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INTERNATIONAL TRADE

Synopsis of Recent GAO Reports on Trade Issues

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The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

The Honorable Daniel Rostenkowski
Chairman, Committee on Ways and Means
House of Representatives

Proposals now before the Senate and House would significantly amend current laws that seek to remedy unfair foreign trade practices, to offset the effects of foreign subsidization or dumping of products on U.S. markets, to protect U.S.-held intellectual property rights, and to provide effective safeguard relief to industries that are injured by imports. Additionally, the United States has entered into a new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade. Current negotiating authority expires on January 3, 1988, so continued U.S. participation depends on congressional extension of that authority.

To assist in consideration of this legislation, this report summarizes the principal conclusions and recommendations from our recent reports and testimony that analyze U.S. international trade laws and policy.

Although the pending legislation addresses real concerns of U.S. businesses that compete with foreign producers, trade law alone cannot eliminate the U.S. trade deficit. There is a growing realization that the deficit results from different economic conditions among nations and the divergent policies that they follow, and that effective responses to foreign trade practices alone will be insufficient to stop or reverse the trade deficits. One reason is that the continuing trade deficits are inherently tied to the inflow of foreign capital to the United States, which is substantially caused by the inability of the United States to finance domestic private investment and the budget deficit with domestic savings. U.S. trade laws can do little to change this capital inflow since they do not address that major underlying cause.

While trade law alone cannot guarantee that U.S. businesses will sell goods and services overseas, it can be a powerful tool to ensure that they have access to those markets. Since the U.S. economy is increasingly connected to the international economy and more U.S. production and jobs are

affected by international trade, it is essential that the rules governing it be clearly understood, carefully observed, and strictly enforced. If international trading rules that seek to ensure international competition without any unfair advantages are abandoned or inadequately enforced, U.S. industries that might have been competitive may find themselves unable to respond to foreign competition.

The 10 appendices to this letter provide brief summaries of the trade issues that we have recently examined. The appendices also outline our conclusions and those recommendations on which actions have not been completed. We did not request agency comments on this briefing report. Most of the summaries also include brief discussions of policy options advanced by others. These discussions are intended only to note the diversity of opinion on these issues. In some cases, we offer our opinion on the options. When we do not comment, however, it does not necessarily mean that we agree with the policy option.

We are sending this report to other congressional committees with responsibilities for issues it addresses. We will provide copies to others upon request.

Sincerely,

Allan I. Mendelowitz
Senior Associate Director

Contents

ABBREVIATIONS

EEP	Export Enhancement Program
FAS	Foreign Agricultural Service
GATT	General Agreement on Tariffs and Trade
GAO	General Accounting Office
ITC	International Trade Commission
USTR	U.S. Trade Representative
US&FCS	U.S. & Foreign Commercial Service

U.S. PARTICIPATION IN THE MULTILATERAL TRADING SYSTEM: GATT AND THE NEW ROUND OF MULTILATERAL TRADE NEGOTIATIONS

PRINCIPAL ISSUES

Trade experts generally agree that the international trade rules embodied in the General Agreement on Tariffs and Trade (GATT) are no longer adequate to address the current and emerging, often contentious, trade issues facing today's multilateral trading system. Fear over the specter of global trade wars is heightened by increasing protectionist demands on most domestic fronts. Frustration with the apparent inability of the GATT to stem the rise of trade barriers and to resolve trade disputes has led to questions about its utility and effectiveness and has prompted many proposals for improvement.

The new round of multilateral trade negotiations launched in Uruguay in September 1986 has a large and complex set of issues to address. The U.S. government's agenda for this new round centers on strengthening the GATT system itself and increasing multilateral discipline for the current rules, expanding world market access, and extending GATT discipline to areas currently not covered by international trading rules (e.g., services, investment, and intellectual property rights). Other countries, particularly developing and newly industrialized nations, would prefer to emphasize trade liberalization, debt, and exchange rate issues. Basic disagreement exists on whether to add new issues to the agenda when such long-standing issues as subsidies, agriculture, and the dispute settlement process remain unresolved. There are concerns that it will take years to negotiate agreements in the new round, increasing the stress on a system that is hard pressed to address current trade disputes.

Despite general agreement that the GATT system is not capable of solving all international trade problems, there are few advocates of replacing it with a new system or abandoning the effort to impose some discipline or rules on international trading practices. Many trade experts, however, are not optimistic regarding the chances for successfully completing agreements in all major agenda items for the new round. Some fear that not reaching agreements will even further weaken the multilateral system that is already under severe strain. Suggestions have been made that perhaps "sub-optimal" solutions are better than none at all--that although broad agreements may not be possible in certain areas, agreements that address only specific issues or that are entered into by some, but not all, GATT signatories might be realistic goals. Such agreements addressing major issues, including subsidies and government procurement, were in fact the major

achievements of the Tokyo Round, which concluded in 1979. Bilateral negotiations (such as the proposed U.S.-Canadian Free Trade Agreement) have also been advocated to complement GATT negotiations and to provide guidelines and impetus to eventual multilateral agreements.

CONCLUSIONS

In a number of reports on the GATT system and various multinational agreements,[1] we concluded:

-- Despite difficulties, GATT has made significant contributions to a more open, competitive flow of world trade. GATT objectives are generally in consonance with U.S. trade policy objectives, and it is in the interest of the United States to continue to support the GATT system and principles.

-- Although the effects of non-tariff measures on world trade have become increasingly important, quantifying these effects has been extremely difficult since no agreement has been reached on the best method of calculation. The negotiating strategy of reciprocal concessions that successfully led to reduced tariffs during past rounds of multilateral trade negotiations thus cannot be easily employed to reduce or remove non-tariff measures.

