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RESTRICTING SHOE IMPORTS: CONGRESS SHOOTS ITSELF IN THE FOOT

INTRODUCTION

In an effort to stem the protectionist tide in Congress last December, Ronald Reagan vetoed legislation passed overwhelmingly by Congress that would severely restrict imports of textiles and shoes. Congress is expected to seek to override the President's veto this summer. If the override is successful, it would be costly for the American consumer. And while textiles have been the principal focus of the debate thus far, the impact of the legislation on the cost of shoes for Americans could be considerable.

The International Trade Commission (ITC) declared last year that imports of nonrubber footwear have caused "serious injury" to the U.S. footwear industry and its workers. Accordingly, it recommended to the President that he impose quotas to roll back footwear imports to their 1983 levels--or approximately 18 percent below the 1984 level of 575 million pairs. The legislation vetoed by Reagan generally followed the ITC recommendations.

In the past, the U.S. footwear industry has enjoyed the benefits of selective quotas, such as those applied only to imports from South Korea and the Republic of China on Taiwan (ROC) from 1977 to 1981. Now the industry is asking for nearly global quotas that would restrain shoe imports from more than 70 countries.

Studies of the South Korea and ROC quotas conducted in 1981 reveal that restricting the supply and raising the price of shoes forced U.S. consumers to pay as much as \$1.6 billion more per year (in 1980 prices) than they otherwise would have during the 1977-1981 period. Even though this protection may temporarily have increased

the number of jobs in the U.S. footwear manufacturing industry (at the expense, of course, of jobs elsewhere in the U.S., such as in retailing and wholesaling), studies indicate that the cost to consumers for each job saved was approximately \$40,000. This may be a high price for temporarily "saving" jobs that paid an average wage of \$9,100 in 1981.

The proposed global quotas would be much more costly. Recent studies show that the quotas would force U.S. consumers alone to pay as much as \$3.1 billion more for footwear annually. This would mean an estimated cost per job saved of \$95,385--almost seven times the average footwear manufacturing salary of \$14,000 in 1985. It is hard to imagine a better example of why it makes no sense to use quotas to "save" jobs. Lawmakers should consider this heavy cost when they consider overriding the veto.

THE BENEFITS AND COSTS OF PARTIAL PROTECTIONISM

In 1977 the U.S. government negotiated five-year "voluntary" trade restrictions on footwear imported from South Korea and the Republic of China. This "partial protectionism" provides a case study of the costs imposed by quotas.

Who Pays the Costs of Protectionism?

Studies of these restrictions reveal that, by reducing supply and driving up prices, the quotas cost consumers as much as \$1.6 billion per year in 1980 prices.¹ This amounts to an average annual consumer cost of as much as \$40,000 per job "saved" by protectionism in the domestic footwear industry.

There is much evidence, moreover, that protectionism's costs are not borne equally among Americans in different income categories. Protectionism is the equivalent of a regressive tax, imposing proportionately greater hardship on lower-income groups than on those in higher brackets.

The quotas on South Korean and ROC footwear manufacturers limited the total volume of shoes imported into the U.S. Research shows that such supply restrictions drive up the price by approximately the same absolute amount for all shoes, regardless of quality. This means that higher quality shoes become relatively cheaper. If quotas cause an average price increase of, say, \$10, then a \$20 pair of shoes will climb to \$30, while a \$40 pair will climb to \$50. Originally, the

1. See Michael C. Munger, "The Costs of Protectionism," Challenge, January/February 1984, pp. 54-58.

cheaper shoes were half the price of the more expensive pair. But after the price hike, the cheaper shoes cost 60 percent of the other pair. Many consumers are likely to conclude that the higher-priced shoes are better value for the money. In the case of the shoes from South Korea and Taiwan, economist Joon Suh of Washington University in St. Louis found that prices on imports were increased more proportionately among lower-priced (and lower-quality) items.²

A survey by the U.S. Bureau of Labor Statistics of the Department of Labor also found that lower-income families spend proportionately more of their income on footwear than do wealthier families.³ The survey reported that those families with after-tax income under \$7,000 per year spent 1.03 percent of their income on footwear; by contrast, those with after-tax income exceeding \$25,000 spent only 0.56 percent of that on footwear. Thus, even a proportionate increase in footwear prices among footwear of different quality would impose almost twice the burden on the low income groups as on the high income groups.

