Post-Hearing Brief from the Footwear Distributors & Retailers of America to the U.S. International Trade Commission
Investigation No. 332-325
The Economic Effects of Significant U.S. Import Restraints: Ninth Update

February 16, 2017

The Post-Hearing Brief submitted by the Footwear Distributors & Retailers of America (FDRA) provides additional information on questions raised during the February 9th hearing before the Commission on significant U.S. import restraints impacting the footwear industry. Specifically, the brief will address the relationship of U.S. footwear manufacturing to global supply chains, the impact of the Harmonized Tariff Schedule of the United States (HTSUS) on footwear design, the Miscellaneous Tariff Bill (MTB) process, and the increase in landed costs for footwear.

The Importance of Global Supply Chains to U.S. Manufacturing

During the February 9th hearing, Commissioner Williamson discussed the idea that freedom in global supply chains directly impacts the competitiveness of U.S. companies. For the footwear industry, global supply chains not only allow companies to deliver the quantity of footwear that U.S. consumers demand each year; these supply chains support U.S. manufacturing.

The vast majority of domestic footwear manufacturers are also importers. Today, 99% of shoes are imported, and this reflects the need to deliver nearly 2.5 billion pairs of shoes annually to the U.S. market at affordable prices, with values determined by U.S. consumers. For example, a company may manufacture a small line of high-end leather boots domestically for a very limited market segment and also import a high quantity of lower cost children's shoes to reach a much larger customer base.

Reducing footwear duties therefore creates savings for the overall company that can be re-invested back into domestic manufacturing. In fact, four leading U.S. footwear companies made this argument on March 7, 2016 in a letter to Ambassador Michael Froman, the United States Trade Representative, regarding the importance of the Trans-Pacific Partnership (see attached letter).

Today many domestic manufacturers also depend on inputs from abroad to make products in the U.S. For the footwear industry, global supply chains provide necessary footwear components used in all non-military domestic production and assembly and play an essential role in the absence of U.S. tanneries needed to make leather footwear.

U.S. manufacturing has evolved considerably over the past century towards producing items of high value, just as the footwear industry has evolved in order to compete and meet the needs of consumers. With manufacturing, the U.S. has transitioned production towards high-value manufacturing sectors ranging from industrial machinery to chemical production, while increasing productivity year over year. At the same time, the shift away from large-scale footwear production in the U.S. occurred decades ago.

Despite having a relatively low value, footwear production is extremely capital and labor intensive, still requiring more than 120 touches to make a basic pair of leather shoes and over 200 touches for upscale dress shoes. Due to the capital and labor requirements for footwear production, the need for a large workforce dedicated to learning the particular skills of shoemaking, the relative low value of footwear, and the billions of pairs required annually for the U.S. market, a return to the large-scale footwear production of the early 20th century remains highly unlikely.

However, recently companies have made important investments in advanced manufacturing in the U.S. for certain high-end segments of the market. In fact, brands that utilize global supply chains have generated headlines for building new advanced manufacturing facilities in the U.S., including the Reebok Liquid Factory in Lincoln, Rhode Island; Adidas Speedfactory in Atlanta, Georgia; and the Under Armour Lighthouse facility in Port Covington, Maryland. Although limited by product type and current capacity – producing tens of thousands of pairs of shoes compared to the billions imported each year – these facilities represent important progress in this area and a focus of the industry in making products closer to consumers and providing greater customization.

As the Commission considers the cost of U.S. import restraints for the ninth edition of this report, FDRA believes it is highly valuable to examine the role that global supply chains play in supporting the U.S. economy, including the manufacturing sector. One of the key aspects of the Trans-Pacific Partnership (TPP) is that the agreement, for the most part, adopted a 21st century trade policy that reflected global footwear supply chains. This encompassed years of trade negotiations and consultations with the entire industry and domestic interests. TPP would have eliminated duties on every footwear tariff line in the HTSUS for TPP countries, 140 at the 8-digit HTSUS level in the first year of implementation, with the remaining 18 HTSUS lines phased out over a 12-year period.

