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CONGRESSIONAL TESTIMONY

The Economic and Jobs Impact of Auto Tariffs

Committee on Health, Education, Labor & Pensions

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My name is Stephen Moore and I am the Distinguished Visiting Fellow in the Project for Economic Growth at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

President Trump has proposed auto tariffs of 20 to 25 percent on imported automobiles and automobile parts. Although the White House has made progress in trade negotiations to reduce tariffs and other trade barriers against American exports aimed at getting tariffs down to zero, Trump is still holding firm on special tariffs on autos, steel and aluminum. These are said by the White House to be necessary for national security reasons. But the auto tariffs are also designed to save America autoworker jobs. That's a defensible goal, but the impact on overall jobs – even in the U.S. auto industry may be negative, and other economic effects, including the increase in the costs of buying a new car, make auto tariff implementation inadvisable.

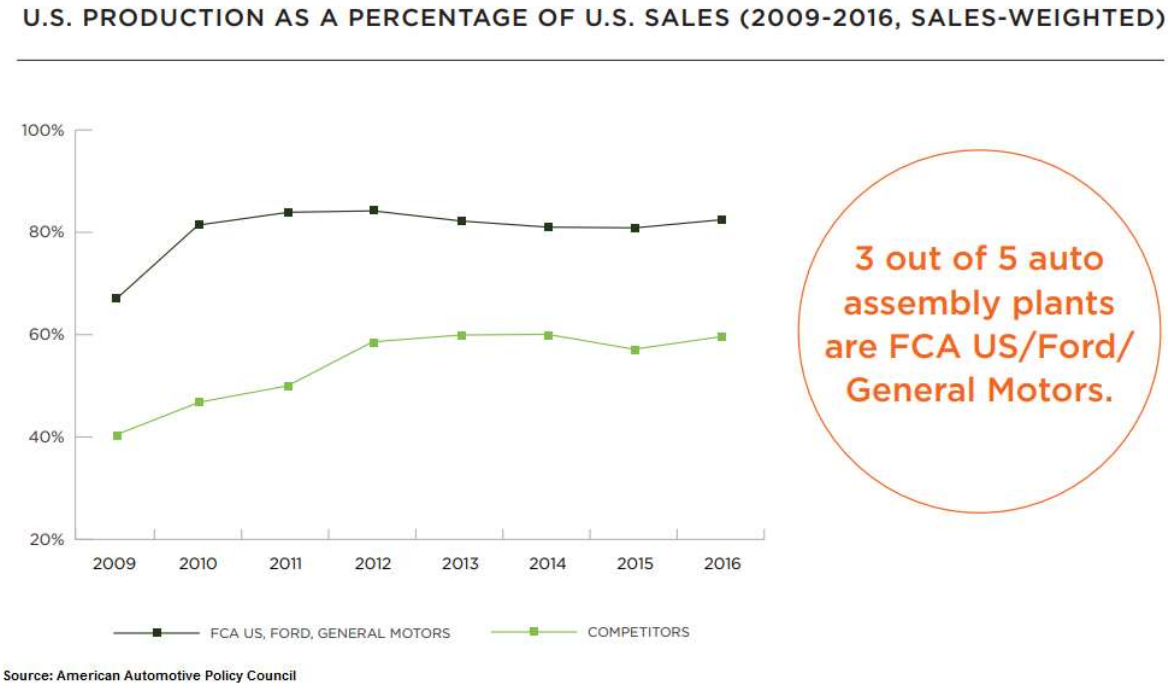
History suggests that auto trade restrictions almost never deliver the promised benefits. Back in the late 1970s and early 1980s the U.S. put trade restrictions on the surging Japanese auto companies – including Honda and Toyota. A landmark study by Robert Crandall of the Brookings Institution found that from 1982-85 those trade barriers led to a "$10-$15 billion welfare loss absorbed by U.S. consumers in 1982-85." He argues that the benefits to the domestic auto industry from those policies (about 1.3 million more cars built) were unlikely to be "worth more than a fraction of the cost." The policies were a big net loser for the economy[1]. Most economists come to the same conclusion regarding the Bush steel tariffs in 2002.