In fact, the burden is even more regressive because quotas cause more than proportionate price increases among lower-priced shoes, which are purchased in greater volume by lower-income families. Suh calculates that the poorest families in the Bureau of Labor Statistics survey, those with after-tax income under \$7,000, paid a "quota tax rate" (that is, the increase in shoe expenditures divided by family income) that was three times greater than the rate paid by the wealthier families.

Over time, moreover, the higher relative price for better quality footwear from South Korea and the ROC caused an increase in the supply of those items, thereby reducing production costs through economies of scale and actually lowering their price in the importing country. The net effect of quotas thus is a regressive tax that burdens lower-income families most harshly, coupled with a "subsidy" to wealthier consumers in the form of lower prices for the higher quality items they can afford. And by forcing lower-income consumers to purchase more costly shoes, quotas force them to spend an even greater portion of their income on footwear. This makes the "quota tax" an even greater burden for the poor.

Despite the dismal results of the five-year experiment with quotas on South Korean and ROC footwear, the American Footwear Industries Association and such labor unions as the Amalgamated

2. Joon Suh, "Voluntary Export Restraints and Their Effects on Exporters and Consumers: The Case of Footwear Quotas," Working Paper No. 71, Center for the Study of American Business, Washington University at St. Louis, October 1981.

3. U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, 1972-1970 (Washington, D.C.: U.S. Government Printing Office, 1974.)

Clothing and Textile Workers Union and the United Food and Commercial Worker International Union are pressing for global protectionism. Testifying before the Senate Finance Committee, they urged "tough action" to control "imports from the entire world through...global quotas."⁴

Some Effects of the ITC Proposals

Worldwide quotas on footwear imports would impose heavy burdens on American consumers. The total cost would be equal to the total shoes purchased multiplied by the increase in price. The increase in imported footwear prices depends on both the percentage reduction in imports achieved by the proposed quota (the ITC proposes a 17.6 percent cutback) and the responsiveness of consumer demand to price increases (or the "elasticity of demand"--the percentage change in the quantity demanded for a one percent rise in price).

The best estimate of the price elasticity of demand for footwear is -1.5; this means that for every 1 percent increase in import prices, quantity demanded falls by 1.5 percent. To achieve the 17.6 percent cutback of imports proposed by the ITC, prices of imports would have to rise by 11.7 percent (17.6 percent/1.5). Since the quantity of footwear supplied to the total U.S. market would be reduced, prices of domestically manufactured footwear almost surely would increase by approximately the same degree. In 1984 the average price of all footwear in the U.S., imported and domestically manufactured, was approximately \$22.82 per pair.

Americans purchased 864.4 million pairs of shoes in 1984.⁵ Assuming that quotas cut imports by 17.6 percent, imports would decline by 101 million pairs. At the same time, higher prices would spur an output increase of 79.4 million pairs by domestic producers, since the responsiveness of supply to changes in price (known as the "price elasticity of supply") in this industry is estimated as 2.28--that is, every 1 percent increase in price induces a 2.28 percent increase in quantity supplied. Thus the total volume of consumption, with quotas, would be 842.8 million pairs. Multiplying the 11.7 percent rise in price by the average of consumption volume before and after the quota (853.6 million pairs) yields approximately \$2.3 billion. This is, by conservative estimates, the extra annual cost of footwear to American consumers imposed by global quotas. The ITC, meanwhile, expects that its suggested quota would increase prices

4. Testimony of F.A. Meister, President of the American Footwear Industries Association, before the U.S. Senate Finance Committee, Subcommittee on International Trade, September 9, 1980, p. 156.

