

Mr. Trump Failed 'Trade Tariffs 101' At Wharton



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May 31, 2019 @ 1:40 PM



It's all but inevitable that we veteran international trade negotiators at some point in our career will find ourselves in a grand office with the senior-most political leader of a country explaining the mundane process of how certain trade policies actually work. It could be one's own President; a nation's leader from the opposing side who wants to get a technical explanation of the contours of a counteroffer directly from the "horse's mouth" of the negotiator; or the prime minister of a third-party country for whom you have been hired to provide independent counsel on a trade negotiation he or she has underway with another country's head of state.

From his tweets, his jousting with the press on the White House lawn as prepares to board Marine One, or in his speeches at his almost weekly rallies across the country in arenas filled with his supporters, it is clear that U.S. President Donald Trump is in dire need of such assistance—in particular, with respect to how tariffs on U.S. imported merchandise are administered and the economic incidence of the payments of such tariffs. For months on end, Mr. Trump continues to repeat his false assertion it is China who pays the tariffs he's imposed on Chinese produced goods imported by the U.S.

A recent example will suffice. On May 5, 2019, Trump tweeted: "For 10 months, China has been paying Tariffs to the USA of 25% on 50 Billion Dollars of High Tech, and 10% on 200 Billion Dollars of other goods."

Such utterances no doubt resonate with the president's base—at least they did during the [early](#) stages of Trump's trade war with China—which he initiated on April 3, 2018 with his announced plans to impose the 25% tariffs to which his tweet refers on 1,333 Chinese products that covered just over \$46 billion of U.S. imports from China. But the statement is as factually incorrect as asserting that Mondays follow Tuesdays on the weekly calendar.

One can only conclude that either Mr. Trump has not been sufficiently or correctly briefed by the U.S. Trade Representative, Robert Lighthizer, or the Chairman of the President's Council of Economic Advisers, Kevin Hassett, on the simple mechanics of how import tariffs are administered; he doesn't comprehend what has been explained to him; or worse yet, he refuses to acknowledge that actually he does understand how import tariffs work, hardly an arcane bit of knowledge one presumes any student attending the Wharton School—from which Mr. Trump was graduated in 1968—would easily master.

Tracing out how and where within the “stream” of a cross-border merchandise transaction import tariffs are levied by *any country* is straightforward. It conveys in black and white who pays them.

Tariffs are imposed by the government of the importing country (say, the U.S.) on top of the price and shipping costs of the foreign-made product as it first hits customs onshore in the importing country. Thus, in the first instance the tariff on imports is paid by customers in the *importing country*—whether the direct end-using consumers or businesses, or by companies that in turn resell the product, perhaps after further processing, *within* the importing country. In the U.S., the agency collecting tariff revenues is U.S. Customs and Border Protection, which is part of the Department of Homeland Security.

Import tariffs are *not* imposed by the government of the importing country on the product *before* it passes through the exporting country's (say, China's) customs agency and then moves offshore, wending its way to the shores of the importing country. In other words, U.S. Customs and Border Protection does not collect its tariff revenue from customers (consumers or companies) within the exporting country—in this instance China. Perhaps *that* is how Mr. Trump believes import tariffs are administered.

Nor is it the case that Chinese customs officials collect tariff revenues *on behalf* of U.S. Customs and Border Protection from Chinese consumers or companies at customs stations within China *before* Chinese-made goods are shipped abroad.

Now, if Trump were able to pull off that scheme, it would be one mean feat!

(It is true that in certain circumstances, governments may exact tariffs on their own countries' *exporters*. Historically, this has been the case for countries highly dependent on natural resource exports as way for governments to capture “economic rents.” But export tariffs are hardly at play in the U.S.-China trade imbroglio.)

To be sure, the foregoing explanation of who *administratively* pays import tariffs is rudimentary. It is deliberately so, as is the frame of the President's tweets and assertions. Perhaps it will help telegraph to the president how to think about the actual workings of his import tariffs on Chinese goods.

