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How Simple Changes to Tariffs Could Help U.S. Manufacturers

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The myth of decline dominates the narrative about U.S. manufacturing. Yet, the preponderance of evidence indicates that U.S. manufacturing, relative to the past and relative to other countries' manufacturing sectors, excels by the metrics that speak to its current and future prospects. But it could be doing even better if Congress made some simple changes to the outdated U.S. tariff system.

According to WTO and OECD figures, intermediate goods trade may account for as much as 75% of all global trade. The proliferation of cross-border investment and transnational supply chains has blurred the distinctions between U.S. and foreign products and has rendered tariffs on imported inputs incompatible with the imperative of wooing, securing and maintaining productive, capital investment in the U.S. To compete more effectively at home and abroad, manufacturers in the U.S. need access to imported inputs at world market prices. Last year, about 55% of U.S. imports were intermediate goods and capital equipment, the purchases of U.S. producers.

Yet, under U.S. tariff policy, many imported inputs remain subject to import taxes. Duties on products such as magnesium, sugar, polyvinyl chloride and hot rolled steel may please domestic producers, who are freed to raise prices and reap larger profits. But they are costly to U.S. producers of auto parts, food products, paint, and appliances, who consume those products as inputs in their own manufacturing processes. These taxes chase manufactures to foreign shores, where those crucial ingredients are less expensive, and they deter others from setting up manufacturing operations stateside.

During the financial crisis and subsequent recession, as G-20 governments were pledging not to resort to beggar-thy-neighbor protectionism, the Canadian and Mexican governments went even further and slashed duties on imported intermediate goods. Each government properly recognized import duties as business costs and, since business revenues were projected to plunge on account of the global economic contraction, acted to limit the adverse impact on their businesses by reducing their costs through trade policy. That logic is universal, and does not only apply in times of economic recession.

Not only does current U.S. tariff policy elevate the interests of certain producers over others, but it tends to favor the lower-value-added, basic-materials producers to the higher-value-added, intellectual property-, capital-, and export-intensive industries, which usually contribute more to GDP and create higher-skilled jobs.

In 2013, U.S. Customs collected nearly $41 billion in duties, taxes and fees levied on imports, with approximately $24 billion collected on imported inputs, which amounts to nothing more than a tax on U.S. value creators. Removing that tax would encourage U.S. and foreign companies to locate or expand in the U.S. and hire more workers. What has been a deterrent to investment and production could be turned into a magnet for investment and production.

Establishing a policy of zero tariffs on intermediate goods would go a long way toward bolstering U.S. attractiveness as a destination for both U.S. and foreign direct investment, which will be a major determinant of manufacturing success and economic growth in the 21st century.

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