5. Ibid.

by 19 percent rather than 11.7 percent. This would increase the annual costs by approximately \$3.1 billion annually.⁶ The President's Council of Economic Advisers estimates the added costs at \$2.9 billion.⁷

In sum, the ITC's proposed global quotas are likely to cost consumers between \$2.3 billion and \$3.1 billion annually over a five-year period. This is a very high price to pay for the net employment created by the quotas. The increase in employment would, in any case, only be temporary. Moreover, the inequities already experienced with partial protectionism likely would be intensified by global quotas. Indeed, the regressive effects of the import quotas imposed on South Korea and the ROC from 1977 to 1981 resulted from only a 3 percent increase in the average price of imported shoes, and that amounted to an extra \$1.6 billion "tax" on U.S. consumers. Global quotas would intensify these inequities, since footwear prices would rise up to six times more than under the system of partial quotas.

Another cost is that imposed on other American industries and workers by trade restrictions. Foreign industries likely would lobby their governments to impose retaliatory protectionist measures against American firms. The costs of such measures are uncertain, but the President's Council of Economic Advisers projects them at approximately \$2.2 billion in lost profits and wages.⁸ This would increase the estimate of the costs of protectionism to between \$4.5 billion and \$5.7 billion.

These costs are very high compared with the number of jobs created. The ratio of shoe production to employees was 2,464 pairs per worker in 1980. On this basis, the estimated 80 million extra pairs produced in America with quotas in effect would create about 32,500 jobs. Therefore, the annual cost for "saving" each job in the domestic footwear industry would be between \$138,461 and \$175,384--about ten to twelve-and-a-half times the \$14,000 annual salary paid for such jobs in 1985. It would be much cheaper simply to give footwear manufacturing workers \$14,000 in cash to pay them off.

6. Official Transcript, "Proceedings Before the U.S. International Trade Commission (Washington, D.C.: ITC, June 12, 1985).

7. As cited in "Relief for the Footwear Industry," Message from the President of the United States, House Document 99-100, 99th Congress, 1st Session, September 4, 1985 (Washington, D.C.: U.S. Government Printing Office, 1985).

8. Ibid.

EMPLOYMENT AND PRODUCTIVITY EFFECTS

Global quotas would raise domestic footwear prices, which would bring about a larger supply and, consequently, an increased "derived demand" for employment in the industry. But there also would be job losses in the wholesale and retail footwear trade, since the higher prices resulting from global quotas would reduce the total supply of footwear on the market. With the number of shoes purchased falling by 2.2 percent because of the proposed quotas, and assuming that wholesale and retail employment would decline by the same 2.2 percent, 7,165 jobs would be lost as a result of the global quotas (given the 325,685 shoe retailing jobs in 1984).

Global quotas also would impair the dynamics of competitive markets. Over time, it is competition that provides incentives for all manufacturers to innovate and to make use of cost-reducing or quality-enhancing technology.

Incentives for technological advance, however, would be reduced by protectionism. Slowing the advances would put the U.S. footwear manufacturing industry at a further disadvantage in international markets, which in turn would lead to further demands for protection, stifling technology even more. Dependence on protectionism is no better for an industry's long-run economic health than dependence on welfare payments is for an individual's.

Technological change is a major engine of economic expansion. MIT economist Robert M. Solow estimates that it probably accounts for as much as 80 percent of U.S. economic growth.⁹ Other studies support this calculation.¹⁰ Thus protectionism by reducing the incentive for innovation will make the U.S. footwear manufacturing industry less competitive in international markets. In the long run, this means fewer jobs for Americans.

If protectionism could save jobs, then the most protected industries, such as steel, textiles, and automobiles, should be among the most robust for employment. In reality the opposite is true. Decades of protectionism has stifled competitiveness, resulting in thousands of employees being thrown out of work. International competition can never be eliminated, only forestalled. The International Trade Commission itself has admitted recently that, when the footwear manufacturing industry was faced with a more than 100

9. Robert M. Solow, "Technological Change and the Aggregate Production Function," Review of Economics and Statistics, August 1957, pp. 312-320.

10. Morton Kamien and Nancy Schwartz, Market Structure and Innovation (New York: Cambridge University Press, 1981).

percent increase in the demand for athletic footwear, from 1979 to 1983, "domestic firms were slow to respond,"¹¹ permitting foreign manufacturers to capture a much larger market share.

