Bloomberg

Trump's Reciprocal Tax Faces Rough Ride Under World Trade Rules

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May 5, 2017

There's something attractively simple about President Donald Trump's idea for a reciprocal tax: charge high tariffs on our products, and we'll ding you right back.

Putting that concept in place without violating America's international trade obligations -- or pushing up the prices consumers pay for everything from televisions to toothbrushes -- would be another story. Yet Trump's enthusiasm for the idea of punishing countries that impose high tariffs on U.S. imports with matching tariffs on their exports was evident in an interview with Bloomberg News this week.

"I love a reciprocal tax," Trump said in the interview. "Nobody can fight it. It's fair and it's something that we are working on very strongly."

It's the latest in a variety of proposals the Trump administration has floated as a way to reduce the $500 billion U.S. trade deficit on goods and services. Revenue raised could help fund an aggressive plan to cut taxes and ramp up infrastructure spending.

Trump's crusade for "fair trade" was on view early in his presidency when he invited Harley Davidson executives to park their bikes on the White House lawn, and was alarmed to find the company is charged tariffs of as much as 100 percent to export its products. Since then, he appears to be leaning toward a reciprocal tax as opposed to a border-adjusted tax -- the hotly debated House Republican blueprint -- which would tax companies' domestic sales and imports while exempting their exports.

One of Trump's trade lieutenants, Commerce Secretary Wilbur Ross, calls "the concept of reciprocity" a valid idea. "There are structural problems to it, but there's a logic to it," he said in an interview Wednesday. The White House declined further comment.

Trade Rules

Trade experts say the measure would almost certainly run afoul of global trade rules. While Trump calls the proposal a "tax," it actually has to do with the tariffs that countries levy on imported products. As nations joined the World Trade Organization, they agreed to keep their tariffs below a certain level, known in trade argot as the "bound rate."

However, not all countries have the same tariff ceiling. As the biggest economy in the world, the U.S. has a bound rate of about 3 percent, while an emerging market such as Mexico has a ceiling of about 36 percent.

Countries can charge tariffs up to the bound rates set by the WTO, meaning the U.S. would face a trade complaint if it tried ratcheting up to match Mexico’s tariff rate -- a complaint the U.S. would almost certainly lose, trade experts say. Trade disputes that can’t be resolved bilaterally can take years to finally wind through the global system with a ruling.

“For anyone not steeped in the strangeness of trade negotiations, what he said makes perfect sense,” said Edward Alden, a senior fellow at the Council on Foreign Relations. “It’s unfortunately not the way the system has worked for a long time. You might have a higher tariff on ladies’ underwear and I might have a higher one on soybeans. It’s all part of the package of concessions that’s been worked out in the negotiations.”

A reciprocal tariff would undermine decades of work by countries to gradually lower trade barriers since WWII, said Dan Ikenson, a trade-policy expert at the Cato Institute in Washington. Other countries would likely retaliate, putting the U.S. at risk of being embroiled in a global trade war, he said.

“It’s a 180-degree turn from the spirit of GATT,” said Ikenson, referring to the 1948 accord that has served as the basis of world trade negotiations. The General Agreement on Tariffs and Trade “was signed in recognition of the fact that protectionism contributed to the decline of the global economy and was one of the contributors to the Second World War.”

Hiking import duties wouldn’t necessarily achieve Trump’s goal of slashing America’s trade deficit. Iran has the highest trade-weighted average tariff rate in the world, according to data compiled by the World Economic Forum. Neither Iran nor the others in the top five -- Bhutan, Sri Lanka, Nepal and Pakistan -- are major contributors to the U.S. trade deficit.

China is easily the biggest source of America’s trade deficit, accounting for $310 billion of last year’s gap, followed by Germany at $68 billion and Mexico at $62 billion.

“At the end of the story, this is not going to have a big effect on the trade deficit, the president’s preferred measure,” said Dany Bahar, a fellow at the Brookings Institution.

Even if the U.S. reduces its trade deficit with individual nations, that won’t solve the underlying fact that America spends more than it saves, meaning the deficit will likely just migrate somewhere else, said Bahar.

A reciprocal tax “does sound an awful lot like a tariff,” Eric Lascelles, chief economist at RBC Global Asset Management, said in an interview. “This is where the lines grow quite blurred between tax policy and trade policy.” The president has a lot more unilateral sway over adjusting tariffs than overhauling taxes, which often needs a green light from Congress.

Imposing or increasing tariff rates can raise costs -- both for consumers and manufacturers using imported materials and relying on integrated supply chains, said Jason Waite, an international trade and regulatory lawyer at Alston & Bird LLP. “It’s not always just the guy buying cheap shoes, it’s also the automaker in the production chain,” he said.

Trump doesn’t seem to differentiate “between taxes and tariffs,” said Vanessa Sciarra, vice president for legal affairs at the National Foreign Trade Council, a trade and lobbying group whose members include Wal-Mart Stores Inc. and Ford Motor Co. The Constitution gives the president “a lot of statutory authority to play with tariffs, so in his mind, it’s probably all flowing in one stream.”