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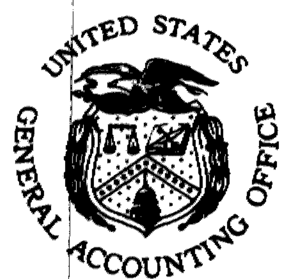
BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Perspectives on Trade and International Payments



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This is our detailed report on Perspectives on Trade and International Payments.

The report discusses many of the key issues which we believe the Congress will need to address in the development and implementation of policies designed to improve the U.S. balance of trade and international payments. In our view, there is an urgent need for congressional attention to the issues discussed in our report, particularly Government organization.

Copies of this report are being sent to the Director, Office of Management and Budget; the Special Representative for Trade Negotiations; and heads of executive agencies involved in trade and international payments matters.

Comptroller General
of the United States

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CHAPTER 1

INTRODUCTION

World trade is fundamental to the economic objectives of all countries, and the international trading environment should be relatively free of artificial restraints. This could insure greater participation and create incentives for political and economic cooperation. In the last few years the world trade picture from the U.S. point of view has become cloudy. New factors which tend to distort normal commercial flows have been added. To cite just a few, there is greater involvement of centrally planned economies, virtual foreign government dominance of key industrial sectors, increasing energy costs to many countries and the consequent need for larger amounts of foreign exchange, and trends toward policies more protective of domestic employment levels.

These factors and the policies established to achieve their objectives have converged to strongly erode the once dominant U.S. role in world trade and to seriously challenge U.S. economic and political leadership. In 1977 and 1978 the United States suffered staggering deficits of $31 billion and $34 billion in merchandise trade and $15 billion and $16 billion in the current account. The U.S. position improved somewhat in the first quarter of 1979, as officials had predicted. The merchandise trade deficit was $6.1 billion, compared to a deficit of $6.4 billion in the fourth quarter of 1978. The U.S. balance on current account shifted from a deficit of $0.31 billion in the fourth quarter of 1978 to a surplus of $0.16 billion in the first quarter of 1979, the first surplus since the fourth quarter of 1976, according to the Department of Commerce. These deficits, far surpassing previous experience, bring into sharp focus the U.S. need for a real commitment to an improved trade posture and the inadequacy of U.S. policies, programs, and institutions for coping with these changed conditions.

U.S. foreign economic policy is predicated on contributing to a stable international trading environment. The United States is a strong and important market for other countries' goods; thus, U.S. trade and payments deficits present not only an immediate problem but also one of a longer term involving many trading countries.

We undertook this study because of the 1977-78 deficits and the desire to share with Congress the results of our past and current work. We intend the study, which is a

compendium of issues, to assist in deliberations on related legislation that will be considered in the 96th Congress.

The executive summary and the study contain the results of our work in the trade and payments area over the past 5 years; 13 interrelated issue categories present what we believe are important questions that Congress should consider in trying to come to grips with the fundamental problems of U.S. trade. Even though some of these issues and questions previously have been raised by us and by others, we feel it is important to raise them again in view of the current international trade situation. People who reviewed this report were concerned that our view of the need for a closer Government-business relationship meant a closely integrated national economic planning system. That was not our intent. We believe that there are many areas in which the Government and business can work together harmoniously and effectively for mutual gain. The relationship sought will have to evolve in such areas as industrial policy, but certainly would fall considerably short of the systems used by Japan and some European countries.

We have long been concerned with trade and payments balances, as illustrated by the lengthy list of reports in appendix II. Our work has included studies on export promotion programs, Government organization, export financing, productivity, foreign military sales, and foreign investment. Our approach on trade issues has emphasized the desirability of expanding U.S. exports. Other work, such as on productivity and foreign military sales, has emphasized broader objectives not specifically linked to export expansion.

