.S. tariffs today are taxes paid by Americans, never by foreign exporters or governments.

II. LIKELY EFFECTS OF A HIGHER TARIFF

What effects could we expect from a higher U.S. tariff? I suggest three: higher prices for families, eroded competitiveness for U.S. industry, and losses for American exporters.

A. Higher Prices, With Heaviest Impact on Low-Income Americans

First, families will pay more for goods.

Last year, for example, Americans imported $250 billion in energy, $241 billion worth of food, $25 billion in shoes, $184 billion in pharmaceuticals, $56 billion in smartphones, and $1.6 billion in crutches.[4] Tariffs now vary significantly for such products, with averages near zero for most energy products, precisely zero for medicines, smartphones, and crutches, and 12% for shoes. A higher tariff rate will affect all such products in the same way, raising buyers' "landed costs" and, therefore, (all else equal) raising store prices. So we should expect grocery, clothing, first-aid, and other common store products to cost more.

This will raise prices for everyone, but will hit lower-income families hardest. The reason for this is simple: lower-income families spend more of their income on goods — food, clothes, home furnishings, auto purchases, medicines, personal care products, and so on — than wealthy families. To be specific, the Bureau of Labor Statistics' Consumer Expenditure Survey shows that in 2023, on average, 134.5 million U.S. households spent 29% of their post-tax income on these goods. Top-decile families, earning on average $353,000 per year, spent about 19% of it on goods while putting more into savings, vacations, and services such as education or health. And single-parent families, whose post-tax incomes averaged $52,000, spent 39% of it on goods.

	All U.S. households	**Top 10% of incomes**	**Single-parent families**
Post-tax income, 2023	$87,869	$271,617	$52,462
Spending on goods*	$25,153	$51,257	$20,398
Share of post-tax income spent on goods	28.6%	18.9%	38.9%

** Excluding restaurant meals, but counting all other Bureau of Labor Statistics goods categories, including food, household supplies, clothes, medicines and first aid, automobile purchases, personal care, toys, consumer electronics, and other goods. Source: BLS' 2023 Consumer Expenditure Survey, https://www.bls.gov/cex/tables.htm*

In sum, tariffs are an inherently regressive form of taxation. The more we rely on them for revenue (or impose them for other purposes), the more taxation will fall on working-class and lower-income Americans.

B. Lost Competitiveness for U.S. Industries

Second, U.S. businesses producing goods will see their competitiveness erode as production costs rise.

Automakers buy metal and paint, factories and farms buy energy and fertilizer, makers of medicines use precursor chemicals, and so on. The permanent "Most-Favored-Nation" (MFN) tariff system exempts many of these goods from tariff taxation by setting the tariff rate at zero, and puts most of its high tariff rates on consumer goods such as clothes, shoes, and silverware. A higher across-the-board tariff would, therefore, hit these businesses much harder than tariff policy now does. As an index of the types of businesses that would see costs rise, a 2021 Government Accountability Office (GAO) study of the "exclusion" process for the 2018/2019 "301" tariffs on Chinese goods reports that of the 52,810 requests businesses filed for exemptions on the grounds that they could not find alternative suppliers, 12,120 were for consumer-goods, 8,460 for industrial goods, and 12,633 for automotive goods (which can be consumer products bought by repair shops, or industrial goods bought by parts manufacturers and vehicle-makers).[5]

With these inputs all rising in cost, American industrial products will cost more and be less competitive, both against imports and in export markets. There will, of course, be winners from this price increase, but they are very likely to be outnumbered by losers. As one example in recent experience, the U.S. International Trade Commission's 301 and 232 study estimated that the 2018 tariffs on steel and aluminum, as of 2021, had increased the size of the two metals industries by about $2.2 billion while shrinking the size of the auto parts, cutlery, machinery, and other metal-using manufacturing industries by about $3.5 billion.[6]

As a more general comment, just as they are a regressive and inequitable consumer tax, they are also inequitable as a business tax, disfavoring sectors that buy lots of goods and favoring those that don't. In practice (and setting aside the macro risk of a 1930s-style international trade war), this would mean relatively smaller U.S. retail, manufacturing, farming, construction, restaurant, hospital, and personal care services sectors, and relatively larger real estate, financial services, some forms of entertainment, legal, and perhaps private education sectors.

