



## Protection's Price

Although specialization and trade make us wealthier, most societies spend a lot of time, money and energy trying to thwart the exchange of goods and services. At home, companies pursuing their self-interest often breed monopolies that restrict supply and hike prices. The same impulse to stifle competition leads to a variety of trade measures aimed at imports.

As the United States reduced tariffs over the past six decades, producers turned to import quotas, antidumping penalties, domestic-content laws, “voluntary” export restraints and other nontariff barriers. Export subsidies, exchange-rate controls, trade licenses, and onerous labeling, packaging and technical requirements further tilt the market against foreign goods.

In whatever guise, protectionism is pure poison for an economy. Time and again, economic studies show that import restraints aren't worth it. They saddle consumers with huge costs. Dozens of researchers have reached this conclusion for a host of products, from steel, automobiles and semiconductors to textiles, apparel and farm products.

Even when they temporarily stave off job losses, trade barriers are costly. For example, trade protection saved 216 U.S. jobs in the production of benzenoid chemicals, used in suntan lotion and other products—but at a cost of nearly \$1.4 million per worker. Because the chemical workers earn a fraction of the protectionist toll, it would cost far less to simply pay them not to work!

In case after case, the costs of protection outweigh the benefits. The tab for each job preserved in the luggage industry is nearly \$1.3 million; in softwood lumber, more than \$1 million; in sugar, more than \$826,000. Moreover, some of the jobs saved are dirty, dangerous and low paying. (*See Exhibit 11.*)

And trade barriers don't deliver on their promise to save beleaguered industries. Even when shielded from foreign competition, most protected sectors have continued to shrink. Steel and textiles—beneficiaries of years of protection—are still not strong enough to compete on their own.

The U.S. automobile industry provides a good illustration of the economic forces unleashed by trade protection. Under pressure from automakers and unions, Washington coaxed Japan into accepting “voluntary” limits in the 1980s on the number of cars it would sell in the United States.

Protectionism didn't spark the renaissance the U.S. auto industry wanted. Asian and European automakers kept coming, lured by American consumers' craving for cars. The companies adapted their strategies for penetrating the U.S. market; they moved production to plants in the United States and shifted their focus to high-quality, luxury vehicles.

As a result, foreign producers captured a larger share of the high-priced, high-profit segment of the car market. In the 1990s, the average prices of imported and domestic models were relatively close. In 2001, the imports sold for nearly 40 percent more, on average, than U.S.-made cars. Even with protection, Detroit couldn't hang onto this lucrative slice of the market. Domestic

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## EXHIBIT 11. The High Cost of Protectionism

How much does it cost to protect a job? An average of \$231,289, figured across just 20 of the many protected industries. Costs range from \$132,870 per job saved in the costume jewelry business to \$1,376,435 in the benzenoid chemical industry. Protectionism costs U.S. consumers nearly \$100 billion annually. It increases not just the cost of the protected items but downstream products as well. Protecting sugar raises candy and soft drink prices; protecting lumber raises home-building costs; protecting steel makes car prices higher; and so forth. Then there are the job losses in downstream industries. Workers in steel-using industries outnumber those in steel-producing industries by 57 to 1. And the protection doesn't even work. Subsidies to steel-producing industries since 1975 have exceeded \$23 billion; yet industry employment has declined by nearly two-thirds.

	Protected industry	Jobs saved	Total cost (in millions)	Annual cost per job saved
1	Benzenoid chemicals	216	\$ 297	\$ 1,376,435
2	Luggage	226	290	1,285,078
3	Softwood lumber	605	632	1,044,271
4	Sugar	2,261	1,868	826,104
5	Polyethylene resins	298	242	812,928
6	Dairy products	2,378	1,630	685,323
7	Frozen concentrated orange juice	609	387	635,103
8	Ball bearings	146	88	603,368
9	Maritime services	4,411	2,522	571,668
10	Ceramic tiles	347	191	551,367
11	Machine tools	1,556	746	479,452
12	Ceramic articles	418	140	335,876
13	Women's handbags	773	204	263,535
14	Canned tuna	390	100	257,640
15	Glassware	1,477	366	247,889
16	Apparel and textiles	168,786	33,629	199,241
17	Peanuts	397	74	187,223
18	Rubber footwear	1,701	286	168,312
19	Women's nonathletic footwear	3,702	518	139,800
20	Costume jewelry	1,067	142	132,870
	<b>Total</b>	<b>191,764</b>	<b>\$44,352</b>	
	<b>Average (weighted)</b>			<b>\$ 231,289</b>