-- Many nations are participating in bilateral trading arrangements and taking unilateral actions that can violate the non-discrimination principle of the GATT. Further, key competitive factors in numerous market sectors are either not governed by multilateral rules or are inadequately governed. The U.S. government, along with all contracting parties, is challenged to negotiate agreements to bring these factors into GATT's multilateral framework as well as to develop creative, competitive bilateral practices which still reflect GATT

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[1]See Current Issues in U.S. Participation in the Multilateral Trading System (GAO/NSIAD-85-118) Sept. 23, 1985, The International Agreement on Government Procurement: An Assessment of its Commercial Value and U.S. Government Implementation (GAO/NSIAD-84-117) July 16, 1984, Benefits of International Agreement on Trade-Distorting Subsidies Not Yet Realized (GAO/NSIAD-83-10) Aug. 15, 1983, and The Difficulty of Quantifying Non-Tariff Measures Affecting Trade (GAO/NSIAD-85-133) Sept. 30, 1985.

principles and which may eventually spur consensus on multilateral rules.

From our analyses of specific GATT Codes or individual market sectors, we concluded:

-- Services: Over the last decade, service sector trade has grown dramatically as has the importance of services in individual countries. Agreement to liberalize service sector trading could promote increased levels of world trade and lessen or eliminate market opportunities lost because of government restraints. The extension of GATT provisions to services will be difficult, however, since myriad trade restrictions exist due to national efforts to protect domestic industries and markets. An agreement to prohibit or to limit new trade barriers may be attainable, however, and would probably have advantages over the current lack of agreement.

-- Agriculture: The GATT has evolved with some provisions that are more lenient for agriculture than for manufactured goods. These allow contracting parties' agricultural programs to pursue domestic objectives even when they adversely affect international trade. Although development of GATT rules regarding agricultural subsidies is on the agenda for the new round, better rules alone cannot eliminate U.S. trade difficulties in this area.

-- Subsidies Agreement: Our 1983 report found that using this agreement to reduce subsidies has had little success--attempts to persuade developing countries to reduce subsidies have produced few results, and reporting requirements have done little to improve disclosure of subsidies information.

-- Government Procurement: In our 1984 report, we found that the Government Procurement Agreement has not had the commercial impact originally anticipated. The U.S. government opened a greater value of procurements to foreign competition under the Agreement than did all other signatories. Many foreign procurements are too small to be covered by the Agreement and use non-competitive procurement procedures.

-- Safeguards: GATT allows nations to impose safeguard actions providing temporary import relief to declining industries but calls for that relief to be limited in its departure from GATT principles. In recent years, however,

there has been a significant increase in the number of safeguard actions that governments take outside the bounds of GATT, which are frequently called "gray area actions." Efforts to negotiate a safeguards code to govern such actions and lessen the use of gray area actions are continuing in the multilateral trade negotiations now beginning, but these negotiations still face the unresolved dilemma of finding a balance between national decisions to protect particular industries and the multilateral commitment to lessen trade barriers.

RECOMMENDATIONS

Our analysis of GATT issues has led to the following recommendations:

-- The GATT dispute settlement mechanism needs strengthening in order to resolve trade disputes more expeditiously. U.S. trade complaints brought under section 301 of the Trade Act of 1974, as amended, should not be held hostage to this international process and limits should be set, if necessary on a unilateral basis, for the maximum length of time any case can remain in the GATT dispute settlement process.

-- In negotiations to develop a Safeguards Code, the U.S. Trade Representative (USTR) should explore including auctioned quotas as an option for nations to impose temporary safeguard protection for industries that are injured by imports.

-- Since government assistance is viewed as key to the success of the Government Procurement Agreement, U.S. government efforts to inform private industry and to facilitate successful bidding should be improved.

COMBATING UNFAIR FOREIGN TRADE PRACTICES UNDER SECTION 301 OF THE TRADE ACT OF 1974, AS AMENDED

PRINCIPAL ISSUES

Section 301 of the Trade Act of 1974, as amended, gives the President broad powers to enforce U.S. rights granted by trade agreements and to attempt to eliminate acts, policies, or practices of a foreign government that are unjustifiable, discriminatory, or unreasonable and that restrict U.S. trade or violate international trade agreements. Section 301 is the primary provision in U.S. trade law authorizing the U.S. government to act against unfair trade practices that restrict U.S. export access to foreign markets (several U.S. trade laws cover unfair imports into the U.S. market). Further, section 301 creates a unique relationship between U.S. and international trade law--allowing private parties to enlist the aid of the U.S. government to combat an unfair foreign trade practice through the GATT dispute settlement mechanism.

Despite the potential strength of this provision, concerns have grown that the 301 process is too lengthy, too uncertain, and too seldom used. If negotiations with a foreign government to remove the objectionable practice are unsuccessful, section 301 directs the President to take all appropriate and feasible action, including invoking the dispute resolution procedures in international trade agreements or retaliating against the foreign government's practice. However, complaints have arisen that the "political will" to force the resolution of trade disputes has been lacking.

Various proposals have been made to strengthen section 301. There has been strong support for the concept of mandatory, automatic action in response to foreign trade agreement violations--requiring USTR to self-initiate a section 301 investigation if a foreign practice adversely affects U.S. exports to a significant extent or requiring the President to retaliate in the amount equal to the foreign restrictive practice. Imposing a requirement for automatic action would limit presidential discretion. Whether or not this would ultimately strengthen or weaken this provision is uncertain. Mandatory action in response to unfair foreign trade practices might strengthen U.S. efforts to persuade other nations to adhere to international commitments, such as the GATT. A potential drawback, however, is that removing presidential discretion could limit potentially useful negotiating flexibility.

