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S. 490: PROTECTIONISM'S DANGEROUS LOADED GUN

INTRODUCTION

Even as the U.S. trade deficit begins to climb out of the red, as the U.S. manufacturing sector grows more efficient, and as the U.S. economy continues to add hundreds of thousands of new jobs, Congress is playing with an economically dangerous loaded gun--protectionist trade legislation. The House of Representatives has passed a bill, H.R. 3, which would force the President to erect protectionist barriers against countries running arbitrarily defined "excessive" trade surpluses with the U.S. Economists, liberal and conservative, denounce this as economic suicide. Now the Senate will flirt with protectionism as S. 490 reaches the floor for debate in the coming weeks.

The U.S. trade deficit has fueled much of Congress' drive for trade legislation. These measures in part are aimed at opening foreign markets further to U.S. goods, but they also would close the U.S. market to imports.

These bills seriously misunderstand the causes of the U.S. trade imbalance. Foreign protectionism, for example, has relatively little to do with the U.S. trade deficit. Though some barriers exist to U.S. goods overseas, particularly in Japan, few new trade barriers have been imposed in recent years. In fact, over the last five years, the U.S. has erected more new restrictions to imports than have its major trading partners. Ironically, the trade deficit to a great extent results from America's economic strength, high rate of job creation, and dynamism. These factors have kept the level of U.S. exports generally flat in the last few years. There are three reasons for this:

1) **A strong dollar** was created by the robust U.S. economy; this pushed up the prices of American goods in overseas markets;

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2) A huge American demand for imports has been created by the expanding U.S. economy.

3) The economic weakness of many U.S. trading partners has meant that they have been less able to purchase U.S. products.

The trade legislation now pending does not address these fundamental causes of the U.S. trade imbalance. All that the bills would do is protect a few local interests at the expense of the rest of the U.S. economy. What is worse, the emphasis on the trade deficit diverts attention from congressional refusal to deal with the darkest cloud on America's economic horizon: the high level of federal spending.

America's existing trade laws, meanwhile, generally are adequate to deal with such trade problems as import surges that harm U.S. industries or unfair foreign trade practices. If anything, these regulations too easily allow special interest groups to obtain trade protection on dubious grounds. Both the House and Senate bills would make it easier still for these groups to restrict imports.

Paying Too High A Price. Although existing laws can deal with the trade issue, many members of Congress nonetheless feel that they must do "something" to show their concern over the trade deficit. The Reagan Administration has said it will accept a trade bill this year as long as it is not overly protectionist. The primary goal of the Administration is to gain an extension of its authority to negotiate international trade liberalization in the new round of General Agreement on Tariffs and Trade (GATT) talks. Authority runs out early next year. The Administration, however, may pay much too high a price for this authority if it is forced to accept the provisions of the pending trade bills.

Once the Senate passes its trade bill, representatives of both Houses will meet in conference to work out a compromise. If this passes both Houses, it will go to the President for signature or veto. The two bills are different enough to require extensive changes in the conference committee. And since both bills currently contain provisions unacceptable to the Administration, the conference committee will have to eliminate key protectionist provisions to avoid a veto.

Promoting Exports. The Senate bill fails to meet the Reagan Administration's free trade criteria on several counts. First, changes in the current trade law governing relief for U.S. firms from surges of foreign imports would remove the President's discretion to decide what degree of relief, if any, is appropriate. Proposed changes in the law would make it easier for U.S. industries to gain trade protection even if imports are not the primary cause of their economic difficulties. In addition, attempts in the draft Senate bill to mandate retaliation against countries unfairly restricting access to their markets for U.S. goods would weaken America's ability to deal with such practices. Finally, a number of possible floor amendments to the Senate bill would violate the GATT, thus undermining the Administration attempts to open overseas markets further to U.S. goods.

Rather than these economically unwise proposals, the Senate should consider ways to promote open markets and U.S. exports. Among them: extending the President's authority to negotiate in the new round of GATT talks, allowing the President to negotiate Free

Trade Areas with nations desiring free trade and completely open markets, and strengthening the protections for the patents and intellectual property of U.S. companies.

