BEWARE, MR. PRESIDENT, OF BACKDOOR PROTECTIONISM

A petition from Houdaille Industries, a little-known Florida machine tool company, is stirring up considerable debate among top U.S. trade and White House officials. Soon it will land on Ronald Reagan's desk for a final decision. What is involved is a dangerous precedent for backdoor protectionism.

Whatever its outcome, the petition will have important implications for Japanese industrial policy, the durability of established procedures for resolving international trade disputes and--especially--for credibility of the Reagan free trade stance.

Houdaille Industries is asking the President to invoke an obscure provision of the Revenue Act of 1971 to deny to American firms the 10 percent investment tax credit (ITC) if they purchase certain Japanese machine tools. Section 103 of the Revenue Act gives the President total discretion to deny the ITC to imports from a country that "engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce." If the President agrees with the petition, it will be the first time the section will have been invoked.

Houdaille wants the President to unsheath this tax weapon because the Japanese machine tool industry, it claims, has been cartelized with the tacit approval of the government, and has received substantial government subsidies from export programs and motorcycle and bicycle racing revenues. The Japanese, on the other hand, maintain that no cartel exits and that the government subsidies are minimal.

The U.S. Senate already is lined up with Houdaille. On December 21, the Senate passed a nonbinding resolution urging the President to grant Houdaille's petition. As the President now makes his decision, he must consider the costs that a rising tide of protectionism would impose on the U.S. economy and consumer.

Machine tools are key components of nearly every industrial firm, and particularly to the $200 billion capital goods industry. If the investment tax credit is denied to imports, machinery purchasers either would have to pay 10 percent higher prices for the Japanese imports (since there would be no ITC), or buy U.S. products which they apparently do not prefer. Either alternative would endanger the worldwide competitiveness of U.S. industry and undermine the President's call to retool and modernize the U.S. industrial base.

Closely watching what Reagan does is the U.S. semiconductor industry, telecommunications, robotics and automobile companies. They may be ready to leap into the protectionist queue. Section 103 of the Revenue

Act of 1971 is so open ended and vague that it could open up the floodgates to companies seeking to shut out foreign competition. Foreign countries then could not be expected to watch placidly as their exports are discriminated against in U.S. markets. As a major exporter of capital goods, the U.S. would end up a big loser if foreign countries retaliated by denying U.S. exports similar tax advantages.

The Administration should resist opening this Pandora's box of protectionism. There are already legal procedures available to U.S. companies facing unfair foreign export subsidies and these remedies, unlike Section 103, quite properly put the burden of proof on the company.

The Houdaille petition, however, touches a much more sensitive nerve than alleged subsidization. By implication, it questions the fairness of the Japanese economic system in general. Just how important is the Japanese policy of government-industry collaboration? Is it fair to U.S. competitors? Many close observers of the Japanese system feel that it is fair and that market forces dominate economic decisionmaking in Japan. Even U.S. machine tool industry spokesmen concede that Japanese manufacturers have succeeded largely by offering the world's most technologically advanced machine tools, at the cheapest price, and with the quickest delivery times--in short, by being the best world-wide competitors. Indeed, the National Machine Tool Builder's Association, of which Houdaille is a member, sent a study mission to Japan in 1981 and discovered no significant subsidies to the Japanese machine tool industry and no evidence of a machine tool cartel.

As for subsidies in general, it is a sin of which the U.S. too is guilty. The U.S. Export-Import Bank, for instance, provides subsidized long-term loans to purchasers of U.S. exports, the Agriculture Department sets minimum prices for wheat, dairy, and other products, and the Overseas Private Investment Corporation (OPIC) provides loan guarantees, advisory services, and insurance against political risk.

The Japanese machine tool market is dynamic and highly competitive. The share of Japanese production accounted for by the top five producers has declined by 30 percent between 1968 and 1981--hardly a classic cartel. In short, the Japanese machine tool manufacturers do not appear to owe their success to unfair or collusive government.

This won't stop some hard hit American firms from crying foul, but the President should deny the Houdaille petition for what it really is: a subtle form of backdoor protectionism.

Thomas M. Humbert
Walker Fellow in Economics

For further reading:

Regulation magazine, The American Enterprise Insitute, January/February 1983, pp 6-8.
Robert Samuelson, "Industrial Deception," National Journal, October 16, 1982, p. 1763.
Senator Steve Symms, "Fair Trade," Congressional Record, January 26, 1983, pp. 66-78.