The Heritage Foundation Backgrounder

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IMPORT QUOTAS: AN UNWISE SOLUTION

BACKGROUND

As a remedy for the auto industry's ills, many prominent policymakers, including Transportation Secretary Drew Lewis and Commerce Secretary Malcolm Baldrige are advocating the establishment of an import quota on Japanese cars. A temporary restraint, it is reasoned, will help the domestic manufacturers through their current difficulties and better prepare them for the highly competitive environment of the eighties.

The Administration, whose official position has yet to be announced, should reject the plea for protection. Philosophically, quotas are a move away from a trade policy based on the notions of competition and consumer sovereignty. Practically, quotas will not achieve the promised results. The auto industry's troubles are much deeper than competition from abroad, and quotas would serve only to mask the real problem.

Proponents of the quotas support their position by citing the dismal 1980 profit performance of U.S. manufacturers. Chrysler lost $1.7 billion, Ford $1.5 billion, and even General Motors suffered losses of over $750 million. With over $70 billion in investments needed during the next five years, it is feared domestic producers will be unable to afford the retooling vital to the rebirth of the American auto industry.

Another perspective of the same picture was revealed in a recent letter to the Washington Post by the governors of six states heavily dependent on the auto industry. In urging adoption of the quotas, they pointed out that nearly 200,000 auto workers have been laid off, with another 700,000 workers having been hurt through a ripple effect.

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Quotas are not the solution to the auto industry's woes because imports are not the most significant factor in its decline. The United States International Trade Commission, in response to a petition by the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) for import relief, found that the economic recession harmed domestic auto manufacturers far more than the Japanese competition. USITC Chairman Bill Alberger estimated that even if imports had been held constant and the increase in import purchases had instead gone to domestic consumption, domestic car sales would have fallen by 80 percent and 60 percent of the actual decline in 1979 and the first half of 1980, respectively.

Furthermore, even the increase in imports is not due entirely to greater competition, but to a shift in consumer preferences. Consumers were often willing to postpone purchases, and those that did buy were more interested in the economical, fuel-efficient models which Detroit is only now beginning to produce.

A limitation on imports will neither alter households' financial status nor will it by itself make the less fuel efficient autos more attractive. Since these are two extremely significant factors in the decline of U.S. car sales, quotas will not substantially increase the profitability of U.S. manufacturers, nor will they restore many of the lost jobs. Ironically, the Department of Transportation estimates that if the desired retooling is achieved, the U.S. auto industry will become so efficient as to no longer require 100,000 of the current jobs.

A major factor in the relative cost of domestic versus imports has been the higher cost of labor in the United States. When measured against Japanese scales, U.S. auto industry wages are nearly 50 percent greater. Within the U.S., auto workers' hourly wages, including fringe benefits, are 60 percent higher than the average manufacturing hourly wage. Ten years ago, the differential was only 40 percent.

Recently, the UAW has shown some flexibility in its wage demands. Certainly the special consideration given Chrysler suggests a moderation in the rise of wages. However, quotas may place the newfound restraint in jeopardy. While bargaining for wages and prices is crucial to a market economy, an important and often overlooked element of the negotiation is risk. Both labor and management are aware that the demand for, and acquiescence to, extraordinary wage rates heightens the risk of the firm's or industry's failure. Import quotas, by reducing the risk to both sides, reduce the desirability of temperence and could very well lead to a resurgence in labor costs.

It is clear that the intended beneficiaries of quotas are the domestic auto employees and stockholders. The victims are much more anonymous. The cost will be paid by future consumers who are unable to purchase an import or must pay a higher price. (The more stringent and effective the quotas, the higher prices

will be.) Even those who have no intention of purchasing an import will face higher prices because potential import purchasers will shift to domestics, thus driving those prices up also.

An even greater cost is the possibility of Japan or other nations responding to the U.S. quotas with trade restrictions of their own. The human cost would undoubtedly exceed that of the current situation because: 1) the median domestic worker is paid much less than the auto worker (and therefore unemployment payments would be smaller); and 2) there is no retraining program, such as trade adjustment assistance, offered to employees of export industries.

In addition, a less open economy would create inefficiencies which would hurt all consumers. It should be noted that negotiated quotas, as U.S. Trade Representative William Brock has discussed, do not create as great a risk for retaliation as does the legislative approach advanced by Senators Danforth and Bentsen.

Both critics and advocates of the quotas attribute the precarious position of the domestic industry in large part to government policies. Certainly price controls on oil created an environment of cheap and plentiful gas, which of course suddenly collapsed, leaving auto manufacturers making the wrong sized cars. The industry does have a case for some sort of indemnification, but import quotas are neither equitable nor efficient. Rather than the government (taxpayer) paying for its error, the cost would be shifted to the new car buyer and workers in export industries. The most efficient form of indemnification, because it would not distort any prices and thus create economic biases, is a simple cash payment. If the sole object is to correct a policy mistake which severely injured the auto industry, the current debate about quotas should instead be focused on the size of the transfer.

Since the quotas will not save the auto industry, the questions are what will, and should the attempt be made to rescue domestic manufacturers? Essentially, it is the Chrysler question revisited. Consistency within the Reagan economic package would dictate no special treatment for the auto industry. The program for recovery is a broadly-based freeing of resources with the market directing the uses. If, as some suggest, special tax credits are given auto manufacturers, the government would be overriding the market's judgment.

Undoubtedly, without assistance the auto industry will have a rough time. Stock vaues will fall and wages will rise much more slowly. However, that cost is both more obvious and effective than directing resources from less political but more economically efficient uses.

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