Trade Facilitators, Inc.

Tariff Truths: The FACTS of the Case

By

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Introductory Statement

With the November 5th elections approaching, the discourse on U.S. import tariffs is now on blast. Since 2018 when the previous Administration implemented the Section 301 Tariffs on China, I've been mostly quiet on this topic. However, given the role that tariffs are playing in the 2024 Presidential contest and of greater importance, their potential for a positive or negative impact on the economy, it's time to clear the air on a few points.

China Doesn't Pay the Tariffs

First off, China doesn't "Pay the tariffs". Despite the insistence on this storyline, the U.S. Importer of Record pays tariffs (aka "duties") on imports, regardless of whether goods originate in China or any other country. For proof of this **FACT**, one needs to look no further than the electronic customs entry that importers must present to U.S. Customs & Border Protection (CBP) to clear foreign goods into United States.

Known as an "Entry Summary" (aka "Customs Form 7501") this e-transmission provides U.S. CBP with details on, among other things, the foreign seller, the U.S. importer of record, value, description, and country of origin of the goods, as well as the Harmonized Tariff Schedule number that classifies a product. U.S. CBP then uses this data to calculate the dollar amount of duties and fees owed on a given import shipment.

In the end, the Entry Summary is an invoice issued by U.S. CBP for duties payable to the U.S. Treasury. And you can rest assured that this invoice is not paid by China. The **FACT** is that the U.S. importer on the Entry Summary is responsible for paying all import duties & fees. Not China, not India, not anyone other than the importer.

In all fairness, it is also **FACT** that as a trade policy, the imposition of high import tariffs has been used for centuries to discourage importers from doing business with certain countries. The rationale is quite simple: Make it so expensive to import from a given country that importers won't do business with them anymore, seeking alternative sources of product either domestically or from other foreign nations (normally the latter).

To a limited extent, the above is what happed with the Section 301 Tariffs of 2018. While China remains strong in its exports to the U.S. (our #3 trading partner), plenty of U.S. importers switched product sourcing to countries like Vietnam and Mexico. Some even brought production back to the U.S. In that sense, it is a **FACT** that China did "pay" a price through lost business, but never once did they send a cent to the U.S. Treasury.

As a side note, the cost implications of the Section 301 Tariffs are also easy to explain. With a 25% tariff increase on Chinese goods, U.S. importers had to choose from three options. First, the importer could approach their Chinese supplier for a price cut to reduce the tariff's impact. Second, importers could cut other costs in their companies to make up for the loss in profitability. Third, and this was by far the option of choice, the additional cost of tariffs was passed on to the final consumer (i.e. everyday Americans).

The Pros & Cons of Tariffs

Whenever pundits spout off on the downside of tariffs, they revert to the go-to-example of the Smoot-Hawley Tariff Act of 1930. Although it is true that high tariffs on imports intended to protect U.S. businesses during the Great Depression actually made things worse, there are other examples that tell a broader, more systemic tale.

Before the adoption of the U.S. Constitution in 1789, our fledgling country operated under the Articles of Confederation. Among other weaknesses found in this document, the Articles allowed individual states to make their own laws on commerce, create their own currency and most salient for this discussion, charge their own tariffs.

In recognition of this flaw, Article 1, Section 8 of the Constitution put the levying of duties in the hands of Congress at the Federal level. As a result, the growth of the U.S. economy over the last 235 years has been based (in part) on "free trade" between the states and in particular, no tariffs between them. "Revolutionary" at the time, the Founding Fathers wrote in 1787 what it took the EU until 1993 to accomplish.

A more recent argument for high universal tariffs is that they will generate so much revenue that income taxes can be lowered and the budget deficit eliminated. That's an appealing point, but let's not forget the **FACT** that the 16th Amendment to the Constitution (1913) enacted the federal income tax because Uncle Sam knew that tariff revenues alone couldn't cover future outlays. If that was true in 1913 (and it was), why would anyone be inclined to believe that duties will pull off such a miracle in 2025?

For even more historical context on U.S. tariff policy, let's fast forward to 1985 and the implementation of America's first Free Trade Agreement with Israel. A milestone event, it was right around this time that the U.S. began to lower customs duties for many countries, while creating "Special Tariff Treatment" programs for others.

Beginning in the early 1990s and as an enabler of "cheap imports" that included computers, laptops, cell phones, consumer electronics and fashion goods, it was low customs duties (in part) that rendered inflation virtually non-existent for the ensuing three decades. Prior to 2024, there were a couple of reasons why a shopper could pay $20 for a pair of jeans or $1 for an avocado at Walmart, and one of them was low tariffs.

With the above said, it must also be stated that there is a place for the strategic use of tariffs. A demonstration of this **FACT** is the use of countervailing and antidumping duties against countries and companies that seek to take unfair advantage of the U.S. Whether it's steel, rubber, paper, solar or other products, American companies should be protected by the government against the rapacious acts of foreign competitors.

Reasonable Questions to Ask

For the sake of argument, let's say that all the above is a big crock of you-know-what and that an ultra-high tariff system is put in place in early 2025. Given the ramifications for the U.S. economy, let's move on to some questions that the implementors of such a policy must be able to answer prior to making such a "Bet the farm" decision.