## EXHIBIT 12. Any Which Way It Can

There are 768 million motor vehicles in operation around the globe. Nearly 200 auto companies run 741 assembly plants in 508 cities and 59 countries, producing thousands of different vehicles for consumers in more than 150 countries. Ford Motor Co. produces cars in 17 countries—nearly three-fourths of its production now occurs outside the United States. General Motors Corp. exports more cars from Germany than does BMW. Half of all Toyotas and three-fourths of all Hondas sold in America are built here. The 2001 Honda Civic coupe is 75 percent domestic content; the Ford Escort, 60 percent.

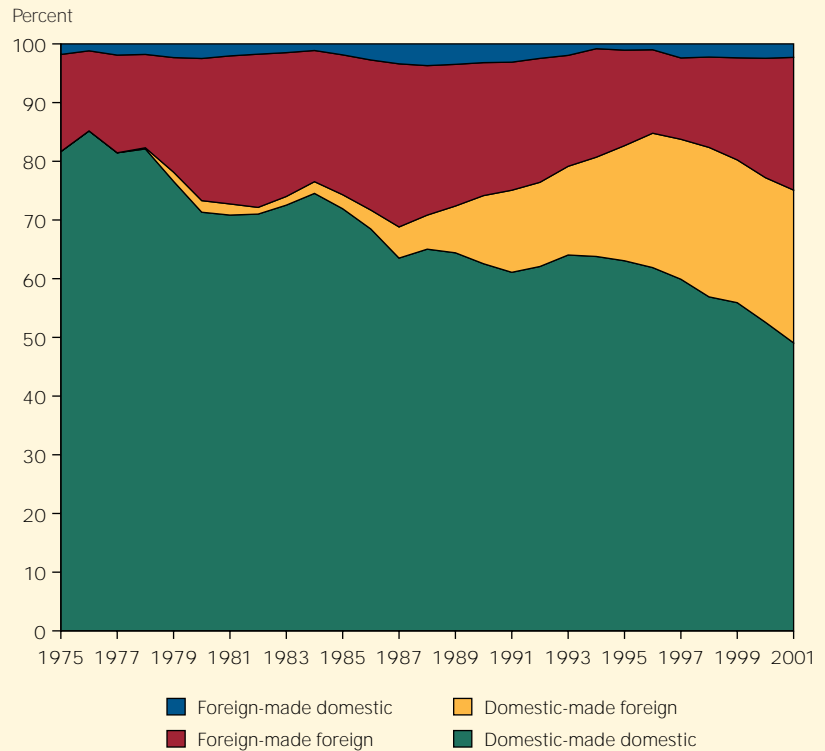
What's the message in all this? A highly globalized and competitive auto industry gets vehicles to consumers any which way it can. That's how markets work.

Protection only thwarts the process, and it can't deliver what it promises to workers or industry anyway. A prime example is the "voluntary" export restraint imposed on Japanese automakers in 1981. At the time of the protectionist legislation, foreign-based imports were 26 percent of U.S. auto sales and domestically made foreign cars were just 2 percent. Imports made up 23 percent of the nation's luxury car market; the average import sold for \$8,896—slightly less than a U.S.-made car (\$8,912). There were 1.9 million workers in the U.S. transportation equipment industry.

In 2001, 23 percent of U.S. sales were imports, but 26 percent were foreign cars built in this country. Imports comprised 58 percent of the U.S. luxury market; the average import sold for \$27,477, nearly 40 percent more than a domestically made car (\$19,654). Since 1981 the U.S. transportation equipment industry has lost more than 210,000 workers. Moreover, according to *Consumer Reports*, foreign-based producers make 25 of the 30 most reliable used cars.

Protect—and harm.

### U.S. Retail Sales of Passenger Cars



automakers' market share and employment continued to slide in the 1990s, although new jobs were created in the foreign-owned factories. (See Exhibit 12.)

