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On the Cusp of Historic Tax Reforms

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The GOP blueprint, including its border tax adjustment, will boost free trade.

By gaining quick congressional enactment of the tax reforms in the Ryan-Brady GOP blueprint, "A Better Way for Tax Reform," President Trump can in months accomplish historic reforms that have for decades eluded other presidents and Congresses. Furthermore, the economic burden of the blueprint's roughly $1 trillion import-tax adjustment will for a combination of reasons fall partly on foreign companies that export into the U.S. market. If President Trump uses that $1 trillion of import-tax revenue to finance a big cut in U.S. income-tax rates, he can, in effect, require foreigners indirectly to help pay for the reduced income taxes on Americans. A good deal for America.

In addition to facilitating "tax shifting" (we get the money, others bear the economic burden), border tax adjustments provide a double-whammy boost to American jobs and income growth. That is because excluding exports from tax while taxing imports interacts powerfully with other vital reforms — such as low, newly reduced U.S. tax rates and first-year expensing of U.S. plant and equipment. Together, these reforms will help make America the predominant manufacturing and headquarters hub for doing business in the global economy. The Tax Foundation projects that within ten years, GDP will be 9.1 percent higher, wages will be 7.7 percent higher, and there will be 1.7 million more jobs than under current law.

The logic is impeccable. Instead of building plants abroad and having to absorb the new U.S. import-tax adjustment when they sell back into the U.S. market, American companies will invest in U.S. plants built here at home. Tax rates will be low on their income from products sold into the ever more prosperous U.S. market. In addition, the tax rate will be zero when they export American-made goods from U.S. factories. For the same reasons, foreign-owned companies will flock to the U.S. — bringing with them new jobs and purchasing U.S. equipment for doing business here and around the world. (If they stay abroad and sell their foreign-made goods into the U.S. markets, they will be hit by the import-tax adjustment set out in the Ryan-Brady plan.) Because the GOP blueprint allows U.S. companies for the first time to stay home and export products tax-free, it also allows them the option of building factories abroad when necessary — but only for the purpose of gaining a beachhead for American exports and so that they may compete directly in foreign markets they cannot otherwise reach. If, on the other hand, they sell back into the U.S. market, they will be hit by the import-tax adjustment. Indeed, it is possible that under President Trump's version of the GOP tax-reform, a truly "runaway" U.S. company might be hit with an extra-large import tax when it manufactures abroad for the purpose of selling back into the U.S.

In a January op-ed in the Wall Street Journal, distinguished economist Martin Feldstein observed that induced changes in currency exchange rates can cause the entire economic burden of the import-tax adjustment to fall on foreign labor and capital. It's uncertain whether exchange-rate changes always occur that quickly and powerfully. But in a more prosaic way, Economics 101 tells us that even with no exchange-rate changes at all, all or part of the economic burden of the import tax will fall on would-be foreign sellers into the U.S. market. They must lower their prices to absorb import taxes in those cases where there is (or quickly can be) a comparable American-made product.

The import tax adjustment in “A Better Way” is not a trade protectionist measure. Unlike a tariff that erects a trade-distorting barrier, the GOP plan ends the current subsidy for imports (and importers) that distorts trade. At present, we exclude imports from U.S. tax even though the foreign country of origin has already excluded them from value-added tax. Similarly, excluding U.S. exports from tax eliminates a double tax penalty that now exists because we tax U.S. exports even though the country of destination will tax them again. By taxing imports excluded from value-added tax by the country of origin and by not taxing exports that are taxed by the country of destination, the GOP’s proposed border tax adjustments would help level the international tax playing field. This would be a good thing for free trade and should be applauded as such. Even though some portion of the import-tax adjustment will probably be borne by some U.S. companies, and some consumers might pay a little more for some imports that are now subsidized, almost everyone should be better off overall, by a wide margin, when we consider the Ryan-Brady proposal as a whole. It provides an enormous tax cut for businesses and individuals, about $2.4 trillion over ten years before taking into account feedback revenues from $14.4 trillion of reform-induced additional economic growth for the same period. A big across-the-board tax cut and a surge in jobs, income growth, and consumer spending is hard to beat.

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