IMPORT INJURY RELIEF: SECTION 201 OF THE 1974 TRADE ACT

The GATT treaty of 1947 does not permit countries to increase tariffs above existing levels or to impose quotas, except under such special circumstances as when a sudden surge of imports makes it difficult for the domestic industry to adjust in a timely manner. Section 201 of the U.S. Trade Act of 1974 states that, when such a special situation exists, an industry that believes it is suffering damage from foreign imports can ask for temporary trade restrictions, to facilitate an orderly adjustment to the new market situation. In these circumstances, the domestic industry does not allege unfair trade practices by foreigners, only import injury. Such cases usually are handled by the U.S. International Trade Commission (ITC), which is an independent, quasi-judicial federal body dealing with these matters. The ITC determines whether injury has occured primarily as the result of imports and what, if any, trade remedy is appropriate. Protection usually comes in the form of quota restrictions on imports. The President can accept or reject the ITC recommendation or devise his own plan.

Reducing Incentives to be Competitive. Proponents of this system maintain that temporary trade restrictions allow the market to adjust more smoothly. It is questionable, however, whether this approach has been effective. Behind a wall of trade protection, industries have less incentive to modernize and become more competitive. They often avoid making hard business decisions. Example: periodic protection since the late 1960s has enabled American steel producers to boost salaries for their workers faster than their productivity increased. At the same time, the steel makers were able to avoid investing sufficiently in capital improvements. The predictable result: American steel today is more expensive than most foreign steel and thus is in as poor a competitive situation as it was when protection measures began.

In light of this experience, any revisions of Section 201 of the Trade Act should not hinder the market adjustment process. When the Senate addresses Section 201, it thus should:

1) Not weaken or remove the President's power to accept or reject ITC relief recommendations.

The Senate bill as now drafted would force the President to accept ITC import relief recommendations, allowing him only to make minor changes in the form of relief but not in its degree or amount. Yet the President is in a better position than the ITC to take the broad and long view, balancing the interests of a particular industry suffering injury due to imports against the interests of American consumers, workers, other industries, the economy in general, and foreign policy concerns. The ITC by its nature focuses only on the case before it and cannot make such evaluations. Further, the kind of trade relief that the ITC is empowered to recommend can have profound effects on the U.S. economy. To entrust such decisions ultimately to a small panel of political appointees, no matter how well meaning they may be, puts too much power in the hands of unelected officials. The President should retain this check over ITC decisions.

2) Allow all ITC commissioners to continue to vote on the form of relief.

When a Section 201 injury case is brought before the ITC, the panel first must decide whether the domestic industry has been injured by imports. If a majority of the commission so decides, a separate vote is taken on what relief, if any, is recommended for the industry. All ITC commissioners now participate in both votes. The draft Senate bill, however, would prohibit ITC commissioners who do not find imports to be the primary cause of injury from voting on injury relief. This would mean that the tempering influence of the dissenters would be missing in determining a remedy. Dissents on whether imports are the primary cause of injury are often on solid economic grounds. For example, a commissioner might maintain that a failure of the domestic industry to invest in capital improvements was more important as a cause of an industry's problems than were imports. Such a commissioner's vote on a form of import relief would add a valuable voice to the decision making process.

3) Not narrow the definition of an "industry" suffering injury.

The draft Senate bill would require the ITC to focus only on the domestic production facilities when determining whether an industry is suffering injury from imports. This contradicts the goal of Section 201, which is to aid trade adjustment. Example: a healthy American electronics firm might have weak domestic production facilities but strong overseas branches. Therefore, although the firm would already be "adjusted" to the international economic situation, with a profitable mix of domestic and overseas facilities, it could still receive protection.

By ignoring overseas facilities and operations in the definition of any "industry," the ITC could rule to cut off the very cure for an industry's competitiveness problems: imports. The U.S. auto industry, for example, has grown more competitive by importing certain automobile models as well as parts for their domestic production lines. It would be economically damaging, therefore, to narrow the definition of an industry.

4) Not weaken the criteria for determining whether imports are the cause of an industry's troubles.

The ITC now can find an industry to be injured by imports only if import pressures are as important a cause of problems as any other single factor. Example: if decline in domestic demand is a more important cause of an industry's difficulties than imports, then the current law does not permit import relief to be granted. The draft Senate bill basically would exclude a general business cycle downturn as a factor to be considered by the ITC when seeking the cause of injury. Specifically, the Senate provision would require that a recession be broken down into its many constituent economic parts, such as unemployment and low consumer demand. This would mean that, during a recession, many industries that are not suffering primarily because of imports nevertheless could receive import relief. In such a case, Section 201 could not be claimed to be aiding market adjustment of the industry.

5) Not tie injury rulings to other unfair trade practices.

