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Submission of the National Retail Federation

to the

House Ways and Means Committee

Hearing on Border Adjustment and Increasing U.S. Competitiveness and Preventing American Jobs from Moving Overseas

May 23, 2017

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The **National Retail Federation** NRF is the world's largest retail trade association, representing discount and department stores, home goods and specialty stores, Main Street merchants, grocers, wholesalers, chain restaurants and Internet retailers from the United States and more than 45 countries. Retail is the nation's largest private sector employer, supporting one in four U.S. jobs — 42 million working Americans. Contributing $2.6 trillion to annual GDP, retail is a daily barometer for the nation's economy. NRF.com

The National Retail Federation believes that the most important aspect of any tax reform measure is its impact on the economy and jobs. Consumer spending represents two-thirds of GDP, and one-in-four Americans are employed in the retail industry. The NRF believes that tax reform that shifts the tax burden from businesses to consumers will present an unnecessary risk to our economy. The NRF believes that a reform of the income tax, by providing a broad base and low rates, will bring the greatest economic efficiency and will stimulate economic growth without harming the American consumer and causing the economic dislocations inherent in the transition to a new consumption tax system.

Impact of the Border Tax Adjustment on the Retail Industry

The Ways and Means Committee's Better Way Tax Reform Plan would deny importers the ability to deduct the cost of their imports. A substantial percentage of goods sold in retail stores are imported. The goods are either directly imported by the retailer or by one of their suppliers. The vast majority of these items (footwear, apparel, toys, etc.) are not manufactured in the United States so there is no opportunity to substitute American made inventory. The tax also applies to other goods that must be imported like fuel, chemicals, coffee and cocoa.

Retailers are high effective taxpayers under current law, paying more than 37% of their income in state and local taxes. The border tax proposal would cause the tax burden on retailers to skyrocket. Under this proposal, many retailers will have a tax burden that is larger than their profits. In specialty apparel, for example, retailers import 90-100% of what they sell. These retailers will end up with effective tax rates that are 3-5 times larger than their profits. Obviously, they will have no choice but to pass the tax cost forward to their customers. However, their customers will not see their wages go up by 15% even with growth in the economy. So they will consume less with the dollars they have, and essentials, like food and gasoline, will receive a larger share of consumer dollars. Many Wall Street analysts have predicted this could destabilize retailers that are currently financially viable.

Small businesses may be particularly vulnerable to the impact of the border tax on prices. Because they do not have the economies of scale to be able to negotiate with their suppliers, they will be more likely to have to absorb the full impact of the tax increase and will be less competitive to the extent they try to pass that price forward to their consumers. Small businesses make up 98 percent of the retail industry and provide 40% of the industry's 42 million jobs.

Impact of the Border Adjustment Tax on Prices

Our retailers predict that they would have to raise price by approximately 15% to break even under the House Blueprint. An NRF analysis of the plan predicts that the plan could cost the average family of four $1700 in the first year alone, which includes a 35 cent increase in the cost of a gallon of gas. Hardest hit would be low and middle income consumers, especially those on fixed incomes.

Economic theory suggests that the dollar will strengthen to offset any impact of the tax on prices of imports. However, many currency experts dispute that a strengthening of the dollar will happen quickly or that it will completely offset any impact on prices caused by the border tax. According to Kenneth Rogoff, Harvard economics professor and former Chief Economist for the International Monetary Fund, "40 years of research have taught us that it is unrealistic to assume that a border tax will quickly lead to a sharp offsetting movement of the dollar, because exchange rates can move wildly away from their fundamentals for many years at a time. The process could take many years, and the short-term effects on U.S. unemployment easily could be negative." [1] Even if the dollar strengthens in the long-term, we still expect a decline in sales of goods sold by retailers because economists believe the tax will create a preference for non-tradeable goods over tradeable goods.[2]

Overall Impact of the House Blueprint on Growth in the Retail Industry

Proponents of the House Blueprint have argued that it is important to evaluate the proposal as a whole in terms of its impact on a business or industry, rather than look at any particular provision in isolation. The NRF engaged Ernst & Young to conduct a macroeconomic study of the impact of the House Blueprint on the retail industry, with a focus on retail spending and retail employment. The study[3] found that even without taking into account the impact of the border adjustment tax, retail spending and retail employment would decline for six years under the proposal compared to where they would be under current law. If the border adjustment tax were layered onto the model, the declines in retail spending and employment were presumed to be more severe.[4] The reason that retail spending and employment decline under this analysis is because the House Blueprint moves our current income tax system towards a consumption tax.

Figure 1 shows the estimated impact of the House Blueprint on retail spending, without taking into account any possible impact of the border adjustment tax.