Of course, it does not sufficiently capture the complexity of the multiple transactions, including physical transformations, which an imported product may experience in today's globalized economy before its ultimate purchase by the end-user. Such an analysis would give an even richer picture of the economic incidence of the costs of the U.S. import tariffs on China.

To this end, a number of my fellow Ph.D. trade economists have undertaken various quantitative estimates at the macro level of who is absorbing the costs of Mr. Trump's tariffs.

The most recent set of calculations on this score is a study written by the International Monetary Fund's (IMF's) chief economist and her colleagues. They estimate that the costs *to date* of the tariffs have been borne almost entirely by U.S. importers. In addition, in light of the fact that most of the 2018 tariffs imposed by Trump were on Chinese *capital goods*, as economic theory would suggest, the (IMF) calculations indicate that while some portion of the tariffs has been passed on to U.S. *consumers*, another portion has been absorbed by the U.S. *importing firms* through lower profit margins.

Complementing the IMF's research, the Federal Reserve Bank of New York (FRBNY) recently estimated the *prospective* costs of the 15 percentage-point increase in tariffs that Mr. Trump announced in May 2019. These will cover about \$300 billion in U.S. imports of Chinese *consumer goods*, including clothing, mobile phones and toys. The FRBNY estimates these will result in an annual cost of \$831 per American household. This is about twice the size of what the FRBNY estimated as the costs on U.S. consumers from Trump's 2018 tariffs. Importantly, the May 2019 tariffs, along with those in place since 2018, would mean that essentially *all* Chinese imports to the U.S. have been subjected to increased tariffs by the Trump Administration.

If neither the rudimentary analysis of how tariffs are administered nor the quantitative estimates are insufficient to convince the President who actually pays or bears the costs of his import tariffs on China, he need only reflect on the aid he is providing to U.S. farmers as a result of China's retaliation to Trump's actions.

Just this May, he approved \$16 billion in such support. This is on top of the \$12 billion he doled out last year to U.S. farmers. Of course, farmers are part of the president's base. That he is trying to appease them through earmarked compensatory payments illustrates the point made above that while they may have *initially* supported his tariffs on China, the negative impacts on their wallets has deflated their expectations that the President's policy—at least to date—has been [serving their best interests](#).

Regrettably, for Mr. Trump, there are other constituencies of his base throughout America's heartland, Rustbelt and elsewhere that are feeling as much pain as farmers from his 2018 tariffs—or will do so shortly as the bite of his newest wave of tariffs kick in.

Perhaps saddest of all is the fact that imposing tariffs—the president's choice, if not sole, instrument to seemingly induce WTO-sanctioned "[behind-the-border reforms of China's economic regime](#)"—simply will not work to bring about that result.

To put it in the simplest of terms, the pinch of tariffs occurs at the border; they will do little (if anything) "behind-the-border". Hence they will not serve to eliminate the hold of the state on the free play of prices in China; provide for the protection of intellectual property; reduce the huge subsidies given to state-owned enterprises by state-owned banks (which only pretend to require debt repayments); and end artificial barriers to market entry and exit.

We Americans are willing to endure pain for gain. But let's not fool ourselves into thinking as Mr. Trump does, that simply eliminating our bilateral merchandise trade deficit with China, which in and of itself is [not an economically meaningful objective](#) but which his tariffs *may* well do, will alter the core of China's conduct in the global trading system.

In a nutshell, no matter how high or expansive are tariffs, they will not create effective incentives for China to execute the fundamental market-oriented reforms Beijing legally obligated itself to undertake in its 2001 WTO Accession Agreement. That is the real endgame.

Achieving that goal--necessitating a reduction in the fundamental role of the state in China's economy, which of course Chinese President Xi Jinping is loathe to do since that is the *raison d'etre* of the Communist Party--is a wholly different matter. That would require *both* using a different [arsenal](#) and employing a fundamentally different [strategy, especially marshaling a multilateral coalition of the world's leading trading partners](#). Our President seems to be moving us further away from that path each passing day.

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