The draft Senate bill would consider foreign government assistance to an exporting industry or the presence of an anti-dumping or countervailing duties ruling against a

foreign industry as prima facie evidence of injury to U.S. industries. This proposed provision confuses the purpose of Section 201, which clearly is to provide trade adjustment relief for U.S. industries injured by legal imports. Section 201 is not designed to deal with unfair trade practices. Other U.S. statutes deal with this. Quota restrictions on imports meant to aid U.S. industries in the adjustment process are not the appropriate remedy for unfair trade practices.

6) Avoid using trade adjustment plans as a basis for government economic planning.

A frequent criticism of the Section 201 trade relief process is that it does not discriminate between industries that could become competitive with time and those destined to shrink due to changing economic factors. It is understandably difficult for the ITC or the President to judge what would be a proper relief plan if it is not clear whether the goal of relief is to help a domestic industry cut back operations in an orderly fashion or to help it become more competitive. The draft Senate bill requires that an industry seeking relief from the ITC state its adjustment prospects. Further, the ITC is instructed to develop relief appropriate to promote the stated goal of the industry.

In one sense this proposed Senate provision points to the flawed nature of the Section 201 process. The best way for an industry to become competitive or to scale back its operations, of course, is to react to market changes as they occur. Government trade relief usually only slows the process.

Ghost of Industrial Planning. This Senate proposal should not become a disguised form of what sometimes are called "plan development groups" or PDGs. Consisting of representatives from the industry's management, labor unions and federal government officials, a PDG ostensibly would formulate a strategy to make the industry competitive. PDGs are obviously a form of national industrial planning that would give some ailing industries government subsidies and trade protection at the expense of more dynamic, expanding industries, and the U.S. consumer and taxpayer. The Senate Finance Committee wisely rejected such planning groups when the trade bill was marked up. Yet the requirement that an adjustment plan be filed by an industry petitioning the ITC for relief invites amendments on the Senate floor or other future provisions in the direction of national industrial planning. Such moves should be avoided.

7) Reject quota auctioning.

ITC relief for import injury usually takes the form of quotas that limit the quantity of goods entering the U.S. market. Quotas are a particularly wasteful means of trade protection. Since they limit competition, the domestic industry is usually slower to adjust to economic changes. Quotas also allow both the domestic and foreign suppliers to charge higher prices for their goods. With quotas, the U.S. consumer loses, while foreign and domestic manufacturers gain enormously. Preferable to quotas are tariffs. They would allow complete market access for foreign firms, though at a price. This ensures greater competition than do quotas. Tariffs, at least, yield extra revenues to the U.S. Treasury rather than higher profit margins to foreign manufacturers. The problem is that using tariff increases as a form of injury relief runs into GATT legality problems.

In an attempt to use features of both quotas and tariffs, the draft Senate bill calls for a pilot program to auction quota rights. Foreigners would bid for the right to sell the limited amounts of a foreign good allowed in the U.S. under quota limits. This would syphon off the quota-related profits from foreign producers and give them to the U.S. Treasury. This approach has serious problems. First, quota auctioning would mean that the largest, richest foreign businesses would shut out their smaller, yet possibly more efficient, foreign rivals, restricting market competition even further. Second, the revenue generated would give politicians incentives to continue quotas long after they had outlived their ostensible usefulness. Quota auctioning would pile worse economic policy on bad and thus should be avoided.

UNFAIR TRADE PRACTICE RELIEF: SECTION 301 OF THE 1974 TRADE ACT

Section 301 of the 1974 Trade Act gives the President a tool to deal with other countries' unfair practices and to secure their adherence to accepted international trade practices. If these countries deny U.S. exporters or businesses access to their markets, or otherwise discriminate against American businesses, the affected businesses can file a complaint with the U.S. Trade Representative. The USTR, with presidential approval, then decides whether to conduct an investigation. Should unfair trade practices be identified, Section 301 allows the President to act against specific foreign industries.

Threat of Sanctions. Section 301 also requires the U.S. to attempt to negotiate a resolution to each dispute. In some 40 percent of Section 301 cases over the past decade, the dispute was settled by negotiation, without imposition of sanctions. The threat of sanctions apparently has been enough. If action is necessary, the President can impose added duties or import restrictions or remove other trade privileges extended by the U.S. to the offending country.

The Reagan Administration has made a more vigorous use of Section 301 than any previous administration, initiating a number of cases where unfair trade restrictions by foreign countries were suspected. Yet the Senate's draft bill would change Section 301 in a way that would make it more difficult to open markets both in the U.S. and overseas. When the Senate addresses Section 301, it thus should:

1) Not mandate trade investigations and automatic retaliation.