What is very different today from even the failed trade protectionist policies of the 1970s, 80s and 2000s is that global supply chains make it increasingly difficult to determine what country made the car. The steel in a Ford truck may have come from Canada, the parts from Singapore, the electronic gadgetry from Germany and some of the assembly in Mexico. But the Trump tariffs are imposed not just on imported cars but on the auto parts, which makes manufacturing the car in the United States clearly more expensive. For example, the Nissan Rogue, which is made in Tennessee has front seat parts that cross NAFTA borders four times. A 25 percent tariff on these cross-border transactions would be highly punitive.

But there is another big difference between the American auto makers today versus 25 years ago. The United States builds about 12 million cars and light trucks a year. The domestic auto producers in Detroit are down by about 3.5 million cars between 1994-2016. The cars made outside of Detroit, by Nissan, Honda, Toyota, BMW, and others are up by more than 3 million in sales over that period. Auto production in the United States has shifted from outside of the Motor City and to the Southeast, states like Tennessee, Alabama, Texas and South Carolina. These

[1] Robert W. Crandall, "The Effects of U.S. Trade Protection for Autos and Steel," Brookings Papers on Economic Activity, Brookings Institution, 1:1987. https://www.brookings.edu/wp-content/uploads/1987/01/1987a_bpea_crandall.pdf

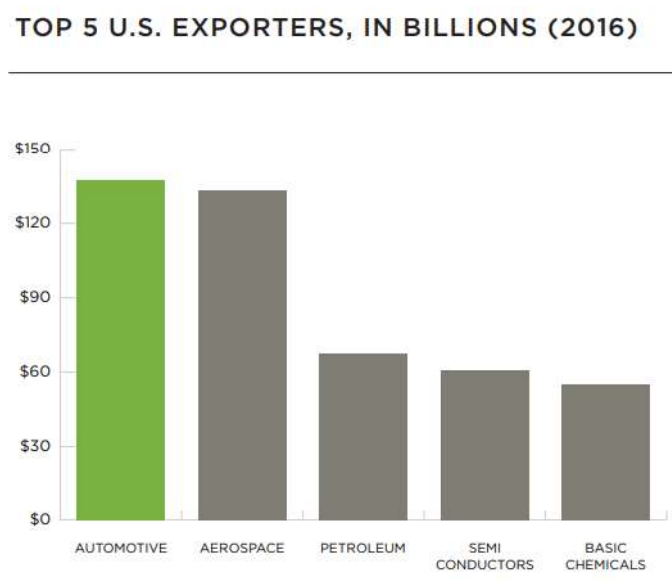
states have lower costs and Right to Work laws that make them highly competitive in global markets. These also tend to be foreign auto companies with plants in the United States.



They also import many of their parts and assembly from other nations. Tariffs on these imported intermediate goods will make American cars more expensive and thus less desirable to consumers here and abroad.

Another feature of the U.S. auto industry that is not well understood is that the U.S. is a large and growing auto export country. With $50 billion of annual sales abroad, America is the third largest exporters of cars, behind Germany and Japan[2]. This means that America may end up losing many auto jobs due to the 25 percent tariffs if other nations retaliate with higher tariffs on American-made cars. This is one of the reasons most of the American auto companies *oppose* the tariffs that are supposed to "protect" them from foreign competition.

[2] United States Department of Commerce, Bureau of the Census, Foreign Trade Division TPIS Database: USHS EXPORTS, Revised Statistics for 1989-2016.
https://www.trade.gov/td/otm/assets/auto/New_Passenger_Exports.pdf



Source: American Automotive Policy Council

Lost Jobs

The immediate employment impact of the Commerce Department's proposed 25 percent tariff on automobiles and automobile parts would result directly in a two percent drop in auto sector employment, rising to 5 percent and a total job loss of over 600,000 after expected in-kind retaliation by trading partners, according to an analysis by the Peterson Institute for International Economics.[3]

Table 1 Effects of Trump's proposed auto tariffs

	US autos and parts percent change				Change in total US employment
	Imports	Exports	Production	Employment	
Scenario 1: 25 percent US tariffs on all countries for autos and parts	-5.29	-2.53	-1.50	-1.92	-195,000
Scenario 2: Scenario 1 and retaliation in-kind by all countries	-6.70	-8.80	-3.98	-5.07	-624,000

Source: Calculations by Sherman Robinson and Karen Thierfelder.

