



Auditing the Administration’s TPP “Tax Cut” Claims: Funny Math and Misdirection

Executive Summary

With job-creation claims about the Trans-Pacific Partnership (TPP) falling flat, the Obama administration has shifted to a “tax cut” narrative to sell the deal, claiming it provides 18,000 “tax cuts” for “Made in America” goods. But a review of TPP tariff schedules reveals the 18,000 figure is dramatically inflated. More broadly, focusing on the number of tariff line cuts is a misdirection from the real questions of how the TPP would affect U.S. employment and growth.

The 18,000 figure is obviously wrong. In 2014, the United States exported items relating to a total of 8,687 tariff categories to *all* of the 11 TPP countries. Even assuming tariffs remained in each category, and many already are duty-free, the pact clearly would not equate to “tax cuts” for 18,000 U.S. products. Moreover, administration documents state that the 18,000 figure refers to tariffs with just the five TPP nations that do not now have a U.S. free trade agreement (FTA). But the United States only exported to these nations under 7,289 tariff categories.

That the administration’s 18,000 figure represents double, triple or quadruple counting also is revealed by reviewing the TPP tariff schedules for Brunei, Japan, Malaysia, New Zealand and Vietnam. None lists more than 10,000 tariff categories with many lines duty-free absent a TPP.

But more importantly, redirecting attention to an impressive-sounding number distracts from the real question: Would cutting even 18,000 tariff lines necessarily equate to more U.S. exports, jobs or growth? The U.S.-Korea FTA has almost 10,000 tariff line cuts.¹ Yet, in its first three years, U.S. goods exports to Korea dropped 7 percent and the U.S. trade deficit with Korea surged 90 percent.

The United States already has FTAs with the six TPP partners that collectively represent more than 80 percent of the trade counted in the oft-touted statistic that the TPP covers 40 percent of world trade. Thus, tariffs on U.S. goods going to Australia, Canada, Chile, Mexico, Peru and Singapore already are gone or are being eliminated. So while TPP countries may account for 40 percent of world trade, the TPP would cut tariffs on only 20 percent of that 40 percent share.

Even placing the TPP “tax cut” narrative into that limiting reality, whether cutting tariff with the other five TPP nations would translate into more U.S. exports depends on whether tariff *levels* in the remaining five TPP countries are sufficient to limit U.S. market access and whether the United States produces, and the TPP countries demand, goods that would obtain cuts.

For 80 percent of the categories in which the United States exports anything to the five relevant TPP nations, we export only small amounts. As shown in Table 1 below, tariff lines in which the United States exported less than \$5 million per year comprised 5,830 of the 7,289 export code lines. For 25 percent of the tariff lines, the United States exported less than \$100,000. In only 21 tariff lines did the United States export more than \$500 million, and some of these lines already are duty free.

As far as the level of existing tariffs, Japan comprises fully 88 percent of the combined gross domestic product (GDP) of the TPP countries that do not already have a U.S. FTA. According to the World Bank, Japan's average applied tariff weighted by product import shares is now only 1.2 percent.² Indeed, the tariff *levels* in the remaining five TPP countries without a U.S. FTA are generally low. That tariff barriers among the TPP countries are not significant is one reason that prominent economists that supported past U.S. trade pacts, like Paul Krugman, have scoffed at the notion that the TPP could produce significant economics gains.³

The raw number of tariff lines countries agree to cut in a trade pact also does not tell us much about how consumer prices will be affected. Average U.S. tariff levels are low, but there are categories for which the United States retains significant tariffs. The TPP includes tariff cuts on the shoes Nike produces in Vietnam to sell here, but currently shoes that retail for more than \$100 cost about \$10 to make. The tariff is charged on the cost, thus even a major percentage cut does not equate to much money. And, whether a firm like Nike will reduce prices or simply gain more profit on an item imported for sale here is determined by what consumers are willing to pay for the product.

While firms importing goods into the United States determine whether to pass savings related to U.S. tariff cuts on to consumers, the TPP's reduction or elimination of tariffs does necessarily reduce U.S. Treasury revenue. According to President Barack Obama's proposed 2017 budget, the TPP would cost the United States about \$28 billion in lost tariff revenue over the next 10 years. (The calculation is based on the assumption that the TPP takes effect in 2017.)