In several of its provisions, the draft Senate bill would require the Administration to identify countries engaged in "adversarial trade" practices that close their markets to U.S. goods, create market distortions, or violate fair trade agreements. If the investigation concludes that "adversarial trade" practices do exist, negotiations must be initiated to eliminate them. If negotiations fail, retaliation is mandated.

Because the Senate's proposals would set strict timetables and guidelines by which the President must proceed in Section 301 cases, Administration flexibility would be limited. The result probably would be that the U.S. would be less successful in opening foreign markets. The reason: the new restrictions would create an incentive for Administration officials to avoid initiating any cases that they are not certain they could win or in which they would not be willing to see mandatory sanctions applied if negotiations failed. The President and the Administration would have a strong incentive not to initiate as many

unfair trade cases as they have. Much of the success so far has been due to the ability of the Administration to be flexible.

2) Avoid defining anti-competitive practices in terms of economic activities by private firms.

One provision of the draft Senate bill redefines as an unfair practice under Section 301 the "toleration by a government of systematic anti-competitive activities by private firms" that allegedly restrict the market. Actions by private businesses, however, logically cannot be considered anti-competitive or restrictive. It is the right of businesses, as with individuals, to buy from whom they please and to contract with others on whatever terms are mutually agreeable to the parties involved. The Senate bill would allow U.S. businesses that do not make sales to private firms in foreign countries, where no foreign government restrictions are involved, to obtain U.S. government intervention to secure such sales. If the foreign government involved fails to force its firms to "buy American," the U.S. government could retaliate by closing the American market. Section 301 cases should focus only on market restrictions by foreign governments, not on the free choices of private businesses.

ANTIDUMPING AND COUNTERVAILING DUTY CASES

If a foreign industry persistently sells its products in the U.S. at a price below the cost of production (a practice called "dumping") or if a foreign country subsidizes its exports, U.S. businesses can complain to the International Trade Commission. If the ITC determines that dumping or illegal subsidies have occured, the Administration can impose countervailing duties on the offending country to deny it the advantage gained by such practices.

Dumping is a dubious economic concept. Often it is a legitimate and acceptable business practice, for example, to sell below the cost of production to launch a new product line or to liquidate inventory as the price of an item drops. Private businesses cannot, of course, continue to sell goods below the cost of production indefinitely.

If dumping depends on a government subsidy, then an unfair practice clearly is involved and action is appropriate under U.S. law. While subsidies to foreign goods imported by the U.S. give the American consumer a bonus, they distort the market. It thus is reasonable for the U.S. government to counter such practices. In devising countermeasures to dumping and foreign subsidies the Senate should:

1) Reject reforms that violate GATT and other international trade agreements.

Amendments will likely be offered to the Senate bill that could allow retroactive penalties to be applied to parties violating dumping and subsidy restrictions, could allow a previous dumping offense to be proof of guilt in a current case, or could apply punitive penalties to offenders. These measures violate GATT provisions. In antidumping and countervailing duties cases, according to the GATT, injury must be proved; relief must be offsetting, not punitive, and it must be prospective, not retrospective. Violating the rules of the GATT would make it more difficult for the U.S. to push at the Geneva GATT talks for freer, more open markets.

2) Not allow a private right of action for dumping cases in U.S. courts.

The standards governing international trade, especially the definition of "fair" or "unfair" trade, is determined by the GATT and other international agreements. The U.S. International Trade Commission was established to deal with cases arising under U.S. trade laws which conform to these agreements. The Secretary of Commerce has the job of administering these laws against foreign offenses. An amendment expected to be introduced by Senator Arlen Specter, the Pennsylvania Republican, would allow private companies to sue for damages in U.S. courts over alleged dumping by foreign businesses. This would violate current international trade laws. The GATT authorizes only one course of action against dumping, that is, the imposition of duties to offset the amount of the dumping. The Specter Amendment, meanwhile, would be likely to trigger similar foreign legislation against U.S. exports. And foreign judicial systems dealing with such cases are likely not to be as insulated from interest group political pressure as is the American system. The amendment also would undermine the Administration's ability to strengthen international laws against unfair trade practices in the new GATT round. In addition, a private right of action would have a chilling effect on U.S. importers, since they could never be certain whether they might be held liable for dumping damages resulting from overseas purchases. Finally, such cases might well drag on for years, assuring that the offending practices would not be dealt with on a timely basis.