SCOPE OF REVIEW

We examined past GAO reports and testimony. We drew heavily on published data on the issues discussed and on agency and congressional records, testimony, and reference material. Our work was done in Washington during November 1978 to July 1979. Informal discussions were held with agency representatives, and a specially convened panel of consultants discussed the report during a one-day seminar in March. The comments by the agencies and consultants were considered in this report, but it was not offered for official agency comment.

This report is basically informational and not a detailed analytical study of the issues. It is not so much a traditional review as an expression of accumulated GAO

knowledge and concern. Appendix I summarizes legislation enacted during the 95th Congress directly affecting trade and international payments.

CHAPTER 2

U.S. TRADE AND PAYMENTS PROBLEMS

The trade and current account balances of the United States moved from surpluses in 1975 to enormous deficits by 1978. It should be noted that these balances were influenced by the stage of the business cycle. 1975 was a recession year resulting in lessened import demand. As the United States began moving out of the recession in 1976 and the economy expanded, demand for imports grew also. Capital inflows decreased during 1976-78, while the net increase in U.S. liabilities to the monetary authorities of industrial countries increased substantially, reflecting intervention by foreign central banks to support the dollar. Outflows of capital from the United States have also experienced wide swings during this same time.

WHAT HAS HAPPENED SINCE 1975?

Major changes have occurred in the merchandise trade, services, and current accounts, as shown in Table 1.

Table 1

U.S. Merchandise Trade, Services, and Current Account Balances 1975-78 (note a)

	1975	1976	1977	1978
	(billions)			
Merchandise trade:				
Exports	$107.1	$114.7	$120.6	$141.8
Imports	98.0	124.0	151.7	176.0
Trade balance	9.1	-9.3	-31.1	-34.1
Services:				
Military transactions, net (note b)	-.9	.3	1.3	.5
Investment income, net	12.8	15.9	17.5	19.9
Travel and transportation, net	-2.5	-2.2	-3.0	-3.1
Other services, net	4.6	4.7	4.7	5.9
Services balance	14.0	18.7	20.5	23.2
Unilateral transfers, net	-4.6	-5.0	-4.7	-5.1
Current account balance	$ 18.4	$ 4.3	$-15.3	$-16.0

a/Figures are on a balance-of-payments basis; may not add because of rounding

b/Goods and services transferred under military sales contract, less imports of goods and services by U.S. Defense agencies

Both imports and exports of merchandise have grown, but whereas imports increased 80 percent, $98 billion to $176 billion from 1975 to 1978, the growth in exports has been slower, only 32 percent, from $107.1 billion to $141.8 billion by 1978. This faster growth of imports shifted the trade balance from its surplus position in 1975 to a deficit of $34 billion in 1978.

The positive growth of 66 percent in the services balance over this same period has helped to mitigate the effect of the trade balance deficits on the current account balance. In fact, the continued surplus of the services balance has an even greater future impact on the accounts. Three of the econometric forecasts used in our executive summary project a growth in the services balance that helps the merchandise trade and services balance move into a surplus position after 1981. Net receipts on investments abroad was the major source of growth in the services balance. It grew 55 percent from 1975 to 1978 and reflects principally the return on previous investments made abroad.

Capital inflows--direct investment by foreigners in the United States, earnings of foreigners reinvested in their U.S. affiliates, deposits in U.S. banks, and purchases of U.S. securities, excluding changes in U.S. liabilities to the monetary authorities of industrial countries--declined by $4.3 billion or 13 percent from 1976 to 1978, as shown in table 2.