C. Exporters Lose Customers and Risk Retaliation

Third, U.S. exporters — a $3 trillion part of the American economy — are likely to suffer through lost customers and retaliation.

If U.S. tariff rates rise in a more economically isolationist America, some of our main foreign markets will contract, and their downturn will damage successful American businesses. The U.S. relationships with Mexico and Canada are an example here. The two countries buy over $700 billion in U.S. goods every year, and many U.S. exporters specialize in providing them with very sophisticated, high-value parts and components used to assemble final goods. For example, New Mexico, Texas, and Arizona are the three states most reliant on exports to Mexico. Mexico buys 70% of New Mexico's exports; by another measure, Texas' $130 billion in exports to Mexico represents 5% of Texan state GDP. New Mexico's $3.5 billion in exports to Mexico include $1.7

billion in computer parts, $230 million in magnetic and optical media, $290 million in electrical components, and $190 million in semiconductor chips — that is, high-tech inputs destined not for Mexican households but for auto plants and factories assembling appliances.[7] Imposing a 25% tariff on these resulting cars and TVs as they flow back to the U.S. will likely close many of the plants producing them; as this happens, suppliers in Las Cruces, Albuquerque, and Rio Rancho will contract along with them.

Similar examples appear throughout the United States. Texas' exports to Mexico include $10.8 billion in semiconductor chips, $5.1 billion in electrical equipment, and $7.0 billion in auto parts. Arizona sells Mexico $4 billion in semiconductor chips, electronic and electrical equipment, resins, and auto parts. Virginia ships $200 million in auto parts and $250 million in computer equipment to Canada and Mexico. On the northern border, Ohio's $5 billion worth of metals and auto parts destined for Ontario and Quebec auto plants would face the same risks, as would Maine's $320 million in lumber mill and paper products and Wisconsin's $1 billion in auto parts, electronics, and power transmission equipment.

Meanwhile, some foreign governments — perhaps many — will retaliate against higher U.S. tariffs with tariffs of their own. This was the case in the early 1930s, after the "Smoot-Hawley" Tariff Act of 1930 (the last time we experimented with an across-the-board tariff increase), and economic historians generally agree that the resulting cycle of retaliation and tariff hikes deepened and prolonged the Depression. More recently, the Chinese retaliation for the 2018/2019 "301" tariffs led to the loss of $20 billion per year in farm exports. Canada, Mexico, and China together — all subject to tariff threats last month – buy fully half of U.S. farm exports and contribute about 10% of all U.S. farm income[8], and agriculture is typically an early target for such actions. Nor might tariffs on U.S. goods be the only form of retaliation: if the U.S. abandons WTO rules on tariffs, others may retaliate in different arenas – for example, by abandoning the WTO rules on intellectual property that underpin U.S. research spending and technological innovation. Exporters are valuable parts of our economy, especially in manufacturing and agriculture, and we should not lightly sacrifice them.

Or, to choose a particular community, our 1,139 African American exporters sell $1 billion a year abroad, with Canada as their top market. According to last year's Census/BEA survey, they have 21 employees per firm on average, at a payroll of $75,000 per worker, compared to 11 employees and $54,520 per worker for privately held U.S. businesses in general.[9] These are successful firms and good employers, and we shouldn't sacrifice them lightly.

III. UNLIKELY EFFECTS OF A HIGHER TARIFF

So the likely effects include higher prices, erosion of competitiveness in U.S. goods-producing and -using industries, and risk to American exporters. On the other hand, tariff increases are quite unlikely to reduce U.S. trade deficits or to raise U.S. industrial output.

