WASHINGTON UPDATE

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A Brief Primer on Tariffs and Trade

Ever since the administration of President Trump began imposing tariffs on foreign good, the president has often asserted that when the United States places a tariff on a foreign import, that other country directly pays the bill. Like many of his other assertions, this one is also incorrect, but that does not prevent the president from repeating it. For example, on November 29, 2018, Trump tweeted, “Billions of Dollars are pouring into the coffers of the U.S.A. because of the Tariffs being charged to China, and there is a long way to go.”

When trying to understand how tariffs work, perhaps the first question that would arise is who is responsible for paying them. Logically, it might seem that either the foreign government or a company that sells the foreign goods in the United States would be liable for tariffs. When the U.S. government imposes a tariff on foreign goods, however, neither the foreign government nor the company selling the goods in the U.S. is technically responsible for the paying the tariff.

Tariffs are usually paid by companies that American businesses that import goods here. Most American importers do not handle the paperwork on imported products themselves. They retain the services of entities commonly known as an importer of record. These companies navigate the process of importing goods into the United States, a complicated process as evidenced by 211-page publication from the U.S. Customs and Border Protection (CBP) titled *Importing into the United States A Guide for Commercial Importers* (last revised in 2006.) The importer of record has experience in dealing with CBP and its system for inspecting imports and levying any duties on them. (Broadly speaking, “duties” are a tax or fee placed on an import. Tariffs are a form of duty.) Thus, when imported goods first enter the U.S. in a port of entry, the importer of record receives the initial bill for the tariff.

This is where the question of who ultimately bears the cost of tariffs becomes a bit more complex. An importer of record is little more than a middleman that provides a service, and its business model would not survive the cost of paying tariffs. Service providers nearly always pass on costs to their customers. Therefore, a company that contracts with an importer to bring goods into the United States will almost always see the costs of that contract rise after a tariff has been imposed on goods it imports. For example, as a result of the tariffs, the importer of record might wind up paying between 10 and 25 percent more to bring in the exact same product it imported before the tariffs. Those costs are passed on to the company that intends to sell the goods in the United States, which means the selling company faces a choice regarding those additional costs.

Most likely, the selling company would pass on the added tariff costs to consumers, in the form of higher prices, especially in a competitive market where the supply chain cannot be moved easily. An example of this phenomenon is washing machines and solar products (*e.g.*, solar cells and modules). The prices of these items rose here earlier this year after the Trump administration’s tariffs on them. In other instances, importers may also try to reduce the cost of tariffs by switching suppliers or changing the products they sell if they are able to do so. In the case of tariffs on Chinese products, that could mean moving a factory from China to Vietnam, for example. In this case, no one would pay a tariff

If the American company cannot avoid the tariff, it could negotiate concessions from its Chinese supplier, by using whatever leverage it has, including the threat to shift production. In those circumstances, the tariffs would reduce the Chinese supplier’s profits, as it would bear at some of the cost of the tariffs. It appears that some American companies have been able to pass some of the cost of tariffs back to their Chinese suppliers.

Finally, some American companies may choose to absorb the extra costs themselves, by accepting lower profits. They would neither raise prices nor immediately pay to shift production, based on the theory that the imposition of tariffs would not change the most economically efficient price to charge for the product. That may be the case with Apple, which charges such a high premium for its iPhones that it can easily accept smaller profit margins on them (relatively speaking) for some time, if the administration were to impose tariffs on the phones. Companies like Apple would be making a bet that the imposition of the tariffs would be for a relatively brief time.

China would never pay tariffs directly, but tariffs would hurt it indirectly. China’s economic growth, which is already under pressure, would be lower if companies were to move production to Vietnam, for example. Of course, such moves would not provide America with additional jobs or any other substantial benefits from the tariffs. Moreover, in the short term, moving production to another country outside of China would create logistical problems for the Chinese supplier and the U.S. importer. Additionally, Chinese companies forced to cut costs due to American tariffs could have their profits reduced forcing them to reduce hiring or close entirely. That could put pressure on them to move to places that do not face U.S. tariffs like Vietnam.

It is important to remember that the Chinese economy is still export driven. If higher prices result in American consumers buying fewer Chinese goods, that would clearly hurt China. While that much is clear, it is also worth noting that tariffs can become an indirect tax on American consumers. Although the U.S. government is not “charging” a tax on China or the American public, Americans and Chinese companies are paying for the increased costs regardless.

Tariffs are a genuine additional cost; someone must bear its brunt, and the money does go somewhere, in this case to the U.S. government. In that sense, President Trump is absolutely correct. His tariffs are indeed bringing several billion additional dollars into the public fisc. According to the Department of Treasury, tariff revenues exceeded $5.5 billion in October, a noticeable 40 percent increase from $3.2 billion in October 2017. Overall, tariff revenues increased by $7 billion for the government’s fiscal year ended September 30, 2018. What is much less clear is the effect of tariffs on the overall U.S. economy and the financial health of various American businesses.

Any discussion of tariffs and trade wars requires a cautionary note, however, in that tariffs have done nothing to improve the U.S. trade deficit. The monthly trade deficit increased to $59.8 billion in December 2018 (the highest gap for any month since December 2008). Overall, the annual trade deficit rose by $68.8 billion from 2017 to 2018, and it stands at $621 billion for 2018. Thanks to a strong American dollar, the trade gap is now at a ten-year high. If the president wants to address the trade gap and to make U.S. goods more competitive in the rest of the world, his priority should be the U.S. dollar.