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WEEKLY ECONOMIC COMMENTARY

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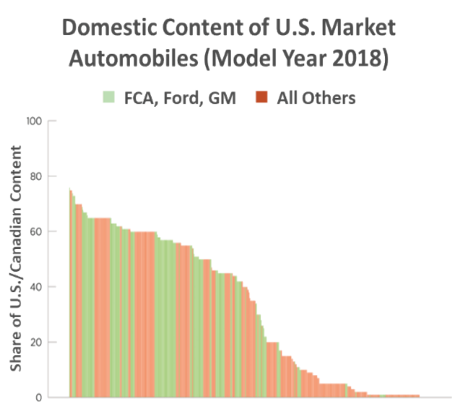
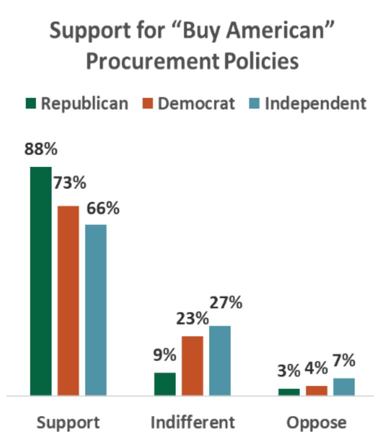
Ryan reviews the latest in a long history of policies to support domestic production.

Growing up, I recall the sticker on the back of our neighbor's Chevrolet van: "Buy American: The Job You Save Could Be Yours!" I don't know if the placard swayed any purchasing decisions, but perhaps it planted an interest in economics in my young mind.

Alas, slogans that fit on a bumper sticker are rarely comprehensive policy positions. So it goes with "Buy American," or any other country's marketing efforts to support domestic production. These politically popular exhortations have been around longer than most of us have been alive, but they sound much better than they perform in practice.

First, merely defining a product's country of origin is difficult in an era of global supply chains. The more complex the item, the more international ingredients it contains. Cars and trucks are a ready example. Out of about 350 models available in the U.S. in 2020, 91 had a point of final assembly in the U.S. The list includes Japanese, German, Korean and Swedish names, with many of their models containing more locally made parts than domestic brands. These international companies' U.S. factories employ thousands of American workers.





Sources: American Automotive Policy Council, Trade Vistas, Renaissance Macro Research

Secondly, most countries do not have domestic industries for all goods; patriotic shoppers will find buying local simply not possible for many purchases. Consumer electronics are almost exclusively made in Asia. The concentration of semiconductor producers in Taiwan has become a risk to supply chains everywhere.

And thirdly: where domestically made goods are available, they must compete with imported offerings, which often carry lower prices and higher quality. Manufacturers are skilled at locating production wherever their raw materials and labor can come together in the most cost-effective manner. If domestic producers cannot match this efficiency, they will lose market share. Free trade has given consumers more choices at lower prices; patriotic sentiment may not be enough to compensate for paying more.

Domestic producers on the losing end of market share battles can lobby for government support. Like many leaders before him, U.S. President Joe Biden is putting forth policies meant to promote domestic production. We see no reason to believe his efforts will be any more fruitful than those of his predecessors.

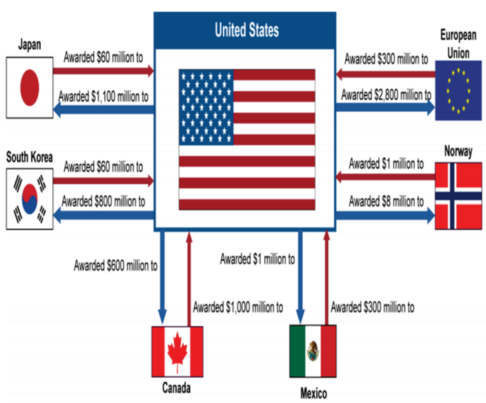
The benefits of free trade apply to government purchases, too.

Candidate Biden laid out detailed proposals for making more in America, focusing on the sizeable purchasing power of the federal government to compel more domestic production. This idea is well-worn. In 1933, President Herbert Hoover signed the Buy American Act, the first official prioritization of domestic manufacturers for government purchases. To this day, the country has never lived up to the ambitions of that legislation.