Review of TPP Tariff Lists Reveals the 18,000 Figure Is Dramatically Inflated

That the administration's 18,000 figure represents double – or triple or quadruple – counting of cuts to the same tariff categories for the five nations with which the United States does not already have FTAs is made clear by a review of the actual tariff schedules for Brunei, Japan, Malaysia, New Zealand and Vietnam. None of these nations lists more than 10,000 tariff categories, and many are already duty-free without the TPP.

Further, even for the categories in which these five TPP nations make tariff cuts, there are many in which *the United States exports nothing or only minimal amounts to those nations.*

In 2014, the United States only exported any goods in 7,289 tariff categories to the five nations without pre-existing U.S. FTAs. Among the items we simply do not export are those relating to species that the administration claims the TPP's Environment Chapter will help conserve. Yet perversely, the list of tariff cuts that the administration counts as a benefit of the TPP includes Malaysia's shark fin tariff, Vietnam's whale meat tariff and Japan's ivory tariff.

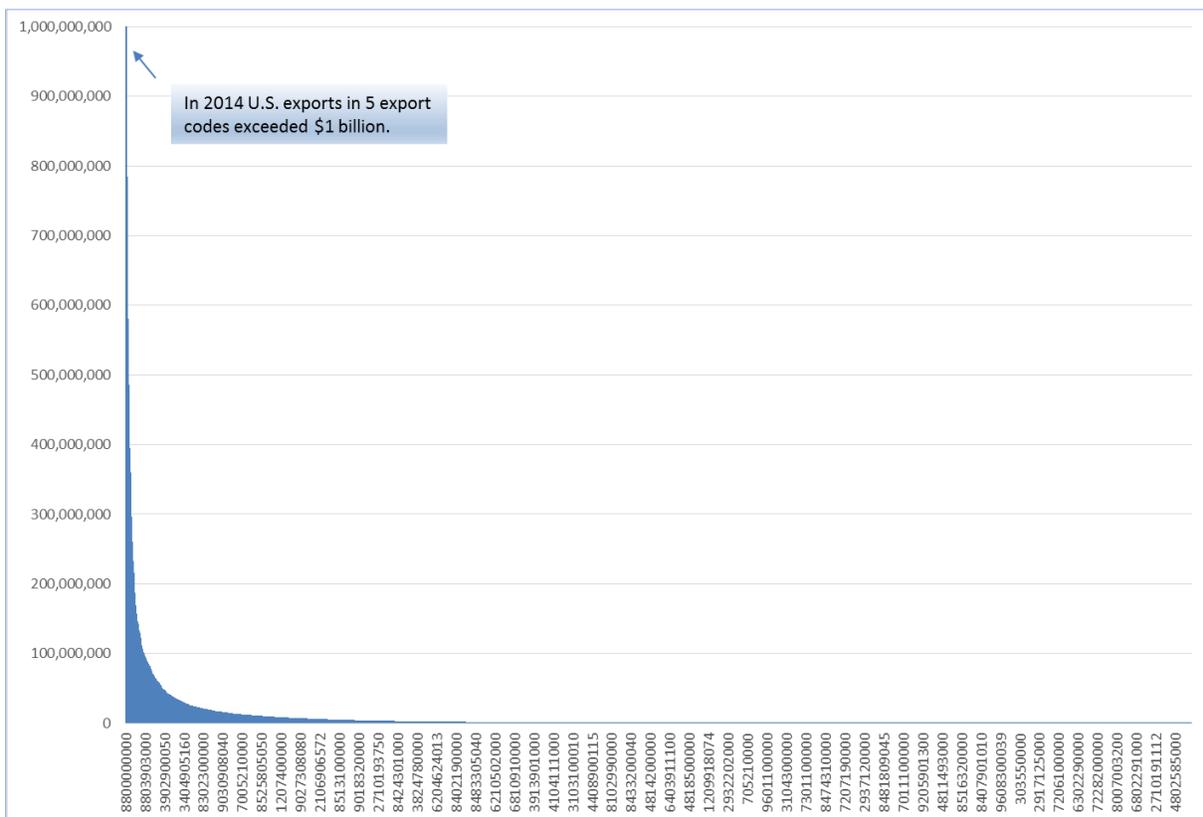
For 80 percent of the categories in which the United States exported anything to the five relevant TPP nations, it was small amounts. As shown in Table 1, below, tariff lines in which the United States exported less than \$5 million per year comprised 5,830 of the 7,289 export code lines. For 25 percent of the tariff lines, the United States exported less than \$100,000. In only 21 tariff lines did the United States export more than \$500 million to these countries, and some of these lines already are duty free.

