NATIONAL REVIEW

A Laughable Attack from Pro-BAT Lobbyists

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You know you are doing something right when lobbyists and interest groups are attacking you and when their main line of attack is that you are allegedly a paid shill for some corporate interest. Case in point: Lobbyists for Boeing, GE, and other big interest groups united under the American Made Coalition banner sent out yet another e-mail protesting my position on the border-adjustment tax. This time around (there were others), the article that offended them is one I wrote with the Cato Institute's Dan Mitchell in the Wall Street Journal.

It's worth noting that Dan Mitchell and I have a long track record of 1) fighting against destination-based taxes, which the border-adjustment tax is an example of, 2) fighting for tax competition, which would be undermined with a BAT, and 3) a very long track record of fighting for free-markets and against policies that would expand the government (whether they are being pushed by Democrats or Republicans). The coalition, on the other hand, is made up of actual lobbyists paid by special interests who think they will benefit from the measure, which makes their allegations of us being hired guns pretty laughable. In our article, we debunk the claim that other countries' VATs are creating an unlevel playing field and are unfair to U.S. companies.

As I have written many times in the Corner, I am sure it makes for a great sound bite but it is simply not true. Other countries' tax systems are not the problem. The United States is the cause of our problems because of our super-higher corporate tax rate and worldwide tax system. Yet, the lobbyists from this American Made coalition and others are eagerly pushing this line to make the case that we need to impose a 20 percent tax on imports and exempt all exports.

Interestingly, in their e-mail they make zero mention of this, even though it was the main point of our article. So of course, being the optimist that I am, I am hoping that it means they have given up on using this misleading argument! Instead, they complain about a paragraph in our article that argues that currencies are unlikely to fully and rapidly adjust.

They write: And while de Rugy and co-author Daniel Mitchell have to reach all the way back to 2005 to find a study that supports their position, more recent work done by the Department of Treasury and others makes clear that when other countries have incorporated border adjustments into their tax codes, the currency markets worked to protect consumers: The Office of Tax

Analysis asserts in a January 2017 report that border adjustment does not have trade effects because after-tax prices on domestic goods have risen relative to foreign prices as anticipated.

An April 2017 report from the Peterson Institute for International Economics drew a similar conclusion, asserting countries implementing border-adjusted consumption taxes experienced a rise in real exchange rates. Leaving aside the fact that there is much more than one article raising questions about the likelihood of a full and rapid currency adjustment, it's pretty interesting that they should mention the two articles above to make their case to the contrary.

For instance, the Peterson Institute article looks at examples of adjustments after the implementation of a VAT and finds that currency will ultimately adjust but that it may take up to three years, which I wouldn't call an "immediate adjustment." I would add that such an amount of transition time could be lethal for some companies. The Peterson study also notes that the VAT study findings do require some serious caveats if you want to apply it to the House Republican Tax Blueprint. First, border-adjusting the corporate income tax "differs in important ways" from implementing a VAT. This in turn may have important consequences in terms of how and how much adjustments happen. Second, the "United is special" and such an adjustment "might disrupt the global financial system given the dollar's dominant role in finance."

Third, the dominance may mean a failure to adjust fully and a need for prices to go up. They write: Alternatively, the special role of the dollar could mean that the nominal exchange rate responds only partially to trade pressures, especially if other countries resist the corresponding depreciation of their currencies. Limits on dollar appreciation would force the adjustment to come through US prices and wages instead.

It would take time for prices and wages to reach a new equilibrium, because wages are set in advance through contracts, and the Federal Reserve may not accommodate the full shift. Fourth, and this is a biggie, the House proposal requires a large 25 percent adjustment of our currency to avoid disruption after the introduction of the 20 percent BAT.

As the authors, Caroline Freund and Joseph E. Gagnon, note, "Whether adjustment eventually comes through a 25 percent dollar appreciation or a 25 percent increase in US wages and prices or some combination of the two, these adjustments are large, and much larger than the events studied in this paper, and hence more likely to be disruptive." In other words, I don't think this study makes a strong case for their position. I could go on and on but I am happy to settle for this: There is a great deal of uncertainty around the issue and asserting that we know for sure that the adjustment will be big enough and immediate lacks real humility.

Currency traders and strategists — whose jobs and pay are based on observing and predicting the changes in a $5.1 trillion-per-day currency market — say the following: You'd be hard-pressed to find anyone in the market who believes it will result in the greenback strengthening 25 percent, as the plan suggests. Part of the reason has to do with what they see as a misinterpretation of the underlying theory when applied to the real world. But just as important is the fundamental failure of politicians to appreciate how unpredictable the vast, foreign-exchange market can be, especially when global economic drivers collide and trillions of dollars change hands every day.

“The FX market is the most difficult thing to forecast, and to build an inter-generational tax reform based on the assumption of what the FX market will do is a laughable notion,” David Woo, the head of global rates and FX strategy at Bank of America, said in a Bloomberg TV interview. I could also add that being such a cheerleader for large adjustment ignores that they alone are likely to cause unpleasant major distortions. Finally, once again the lobbyists are unhappy that Mitchell and I ignore the rest of the Republican tax plan to focus on the BAT.

But that point doesn’t hold water. Sure, we like the rest of the plan a lot. Sure we believe that it would be great to implement it without a BAT. Sure, we know that the rest of the plan would trigger economic growth. But agreeing to a BAT because the rest of the plan is great is like saying that it is always a good idea to buy an awesome house in a bad neighborhood.

It’s not — and most people will decide to pass on the awesome house to get their second- or third-favorite house rather than live in that neighborhood. The same is true here. We would love the plan without the BAT. But with it, it’s not a risk worth taking, especially considering that there are other things that can be done — better neighborhoods and second-best houses if you will.

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