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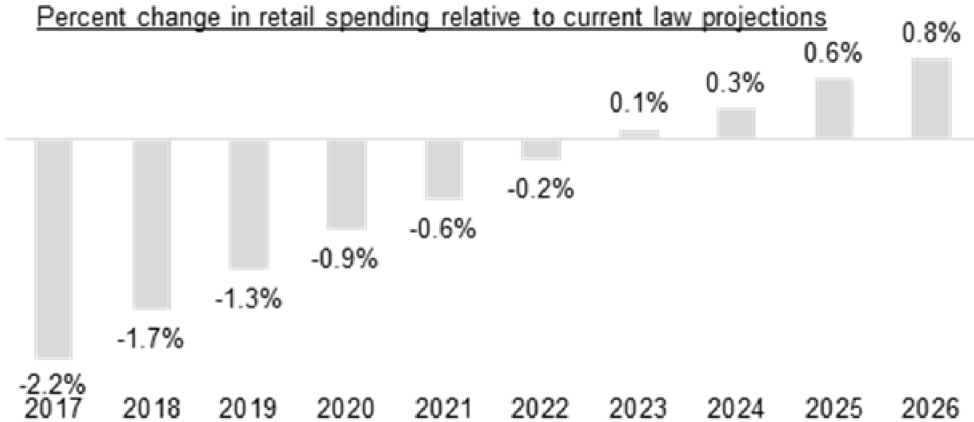
[1] https://www.bostonglobe.com/opinion/2017/03/20/trump-damaging-border-tax/uz9OsK5BJet06pYlOfndsL/story.html

[22] See, for example, Martin Feldstein and Paul Krugman, 1990, "International Trade Effects of Value-Added Taxation."

[3] Ernst & Young, Macroeconomic Analysis of the Impact of House Republican Blueprint for Tax Reform on the US Economy and Retail Spending, prepared for the National Retail Federation. May 2017.

[4] Because of the debate over whether the dollar would strengthen to offset any possible impact of the border adjustment tax, how long any adjustment might take, and whether the adjustment would completely offset a potential price increase on all products, they did not make assumptions with respect to when or how much adjustment would occur in their model.

Figure 1. Estimated Impact of the House Blueprint on Retail Spending



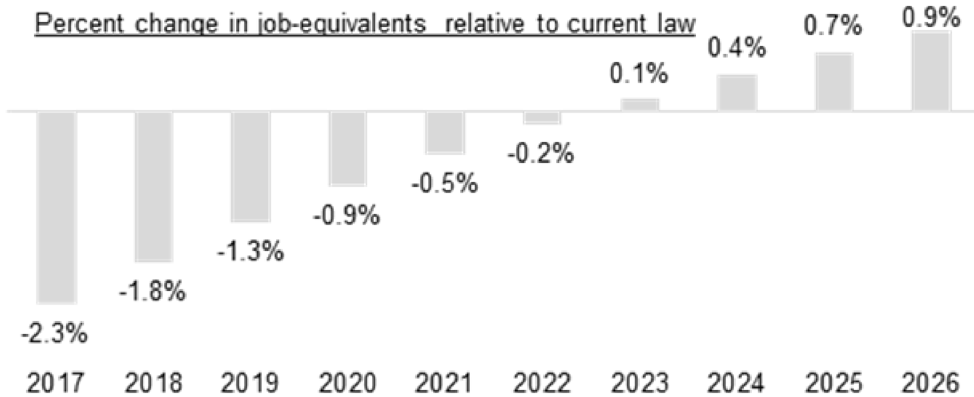
Retail spending scaled to $4.3 trillion US economy in 2015 (in billions)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Current law	$4,298	4,298	4,298	4,298	4,298	4,298	4,298	4,298	4,298	4,298
House Blueprint	$4,204	4,225	4,242	4,259	4,272	4,289	4,302	4,311	4,324	4,332
Change	-$90	-70	-60	-40	-30	-10	*	10	30	30

*Smaller in magnitude than $5 billion.
Note: These estimates do not reflect the potential impact of the border adjustment provisions. The analysis assumes the House Blueprint to be fully effective January 1, 2017, with no transition rules. For models of this type, roughly two-thirds to three-quarters of the long-run effect is generally reached within a decade, although this period would be longer for consumer and retail spending due to the shift towards a consumption tax under the House Blueprint.
Source: EY analysis.

Figure 2 shows the estimated impact of the House Blueprint on retail employment, without taking into account any possible impact of the border adjustment tax.

Figure 2. Estimated Impact of the House Blueprint on Retail Trade Job-Equivalents



Job-equivalents scaled to the 13.6 million retail trade sector in 2015 (in millions)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Current law	13.6	13.6	13.6	13.6	13.6	13.6	13.6	13.6	13.6	13.6
House Blueprint	13.3	13.4	13.4	13.5	13.5	13.6	13.6	13.7	13.7	13.7
Change	-0.3	-0.2	-0.2	-0.1	-0.1	*	*	0.1	0.1	0.1

*Smaller in magnitude than 0.05 million.
Note: These estimates do not reflect the potential impact of the border adjustment provisions. The analysis assumes the House Blueprint to be fully effective January 1, 2017, with no transition rules. Job-equivalents impacts are defined as the change in total labor income divided by the baseline average labor income per job. For models of this type, roughly two-thirds to three-quarters of the long-run effect is generally reached within a decade, although this period would be longer for consumer and retail spending and retail job-equivalents due to the shift towards a consumption tax under the House Blueprint. Figures may not sum due to rounding.
Source: EY analysis.

This economic analysis demonstrates that the overall impact of House Blueprint on the retail industry is not positive, and, in fact, the retail industry would be expected to decline for at least 6 years under the proposal. When the border adjustment tax is analyzed in this context, it is even worse for the retail industry.

<u>Conclusion</u>

The retail industry has been a strong proponent of income tax reform. We believe that income tax reform that lowers the rates and broadens the tax base can provide economic growth for the economy as a whole and can be good for the American consumer. We do not believe that a new tax system that shifts the burden of taxation to the consumer is good for our industry, which is the nation's largest employer, or good for the American consumer. We urge you to reject the border adjustment tax and modify the House Blueprint so that it does not shift the tax burden to consumers.