Table 1: 2014 U.S. Exports to Five TPP Nations Without U.S. FTAs by Value of the Export Code

| <u>Export Value Range (\$)</u> | <u>Number of Codes</u> | <u>Total Value (\$)</u> |
|--------------------------------|------------------------|-------------------------|
| 1-9 billion | 5 | 16,212,382,328 |
| 500 million - 1 billion | 16 | 10,939,237,752 |
| 250-500 million | 27 | 9,100,251,504 |
| 100-250 million | 78 | 11,466,800,266 |
| 50-100 million | 124 | 8,954,496,825 |
| 25-50 million | 203 | 7,223,140,638 |
| 10-25 million | 502 | 7,928,421,143 |
| 5-10 million | 504 | 3,632,484,004 |
| 1-5 million | 1,628 | 3,864,877,808 |
| 500K - 1 million | 777 | 555,039,410 |
| 250K - 500K | 751 | 273,459,179 |
| 100K - 250K | 861 | 142,245,662 |
| <100K | 1,813 | 61,952,481 |

Quixotic categories counted in the administration’s total of tariff line cuts for which U.S. exports are miniscule include jellyfish, live goats, live buffalo, live birds of prey and springs for clocks and watches limited in value.

Chart 1: 2014 U.S. Exports Free Alongside Ship Value in Dollars vs. Listed Export Code



The administration's "TPP Guide to 18,000 Tax Cuts" document also bizarrely highlights goods that TPP nations simply do not buy in volume *from anyone*. Consider the 34 percent "tax" cut by Vietnam on Alaskan caviar. In 2014, Vietnam's per capita GDP was about \$2,000, and about \$150,000 worth of caviar was imported by Vietnam from anywhere. Or consider Vietnam's 5 percent tariff on skis from Colorado, when Vietnam only imported about \$50,000 in skis in total. Other highlights: Vietnam and Japan will eliminate their tariffs on silkworm cocoons, Brunei will cut its tariff on ski boots and Vietnam will eliminate its tariff on camels.

Finally, 1,225 of the tariff reductions in the U.S. products sold to the five TPP nations without U.S. FTAs won't be realized for over a decade or more. This includes products such as beef, which will still face a 20 percent tariff in Japan in the 10th year after TPP would go into effect.

The Number of Tariff Lines Cut Does Not Equate to More U.S. Exports or Jobs

Cutting even 18,000 tariffs would not necessarily equate to gains in U.S. exports or the creation of more U.S. jobs. At issue with respect to exports is whether existing tariffs are high enough to reduce U.S. market access and whether a country making significant cuts has demand for U.S. exports, which relates to both the size of the economy and income levels. And, whether any gain in exports will translate to a net gain in U.S. jobs requires consideration of whether the United States is likely to experience a major flood of imports that will swamp export gains.

The United States already has FTAs with six of the 11 TPP negotiating nations, meaning tariffs on U.S. products are already being zeroed out. Thus, the question boils down to tariff levels in the remaining TPP countries, which are generally low.

Japan comprises 88 percent of the combined GDP of the TPP countries that do not already have a U.S. FTA. According to the World Bank, Japan's average applied tariff weighted by product import shares is now only 1.2 percent.⁴ That tariff barriers among the TPP countries are not significant is one reason that prominent economists that supported past U.S. trade pacts, like Paul Krugman, have scoffed at the notion that the TPP could produce significant economics gains.⁵

The TPP's remaining countries are Malaysia, which has a GDP smaller than Maryland; Vietnam, where per capita annual income is \$1,740; Brunei with a population the size of Mobile, Alabama and New Zealand with a population smaller than the Washington, D.C., metro area. In sum, with respect to gains resulting from tariff cuts and setting aside additional significant factors limiting U.S. market access, such as non-tariff barriers and currency manipulation, the TPP provides limited market access "opportunities."