Another proposal would reform section 301 by setting absolute and shorter time limits on the often lengthy section 301 process. Other proposals would transfer decisionmaking authority to USTR from the President, specify definitions of unfair trading practices (e.g., industrial targeting or denial of international worker rights), or set up specific reviews to assess the results of each action taken under section 301. Opponents to these proposals maintain that the statute is strong enough and broad enough as it now stands and merely requires the political will to use it to its full capacity.

CONCLUSIONS

In reviews of the section 301 process and of foreign industrial targeting,[1] we concluded:

-- Despite the power of section 301 to address virtually any unfair trade practice, including foreign industrial targeting, presidential discretion to act in response to unfair practices must balance conflicting trade, foreign policy, and national security concerns. Section 301 cannot be a panacea for all international trade problems.

-- Section 301 petitioners were often dissatisfied with the overall process, particularly the lengthy time required to resolve cases, the extent of evidence required by the U.S. Trade Representative, and the uncertainty of any eventual remedy or implementation of negotiated settlements. Indeed, petitioners assert that complaints presented in original section 301 petitions often are never fully resolved--citing that associated trade injuries often are not remedied whether or not the unfair trade practices are eliminated.

-- A credible threat of action, such as retaliation or even the initiation of a section 301 complaint, can provide leverage and serve as an important negotiating tool. In fact, the threat of action may prove more useful than the action itself, since the use of retaliation has not been fully successful in eliminating specific trade barriers cited in section 301 complaints.

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[1]Combating Unfair Foreign Trade Practices (GAO/NSIAD-87-100) March 1987, and Foreign Industrial Targeting--U.S. Trade Law Remedies (GAO/NSIAD-85-77) May 23, 1985.

-- Section 301 cases are often lengthy, with some cases taking as much as a decade to resolve. Whether or not a case must be directed to GATT dispute settlement is generally the key determinant to how long resolution will take, since time limits are often nonexistent or not met in this GATT process. Trade law experts and section 301 case participants agree that the dispute settlement process is too lengthy and needs improvement, and although this issue is set as a primary objective for the new round of multilateral trade negotiations, time limits need to be set in advance of the conclusion of these talks (which could be protracted).

RECOMMENDATION

We recommended that Congress amend section 301 to require that the USTR set a date for each section 301 case, at which time the United States would be expected to withdraw from the GATT dispute settlement process if it is not completed. The United States would then pursue other negotiating options to resolve the dispute, such as agreements with one or more nations or unilateral action. The statute should give USTR some flexibility in setting the required limit on participation, based on the complexity and sensitivity of each case.

PROTECTION OF INTELLECTUAL PROPERTY RIGHTS

PRINCIPAL ISSUES

Protection of intellectual property rights (i.e., patents, trademarks, and copyrights) from foreign infringement has emerged as one of the most important trade issues of the 1980s. Foreign firms, often operating in countries that provide no or inadequate legal protection to intellectual property rights, mass-produce protected goods for distribution in the United States and elsewhere. This activity reportedly costs U.S. business millions of dollars annually and undermines the U.S. intellectual property rights protection system.

In response to business concerns, several bills have been introduced in Congress that would strengthen the government's ability to stop counterfeit and infringing goods from entering the country. Firms currently use two separate methods to obtain government assistance. Owners of registered trademarks and copyrights can record their rights directly with the U.S. Customs Service, which is authorized, under certain circumstances, to seize imports that infringe registered trademarks and copyrights. When owners of other types of intellectual property rights, most notably patents, seek relief from foreign infringement, however, they must first obtain exclusion orders from the International Trade Commission (ITC) through year-long (18 months in "complicated" cases) proceedings under section 337 of the Tariff Act of 1930, as amended (19 U.S.C. 1337).

CONCLUSIONS

In reports that assess U.S. government efforts to stop counterfeit and infringing goods from entering the country,[1] we concluded:

-- Not all owners of U.S. intellectual property rights have access to Customs protection. Those that obtain section 337 exclusion orders must meet certain "economic" tests unrelated to intellectual property protection. These tests require firms seeking relief under section 337 to demonstrate that (1) there is a domestic industry, (2) it is efficiently and effectively operated, and (3) the

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[1]International Trade: Strengthening Trade Law Protection of Intellectual Property Rights (GAO/NSIAD-86-150) August 1986, International Trade: U.S. Firms' Views on Customs' Protection of Intellectual Property Rights (GAO/NSIAD-86-96) May 1986.

imported counterfeit or infringing goods have the effect or tendency to destroy or substantially injure that industry.

-- The ITC could improve its administration of section 337 proceedings by decreasing its (1) 7-month time frame for providing expedited temporary relief to firms needing immediate assistance and (2) 12-month time frame for providing relief when the case is uncontested.

-- Obtaining Customs assistance does not ensure that counterfeit and infringing goods will not enter the country. Firms that had obtained Customs assistance reported that imports that counterfeit or infringe goods protected by Customs continued to enter the country. Many of these firms reported that these counterfeit and infringing imports damaged sales and consumer confidence in their products.

RECOMMENDATIONS

We recommended that Congress amend section 337 for cases involving intellectual property rights to:

-- Eliminate the requirement that a complainant be efficiently and economically operated, eliminate the domestic industry requirement, and redefine the injury requirement so that ownership of a valid and enforceable intellectual property right and proof of infringement by imports is sufficient to meet the injury test.

-- Decrease the time required for (1) firms needing immediate government assistance to obtain expedited temporary relief and (2) firms participating in uncontested proceedings to obtain permanent relief.