At a time when consumers are demanding new materials, types, and styles of footwear, FDRA believes it is important to consider whether a tariff regime created in 1930 truly reflects a 21st century footwear market and whether it serves manufacturers that could benefit from removing outdated import barriers and strengthening their supply chains.

The Impact of Chapter 64 of the HTSUS on Footwear Design

The footwear chapter of the HTSUS, Chapter 64, creates confusion and uncertainty for the industry with its 46 pages of tariff lines and 436 different ways to classify a pair of shoes at the 10-digit level. In addition, Chapter 64 often incentivizes designing shoes to meet certain tariff classifications rather than designing shoes based solely on the needs of consumers. Below are specific examples of ways in which Chapter 64 impacts footwear design:

Subheading 6404.20.40 and Women's Pump

Classifying a women's pump with a textile upper involves the weight of the shoe. Subheading 6404.20.40 applies a ten percent duty rate to textile upper shoes with leather outsoles valued over $2.50 a pair. This section applies as long as the footwear is less than 50 percent by weight of textiles, rubber, and plastics, or less than ten percent by weight of rubber or plastics. Since the upper must be textile by definition, the only way to qualify for the ten percent duty rate in 6404.20.40 is to either eliminate the use of all rubber and plastics or to increase the weight of the shoe by using materials other than textile materials, rubber, and plastics. This can be achieved using a hollow heel and filling it with metal balls, nails, or iron power. While increasing the weight of the shoe in this way qualifies it for the ten percent duty rate, adding material to the inside of the heel clearly provides no benefit for the consumer. If the shoe does not meet this weight requirement burden, it would fall under 6404.20.60, resulting in a significantly higher duty of 37.5 percent.

Textile Outsoles

In December 2011, President Obama implemented a change to the HTSUS following the Commission's recommendation (Investigation No. 1205-8) regarding a longstanding practice by the footwear industry of including textile material on the outsoles of shoes. The rule change, which added Additional U.S. Note 5 to the HTSUS, allows the inclusion of textile or fabric on the outsoles of certain footwear in order to qualify for lower duty rates in 6405 and separate breakouts in 6402 and 6404. Adding the fabric material to the outsole can result in a rate of 12.5% instead of 37.5%, which is essential for companies that provide value footwear to individuals and families. The addition of the material, however, does not add to the quality or appearance of the shoe.

Subheading 6404.11.75 and Overlaps

There are circumstances where using "soles which overlap the upper except at the toe or the heel" would be beneficial. This is limited to subheading 6404 and footwear priced lower than $6.50, specifically when an athletic shoe with no foxing or foxing-like band has an overlap at the rear of the shoe which extends beyond the 2.5 inch area. If the shoe has an upper of man-made fibers, and the sole is rubber or plastics with a textile overlay, its classification falls in subheading 6404.11.75, which has a duty rate of 12.5%. Without the overlap, classification would fall in 6404.11.69, which would mean a 37.5% duty rate.

Avoidance of Accessories

6402.99.31 applies to certain footwear having uppers of which over 90 percent of the external surface area, *including any accessories or reinforcements*, is rubber or plastics. In this particular subheading, the accessories are added back to the upper for calculating the total external surface area. Therefore, using too many non-plastic accessories such as

metal or glass on the shoe for design purposes could result in it being disqualified from the 6% duty rate of 6402.99.31.

Protective Footwear

Adding features to a shoe to provide consumers with protection against the elements can lead to its classification as "protective" with rates of 37.5% and 67.5%. This feature of the HTSUS had the result of capturing certain modern trail running shoes with innovative water resistant material under the same subheadings in the HTSUS as would apply to cold weather boots. It took an Act of Congress in 2015 with the enactment of the Trade Preferences Extension Act (Public Law 114-27) to ensure that this one area of footwear innovation was protected. The Act created a new category of "protective active footwear" under 6402.91.42 and 6402.99.32 at rates of 20% instead of 37.5%. This provision applies to footwear "designed for outdoor activities, such as hiking shoes, trekking shoes, running shoes, and trail running shoes, the foregoing valued over $24/pair and which provides protection against water that is imparted by the use of a coated or laminated textile fabric." However, outside of this one limited exception, designing shoes that include protections against the elements will result in incredibly high duty rates.

