Resource Economics, Inc.
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AN ECONOMIC ANALYSIS OF A U.S. BORDER ADJUSTED TAX POLICY

For

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By

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EXECUTIVE SUMMARY

The U.S. manufacturing sector has seen a major decline in both production and employment in recent years. Manufacturing employment has declined by 20 percent since 1998. The decline in manufacturing employment is the major source of the inability of the American middle class and blue collar to maintain historical levels of real income. Despite a doubling of manufacturing productivity since 1978 real factory wage rates have declined by 11 percent. This deteriorating condition in manufacturing is primarily due to the inability of U.S. manufacturing to compete in foreign trade. The manufacturing trade deficit is a major share of the U.S. negative trade balance which now amounts to 7% of GDP or more than $700 billion annually.

U.S. tax policy has a significant impact on the U.S. balance of trade and the long term decline in U.S. manufacturing production and employment. The Border-Adjusted Tax plan (called the Business Transfer Tax or BTT) analyzed in this report addresses the trade imbalance problem by correcting the competitive disadvantage the U.S. has in trade with major trading partners who have some form of border-adjusted tax policy.

An economic modeling system by Regional Economic Models, Inc. (REMI) was used to evaluate the BTT for the U.S. economy and for the State of Texas. The proposed Border-Adjusted Tax or business transfer tax (BTT) policy would make changes both to the taxation of business and the taxation of individuals. On the business side of the ledger the corporate income tax would be repealed and in its place a value-added tax would be imposed but the value-added base would be adjusted by adding the value of imports and subtracting the value of exports and the value of capital purchases. The resulting tax is then reduced by the corporate contribution to social insurance. That is the BTT is a value-added tax (based on value added minus the value of capital purchases) with a credit for exports and penalty for imports, and a credit for the corporate contribution to social insurance. Not-for-profits and all governments would be taxed at the same tax rate on employee expenses and purchases of imports.

The REMI model results indicate that the BTT would put the U.S. economy on a different path by correcting the trade deficit, returning 1.5 million employees to manufacturing, increasing GDP by $892 billion per year, and increasing per capita incomes by 4.1%. Employment would shift from lower paying service sectors to higher paying manufacturing, wholesale trade, mining, and finance and insurance sectors. The shift would slow the growth rate in total employment in the beginning, but the overall growth rate would return promptly to approximately the base forecast levels. Prices would increase on U.S. goods by a modest 7%, but the BTT would redirect consumption toward investment, thus significantly changing the economy's ability to maintain long-term growth. Consumption would slow by $211 billion per year and investment would increase by $344 billion per year.

Texas impacts are generally in the same direction as the nation. Since Texas has a relatively large manufacturing sector, however, the shifts in employment from services to manufacturing

are more pronounced. GRP rises by 6.6% over the base forecast by the end of 10 years compared to 5.1% for the nation.

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