A. Trade Balances Affected Only Modestly

On the first topic, recall that the first Trump administration argued in its first "President's Trade Agenda" report in 2017 that a rise in the trade deficit over time showed earlier administrations justified much more use of protective tariffs:

> "In 2000, the U.S. trade deficit in manufactured goods was $317 billion. Last year [i.e. 2016] it was $648 billion — an increase of 100 percent."[10]

What then happened? As tariff rates rose from a trade-weighted average of 1.4% in 2017 to 3.0% in 2021,[11] the U.S. trade deficit did not fall. Instead, it rose, and especially fast in the manufactured goods the administration's report cited as so troubling. By 2021, the "manufacturing-only" trade deficit figure cited in the 2017 report reached $1.06 trillion — about 60% above the 2016 figure — and with tariffs still in place it has remained in this vicinity since then. The overall U.S. goods/service deficit also rose, from $479 billion to $842 billion in 2021, $785 billion in 2023, and a likely $900 billion in 2024.[12]

Why did this happen? Tariffs do affect trade balances, but their influence is modest. Fundamentally, trade balances equal the difference between national savings and national investment. As a form of tax increase, raising tariffs should reduce government "dissavings" and, therefore, modestly reduce trade deficits (unless there is some offsetting change in investment or private-sector savings). But if a tariff increase is accompanied by other tax cuts – as was the case in 2018 and appears to be the current plan — U.S. savings do not rise and are likely to fall. This is why after the 2018/2019 tariff increases (accompanied by the 2017 tax cut bill) the trade deficit did not fall but instead rose rapidly. If the goal is to reduce the trade deficit in some substantial way, while avoiding an economic contraction, the government tool with the most effect would be an overall reduction in fiscal deficits and policies to encourage private savings, not a tariff.

B. Industrial Sectors More Likely to Shrink than to Grow

Nor is there any reason to expect U.S. manufacturing (let alone agriculture) to grow if tariffs rise. Rather the reverse: in aggregate, manufacturing is likely to contract relative to other industries. The reason for this is that a tariff is, again, a tax on purchases of goods. A higher tariff will mean higher prices for goods, influencing Americans to buy fewer goods, and foreigners to purchase less U.S.-produced goods. We can perhaps see this in the data, as the U.S.' manufacturing sector accounted for 10.9% of GDP before the "232" and "301" tariffs, and now accounts for only 10.0%.[13]

Within these big categories, of course, there will be individual winners and losers. The example of the 2018 steel and aluminum tariffs — somewhat more metals production, offset by larger declines in auto parts, tools, machinery, and other metal-using industries — is a likely foreshadowing of the larger effects of an overall tariff increase.

III. CONSTITUTIONAL TAX POWERS AND THE RISK OF CORRUPTION

Finally, apart from the real-world economic effects of a higher tariff, it is troubling to hear that an incoming administration might be considering an attempt to raise tariff rates without Congressional approval.

The Constitution's Article I, Section 8, language is very clear: "Congress has the power to lay and collect Taxes, Duties, Imposts, and Excises." Nothing in the Constitution gives any hint that a president might decide entirely on his own what tariff rates should be, in general, or as applied to different countries and products. The Constitution designers had good reason to avoid giving presidents (or any single individual) that sort of power, as doing so would raise the risk of impulsive and unsound decisions, and create temptations to use tariffs in corrupt ways to reward family members, cronies, and supporters, and to punish business rivals, political critics, and parts of the country unhappy with a president's policies. If it is legally correct that the International Emergency Economic Powers Act, or Sections 232, 301, and 330 of U.S. trade law, could be used for this purpose, this seems to me at least Constitutionally inappropriate and systemically risky in ways that go beyond strictly economic harms.

