Insight

An Update on Auto Tariffs

JACQUELINE VARAS | NOVEMBER 18, 2019

Last week marked President Trump's own deadline to decide whether to impose new tariffs on automobile imports. While no official announcement was made, the president is widely expected to delay the tariffs for a second time.

The first delay occurred in May, when the president instructed the U.S. Trade Representative to postpone the tariffs and instead pursue auto-focused trade negotiations with Japan, the European Union, and other nations with high export volumes to the United States. Now, the looming threat of auto tariffs is extended indefinitely, keeping U.S. importers and the international trading system in a prolonged state of uncertainty.

The potential for new auto tariffs follows a national security investigation into auto imports that the president ordered last year under Section 232 of the Trade Expansion Act of 1962. Although the findings of the investigation were never made public, the Department of Commerce (DOC) reportedly found that imports of automobiles and automobile parts threaten to impair U.S. national security – empowering the president to impose tariffs on autos.

The national security investigation into autos was the third of its kind. The president previously ordered Section 232 investigations into steel and aluminum, using DOC's findings as justification to impose new tariffs on Canada, Mexico, the European Union, and others. These tariffs, combined with the president's new tariffs on China for unfair trade practices, have raised taxes on over $520 billion of imports and increased nationwide costs by over $100 billion annually.

If the president decides to move forward with the auto tariffs, consumer costs would increase even more. The tariffs would raise prices in two ways: Tariffs on autos would hurt consumers by raising the price tag of imported vehicles, while tariffs on auto parts would raise costs for U.S. automakers that utilize auto imports in production. Furthermore, the tariffs would hurt domestic automakers by reducing their cash on hand for investment in new factories or workers. This reduction, in turn, would slow economic growth – just like the president's previous tariffs on China and others. The Congressional Budget Office estimated that, by 2029, the president's tariffs will reduce the growth of U.S. gross domestic product (GDP) by 0.1 percent and the level of real household income by 0.2 percent.

The president's goal in imposing auto tariffs is also misguided. The tariffs' intended purpose is to make foreign-made autos relatively more expensive than American-made autos, increasing sales for U.S. automakers. According to the president, "American-owned automotive R&D and manufacturing are vital to national security. Yet, increases in imports of automobiles and automobile parts have given foreign-owned producers a competitive advantage over American-owned producers." This is an understandable goal, but in today's integrated global economy, the tariffs are unlikely to have their intended effect.

A car is almost never manufactured in just one country. For example, the Ford Ranger pickup truck is built with a Mexican engine and only contains 35 percent U.S. and Canadian content. Alternatively, six of the top 10 most American-made cars in 2019 were produced by foreign automakers Honda and Acura. As a result, the tariffs on auto parts would increase the cost of vehicles produced in the United States. The tariffs on finished vehicles would incentivize foreign automakers to open more U.S. production facilities, a result with positive economic implications but not one that seems motivated by a national security imperative.

On net, the tariffs would harm U.S. consumers and the economy. The Center for Automotive Research estimates that a 25 percent tariff on all auto imports would increase the average price of a U.S.-assembled vehicle by $4,470 and the average price of an imported vehicle by nearly $7,000. As vehicle sales fall, some automakers and many dealerships would be forced to cut labor, and the economy would shrink. The study also found that the tariffs would reduce U.S. GDP by $59 billion and destroy 715,000 U.S. jobs.

The increase in vehicle prices would decrease consumers' purchasing power, reducing their disposable income. The Tax Foundation estimates that Section 232 tariffs on automobiles would amount to a $73 billion tax increase, reducing the average after-tax income for all taxpayers by 0.47 percent. This tax increase would disproportionally burden individuals with lower incomes: Those in the bottom 80 percent of the income distribution would see their after-tax income fall by 0.49 percent, while the after-tax income of individuals in the top one percent would decrease by 0.39 percent.

Similarly, the Trade Partnership estimates that the Section 232 tariffs on autos would reduce U.S. GDP by $18 billion, reduce exports by 1.9 percent annually, and reduce imports by 2.7 percent annually. Furthermore, a 25 percent tariff on automobiles and auto parts would result in a net decrease of 157,000 jobs. Motor vehicle and parts manufacturing would gain 92,000 jobs on net while other types of manufacturing would lose about 45,000 jobs due to higher import costs and the resulting economic slowdown. The services sector would be hit hardest, where nearly 200,000 jobs would be destroyed. Many of these jobs would be in industries like construction and professional and business services, which are linked to the manufacturing sectors at risk.

The above analyses did not consider the negative impacts of retaliation, an almost certain result if the president imposes auto tariffs. An analysis from the Peterson Institute for International Economics that U.S. tariffs on auto imports combined with likely retaliation against auto exports would reduce production in the automobile industry by nearly 4 percent and eliminate 624,000 U.S. jobs, compared to a 1.5 percent reduction in auto production and 200,000 jobs lost if there is no retaliation.

President Trump has established tariffs as his primary tool in trade negotiations. Unfortunately, they have not earned the president any meaningful negotiating successes. They have, however, harmed U.S. consumers and kept the economy from achieving the growth that it otherwise would have. Moving forward with auto tariffs would exacerbate this economic harm.