[3] Sherman Robinson, Karen Thierfelder, Jeffrey J. Schott, Euijin Jung, Zhiyao (Lucy) Lu, and Melina Kolb, "Trump's Proposed Auto Tariffs Would Throw US Automakers and Workers Under the Bus," Peterson Institute for International Economics, May 31, 2018. https://piie.com/blogs/trade-investment-policy-watch/trumps-proposed-auto-tariffs-would-throw-us-automakers-and

That's only the impact on manufacturers. Dealers would face layoffs as the tariffs price buyers out of the new car market. The Center for Automotive Research found the 25 percent tariff would slash dealer employment by over 117,000 – an average of seven employees per dealership.[4]

In one study by the Trade Partnership, the model found that tariffs could (in the absence of retaliation– a highly unlikely scenario) boost employment in the auto sector. But that increase of about 92,000 jobs would come at the cost of shaving 0.1 percent off of overall GDP and destroying 250,000 jobs in the rest of the economy.[5] That's a net loss of 157,000 American jobs – before retaliation – in an unlikely best case scenario in which the tariffs succeed in boosting domestic sector employment.

The most likely jobs impact scenarios are negative for auto manufacturers, dealers, and the overall economy – both directly and as a result of nearly inevitable retaliation.

Higher Prices for Consumers

For every American who works for an automaker, there are 50 to 100 who buy the cars they make. Since cars are a major expense item in family budgets, the price of new cars and trucks is a major factor for the financial health of American households. The proposed tariffs are a literal regressive tax on car purchasers.

A straightforward analysis of the proposed 25 percent tariff to the foreign content of a typical imported car shows the tariff would add about $6,400 to the price of a $30,000 imported car.[6]

The Center for Automotive Research modeled the impact on U.S. assembled and imported vehicles and found the retail price increase would average $4,400 on imported vehicles and $2,270 on vehicles rolling out of American assembly plants.[7]

However, as a Peterson Institute analysis notes: "Buyers within each market segment substitute different car models in the same class in response to cost. . . . This substitution across models allows all manufacturers to raise prices when tariffs are imposed, regardless of how much foreign content any one of them is using. . . . The key insight is that normal shopping behavior,

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[4] Michael Schultz, Kristin Dziczek, Bernard Swiecki, and Yen Chen, "Consumer Impact of Potential U.S. Section 232 Tariffs and Quotas on Imported Automobiles & Automotive Parts," Center for Automotive Research, July 20, 2018. https://www.cargroup.org/trade-briefing-consumer-impact-of-potential-u-s-section-232-tariffs-quotas-on-imported-automobiles-automotive-parts/

[5] Joseph Francois, Laura M. Baughman, and Daniel Anthonym "An Accident Waiting to Happen? The Estimated Impacts of Tariffs on Motor Vehicles and Parts," The Trade Partnership, May 29, 2018. https://tradepartnership.com/reports/an-accident-waiting-to-happen-the-estimated-impacts-of-tariffs-on-motor-vehicles-and-parts/

[6] Francois et al.

[7] Schultz et al.

not the imported content of any one model, is what makes showroom prices reflect the average cost of higher taxes among similar vehicles."[8]

It therefore makes sense to analyze the consumer price impact on market segments, as the Peterson Institute report does. As the chart shows, the impact of the tariff ranges from about $2,000 on compact cars to nearly $7,000 on luxury compact SUVs. Even if producers pass only two thirds of the tax on to consumers, the impact would still range from $1,400 on compacts to $4,700 on luxury SUVs.