Table 2

U.S. Capital Flows, 1976-78

	1976	1977	1978
	-------(billions)-----		
Capital inflows (changes in net foreign assets in the United States, excluding changes in U.S. liabilities to monetary authorities of industrial countries)	$33.0	$21.9	$28.7
OPEC official investments	9.6	6.7	-.6
Non-OPEC developing country official investments	4.6	1.5	-.04
Direct investment	4.3	3.3	5.6
U.S. securities not included elsewhere	4.1	3.4	5.1
U.S. bank deposits not included elsewhere	11.0	6.7	16.9
Net increase in U.S. liabilities to monetary authorities of industrial countries	3.9	28.9	34.6
Capital outflows (changes in U.S. assets abroad, net)	-50.6	-34.6	-58.7
Statistical discrepancy (unrecorded transactions)	9.3	-.9	11.4

Though capital inflows decreased 34 percent from 1976 to 1977, the inflows in 1978 represented a 31-percent increase from 1977. All of the inflow accounts decreased in 1977. Some of the accounts, such as OPEC and non-OPEC developing country official investments, continued to decline in 1978. But, the increase in the other inflow accounts more than compensated for these decreases.

The net increase in U.S. liabilities to monetary authorities of industrial countries increased almost 800 percent from 1976 to 1978. These huge increases were caused by heavy intervention in the foreign exchange markets by the central banks of several major industrial countries.

There was a net increase of 16 percent in capital outflows from 1976 to 1978. Capital outflows represent such items as direct investment by U.S. firms abroad, earnings of U.S. companies reinvested in foreign affiliates, bank loans to foreigners, and purchases of foreign securities. However, this growth conceals a decline of 32 percent from 1976 to 1977 and an increase of 70 percent from 1977 to 1978.

The net capital inflow in 1978 of $16 billion (table 2) exactly offsets the $16 billion current account deficit for 1978 (table 1). Deficits or surpluses in the current account balance are always matched by net inflows or outflows in capital accounts.

CAUSES

The decline in the U.S. trade position between 1975 and 1978 can be related to factors such as greater growth in the domestic economy as opposed to slower economic growth abroad, increased oil imports at higher prices, and increased competition.

The United States recovered from the 1974-75 recession more quickly than did most other countries and experienced faster growth in its economy. As a consequence, demand for imports, particularly oil, manufactured goods, machinery, and transportation equipment, expanded rapidly and significantly. Imports grew 27 percent in 1976, 22 percent in 1977, and 16 percent in 1978. Petroleum and petroleum products accounted for about 19 percent of the $78 billion increase in U.S. imports during this period. This growth in oil imports at increasingly higher prices has been a major factor in the shift in the U.S. trade balance since 1975.

Foreign demand for U.S. goods was weak during this period due to slower economic growth in most other countries. As a result, U.S. exports increased only 7 percent in 1976, 5 percent in 1977, and 18 percent in 1978. The larger export increase in 1978 was due substantially to improved economic conditions in leading markets abroad together with the lagged effects of the depreciated dollar, which made some exports more competitive.

The U.S. share of industrial countries' manufactured exports (excluding those to the United States to allow for the impact of the higher U.S. growth rate on U.S. demand for imports) declined from 19.2 percent in 1975 to 17.0 percent in 1978. The U.S. share of exports has fluctuated within a range of 17 to 21 percent since 1970.

In any event, the increased competitiveness of developing countries can't be overlooked. For example, a Commerce Department specialist said that Asian manufactured exports to Japan are reducing the U.S. market share in that country and exports from Korea, Taiwan, Singapore, and Hong Kong are displacing U.S. low-technology exports to Latin America and Europe. Increased agricultural exports from developing nations are also affecting U.S. exports. For example, Brazil has been increasing soybean meal exports to traditional U.S. markets. U.S. exports to Europe declined 41 percent between 1976 and 1977, from 4.2 million tons to 2.9 million tons.

Developing countries' manufactured exports increased 15.8 percent a year in real terms between 1965 and 1974. Their share of manufactured exports to OECD countries, the principal market for U.S.-manufactured goods, increased from 6.8 to 9.6 percent between 1971 and 1976, a $10.7-billion improvement. Continued growth of developing countries' manufactured exports is projected between 1975 and 1985 at annual rates in constant dollars of 11.1 to 13.4 percent. The rate of increase will depend on their export policies and on import policies in the developed importing countries.