Korea Trade Pact Tariff Cuts Did Not Result in U.S. Export Gains

Almost 10,000 Korean tariff lines are being cut in the U.S.-Korea FTA. Many cuts went into effect immediately upon implementation. But in that pact's first three years in effect, U.S. goods exports to Korea dropped 7 percent in comparison to the year before the deal. The U.S. trade deficit with Korea surged 90 percent. That deficit increase equates to the loss of more than 90,000 U.S. jobs, counting both exports and imports, according to the trade-jobs ratio that the Obama administration used to project job *gains* from the deal.

The Number of Tariff Lines Cut Does Not Necessarily Mean Lower Prices

The raw number of tariff lines countries agree to cut in a trade pact does not tell us much about how consumer prices will be affected. Average U.S. tariff levels are low and for the most sensitive products that currently have tariffs in place, U.S. negotiators fought for long phase outs.

However, there are categories in which the United States has tariff peaks remaining in place even after the World Trade Organization (WTO). But even when there is a match, reduction or elimination of U.S. tariffs under the TPP will not necessarily reduce prices for U.S. consumers. Whether a foreign producer will reduce prices or simply gain more profit on an item exported here is determined by the market and how offshore producers thus decide to price their goods.

When the WTO eliminated the global apparel quota system and cut tariffs on many categories of apparel, this market was dramatically reshaped. Clothing production in higher-wage countries was offshored to China and other low-cost venues. The savings that low-income consumers gained for *non-branded* imported clothing is often presented as an example of consumer benefits from trade liberalization. But these WTO tariff cuts on apparel already apply to the TPP's low-wage production venues, such as Vietnam, where investment in apparel production has skyrocketed, including by many Chinese firms seeking cheaper production costs. In 2015, Vietnam was the second cheapest apparel production venue in the world and had the fastest-growing imports into the United States, displacing Bangladesh and China. (To put Vietnam's 65 cents an hour wages in perspective, Guatemala was the 11th cheapest production venue, and Mexico the 21st.)

Will TPP tariff cuts translate into price reductions of, say, the large share of Nike shoes produced in Vietnam, given meaningful U.S. tariffs remain on some footwear categories under WTO rules? Nearly one million low-wage contract workers produce most of Nike's products, including more than 333,000 sweatshop workers in 67 factories in TPP nation Vietnam alone. Even with tariffs in place, Nike shoes for which U.S. consumers regularly pay \$100-plus cost less than \$10 to produce. That is to say that even if Nike passed on every penny of savings from TPP tariff cuts, the prospect that low-income consumers would suddenly enjoy bargain-priced Nikes is remote. Rather, Nike could take the money it now pays in tariffs to the U.S. government — which helps fund national defense and children's health insurance — and instead add that to its profit margin.

The Cutting of U.S. Tariffs Does Necessarily Reduce Treasury Receipts

While firms importing goods into the United States will determine whether to pass savings related to U.S. tariff cuts on to consumers, the TPP's reduction or elimination of tariffs does necessarily reduce U.S. Treasury revenue. According to President Obama's proposed 2017 budget, the TPP would cost the United States about \$28 billion in lost tariff revenue over the next 10 years. (The calculation is based on the assumption that the TPP takes effect in 2017.)

The revenue lost from TPP tariff cuts would add about \$1.7 billion to the federal budget deficit in 2018 and increase steadily each year with a projection of \$4.3 billion in 2026. Revenue lost from TPP tariff cuts is projected to exceed \$50 billion over the next decade if all duties were immediately eliminated. However, some U.S. tariff lines phase out over extended periods of up to 15 years.

Why the Administration Seeks to Shift the Focus to the Number of Tariff Lines

As administration claims about the TPP creating American jobs or increasing U.S. economic growth have fallen flat, the administration has tried to shift focus to a “tax cut” narrative to sell the TPP.