RECOMMENDATIONS

Many of the trade reforms in the Senate bill are economically unwise or prompted by protectionist sentiments. Rather than solving trade problems they would lead to market restrictions that would harm U.S. consumers and reduce America's international competitiveness, while making it more difficult for the Administration to deal with genuine unfair trade practices.

Some new trade measures, however, are needed to help keep markets open, keep U.S. industries competitive, and lead to a fairer trading system. Among them:

1) Extend presidential authority to negotiate in the new GATT round.

The new round of GATT negotiations could lead to important trade liberalization. The President's authority to negotiate on a "fast track" basis runs out next January 3. Normally, any agreement submitted to Congress for approval would be subject to amendments. In the case of the GATT, a trade agreement with over 90 countries, amendments would mean renegotiating the entire accord with all parties, a practical impossibility. "Fast track" authority means that the treaty is voted for on a timely basis by Congress, with no amendments. Extension of this authority is necessary if trade liberalization is to proceed.

While the Senate bill does reauthorize "fast track" authority, it also contains a provision that undermines the negotiating process, the so-called "reverse fast track" procedure. This would allow Congress to revoke negotiating authority if both Houses voted within 60 days of one another to do so. Such a provision would make Administration officials less credible in GATT negotiations, forcing them constantly to look over their shoulders at Congress to avoid having the rug of authority pulled out from under them.

2) Grant "fast track" authority for the President to negotiate Free Trade Area arrangements with countries desiring open markets.

The U.S. is currently phasing in a Free Trade Area (FTA) agreement with Israel and negotiating such an agreement with Canada. In an FTA, both countries drop substantially all tariff and quota barriers to one another and attempt to eliminate non-tariff barriers on such matters as service trade, which is particularly important to the U.S. FTAs provide a quicker way for countries to move toward free trade than does the slower and more limited GATT process.

"Fast track" FTA negotiating authority would allow the Administration to liberalize the trade environment much more quickly. Further, FTAs tend to encourage market openings by countries not a party to such agreements. For example, if the U.S. has an FTA with Canada, American goods enter Canada with no restrictions while Japanese goods still face Canadian tariffs. The Japanese are thus at a disadvantage and therefore have an incentive to seek similar trade privileges. The price, of course, would be a Japanese market opened more to U.S. and Canadian goods.

3) Do not require U.S. patent holders to prove economic injury to secure relief when U.S. patents are stolen and illegally used.

An important function of the ITC is to protect the property rights of U.S. companies against patent and trademark violations by foreign concerns. In some cases, however, the principle of property rights is not applied adequately. Sometimes the ITC, for example, requires that a U.S. company not merely prove that its patent has been stolen, but that its business is adversely affected by the importation of the illegally produced goods. Such an "injury test" is inappropriate. At issue is property rights. If an unscrupulous author took another man's published work, replaced the true author's name with his own, published it, and tried to market it as his own work, the case clearly would be one of theft--no one would ask about the impact on sales of the original work. The Tariff Act of 1930 (19 U.S.C. Sec. 1337), which deals with this issue, should be amended to make clear that an injury test is not necessary in the case of a stolen patent.

CONCLUSION

In its present form, the Senate trade bill almost certainly will be vetoed by Ronald Reagan. The President has said, however, that he will sign a trade bill that does not contain protectionist provisions and that promotes trade liberalization. To avoid a veto, the Senate should exclude from the current draft of S. 490 provisions that: 1) limit the President's discretion to decide what trade relief, if any, is appropriate for industries injured by import surges, 2) mandate retaliation for alleged unfair trade practices, and 3) violates provisions of the GATT.

By contrast, the bill should promote open markets and U.S. exports by: 1) granting "fast track" GATT negotiating authority without restrictions, 2) granting "fast track" authority to negotiate Free Trade Areas with countries that desire completely open markets and fair trade, and 3) protecting the patents and intellectual property rights of U.S. companies.

The purpose of U.S. trade laws is to promote freer world trade, open foreign markets to U.S. goods and oppose unfair trade practices. The protectionist provisions of the Senate bill would harm U.S. consumers and, in the long run, make U.S. industries less competitive. The advantages of free markets and free trade are rarely overestimated. The resulting economic efficiency and growth raise the standards of living for all countries involved. The Senate should not give in to the impulse to take short-term actions to do "something" about the trade deficit that in the long run will undermine America's economic prosperity.

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