-- Authorize the ITC to direct the Customs Service to seize counterfeit or infringing goods when there is evidence that a firm or firms have on more than one occasion attempted to bring such goods into the country in knowing violation of an exclusion order.

IMPORT RELIEF UNDER SECTION 201 OF THE TRADE ACT OF 1974, AS AMENDED

PRINCIPAL ISSUES

Section 201 of the Trade Act of 1974, as amended, can provide domestic industries with a period of relief from import competition when imports are a "substantial cause of serious injury." Temporary import relief is intended to provide the industry with an opportunity to adjust to import competition. The relief is granted if (1) the ITC determines that the industry has been seriously injured and (2) the President decides that temporary protection of the injured industry is in the national economic interest.

Businesses have complained that the process of first obtaining an ITC injury determination and then presidential approval of relief is a long, costly process with no reasonable assurance of the outcome. Some trade analysts note that industries that receive protection provided under section 201 almost never successfully adjust to import competition, despite the high costs that such protection imposes on U.S. consumers and other sectors of the U.S. economy.

Various proposals have been advanced to lessen or remove presidential discretion, to lessen reliance on quantitative restrictions as methods of providing relief, or to change the adjustment strategies. To counter the uncertainty of relief under section 201 some analysts have urged that the relief be automatic after an ITC injury determination.

Some other proposals would require tariff protection under section 201 and allocate revenues to adjustment assistance. Alternative proposals would also allow auctioned quotas, with some of the proposals calling for the revenues to be allocated to adjustment.

Finally, there are proposals that would mandate that the adjustment strategies be governed by government, industry, and labor tripartite advisory boards. Such boards have the potential advantage of bringing the major players together and promoting a free exchange of information. Opponents of such plans, however, warn that the boards can become self-perpetuating bureaucracies that do not encourage any greater exchange of information than occurs without them.

CONCLUSIONS

In reviews of the administration and effectiveness of section 201 import relief,[1] we concluded:

-- The protection afforded by tariffs changes unpredictably as exchange rates and other external factors change. Despite the advantages of tariffs (closer adherence to principles of transparent and minimally disruptive protection), quantitative restrictions are most often used although they impose severe costs on the U.S. economy.

-- There is not a sufficient link between protection under section 201 and industry efforts to adjust to import competition. Industrial adjustment is a key element in the success of import relief, but many adjustment strategies are not well monitored.

-- In considering section 201 petitions, the ITC is not bound by precedent; individual opinions since passage of section 201 have not consistently clarified ITC's reasoning regarding the relative weights assigned to the criteria set out in the law for determining injury. This may increase the uncertainty of the outcome. The ITC also may be relying on incomplete and unverified data. Presidential decisions to deny relief also may not provide a sufficiently detailed reasoning to guide future petitioners.

-- The presidential decision to protect an industry is a necessary component of the import relief process, since section 201 relief can impose costs throughout the economy, requiring that the value of the relief to the industry be balanced against the national interest. The President is in the best position to make that judgement.

RECOMMENDATIONS

Our reviews resulted in the following recommendations.

-- To lessen the costs of quantitative restrictions but avoid the uncertain level of protection afforded by tariffs, the

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[1]Changes Needed in Administering Relief to Industries Hurt by Overseas Competition (GAO/NSIAD/ID-81-42) Aug. 5, 1981, and International Trade: Trade Law Remedies Under Floating Exchange Rates (GAO/NSIAD-87-14) Dec. 16, 1986.

Secretary of the Treasury should direct that the Department of the Treasury experiment with quantitative restrictions implemented through an open auction of import licenses in appropriate cases. Although proposals to use the revenues from these auctions to fund assistance may have a potential advantage under international trade rules in that they specifically link the relief from import competition with the remedy of industrial adjustment, we have not recommended such an allocation because there is no assurance that the revenues will be appropriate to fund adjustment and, more importantly, such adjustment plans ought to compete with other valid claims on government funding in the normal budgetary process rather than in a separate process.

-- The USTR and/or the ITC should improve monitoring of adjustment strategies developed by the petitioners, as part of their relief petitions, examining compliance and modification to accommodate changing circumstances.

FOREIGN INDUSTRIAL TARGETING, DUMPING, AND EXPORT SUBSIDIES

PRINCIPAL ISSUES

Industrial targeting involves coordinated government assistance to a domestic industry with the goal of increasing exports of a country's products. The assistance may include explicit export subsidies, research and development subsidies, or relaxed regulatory or tax rules for export industries. There is a great concern (1) that other nations, seeing the size and potential markets of the U.S. economy, have consciously targeted U.S. markets for increased exports and have conducted policy with this goal in mind and (2) that current trade laws are not adequate to prevent the ensuing damage to U.S. industries. The problem may be compounded by delays between the government's action and the actual market impact; government efforts to foster industries may take years to show success and may have long since been eliminated when the effects are felt in the United States, thus making them no longer subject to some remedies available under U.S. trade law. Specifically including foreign industrial targeting as an unfair foreign trade practice under U.S. trade law along with export subsidization or dumping has been advocated, along with plans to address current injury stemming from past government practices.

There are several proposals to explicitly define foreign industrial targeting as an unfair trade practice, either under the countervailing duty law or under section 301. These proposals are based on a belief that enforcement of current law has not been sufficiently vigorous to prevent targeting from injuring U.S. industry and that a provision explicitly addressing targeting is needed to ensure attention to the problem and enforcement of U.S. rights under international trade agreements. Many of these proposals would mandate an automatic response to foreign targeting under U.S. trade law provisions, such as section 301.