Average foreign content shares and tariff-induced price increases

	Compact cars	Compact SUVs/ crossovers	Luxury compact SUVs/crossovers
Estimated current dealer price	$16,852	$22,516	$35,020
Foreign content share (2018)	51	56	84
Steel tariff cost increase	$150	$204	$315
Tax under 25 percent Section 232 auto tariff	$1,907	$2,985	$6,798
Tariff pass-through at 66 percent			
Estimated dealer price with steel and Section 232 tariffs	$18,260	$24,609	$39,728
Price increase due to tariffs	$1,409	$2,092	$4,708
Price increase as percent of current dealer price	8.36	9.30	13.44
Tariff pass-through at 100 percent			
Estimated dealer price with steel and Section 232 tariffs	$18,909	$25,582	$41,992
Price increase due to tariffs	$2,057	$3,066	$6,971
Price increase as percent of current dealer price	12.21	13.62	19.91

Notes: Estimated current dealer price is dealer invoice, including destination fee, minus dealer holdback. Steel tariff assumed to add 1 percent to dealer price net of destination fee and operating profit. Section 232 tariff calculated as 25 percent tax on foreign share of dealer cost, which is dealer price net of destination fee and profit. All figures shown are weighted averages for segment, with the weights corresponding to segment market shares.

Sources: Domestic content from National Highway Traffic Safety Administration (https://www.nhtsa.gov/sites/nhtsa.dot.gov/files/documents/2018_aala_alpha_06262018.pdf); invoice price, dealer price, destination fee, and holdback from Car Buying Strategies (https://www.car-buying-strategies.com/new-car-prices.html); operating margin for each manufacturer data from Bloomberg Finance L.P.; Bloomberg Intelligence; 1 percent increase of price by steel tariff from John D. Stoll and Mike Colias, "Steel, Aluminum Tariffs Could Raise Car Prices by $300," *Wall Street Journal*, March 12, 2018 (https://www.wsj.com/articles/steel-aluminum-tariffs-could-raise-car-prices-by-300-1520867757).

Undermining the Benefits of the Trump Tax Cuts

To put their price impact findings in perspective, the Peterson Institute amortized expected price increases over five years and compared the annual costs to the expected savings from the Trump

[8] Mary E. Lovely, Jérémie Cohen-Setton, and Euijin Jung, "Vehicular Assault: Proposed Auto Tariffs Will Hit American Car Buyers' Wallets," Peterson Institute for International Economics, July, 2018. https://piie.com/system/files/documents/pb18-16.pdf

tax cuts. They found that the tariff-induced increase in the price of a new car would consume about 20 percent of the typical Trump tax cut.

The Tax Foundation also compared the auto tariffs to the Trump tax cuts, but from the perspective of the impact of the tariffs on household incomes. The Tax Foundation found that the proposed tariff would amount to a $73 billion tax increase. Running that tax increase through their Taxes and Growth Model, they found that the auto tariffs would offset half of the value of the Trump tax cuts for low-income households. For middle-income households, the auto tariffs would offset 29 percent of the value of the Trump tax cuts.[9]

Distributional Impact of the Tax Cuts and Jobs Act and Proposed Automobile Tariffs

Percentage Change in After-Tax Income, 2018

Income Group	TCJA	Tariffs	Net	Change in Impact
0% to 20%	1.00%	-0.49%	0.51%	-49%
20% to 40%	1.70%	-0.49%	1.21%	-29%
40% to 60%	1.70%	-0.49%	1.21%	-29%
60% to 80%	1.70%	-0.49%	1.21%	-29%
80% to 100%	3.90%	-0.45%	3.45%	-12%
80% to 90%	1.90%	-0.47%	1.43%	-25%
90% to 95%	2.10%	-0.49%	1.61%	-23%
95% to 99%	3.80%	-0.47%	3.33%	-12%
99% to 100%	7.00%	-0.39%	6.61%	-6%
TOTAL	2.90%	-0.47%	2.43%	-16%

Source: Tax Foundation Taxes and Growth Model, June 2018, and Tax Foundation calculations

The proposed auto tariffs would wipe out a significant portion of the Trump tax cuts across all income levels according to the Tax Foundation model. On top of that drop in income, anyone in the market for a new car would pay thousands of dollars more; for some taxpayers, their entire tax savings could disappear in just the price *increase* for a new car purchase.

