Donald Trump and Paul Ryan's Plan to Put Foreign Investors First

Robert J. Shapiro

The "Border Adjustment Tax" (BAT) endorsed recently by President Trump is his administration's first foray into international economics. It is an inauspicious start.

BAT advocates like House Speaker Paul Ryan promise it will cut the trade deficit by making U.S. exports cheaper abroad and foreign imports more expensive here. The truth is, a BAT won't much affect U.S. exports or imports, and it certainly won't create jobs. It would produce a large stream of new federal revenues, and it could trigger retaliatory tariffs on some U.S. exports. A BAT also would enrich a great many foreign investors and companies, and leave a lot of American investors and large companies poorer. All told, it's the kind of "bad deal" that Mr. Trump once railed against.

Mr. Trump and Speaker Ryan never mentioned a BAT until recently, and the reason they like it now is that it's a cash cow to pay for their sharp cuts in corporate taxes. The Trump-Ryan BAT would give U.S. producers a 20 percent rebate on the wholesale price of any goods or services they export – 20 percent, because that's the GOP's preferred corporate tax rate – and impose a 20 percent tax on foreign goods and services imported here from abroad. It would raise trillions of dollars, because we import about $500 billion more per-year than we export.

For conservatives at least, all those revenues should be a red flag. In a populist period, a subsequent President and Congress may well decide to raise corporate taxes -- and when they do, the BAT's fat revenue stream could well go to fund progressive causes.

Mr. Trump still has no Council of Economic Advisers, so maybe he believes that a BAT will spur U.S. exports and create jobs. Even Peter Navarro should to be able to tell him why that won't happen. At first, a BAT would strengthen demand for U.S. exports and weaken demand for foreign imports here. But those shifts in demand would quickly strengthen the dollar and weaken foreign currencies, perhaps enough to offset the BAT's initial impact on import and export prices. In theory, the currency movements triggered by the changes in prices brought about by the BAT should restore pre-BAT prices for both imports and exports, so the only change would be a lot of new revenues from taxing net imports.

In practice, the BAT's impact on the dollar and U.S. trade is a roll of the dice. As Federal Reserve chair Janet Yellen noted recently, no one knows how closely the currency changes will mirror the BAT's direct effects on prices. If they overshoot, U.S. consumers will pay more for imports; if they undershoot, U.S. export prices won't fall much. On top of that, no one knows how much of the BAT tax U.S. importers will pass along to American consumers, and how much of the BAT rebates U.S. exporters will pass along to their foreign customers. Finally, painful retaliation might follow, since China and others won't take kindly to paying a 20 percent tariff on their exports to the United States, and China's competitors won't like the BAT's substantial devaluation in the yuan-dollar exchange rate.

One effect is certain: The BAT will harm U.S. investors and reward foreign investors as the currency changes reduce the dollar value of U.S.-owned assets abroad and increase the foreign-currency value of foreign-owned assets here. The Bureau of Economic Analysis tells us that in the second quarter of 2016, Americans held foreign stocks, corporate and government bonds, and derivatives worth $12.9 trillion; and foreign-owned financial assets in the United States totaled $20.3 trillion.

If we assume the Trump-Ryan BAT leads to a 20 percent increase in the value of the dollar and a corresponding 20 percent decline in the trade-weighted value of foreign currencies, it would reduce the value of U.S.-held financial investments abroad by nearly $2.5 trillion and increase the value of foreign-owned financial investments here by more than $4 trillion. What kind of deal is that, Mr. President?

The trillion-dollar losers will include U.S. investors in European or Asian mutual funds; U.S. companies with profitable foreign subsidiaries, from Microsoft and Facebook to Coca Cola and Pfizer; and U.S. banks that lend to foreign companies. The trillion-dollar winners will include foreign investors with U.S. mutual funds; foreign companies with major American subsidiaries, from Toyota and Anheuser Busch to Unilever and Phillips; and foreign banks who lend to U.S. companies.

Perhaps the best motto for the Trump-Ryan BAT is "Put Foreign Investors First."

Robert J. Shapiro, chairman of the economic and security advisory firm Sonecon, was Under Secretary of Commerce for Economic Affairs in the Clinton administration. In the 2016 campaign, he advised Hillary Clinton.