Other concerns include the effectiveness of the countervailing duty and antidumping laws in preventing or remedying the effects of foreign subsidies or dumping practices. For example, in administering the countervailing duty law, the Department of Commerce may negotiate a "suspension agreement" with the nation offering an unfair subsidy. In return for Commerce's suspending imposition of a countervailing duty, the other nation agrees to remove or offset the offensive subsidy practice. There are concerns that such agreements are not effective methods of protecting U.S. industry against unfair competition.

If the dollar appreciates on exchange rate markets following imposition of a countervailing or antidumping duty, it can easily

appear that the industry's efforts to preserve its position in face of unfair foreign practices have failed and that the duties imposed are ineffective ways to enforce U.S. rights.

CONCLUSIONS

Broadly defined, foreign industrial targeting is a common practice throughout the world.[1] Virtually every nation offers some form of government aid that could be part of a strategy to improve national competitiveness. This aid includes such policies as U.S. government support of research and development as well as industrial policy strategies where governments are more active participants in business decisions. The line between proper and improper government involvement is not well drawn and is contentious even when international trade is not involved. Furthermore, not all government aid to industry results in improved international standing of the industry; government aid has failed in many cases. Thus, there is great difficulty in defining explicitly the nature of the targeting practices that should be specifically identified as unfair trade practices.

Despite the inherent difficulties in comprehensively defining unfair targeting, foreign strategies to unfairly aid their industries in gaining or increasing U.S. markets have been successful in many cases. We concluded that current U.S. trade law contains adequate tools for countering these strategies. If a subsidy is a demonstrable part of the strategy, the countervailing duty law can be an effective response. Section 301 of the Trade Act of 1974 is sufficiently broad in the range of unfair practices that it might address and in the range of actions that might be taken to counter foreign industrial targeting. Such actions may address current effects of past or discontinued foreign government policies, which are difficult to address under the countervailing duty law.

Suspension agreements are sometimes an effective way to achieve the goal of the countervailing duty law, which is the removal of foreign export subsidies that injure U.S. industries. Frequently, however, U.S. industries find them less effective than imposition of a countervailing duty, particularly since it is difficult to monitor compliance. Accordingly, Commerce has not used suspension agreements often.[2]

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[1]Foreign Industrial Targeting--U.S. Trade Law Remedies (GAO/NSIAD-85-77) May 23, 1985.

[2]Administration of Suspension Agreements by the Department of Commerce (GAO/NSIAD-84-125) June 15, 1984.

Finally, although an exchange rate appreciation following imposition of a countervailing or antidumping duty may damage the U.S. industry that sought relief, protection against all such subsequent injury is beyond the scope and intent of the law. The countervailing and antidumping laws are designed only to offset the injury of the unfair foreign subsidy or dumping practice, not to insulate the petitioning industry from foreign competition.[3]

Since current law appears to be adequate, we do not see a need for legislation to address foreign industrial targeting, suspension agreements, or foreign exchange effects on countervailing or antidumping duties.

[3]International Trade: Trade Law Remedies Under Floating Exchange Rates (GAO/NSIAD-87-14) Dec. 16, 1986.

APPENDIX VI

INTERNATIONAL FINANCE ISSUES

PRINCIPAL ISSUES

The long-lasting period of a strong U.S. dollar, its rapid depreciation, and large daily fluctuations in exchange rates have raised concerns that the current international monetary system based on floating exchange rates is ill-suited for the job of facilitating international trade. The concern about exchange rates and their behavior joins other persistent problems of international finance, such as high levels of debt owed by developing nations and the implications of this debt for U.S. and other developed nation banks that hold that debt. Increasingly, banking and the financial services industry in general are global industries, with transactions conducted across national boundaries, although the regulation of these industries is concentrated at the national level.

CONCLUSIONS

As national economies are increasingly closely linked by trade and financial flows, exchange rates among currencies are becoming much more important economic variables than they had been previously.[1] A wide range of other variables contributes to setting the exchange rate for the dollar, however, making it difficult to predict its behavior over any meaningful period. The difficulty in predicting exchange rate behavior occurs because the exchange rate is the price of a financial asset, much like the price of a stock or bond, and such asset prices are inherently difficult to predict accurately.

While the precise level of an exchange rate is difficult to predict, as is the exact timing and duration of longer-term swings in exchange rate trends, much of the long-term trend in exchange rates is better understood. Exchange rate behavior largely reflects differences in macroeconomic conditions and policies among nations. During the early 1980s, the U.S. macroeconomic policy entailed a stimulative fiscal policy, marked by the large budget deficit and accompanied by a restrictive monetary policy. Since there were no significant changes in the rate of savings to accompany the change in the budget deficit, the deficit was financed by attracting foreign funds into the United States, increasing the demand for and price of dollars in exchange for foreign currencies. Relatively strong economic growth in the

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[1]Floating Exchange Rates in an Interdependent World: No Simple Solutions to the Problems (GAO/NSIAD-84-68) April 20, 1984.

United States reinforced this development, increasing U.S. demand for imports (that were relatively cheap given the dollar's strength) while U.S. exports changed little. The difficulties that many Latin American nations faced in servicing their international debt and the stringent restrictions that they imposed on their imports also hurt an important U.S. export market. Because exchange rate movements can have long-lasting consequences for the economy, particularly those sectors that compete in export or import markets, the exchange rate implications of macroeconomic policy must be an important consideration in formulating policy. Even though the dollar has substantially declined in value since 1985, the effects of its long period of strength are still being seen in the continuing trade deficit.

The system of floating exchange rates has not performed as well as was hoped at its onset, but there is not a simple solution that will address all of the problems of the international monetary system. Exchange rate movements and many other problems are actually attributable to the greater integration of national economies rather than to the exchange rate system. Divergent national economic policies have to be accommodated in some manner, even if it were possible to fix exchange rates.