The administration stopped claiming the TPP would create jobs after a “four Pinocchio” rating by the *Washington Post* fact checker.⁶ The pro-free trade Cato Institute calls the TPP’s investor protections that make it cheaper and less risky to offshore U.S. jobs to low wage nations a subsidy on offshoring.⁷ Even using a methodology that assumes full employment, the major pro-TPP study published by the Peterson Institute for International Economics predicted that 53,700 U.S. jobs will be displaced *per year* in the TPP’s first 10 years. That is, the total job loss projected by the study, despite its rosy assumptions, is more than 537,000 lost jobs in the pact’s first decade.⁸ Using an economic model that allows for the possibility of less than full employment and rising income inequality, Tufts University economists concluded that 450,000 American jobs would be lost under the TPP.⁹

The Department of Agriculture issued the administration’s only major study¹⁰ on the TPP’s economic impact and found it would result in 0.00 percent increased U.S. growth if all tariffs on all products were eliminated, which did not occur. The administration has shifted to citing the major pro-TPP study published by the Peterson Institute, which was updated in 2016.¹¹ That study found that in 2030 U.S. growth rates would be only 0.5 percent higher with the TPP in effect – even using a model that improbably assumed full employment, no change in the U.S. trade balance and no increased income inequality. That is to say that even with those assumptions, the study concluded that gains in U.S. growth would amount to 0.036 percent per year – effectively a rounding error.

“This means that if the economy was projected to grow by 2.2 percent a year in a baseline scenario, it will instead grow at a 2.236 percent rate with the TPP, assuming the Peterson Institute projections prove correct. The projections imply that, as a result of the TPP, the country will be as rich on January 1, 2030 as it would otherwise be on April 1, 2030,” noted economist Dean Baker.¹² TPP proponents tend to use the gross number of projected growth, touting “billions” in gains because in context to projected U.S. economic growth without the TPP, the so-called TPP gain is miniscule. That sum total projected U.S. economic gain approximately equals the amount that Americans will spend on St. Patrick’s Days, over-the-counter teeth whiteners and tattoos by the time the TPP’s benefits are supposed to materialize.

Using an economic model that allows for the possibility of less than full employment and rising income inequality, Tufts University economists found that the TPP would result in a net loss of income in the United States and significant job loss.¹³

Methodology of Our TPP Tariff Cut Analysis

The analysis of tariff cuts discussed in this paper is based on a review of the actual TPP tariff schedules included as annexes to the text of the agreement released in November 2015.¹⁴ The data on U.S. exports to TPP nations come from the U.S. International Trade Commission (USITC).

Our methodology for this analysis did not identify the full number of “duplicate” tariff cuts – the double, triple, or quadruple counting of the same tariff line being cut by various TPP countries – included in the administration’s clearly erroneous claim of 18,000 “tax cuts” in two ways.

First, while we have identified a significant number of tariffs that would be cut by more than one of the five TPP countries that do not have U.S. FTAs, we have not yet identified all such duplicates. Each of these tariff lines would be counted by the U.S. Trade Representative as more than one “tax cut” in its 18,000 figure, even though the categories and codes are identical and in practice mean that some one specific category of U.S. good will no longer face a tariff.

We have not yet identified all of the double, triple and quadruple counting because the TPP tariff reduction schedule codes employed by each of the TPP countries do not all precisely align with each other. That is, the tariff elimination categories (and thus codes) of the individual TPP countries *for the same products* do not precisely align with each other. While we have identified those instances where there is a precise numerical match between tariff codes, we have not manually reviewed the full tariff reduction schedules to attempt to identify *all* such duplicate tariffs based on the actual products covered by the codes that are not precise numerical matches. But we have reviewed sufficient portions of the schedules to identify that using a numerical match methodology undercounts the duplications.

Second, we wanted to identify how many categories of goods that the U.S. actually exports would obtain the tariff cuts proposed in the other countries’ tariff cutting schedules given the fact that a tariff cut is of little value if the United States does not export that good in any significant amount. To do this, one needs to be able to compare U.S. export information with the proposed tariff elimination schedules of the other TPP nations. However, there is not a precise code match in the way the USITC categorizes U.S. exports by product and the tariff reduction schedules in the TPP.

Thus, for example, all countries use the same six digit code for the general category “beef.” But at the more detailed levels used in U.S. export reports and in the other countries’ TPP tariff reduction schedules, the code under which the USITC records, say, the U.S. export of beef brisket may or may not be the same code (representing a category) under which a TPP country records the same product as an import, which is the basis on which its tariff schedules are listed. Plus, different codes may or may not be used for the same product in the tariff schedules of each TPP nations. For this reason, we have not yet conducted a numerical analysis based on exact matches between the codes the other TPP countries use to list their proposed tariff cuts and the categories by which the United States records exports. This analysis would also require a degree of manual review product by product. This would be important information for the U.S. government to provide to producers.

