Insight

About that $1700: A Review of the Data on Border Adjustment and Tax Reform

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Executive Summary

- Opponents of border adjustment claim the policy will dramatically increase prices for consumers, to the tune of $1700 per capita.

- The $1,700 figure is unsubstantiated, cannot be replicated without more methodological transparency, and has been called "baloney" by fact-checkers.

- The price effects associated with this claim ignore the economics literature related to currency effects, but even if taken at face value appear overstated.

- The $1,700 price effect claim appears inconsistent with other more objective analyses.

Introduction

The House Blueprint for Tax Reform would scrap the deeply flawed current tax regime and move the United States' tax code towards a more efficient and pro-growth system. As part of this reform, the Blueprint would move the U.S. business tax system to a destination-based cash flow tax.[1] Under this system, only domestic consumption would be taxed. To isolate these transactions, the Blueprint would include imports in the tax base, and exclude exports, a policy known as border adjustment. The consensus view in the economic literature is that this would leave trade flows unaffected. Accordingly, all else being equal, importing firms would be no worse off, nor exporting firms better off.[2]

However, some industry groups that rely heavily on imports have strenuously opposed the border adjustment element of the Blueprint. As part of this opposition, these groups have argued that the border-adjustment would harm consumers, specifically because the new taxes on imports would be passed along to consumers. The most conspicuous of these arguments is one advanced by the retail industry, which states that the border adjustment would increase prices for consumers by $1700. This brief examines this claim and identifies several critiques that this claim invites.

The Central Claim and Its Flaws

The claim that consumers would face a $1,700 price increase is an assertion made by the National Retail Federation (NRF) on its website. It offers no substantiation for this claim besides a broad explanation of the methodology behind it. Rather, it is asserted to be based on several data sources and third party analysis, but is ultimately just an assertion made by the trade group. Without greater transparency, it is difficult to replicate or verify. Indeed, it has already been labeled, "baloney," by a fact-checking organization.[3]

Setting aside this basic lack of substantiation, several observations about how this claim was constructed can be made. First, the claim explicitly dismisses any currency appreciation effects that would mitigate any consumer impact. Second, the claim is based on the share of imports by industry from the Bureau of Economic Analysis's (BEA) Input-Output tables.[4] Using this dataset, it is possible to examine broad categories of industry with higher relative shares of imports. According to the NRF, these import shares are then further applied to consumer spending data from the BEA and the Bureau of Labor Statistics (BLS) to arrive at $1,700. The NRF doesn't provide these calculations or an associated table. Rather, the single data point (and presumably the most dramatic) that is provided is that households would face "an increase of over $350 per year for clothing alone." This is the only insight into the composition of the $1,700 price increase asserted by NRF. However, even this data point raises questions.

The apparel industry is among the most heavily import dependent industries in BEA's dataset, at about 30 percent of domestic supply stemming from imports. Accordingly, it should represent the most dramatic price appreciation based on the assumptions made by NRF. And indeed, a $350 annual increase in clothing costs for a household would be dramatic. According the BLS Consumer Expenditure survey, the average household expenditure on apparel and related services (dry cleaning, tailoring, etc) was $1,846 in 2015.[5] A $350 increase would represent more than an 18 percent increase in apparel costs for an average household, an increase that is dubious on its face. Taxing the 30 percent import share of apparel at 20 percent suggests a rough price effect, ignoring currency effects, of about 6 percent – a third of the figure that NRF has provided. While this discrepancy may be explained by legitimate methodological or data issues, without greater substantiation for the NRF claim, it suggests the effects are overstated.

It is understandable that import dependent firms may be skeptical of border adjustment. However, and particularly with respect to industries such as retailers that face high-effective tax rates under current law, the dramatic price effect claims from detractors of border-adjustment appear to be overstated. Indeed, an analysis by Goldman Sachs bears this out.[6] According to the Goldman analysis, virtually all industries are better off with border adjustable tax system and a 20 percent rate. The Goldman analysis finds that the apparel industry – the most heavily affected in their dataset would only need to increase prices by 7 percent, again, assuming no currency effects. This analysis is very difficult to square with the NRF $1,700 claim.

Conclusion

Tax reform as envisaged by the House Blueprint would represent a dramatic shift in the U.S. approach to taxation, and it follows that some industries are wary of the policy risk from such an overhaul. However, these industries should examine the totality of the proposal and evaluate it fairly. A revised tax system that lowers the corporate rate and moves away from a structure that encourages firms to locate facilities overseas would benefit the American consumer and prioritize economic growth.

[1] https://waysandmeans.house.gov/taxreform/

[2] See Alan J. Auerbach, "The Future of Fundamental Tax Reform" American Economic Review 87, 2 (1997): 143–46 and Martin Feldstein and Paul Krugman, "International Trade Effects of ValueAdded Taxation," in A. Razin and J. Slemrod, eds., Taxation in the Global Economy (Chicago, IL: University of Chicago Press, 1990), 263–82. Also see https://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/ for a further review of the literature.

[3] http://www.factcheck.org/2017/02/border-adjustment-baloney/

[4] https://www.bea.gov/industry/io_annual.htm

[5] https://www.bls.gov/news.release/pdf/cesan.pdf

[6] David Mericle, Alec Phillips and Daan Struyven, "US Daily: What Would the Transition to Destination-Based Taxation Look Like?," Goldman Sachs & Co., December 8. 2016