As we move on, please be reminded that the current rationale for tariffs is that duties will be so high that foreign companies will come to the U.S. in droves to build factories and create high paying jobs. In that context, the following questions must be answered:

Will foreign countries retaliate with tariffs of their own?

History shows that when one country raises import tariffs, other countries return the favor. China did that in response to the Section 301 tariffs, making U.S. products more expensive there, thus impacting the amount of U.S. exports to the "Middle Kingdom". One need not speculate on what the response to 60-200% duties will be from not just China, but all countries that do business with the U.S.

Tangential to the above question is the fate of the Free Trade Agreements that the U.S. currently has with twenty countries. What happens, for example, if the U.S. scraps the USMCA with Canada & Mexico and applies 60% (or higher) tariffs to their exports? The short answer is that our erstwhile pals will reciprocate in kind. When those levels of costs get passed on to the consumer, it's likely that more inflation won't be far behind.

How long will it take to build the infrastructure needed to support the wave of foreign companies setting up all the new factories?

It is indeed a **FACT** that foreign companies have already "set up shop" in the U.S. to avoid customs duties (especially in the automotive sector). Supporters of high tariffs believe that new factories will be built overnight and that jobs will immediately appear.

Actual experience shows that it will take years to build the hundreds of factories that will be coming on-line. For proof of that **FACT**, look no further than the 2017 announcement by the Taiwanese contract manufacturer Foxconn of a "manufacturing campus" in Wisconsin. According to the same state government that ceded billions in tax incentives to Foxconn, of the 13,000 jobs promised, 750 have been created. While a good thing, that's a far cry from the original commitment that was made more than seven years ago.

With unemployment at 4%, where are all the factory workers going to come from?

In mathematical terms, with unemployment at 4%, one has to wonder where the workers will come from to fill the thousands of open roles. Of course, the standard response to that question is that higher wages relative to industries like retail will attract the needed work force. A fair point to make, but will the rush away from retail drive up labor costs at places like Starbucks, thus making our coveted lattes a $25 luxury item?

As an ironic side note, it is also a **FACT** that lower paying jobs in the U.S. have historically been filled by immigrants. Given the tariff-driven need for more employees to simultaneously fill manufacturing and service-based jobs, the winner of the Presidential election might consider a more creative approach to immigration law.

Who is going to train all the new production workers?

When the U.S. began its transition to an import-driven economy in the 1990s, we sacrificed a lot of manufacturing know-how as industries moved to low-cost nations. This "quiet exodus" of production expertise has created a paucity of engineering know-how that will take a long time to "Build Back Better". American workers are more than capable of doing these jobs, but it will take more than a minute to get them up to speed.

Will the wage difference between U.S. and foreign workers foster inflation?

The original argument for offshoring production was that low overseas costs would make imported goods more affordable for all Americans. That fundamental precept hasn't changed much and although wages have gone up in foreign nations, they're still far behind what a skilled factory worker earns in the U.S.

So, while every American deserves a fair day's pay for a fair day's work, will a 60-65% difference in labor make products uncompetitive in our own home market? How about the competitiveness of U.S. products in export markets? The answer to these questions remains to be seen, but the early math isn't favorable.

Even if goods are "Made in the USA", where will all the raw materials come from?

The **FACT** that the U.S. ceded much of its manufacturing base to other countries years ago also means that the sub-system of raw materials suppliers went with it. This can be seen with existing U.S. manufacturers that import components and sub-assemblies from foreign suppliers for the simple reason that they can't get them in the U.S.

If the above is true for existing U.S. companies, what will happen when all the new manufacturers realize they'll have to source raw materials overseas? Apart from the fact that savvy producers already know that, with tariffs threats ranging from 60-200% on all imports, the math won't be hard for consumers to figure out once they hit the check-out line at Macy's, Home Depot or Target.

Closing Remarks

Of all the statements made here, the most important **FACT** is that the U.S. needs to rebuild its manufacturing base. We've already given up too much production expertise and to continue down that path will only weaken America's global competitiveness.

Although the above is true, it's not unreasonable to challenge the wisdom of applying high tariffs to all industries on the hope that manufacturing will automatically return home. That's a big bet to place on our future and for the reasons and questions presented in this paper, there's a chance that a tariff-based policy won't pan out.

The reality is that there are certain industries where the U.S. can't compete on cost alone and putting tariffs on those sectors will only increase prices without fostering job growth. Those industries include textiles, wearing apparel, footwear, consumer electronics and several industrial sectors where unskilled labor represents most of a product's cost.

Instead, whoever wins the election might consider a more strategic approach to the application of tariffs, continuing to make prudent use of existing tools like countervailing and antidumping duties. While allowing the importation of lower end, labor intensive goods at reasonable tariffs, the U.S. needs to develop a national manufacturing strategy that emphasizes cutting edge industries where highly skilled labor is part of the recipe.

By focusing on industrial development where high-paying jobs are baked into a Value Proposition that stresses next-level engineering, technological prowess and product functionality (a la Germany), the U.S. can revitalize manufacturing without putting the economy at risk.

ABOUT THE AUTHOR

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An author of five books on international business, Dan holds an MBA from the University of Miami and is a licensed U.S. Customs Broker. During his career, Dan has travelled to sixty-five countries, having lived in Mexico and Colombia for a total of five years. Mr. Gardner can be reached via LinkedIn and the website, www.tradefacil.com.