As far as what this means for attempting to eliminate duplicate counting, for a U.S. exporter, the bottom line is that the tariff on a product, such as our hypothetical beef brisket, was eliminated. But because of the mismatches in some categories with respect to TPP-importing countries’ codes, the elimination of the beef brisket tariff may show up as a cut in more than one tariff category across the countries – another way in which the number of “tax cuts” gets inflated relative to the actual application of a tariff cut to a specific U.S. product. Identifying all of the double counting in the administration’s 18,000 figure based on this data mismatch also would require additional manual review of the U.S. export list and how those categories would be coded by the importing countries.

ENDNOTES

¹ The Korean tariff schedule under the U.S.-Korea FTA lists 9,781 tariff lines that are being reduced or eliminated. Available at https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file786_12756.pdf

² World Bank data available at <http://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS>

The weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data are classified using the Harmonized System of trade at the six- or eight-digit level. Tariff line data were matched to Standard International Trade Classification (SITC) revision 3 codes to define commodity groups and import weights.

³ Paul Krugman, “No Big Deal,” *New York Times*, Feb. 27, 2014. Available at http://www.nytimes.com/2014/02/28/opinion/krugman-no-big-deal.html?_r=0

⁴ World Bank data available at <http://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS>

The weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data are classified using the Harmonized System of trade at the six- or eight-digit level. Tariff line data were matched to SITC revision 3 codes to define commodity groups and import weights.

⁵ Paul Krugman, “No Big Deal,” *New York Times*, Feb. 27, 2014. Available at http://www.nytimes.com/2014/02/28/opinion/krugman-no-big-deal.html?_r=0

⁶ Glenn Kessler. “The Obama administration’s illusionary job gains from the Trans-Pacific Partnership” *Washington Post*, Jan. 30, 2015. Available at <https://www.washingtonpost.com/news/fact-checker/wp/2015/01/30/the-obama-administrations-illusionary-job-gains-from-the-trans-pacific-partnership/>

⁷ Daniel J. Ikenson. “A Compromise to Advance the Trade Agenda: Purge Negotiations of Investor-State Dispute Settlement,” *The Cato Institute*, Mar. 4, 2014

⁸ Peter A. Petri and Michael G. Plummer, “The Economic Effects of the Trans-Pacific Partnership: New Estimates,” Peterson Institute for International Economics, January 2016. Available at <http://www.iie.com/publications/wp/wp16-2.pdf>

⁹ Jeronim Capaldo, Alex Izurieta, and Jomo Kwame Sundaram, “Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement,” Tufts Global Development and Environment Institute, *GDAE Working Paper 16-0*, January 2016. Available at http://www.ase.tufts.edu/gdae/policy_research/TPP_simulations.html

¹⁰ Mary E. Burfisher, John Dyck, Birgit Meade, Lorraine Mitchell, John Wainio, Steven Zahniser, Shawn Arita, and Jayson Beckman. “Agriculture in the Trans-Pacific Partnership,” United States Department of Agriculture, October 2014. Available at <http://www.ers.usda.gov/media/1692509/err176.pdf>

¹¹ Peter A. Petri and Michael G. Plummer, “The Economic Effects of the Trans-Pacific Partnership: New Estimates,” Peterson Institute for International Economics, January 2016. Available at <http://www.iie.com/publications/wp/wp16-2.pdf>

¹² Dean Baker “Peterson Institute Study Shows TPP Will Lead to \$357 Billion Increase in Annual Imports” *Medium*, Jan 26, 2016. Available at <https://medium.com/@DeanBaker13/peterson-institute-study-shows-tpw-will-lead-to-357-billion-increase-in-annual-imports-ac6b432cff23#.qm4oecwbl>

¹³ Jeronim Capaldo, Alex Izurieta, and Jomo Kwame Sundaram, “Trading Down: Unemployment, Inequality and Other Risks of the Trans-Pacific Partnership Agreement,” Tufts Global Development and Environment Institute, *GDAE Working Paper 16-0*, January 2016. Available at http://www.ase.tufts.edu/gdae/policy_research/TPP_simulations.html

¹⁴ TPP tariff schedules available at <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpa-full-text>