Promises of productivity improvements are routinely offered to Congress as an excuse to enact protectionist policies. But the footwear manufacturing industry has not lived up to its past promises of improved productivity in return for protectionism; it is not likely to do so in the future.

Table 1

	Pairs of Shoes Per Worker (thousands per year)	Pairs of Shoes Made Per Hour Worked	Real Capital Expenditures Per Year in the Industry (1972 Dollars)
1971	2.706	1.388	31.8
1972	2.725	1.365	37.0
1973	2.679	1.359	42.6
1974	2.628	1.377	38.1
1975	2.620	1.369	25.7
1976	2.273	1.327	23.5
1977	2.665	1.400	24.0
1978	2.645	1.378	24.6
1979	2.679	1.423	33.1
1980	2.690	1.417	33.9
1981	2.541	1.346	47.0
1982	2.524	1.373	27.4
1983	2.677	1.395	n.a
1984	2.464	n.a	n.a
1971-1976	2.655	1.364	33.1
1977-1981	2.644	1.393	32.5
1982-1984	2.558	1.384	n.a

Source: U.S. Department of Commerce, Survey of Current Business, Business Statistics 1971, and 1985 U.S. Industrial Outlook; Footwear Industries of America, Footwear Manual 1983, Footwear Industries of America et. al., in the "Matter of Nonrubber Footwear," Preliminary Brief before the ITC, Investigation No. TA-201-55; and International Trade Commission.

11. International Trade Commission, Report to the President, p. 22.

Labor productivity did not rise significantly during the quota period, 1977 to 1981, or afterwards. (See Table 1.) Nor did real investment in the industry increase substantially during this period. In fact, real annual capital expenditures were actually lower than during the prior five-year period. These data belie the view that the industry will increase its investment spending in return for protectionist favors. If anything, protectionism reduces the incentives for productivity enhancement, a view supported by Table 1.

There are two ways the footwear industry can raise its profits: it can compete in the market by trying to reduce costs or improve the quality of its product, thereby increasing sales; or it can lobby the government for special privileges in the form of import quotas, which limit competition. Once the industry has succeeded at lobbying, it is likely to trust politics rather than improved efficiency as the surest route to profits.

The notion that granting an industry monopoly power and isolating it from competition will induce it to become more innovative, entrepreneurial, and competitive defies common sense. Both theory and evidence indicate that the opposite is more likely. Only eliminating monopoly privilege by abolishing trade restrictions will create an environment conducive to entrepreneurship and productivity enhancement.

CONCLUSION

The issue of protectionism is usually discussed as a means of protecting the livelihood of Americans against the threat of foreign imports. Protectionism is thus defended on the grounds that the interests of American citizens should be placed above those of citizens of South Korea, the Republic of China, Japan, and other foreign trade bogeymen. At best, however, the global quotas proposed by the footwear manufacturing industry and its political allies in organized labor will provide short-lived benefits for a few Americans at a great cost to all other Americans. And such quotas will impose a disproportionate burden on lower-income families.

In the long run, these costs cannot be justified even on the grounds that they save jobs. The long-run effect of protecting an industry from the rigors of competition is that it becomes lethargic, less competitive, and ever more reliant upon governmental handouts. The end result is fewer jobs, not more, as is apparent in some of the most heavily protected industries such as automobiles, steel, and textiles.

The threat of protectionism exists because, even though the costs far outweigh any possible benefits, the benefits are highly visible--the industry and its unions are quick to thank Members of

Congress in very tangible ways for voting for tariffs and quotas. In distressing contrast, protectionism's costs are hidden. Citizens have little incentive or opportunity to determine their share of the costs of protectionism, so are usually fooled into thinking that to favor protectionist policies is to favor Americans over foreigners.

Thus far Ronald Reagan has rejected pleas for additional protectionism in the domestic footwear industry by vetoing legislation incorporating quotas. He should continue to stand firm, and Congress should avoid protectionist legislation that may spell good politics in a few districts, but bad economics for American consumers.

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