Miscellaneous Tariff Bill Process

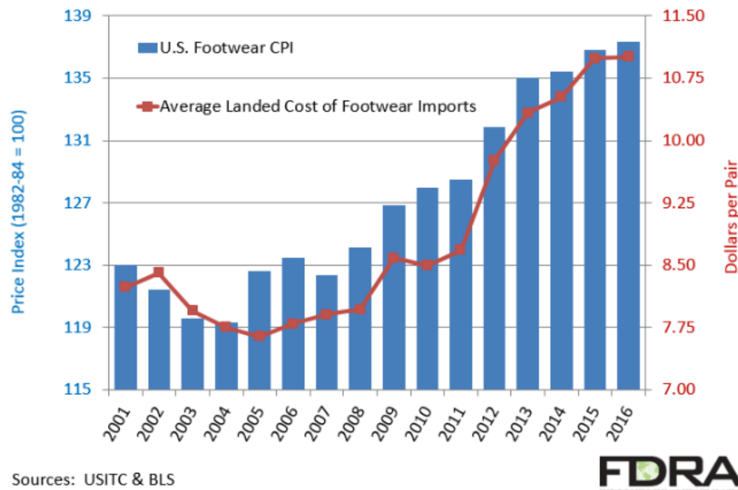
As highlighted during the February 9th hearing, Miscellaneous Tariff Bills (MTB) have been an important tool used by Congress to provide some tariff relief to the industry, although the benefits for footwear companies are limited. MTBs provide only temporary relief and require that the revenue loss to the U.S. Government resulting from each product included in the MTB not exceed $500,000 annually.

The industry had an annual tariff bill of nearly $2.9 billion in 2015 and paid approximately $48.2 billion in footwear tariffs to the U.S. Government over the past 28 years. By comparison, MTBs have saved footwear companies close to $150 million over time. FDRA believes, however, that it is important to achieve duty reduction wherever possible, and MTBs have been very important for certain types of footwear, in particular certain children's footwear, value footwear, and outdoor footwear. Congress approved MTB duty relief for these items for a three-year period in 2006 and renewed the MTB relief for the majority of these items again in 2009 for a three year-period.

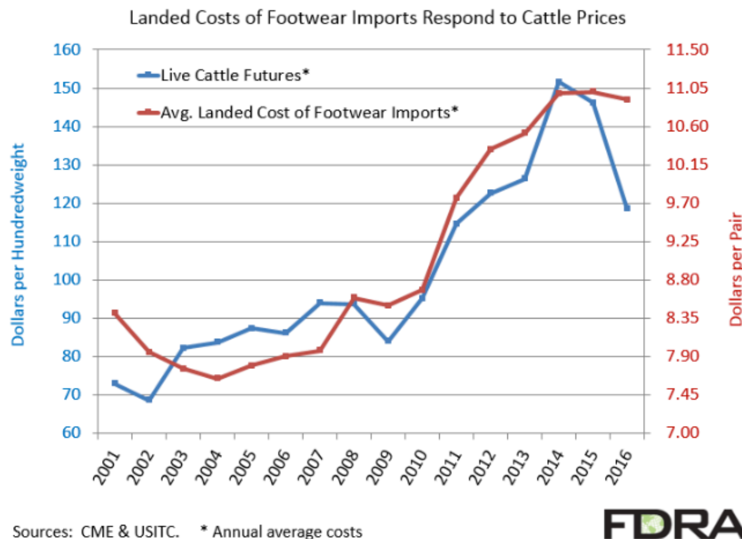
The relief lapsed in 2012 in the absence of an MTB, and as a result, there has been no MTB duty relief for footwear companies over the past several years. Congress created a new MTB process in 2016 with the American Manufacturing Competitiveness Act (Public Law 114-159). In expressing the need for the new process, Congress found that the U.S. Tariff Code "imposes duties on imported goods for which there is no domestic availability or insufficient domestic availability [and] the imposition of duties on such goods creates artificial distortions in the economy of the United States that negatively affect United States manufacturers and consumers." With the new process in place, 112 footwear petitions have been filed, and FDRA looks forward to working with the Commission and Congress throughout the process.