A wide range of alternatives has been advanced to address the concerns about the adequacy of the international monetary system and the floating exchange rate regime. The concerns are often based on a belief that exchange rates, regardless of how they are determined, ought to facilitate trade flows and that the uncertainty and/or persistent currency misalignment of the current floating exchange rate system actually hinder trade. The options range from demanding that the value of the dollar be fixed against a commodity, such as gold, or a bundle of commodities, to increasing U.S. government intervention in exchange markets, to improving international coordination of macroeconomic policy. The alternatives often call, explicitly or implicitly, for a decision to keep exchange rates in a "target zone," with a range of opinions over how precisely that zone can or should be defined and what criteria would be used to change the target.

While experience with floating exchange rates has given little comfort to proponents of that system, the alternatives unfortunately present considerable risks themselves.

-- Exchange rate trends reflect differences in macroeconomic policies and conditions in different nations. Restricting those trends through target zones or fixed exchange rates would force other economic variables, such as prices or interest rates, to absorb these differences.

-- Reliance on a gold standard (or another commodity-based currency system) essentially removes all government discretion over monetary policy. While advocates of this alternative view limiting government control over economic activity as a further advantage of a gold standard, opponents note that (1) historical experience does not demonstrate the advantages that advocates expect from a gold standard and (2) monetary policy, even if conducted under rules to limit discretion, must be able to adjust to changes in circumstances.

-- Decisions on whether or not to intervene in exchange markets are unavoidably risky. While intervention can be an effective tool in some circumstances (such as countering short-term speculation), it can be costly and ineffective as a way to counter longer term trends.

The importance that national economic policies have for other nations as economic integration becomes increasingly important is itself an argument for improved coordination of those policies. It is inherently difficult to put teeth into such proposals, however, since nations have many objectives in setting their economic policies, such as domestic production, employment, and prices, which are difficult to subordinate to international goals. Nations do make efforts to coordinate policies, however, through economic summits and through agreements among nations to agree on common goals and actions, such as the September 1985 and February 1987 agreements among finance ministers and central banks of the Group of 5 to coordinate exchange rate policy.

Our analysis of exchange rate policy did not reveal a need for legislative change; it did reinforce the importance of recognizing how economic policy decisions have international implications for the United States. Exchange rates are the mechanism by which international consequences are seen in the United States.

Recognizing this increased economic integration further shows that financial market reform and liberalization is as important as trade liberalization has been. During the 1980s, for instance, the U.S. financial system has been undergoing significant transformation, at least partly in recognition that financial institutions in the United States operate in global markets. The United States has also been involved in negotiations with other nations to facilitate international financial transactions, such as negotiations with several nations to remove restrictions on U.S. firms investing overseas. The United States also has been

negotiating with Japan to remove restrictions that limit U.S. firms' access to the Japanese financial system.[2]

While increased economic integration has spurred regulatory changes, there are concerns that such integration has increased the riskiness inherent in banking. U.S. policy is in accordance with international conventions for bank regulation, although more could be done to assess the adequacy of home-country supervision of foreign banks when those banks apply for licenses to operate in this nation.[3] In a 1982 report,[4] we concluded that regulatory agency comments on potentially risky foreign exposures in bank examination reports did little to restrain the growth of such exposures. Banking agencies should more clearly communicate to bankers the objectives of these comments and question some of the inputs used by the agencies to identify country risk. In addition, we cited a need for greater uniformity in agencies' bank examination practices for country risk assessment and noted inconsistencies in highlighting risky exposures and reviewing banks' internal systems for monitoring and controlling country risk.

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[2]International Finance: Implementation of the Yen/Dollar Agreement (GAO/NSIAD-86-107) June 3, 1986.

[3]International Banking: U.S. Banking Supervision and International Supervisory Principles (GAO/NSIAD-86-93) July 25, 1986.

[4]Bank Examination for Country Risk and International Lending (GAO/ID-82-52) Sept. 2, 1982.

TRADE IN TELECOMMUNICATIONS SERVICES AND EQUIPMENT

PRINCIPAL ISSUES

Telecommunications trade is assuming increased importance for several reasons. First, telecommunications services are a key component of the "information industry," a sector of the economy with great current importance and perhaps even greater potential. Trade in telecommunications equipment and services, according to one estimate, exceeded $200 billion in 1983 and may double by 1990. Second, telecommunications can be seen as a test case for developing international rules governing trade in services, a major goal that the United States has set for the new round of multilateral trade negotiations.

The telecommunications industry is one in which governments have long exerted significant influence, ranging from regulatory control to outright state ownership. There are relatively few restrictions on foreign firms selling telecommunications equipment and services in the United States. In many nations, the government's role has been changing dramatically in recent years. The United States has seen the breakup of the Bell System into a smaller system and into regional companies. Great Britain and Japan have converted state-owned telecommunications companies into privately owned monopolies. These changes have not been uniform, and foreign access to telecommunications markets remains a contentious issue. Many nations retain "buy-national" rules for their state-owned or controlled industries, since they specifically excluded their telecommunications agencies from coverage of the GATT Agreement on Government Procurement.[1] Standards for equipment also raise difficult issues, since they can easily prevent foreign products from qualifying for major purchases.

The United States is currently involved in a series of discussions with European nations to clarify European regulations limiting market access and to push for greater market access. Talks with Japan following conversion of the Japanese telecommunications monopoly to private ownership also addressed market access issues and produced an understanding that the private company's procurement system would be open to foreign bidders.

In other proposals, the United States would demand reciprocal treatment in telecommunications trade. If other nations do not

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[1] International Agreement on Government Procurement: An Assessment of its Commercial Value and U.S. Government Implementation (GAO/NSIAD-84-117) July 16, 1984.

open their markets to U.S. firms, these proposals would require that the United States restrict firms from those nations from full access to the U.S. market.