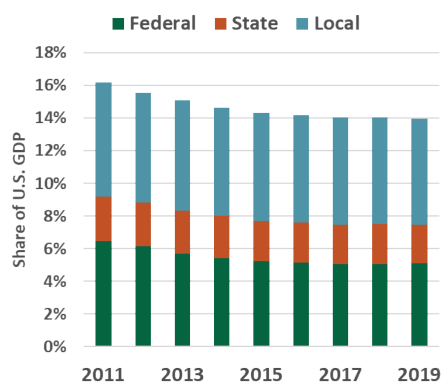
In his first week in office, Biden signed an executive order directing more federal spending toward domestic suppliers and creating a new role of "Director of Made in America" to advance this goal. His infrastructure proposal also contains multiple references to federal procurement. However, nothing in these statements breaks new ground. The Trump administration signed as many as ten executive orders to reduce commerce with foreign suppliers as part of a broader protectionist trade agenda, but they did not materially change the composition of government purchases.

Mandates directing governments to purchase more domestic products are a solution to a problem that has already largely been addressed, as government purchases are heavily domestic. A comprehensive 2019 audit by the Government Accountability Office (GAO) investigated the U.S. government's $290 billion of purchasing contracts signed in fiscal year 2015. Of that amount, only $12.1 billion (4%) was foreign-sourced. The same holds true for other countries, as well: All of the U.S.' primary trading partners make a majority of their purchases from their own domestic sources.

Central Government Procurement Flows



U.S. Government Consumption



Sources: Government Accountability Office, Bureau of Economic Analysis, Haver Analytics

The share of domestic purchases by the federal government was already much greater than the share of imports; it is not clear how much more domestic production the government can compel. And although supporting local suppliers feels like a win, these constraints reduce market function and lead to inefficient outcomes. Studies have estimated that removing Buy American restrictions would lower the cost of U.S. infrastructure projects and might result in increased employment.

Policies that dictate U.S. purchasing restrictions ignore the consequences of stepping away from trade. Trade flows both ways: Every nation that loses sales to the U.S. can retaliate by buying fewer U.S. exports or adding more trade restrictions, harming U.S. producers.

International agreements have also presented a challenge to Buy American pledges. The World Trade Organization's Agreement on Government Procurement (GPA) binds 47 nations to reciprocal policies of open trade for purchases by each nation's government. Any local policies that encourage domestic sourcing must contain carve-outs for agreements like the GPA.

Governments already favor domestic suppliers.

Government purchasers will find that some international procurement is unavoidable. Foreign firms may be the only source for a needed product. If a foreign source offers substantially lower prices, procurement officers must make a difficult value judgment between supporting local businesses and making the best use of taxpayer funds. Reshoring of polluting industries may conflict with environmental policy objectives. And in many cases, foreign purchases are made for government operations abroad; for resources like fuel, building maintenance, or education, bringing a domestic resource would be impractical.

Buying local is not a bad objective, but it is not a panacea. Where domestic producers are viable competitors, they will prosper regardless of procurement policies, and simple catchphrases are not a comprehensive solution to trade dynamics. The sector with the most to gain from these policies may be producers of bumper stickers.

Own Goal

Some sports leagues have been in operation for a very long time. U.S. baseball's National League is 120 years old, the Australian Football League is 125 years old, and several European football competitions (soccer to our American readers) began more than a century ago.

On the other end of the spectrum are competitions that did not last very long. They seemed like good ideas at the time, but ultimately failed. Among this latter group is the recently scuttled European Super League (ESL), whose two days of existence must have set a record for the shortest tenure in history. The short but illuminating saga of the ESL provides a sobering lesson on the post-pandemic economics of sport.

Football leagues and clubs were struggling with profitability prior to COVID-19. Despite ever-escalating revenue from television and merchandising, escalating costs for players and facilities have made it difficult to remain in the black. While salary caps and luxury taxes have discouraged excess in the United States, attempts to establish sensible guard rails for spending in European football have foundered. The presence of deep-pocketed owners for whom team ownership is an avocation has raised the stakes and caused a number of clubs to go deeply into debt.

The pandemic blew a hole in the broad side of the ship of sport. Attendance at venues, and the revenue derived from it, has been severely curtailed; clubs in the English Premier League have cumulatively lost an estimated £365 million of match-day revenues during the past year. The cancellation of matches has allowed some broadcasters to recoup rights fees from teams. In an extreme case, the outlet televising matches of the top French football league went bankrupt, ceasing payments to teams immediately. Efforts to find a replacement have been challenging.

Europe's most prominent football clubs have long lusted after a larger share of revenue generated by the competitions in which they play. With their fortunes dwindling and the pandemic persisting, 12 of them thought the time was right to break away. They were backed by substantial financing and the promise of lucrative fees from broadcasters.

In doing so, they may have forgotten that sports leagues are cooperatives. A relatively level financial playing field promises more even competition where every match attracts some interest. This, in turn, can help maximize revenues for all teams in the league. The fortunes of the collective are often stressed over the fortunes of individual clubs.