Protectionism fails domestic industries because it delays and weakens their response to market forces. Particularly when in trouble, companies need to confront reality and avoid wasting precious time and resources. Sometimes, that reality demands that jobs be cut, companies shut down and even whole industries wither. When industries pursue political favors instead of efficiency or innovation, they only delay the inevitable.

Responding to market signals, vibrant economies shift resources from declining sectors to emerging ones. Trade barriers short-circuit the process by muting the market's message. Labor and capital that could be more productive elsewhere end up stuck in industries where cheaper or better import alternatives are readily available.

When steel companies or sugar producers want to fend off imports, they complain to Washington. A second but far less visible free trade contest takes place in state capitals, where the makers of some goods and services seek to restrict out-of-state rivals.

### Commerce Clause

The Congress shall have power to...regulate commerce with foreign nations, and among the several states, and with the Indian tribes.

—U.S. Constitution

The U.S. Constitution's commerce clause creates a hurdle for state and local interference with the flow of goods and services. Although it's more difficult to impose trade barriers within U.S. borders than without, producers still try. To skirt the commerce clause, they often cloak homegrown trade protection in the guise of promoting consumer protection or public safety.

An 87-year-old Oklahoma law, for example, decrees that only licensed funeral directors can sell caskets—a policy that discourages consumers from shopping around and keeps prices high. Vermont restricts its milk market to in-state dairies. Internet commerce creates a new avenue for state meddling; for example, Texas prohibits the online sale of used cars, and Georgia restricts commerce in replacement contact lenses.

Domestic trade barriers hurt consumers just as much as those aimed at foreigners. The Fraser Institute finds that government intervention costs residents of West Virginia—the least open state—\$5,294 annually, weighted against a national average of \$26,765 in per capita personal income. In contrast, Delaware's citizens gain an average of \$3,882 a year by living in the state with the lowest barriers. A per capita gap of \$9,176, or 34 percent of per capita disposable income, shows just how much even interstate trade issues matter.

The Great Depression provides an example of how trade restrictions lead to economic ruin. America's highly restrictive Smoot–Hawley tariff, passed in 1930, prompted other countries to retaliate by imposing their own trade barriers. Under the weight of the restrictions, world trade contracted sharply over the next few years, compounding excess capacity problems. At



the Depression's depths, about a quarter of U.S. workers were unemployed. (See Exhibit 13.)

Whether aimed at foreigners or fellow Americans, trade restraints aren't just a matter of lost dollars and cents. All protectionist schemes violate basic economic freedoms. They involve third parties using the power of government to thwart the right of others seeking an exchange that will make them better off.

Each time it happens, Americans are less free—and poorer.

### EXHIBIT 13. **Protect and Destroy: The Lesson of Smoot–Hawley**

The stock market hates protectionism. That lesson—perhaps the clearest history has ever taught—comes from the Smoot–Hawley Tariff Act of 1930. In the late 1920s farmers, whose economic fortunes had not kept pace with industrialists', lobbied Congress for tariffs on agricultural products. The proposed act had few political sponsors at first (two of the three major political parties opposed it), and the stock market ignored it.

But as word of the bill spread, more and more U.S. producers joined the bandwagon, arguing for tariffs to assist domestic industry or protect them from foreign competition. Smoot–Hawley eventually expanded to cover more than 20,000 items across the gamut of U.S. production, with rates practically prohibitive to trade. With so many political constituents now on board, the Progressive and Democratic parties jumped the fence and on October 28, 1929, joined the Old Guard Republicans in supporting the legislation. That day the stock market crashed, falling 12 percent.

In the months that followed, foreign governments filed 34 formal protests, and 1,028 economists petitioned President Hoover not to sign the bill. But he did, on June 17, 1930, and the Great Depression engulfed the nation. The Dow Jones Industrial Average fell from a daily high of 381 in September 1929 to a low of 41 in 1932 as world trade contracted from \$5.7 billion to just \$1.9 billion three and a half years later.

It was the most expensive lesson markets have ever taught: Protect and destroy.



### Dow Jones Falls as World Trade Contracts