Lost Lives

If the Trump administration believes its own published model on the relationship between higher new vehicles costs and overall safety of the vehicle fleet, then it should measure the cost of the proposed auto tariffs not just in dollars, *but in human lives*.

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[9] Erica York, "Automobile Tariffs Would Offset Half the TCJA Gains for Low-income Households," Tax Foundation, June 4, 2018. https://taxfoundation.org/automobile-tariffs-2018/

The Trump administration's Department of Transportation and Environmental Protection Agency have published a model that associates higher prices for new vehicles with significant safety harms.

Specifically, in proposing a relaxation of fuel economy standards, the DOT and EPA touted the fact that higher prices "will induce some consumers to delay or forgo the purchase of newer safer vehicles and slow the transition of the on-road fleet to one with the improved safety available in newer vehicles."[10]

Specifically, their proposed deregulatory action prevents an average price increase of $1,850 per vehicle and associated financing, taxes, and insurance costs of an additional $490. Their model shows the rule prevents a total of 12,700 fatalities. About half of those fatalities come from the so-called "rebound effect" that people tend to drive more miles in more fuel-efficient vehicles, a factor not relevant to tariff-induced price increases.

But for the other 6,340 fatalities, *vehicle age* is the most significant factor driving the safety findings.

DOT and EPA say: "Some of these safety benefits will come from improved fleet turnover as more consumers will be able to afford newer and safer vehicles. Recent NHTSA analysis shows that the proportion of passengers killed in a vehicle 18 or more model years old is nearly double that of a vehicle three model years old or newer. As the average car on the road is approaching 12 years old – apparently the oldest in our history – major safety benefits will occur by reducing fleet age."

If major safety benefits come from making new cars less expensive at the Department of Transportation, it stands to reason that making new care *more expensive* by imposing a 25 percent tariff will have the opposite effect on safety by pricing buyers out of the new car market and keeping older, less safe vehicles on the road longer.

DOT and EPA say: "Conversely, if buyers' reaction to the changes in prices and attributes of new vehicles . . . causes a decline in their sales, some travel that would otherwise have taken place in newer, safer cars and light trucks will instead be sifted to older models. As a consequence, the safety consequences and economic costs of motor vehicle crashes will rise."

With nearly every economic model in agreement that the retail price impact of the tariffs will be larger than the savings from the revision of the fuel economy rule, if the DOT and EPA are correct about the relationship between retail price and safety then the tariffs will cost thousands of Americans their lives – indeed it is likely that long-term imposition of the proposed tariffs would cost the lives of all of the Americans who would be saved from the fuel economy rule.

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[10] U.S. Department Of Transportation National Highway Traffic Safety Administration and U.S. Environmental Protection Agency, "Preliminary Regulatory Impact Analysis The Safer Affordable Fuel-Efficient (SAFE) Vehicles Rule for Model Year 2021 – 2026 Passenger Cars and Light Trucks," July 2018. https://www.nhtsa.gov/sites/nhtsa.dot.gov/files/documents/ld_cafe_my2021-26_pria_0.pdf

Conclusion

On balance, the proposed 25 percent tariffs on automobiles and automobile parts run contrary to the central policy priorities of the Trump administration – promoting employment, manufacturing competitiveness, tax relief, and auto safety.

To give the president his due, the threat of auto tariffs has been a springboard to new trade agreements – so far with Mexico and the European Union – that are more advantageous to the United States. So if the ultimate goal of Trump's auto tariffs is to force other trading nations to reduce their tariffs on U.S. products, the tariff club may make sense. But actual implementation of auto tariffs this high would impose net costs to the American that far exceed the benefits to the domestic automakers or their workers.

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