The backlash faced by the separatists from their domestic leagues and international governors was swift and fierce. The break-away was seen as a snatch and grab for revenue that would leave scraps for former competitors. The backlash among supporters of the signatories to the ESL was also swift and fierce. Match day income accounts for only about 13% of the revenue earned by top English teams, but those who buy tickets have an outsized influence on the fortunes of their clubs.

The ESL will eventually fall out of the headlines. Yet the conspiring clubs face repercussions from football's governing bodies, and the economic challenges that gave rise to the plot remain. The top tiers have been wounded, but will probably recover; they have access to revenue streams and credit that can tide them through until stadiums are full again. The debt they will be carrying, however, may curtail their ability to acquire top players.

What is less certain is the financial fate of the lower divisions of European football, which are seen by many as essential to the sporting fabric. Clubs outside of the top tiers often develop players that move on to the top rosters; without adequate resources, the talent pipeline may slow to a trickle.

Socialism is an effective system when it comes to sports leagues.

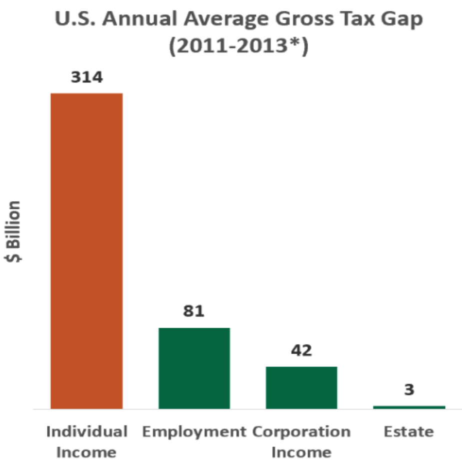
Socialism may not work in many contexts. But when it comes to team sports, it may be the model that fits the best. Mutualization of interests can help all clubs through difficult times, and could provide a model to enhance profitability during the best of times. Leaders of the failed ESL might do well to substitute Karl Marx for Adam Smith on their nightstands.

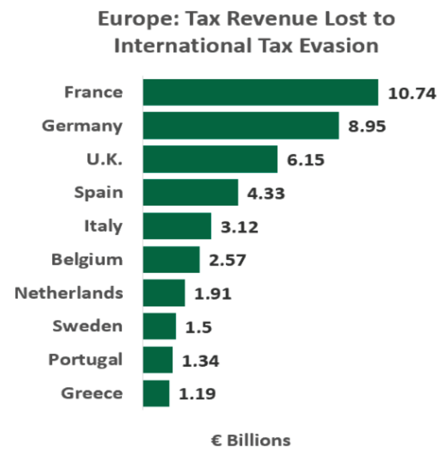
Loop Holes

Two weeks ago, we wrote about how corporate taxation presents a challenge for governments around the world. Corporations aren't the only challenge for exchequers. Some individuals are also cause for concern, evading taxes through misrepresentation and obfuscation. The more assets they own, the wider the window for manipulation.

Estimating the scope of tax evasion is difficult, as tax obligations are concealed through opaque offshore havens and corporate structures. There are a wide range of estimates across different studies: according to one of them, individuals have stashed $8.7 trillion, equivalent to 10% of world gross domestic product (GDP), in tax havens. This practice results in billions of dollars in lost tax revenues annually.

In the U.S., it is estimated that collecting unpaid taxes from the highest earners would boost government coffers by $175 billion a year. The European Union's annual losses on tax evasion amount to €46 billion. Africa alone loses $14 billion in tax revenues annually due to the super-rich using tax havens. Only 1% of India's population pays income tax and declares earnings above the non-taxable threshold.





*Sources: IRS, European Commission; *Published in September 2019*

The true cost of tax evasion is income inequality and poverty.

High-income countries lose more revenue to global tax abuse, but low-income countries suffer the most. By not paying what they owe, individuals deprive governments of the resources to fund development projects like education, healthcare and infrastructure, leading to greater inequality and poverty. The Organization for Economic Co-operation and Development has created the Common Reporting Standard to help tax authorities track the offshore holdings of their taxpayers. But that standard, just like the U.S.' Foreign Account Tax Compliance Act, has many loopholes.

Tax circumvention was getting increased global attention prior to the pandemic. With government debt levels rising rapidly as nations spend to address COVID-19, scofflaws will be pursued with greater force. The Biden administration has proposed an additional $80 billion in funding to the Internal Revenue Service to enhance tax enforcement.

Alex Cobham, chief executive of the Tax Justice Network, said: "a global tax system that loses over $427 billion a year is not a broken system, it's a system programmed to fail." Governments will need to work overtime to restore public faith that the system isn't designed to be rigged.

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