CONCLUSIONS

In several reports that addressed telecommunications trade issues,[2] we concluded:

-- It is difficult to apply GATT principles, such as nondiscrimination and transparent regulation, to telecommunications trade because (1) not all nations believe that these rules are applicable, (2) governments are trying to balance competing goals of regulating the provision of essential services and of increasing the openness of the international trading system, and (3) regulatory and ownership systems that carry out government control over the industry are wide ranging.

-- In the short term, U.S. trade policy will be successful if it can prevent emergence of new trade barriers; removal of old barriers and a true opening of this market is a longer term goal.

-- Bilateral agreements, such as the U.S.-Japan agreement, that govern telecommunications trade may also be effective tools, even if the commercial benefits are not apparent in the short term.

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[2]Current Issues in U.S. Participation in the Multilateral Trading System (GAO/NSIAD-85-118) Sept. 23, 1985, and Assessment of Bilateral Telecommunications Agreements with Japan (GAO/NSIAD-84-2) Oct. 7, 1983.

EXPORT PROMOTION

PRINCIPAL ISSUES

The Departments of Commerce and Agriculture have primary responsibility for promoting exports. We have issued a number of reports[1] on Commerce's export promotion efforts. These reports have focused on Commerce's delivery of services to small, non-exporting businesses and management of the U.S. and Foreign Commercial Service (US&FCS)--the Commerce agency that most directly helps U.S. businesses to export.

CONCLUSIONS

We concluded:

-- The US&FCS, which was created in 1980, initially suffered from resource and policy problems which hindered its first years of operation and caused uneven progress toward the promotion of commercial work overseas.

-- While Commerce's district offices were not effective in influencing businesses to begin to export or to enter new markets as their reported accomplishments suggested, they did provide useful assistance to firms by facilitating exports to established markets. The method of reporting accomplishments, however, did not provide the information needed to manage the program.

-- The Export Trading Company Act of 1982 was passed so that export trading companies, similar to those in foreign countries, would be a means to reduce or eliminate perceived foreign barriers to U.S. exports. However, regulation of export trading companies formed by bank holding companies may hinder their export performance and potential to compete with foreign country export trading companies. We concluded that, while the Federal Reserve Board clearly is authorized to require that more than 50

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[1]Government Programs And Organization Affecting Exports (ID-79-41) Aug. 1979; Problems Hamper Foreign Commercial Service's Progress (GAO/ID-83-10) Oct. 1982; Efforts To Promote Exports By Small, Non-Exporting Manufacturers (GAO/ID-83-21) Jan. 1983; Export Promotion: Activities of the Commerce Department's District Offices (GAO/NSIAD-86-43) Feb. 1986; and Export Promotion: Implementation of the Export Trading Company Act of 1982 (GAO/NSIAD-86-42) Feb. 1986.

percent of an export trading company's revenue derive from exports, the Board should revise its definition of revenues to reduce the extent to which companies view the regulation as a potential impediment to operations while still ensuring that importing does not become the preponderant activity. We also disagreed with the Board's position that export trading companies owned by bank holding companies could serve only as export facilitators by providing export trade services and could not directly provide services to foreign customers.

EXPORT CONTROL OF COMMERCIAL GOODS AND TECHNOLOGY

PRINCIPAL ISSUES

Under the Export Administration Act of 1979, as amended, the U.S. government controls exports of commercial goods and technology having military or nuclear uses if diverted from their intended civilian or non-nuclear purposes. Under the Act, the Secretary of Commerce administers the control system and issues export licenses. Certain kinds of export control licenses are reviewed by the Departments of Defense and State. Export licenses are also required for many subsequent reexports of controlled products to third countries.

Many exporters view U.S. export licensing requirements as stricter than those of other countries and as increasingly less effective because of the growing availability of comparable products from newly industrializing countries, such as South Korea and Brazil. Exporters are particularly concerned with the large volume of exports that require licenses, the complexity of the regulations and the time required, licensing requirements for reexport of U.S.-source parts and components, and foreign availability of goods and technologies subject to U.S. export controls. They fear that sales may be lost and the incentive for U.S. companies to develop new products and technology lessened. A recent National Academy of Sciences report found that, while controls do hamper Soviet acquisition of sensitive goods, they also have an increasingly corrosive effect on U.S. relations with other countries and make it harder for U.S. businesses to compete in the international arena. The President and the Secretary of Commerce recently announced plans to try to address these concerns. The increasing use of export controls to promote foreign policy objectives is also viewed by U.S. exporters as causing concern about the reliability of the United States as a trading partner.

The National Academy's study found that U.S. efforts since the late 1970s to enhance export control effectiveness fail to promote the key objectives of military security and economic vitality. The study makes two basic recommendations. One would strengthen the multilateral export control process, removing unilateral controls where effective multilateral controls are in place and where control is no longer feasible because of a good's widespread production, distribution, and sale. The other would accord greater importance to maintaining U.S. technological strength, economic vitality, and allied unity, balancing these considerations with the problem of military security.

AGRICULTURAL TRADE

PRINCIPAL ISSUES

Over the past 6 years, U.S. agricultural exports have declined significantly in volume and value, and the U.S. share of the world agricultural market has experienced a similar erosion.[1]

Causes of the general deterioration in the U.S. agricultural trade situation have been (1) high U.S. domestic price supports making U.S. prices uncompetitive, (2) the period of high value of the dollar raising the price of U.S. commodities on the world market, (3) increased third world debt reducing demand, (4) rapid technological advances in agriculture increasing production in former markets, (5) expanded foreign government export subsidies, (6) reduced effectiveness of U.S. government export promotion and market development activities, and (7) the imposition of grain embargoes adversely affecting the reputation of the United States as a reliable supplier.