Explanation of the Increased Landed Costs for Footwear

During the February 9th hearing, Commissioner Broadbent asked about the factors causing the increase in the average landed cost of footwear imports displayed in the graph submitted in FDRA's Pre-Hearing Brief (see graph below).



The average landed cost during this period was impacted in part by labor cost increases in China, still the largest supplier of footwear to the U.S. market. As a result, many companies have shifted part of their production to Vietnam, Ethiopia, and other countries. In addition, one of the key factors contributing to the increased landed costs from 2008 through 2016 was the rise in the price of inputs used to make footwear. Over the same period there was a significant and steady increase in the price of cattle used in leather production (see graph below). Rubber prices also increased during the period from 2009 to 2012 before declining; the demand for rubber or synthetic leather as a substitute good would be impacted by the rise in cattle prices as well. With increasing labor costs and input costs that impact consumer prices, tariff reduction for footwear remains an important and meaningful way to drive greater consumer value.



March 7, 2016

The Honorable Michael Froman
United States Trade Representative
600 17th Street Northwest
Washington, D.C. 20508

Dear Ambassador Froman:

As leading footwear domestic manufacturers, we write to express our support for the Trans-Pacific Partnership (TPP). We are strong supporters of TPP because it would strengthen our domestic manufacturing facilities while adding new jobs for Americans in trucking, warehousing, retail and port logistics.

Tariffs on footwear average over ten percent and can reach up to 67.5 percent. These high rates have done little to keep footwear manufacturing jobs in America. We continue to manufacture in the U.S. to meet the needs of specific market segments, but in order to remain competitive, we also import large numbers of shoes to meet the diverse demands of American footwear customers. Rather than help us keep manufacturing jobs, these tariffs today only serve as an added cost in our supply chains and a hidden tax on American consumers. In addition, international tariffs from countries like Japan restrict our ability to export shoes to new consumers.

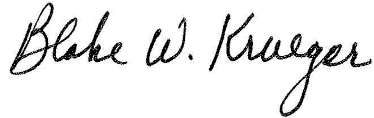
The hundreds of thousands of Americans employed in the U.S. footwear industry, including those who work in our factories in Michigan, Georgia, Pennsylvania, and Oregon, depend on the ability of our companies to remain globally competitive and deliver footwear to consumers all over the world. We strive to make the most innovative products and provide the greatest value to consumers, but struggle with a complex and outdated tariff system here in the U.S. and abroad.

TPP would greatly benefit our industry, because it would reduce some of the outdated duties that limit footwear job creation. The savings that TPP would provide to our industry — $450 million in the first year alone and $6 billion over the first decade — could be used to strengthen our domestic operations. Further, lowering barriers in foreign markets through TPP means that we could see meaningful growth in footwear exports. By both lowering costs on our imported products and allowing us to sell more of our American-made footwear abroad, our companies would be stronger financially and would be able to invest back into our domestic operations.

Thank you for working to advance this important agreement for U.S. footwear companies and consumers. Our plants are always open to a visit from you or any government official to see and hear firsthand how tariffs impact our workers. We remain active partners with the entire footwear industry through the Footwear Distributors and Retailers

of America (FDRA) in helping press for congressional approval of TPP. Please do not hesitate to reach out to us if we can support your efforts on Capitol Hill as well.

Sincerely,



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