CONCLUSION

To conclude, Mr. Chairman, in some unusual cases, specific tariffs have a useful rationale. The Biden administration imposed high tariffs on Russian goods (with the support of Congress) after the invasion of Ukraine. I believe this was the right decision. Section 201 of trade law authorizes temporary tariffs under certain conditions to help struggling industries to restore their competitiveness, which is also a valid goal. The tariffs imposed on Chinese electric vehicles last year can be seen as meant for this sort of purpose, though using a different law.

But a general tariff increase is a poor policy choice. It would diminish American family living standards, weaken American industry, and put exporters, including many of the U.S.' most productive and successful industries, at risk. We do, of course, have many problems to address. But large new taxes on the food, clothes, appliances, medicines families need and the luxuries they enjoy, and the inputs and raw materials farmers and factories need to produce high-quality goods at low cost, are more likely to inflame than ease these problems. We have no need or reason to make such a choice, and I hope we will avoid it.

Thank you again for inviting my testimony this afternoon, and I welcome any questions the Committee may have.

[1] Or in some cases a specialized agent such as a freight forwarder, acting as an expert on the behalf of small businesses or individuals.
[2] The Harmonized Tariff Schedule, known for short as "HTS," is kept by the U.S. International Trade Commission and is available at https://hts.usitc.gov. It divides goods into 11,414 different "HTS lines" from 01012100 for breeding horses to 97069000 for antiques 100 to 250 years old, and gives each line a tax rate known as the "Most Favored Nation" or "MFN" tariff. Individual lines may have many exceptions due to special treatment under a Free Trade Agreement, the "232" and "301" tariffs imposed in 2018 and 2019, or other reasons, but these do not affect the basic responsibilities for paying tariffs or the way they affect American buyers, consumers, and industry.
[3] "Economic Impact of Section 232 and 301 Tariffs on U.S. Industries," U.S. International Trade Commission, March 2023, pg. 124, at https://www.usitc.gov/publications/332/pub5405.pdf
[4] Data from U.S. International Trade Commissions "Dataweb," at dataweb.usitc.gov/.
[5]"U.S.-China Trade: USTR Should Fully Document Internal Procedures for Making Tariff Exclusion and Extension Decisions," Government Accountability Office, July 28, 2021, page 43, at https://www.gao.gov/products/gao-21-506
[6] Economic Impact of Section 232 and 301 Tariffs on U.S. Industries," U.S. International Trade Commission, March 2023, pp. 124-134, at https://www.usitc.gov/publications/332/pub5405.pdf
[7] State export figures from Department of Commerce "TradeStats Express" database, at https://www.trade.gov/report/tradestats-express-national-and-state-trade-data
[8] Agricultural export data from US Department of Agriculture's Global Agricultural Trade System (GATS) database, at https://apps.fas.usda.gov/gats/default.aspx. Export share of farm income from USDA's Economic Research Service, at https://www.ers.usda.gov/topics/international-markets-u-s-trade/u-s-agricultural-trade/u-s-agricultural-trade-at-a-glance/.
[9] "U.S. Exporting Firms By Demographics: 2022 Tables," Census and Bureau of Economic Analysis, Table 1, at https://www.census.gov/data/tables/2021/econ/abs/2021-abs-exporting-firms.html.
[10] "President's Trade Agenda 2017," Office of the U.S. Trade Representative, page 7, at https://ustr.gov/sites/default/files/files/reports/2017/AnnualReport/Chapter%20I%20-%20The%20President%27s%20Trade%20Policy%20Agenda.pdfv.
[11] Rates from U.S. International Trade Commission, "U.S. Imports for Consumption, Duties Collected, and Ratio of Duties to Value, 1891-2023," Table 1, at https://www.usitc.gov/documents/dataweb/ave_table_1891_2023.pdf.
[12] Trade balance data from USITC Dataweb.
[13] Bureau of Economic Analysis, "GDP by Industry" database, at https://www.bea.gov/itable/gdp-by-industry