In an effort to improve the U.S. agricultural trade situation, Congress and the administration have launched two major initiatives, the Food Security Act of 1985 and the new round of multilateral trade negotiations stressing the importance of resolving outstanding agricultural trade problems.

The Food Security Act of 1985 is designed to increase exports, counter subsidized foreign competition and develop new markets. Existing and new export programs under the Act will provide approximately $8-billion worth of government assistance each fiscal year to increase agricultural exports.

In the new round of multilateral trade negotiations, the United States seeks commitments in three areas.

1. Improved market access.

2. Commitments to freeze the present level of export subsidies and eventually to phase them out.

3. Minimizing the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade.

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[1]U.S. Agricultural Exports: Factors Affecting Competitiveness in World Markets (GAO/RCED-87-35BR) Oct. 1986.

CONCLUSIONS

In several reviews of various aspects of the export control program, we concluded:

-- Almost half the export license applications received each year could be eliminated without affecting national security. There is also potential for further reducing license requirements to close U.S. allies.[1] Progress is being made in eliminating unnecessary licensing requirements.

-- In 1985, the start-up period of the Defense Department's review of selected free world license applications, the Commerce Department approved licenses in about two-thirds of the cases for which Defense recommended denial. A high level of consistency in future Defense and Commerce license reviews will raise the question of whether Defense review of individual free world license applications should be continued in its present form.[2]

-- Controls imposed for foreign policy reasons are largely symbolic. Under these circumstances, even the availability of comparable products from other countries does not limit the imposition and maintenance of foreign policy controls.[3] Consequently, the costs of symbolic controls are borne by American businesses in the form of export sales lost to firms in other countries rather than in the country that is the target of the controls.

1Export Control Regulation Could be Reduced Without Affecting National Security (GAO/ID-82-14) May 26, 1982.

2Export Licensing: Commerce-Defense Review of Applications to Certain Free World Nations (GAO/NSIAD-86-169) Sept. 16, 1986.

3Export Controls: Assessment of Commerce Department's Foreign Policy Report to Congress (GAO/NSIAD-86-172) Aug. 19, 1986.

CONCLUSIONS

Our reviews of agricultural trade issues include the following conclusions:

-- Many exemptions and disagreements in interpretation and failures to abide by GATT rules exist in agricultural trade.[2] No agreement has yet been reached on a code of behavior which would lessen the effect of domestic unilateral actions on a country's trading partners.

-- Exports of wheat and wheat flour have increased for several markets targeted under the Export Enhancement Program (EEP) during the last year, but these have been offset by decreased exports to other markets, especially the Soviet Union.[3] Increases in exports to the targeted markets probably can be attributed largely to the fact that the EEP, coupled with sufficient export credit guarantees, was available. Since the program was targeted against the European Community and not against countries identified as non-subsidizers, the design of the EEP restricted its effectiveness in substantially increasing U.S. exports. There is little reason to believe that U.S. agricultural exports will be sustained in targeted markets after the EEP expires.

-- The world agricultural market is experiencing a major change, seen in the overproduction and surplus of major crops throughout the world. U.S. and European Community pricing policies, accelerated improvements in technology, and increased emphasis on agricultural self-sufficiency in developing countries have increased agricultural production worldwide. The current subsidy war between the United States and the European Community is a major factor in unsettling the world market. Countries which were once net agricultural importers have become net exporters. Additionally, developing countries faced with widespread economic problems are importing less food and feed grains. These changes in the world market portend major modifications in agricultural policies and programs of traditional agricultural producers and exporters, such as the United States and the European Community. While the

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2Current Issues In U.S. Participation in the Multilateral Trading System (GAO/NSIAD-85-118) Sept. 23, 1985.

3Review of the Agricultural Export Enhancement Program (GAO/NSIAD-87-74BR) Mar. 1987.

need for major changes in the farm policies and programs of these countries is great, little change has yet taken place as their governments continue to try to adjust programs suited to a different era. The EEP is in essence a bridge program at best. The program, as implemented, deals with the symptoms, not the fundamental causes, of the problems facing U.S. agriculture. Although the EEP may have some effect in encouraging the Community to negotiate, which is a goal of the program, it does not increase world demand for exports in a period of overproduction and surpluses.

-- The Foreign Agricultural Service (FAS) of the Department of Agriculture has allowed cooperators (private, non-profit agricultural organizations) to implement widely varying, long-term programs.[4] FAS has placed few restrictions on total funding for or the duration of a specific program and has not identified what constitutes a successful program or established criteria for cooperators to finance market development efforts. These market development programs could be more beneficial and ensure more effective use of federal funds if FAS clarified program goals and established ground rules for continued program participation. FAS does not have criteria to assess the results of cooperator market development programs.

-- Other countries, such as Argentina, Australia, and Canada, have used both long-term bilateral grain agreements and various forms of countertrade as alternative agricultural trading tools in the midst of increasingly competitive world market conditions, large foreign debt, and hard currency shortages faced by the less developed countries.[5] Recent trends indicate that world agricultural trade will witness continued use of both bilateral grain agreements and countertrade as alternative means to stimulate export development. As of January 1987, the United States had not initiated any pilot barter projects as is required by the Food Security Act of 1985.

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4Review of Management and Effectiveness of FAS' Foreign Market Development Cooperator Programs (GAO/NSIAD-87-89) Mar. 1987.

5Alternative Grain Trading Practices (GAO/NSIAD-87-90BR) Mar. 1987.

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