With respect to the capital flows accounts from 1976 to 1978, the smaller capital inflows in 1977 were largely accounted for by a decline in OPEC investment, smaller prepayments on purchases of U.S. military equipment, increased holdings of foreign-currency-denominated assets due to the dollar's decline, and use of U.S. funds by foreigners to finance foreign investment. The decreases in OPEC and non-OPEC developing country official investments in 1978 were primarily due to the sale of marketable Treasury bonds. The offsetting increases in the other accounts were caused by (1) decisions to expand direct investments or make new

investments in the United States as a result of the profitability of the U.S. market and the dollar's depreciation and (2) significant increases in U.S. interest rates on short-term securities above most foreign interest rates. The substantial increases in U.S. liabilities to monetary authorities of industrial countries were made by several major industrial countries. These countries made large dollar purchases in an attempt to support the dollar and to limit appreciation of their own currencies.

The decrease in outflows in 1977 resulted from a combination of domestic and international factors, such as a revival in domestic business loan demand, a slackening in foreign credit demand, increased cautiousness and competitiveness of U.S. banks in lending abroad, decline in new foreign bond issues, and restraint in direct investment by U.S. firms in foreign affiliates. Factors that had acted to slow U.S. capital outflows in 1977 were offset in 1978 by rising international credit demands for U.S. dollars, foreign borrowings of dollars to purchase other currencies, and increases in reinvested earnings and direct investment abroad.

WHAT SOLUTIONS ARE BEING ATTEMPTED?

There is little doubt that administrations, both past and present, have viewed the trade imbalance as a serious problem. Numerous actions have been instituted to deal with the problem, and President Carter's 1978 State of the Union message recognized the gravity of the situation.

In the face of a prospective 1978 current account deficit almost as large as that of 1977, an even larger trade imbalance, and continued depreciation of the dollar, in late 1978 and 1979 the Government and the Federal Reserve:

1. Presented an anti-inflation program involving voluntary wage and price guidelines and a system of real wage insurance.

2. Introduced several non-tariff agreements negotiated at the Tokyo Round of Multilateral Trade Negotiations.

3. Imposed a 2-percent supplementary reserve requirement on time deposits of $100,000 or more and raised the discount rate from 8.5 to 9.5 percent.

4. Resumed monthly gold sales and increased them to 1.5 million ounces a month.

5. Announced an export promotion program involving increased funds for the Export-Import Bank and for small business entry into export markets.

6. Combined measures to support the dollar, involving borrowing foreign currencies from the International Monetary Fund; sales of Special Drawing Rights; establishing lines of credit with the central banks of Germany, Japan, and Switzerland; and sales of up to $10 billion of foreign-currency-denominated U.S. Treasury securities.

In the short run, the U.S. current account position depends heavily on the relationship between the U.S. growth rate and the growth rates of leading U.S. trading partners. To restore a better balance, the administration has urged U.S. trading partners (especially Germany and Japan) to stimulate their economies through the appropriate use of monetary and fiscal policies.

On January 4, 1979, the President notified Congress of his intention to enter into several agreements on non-tariff measures negotiated at the Tokyo Round of Multilateral Trade Negotiations to reduce world barriers to trade. After the President signs the agreements, Congress must approve them and enact necessary implementing legislation before they become effective. Congress passed the Trade Agreements Act of 1979 to approve and implement certain trade agreements negotiated at the Tokyo Round.

Export promotion and development

On September 26, 1978, the President announced an export promotion program which included (1) a $500-million increase in the loan authorization request for the Export-Import Bank for fiscal year 1980, (2) a $20-million increase in Commerce and State funds for export development, (3) the Small Business Administration's earmarking up to $100 million for loan guarantees to provide "seed money" for small business entry into export markets, (4) a pledge to work with Congress to develop a more effective tax incentive for exports than provided by the present Domestic International Sales Corporations and to resolve the issue of tax relief for Americans working abroad, (5) instructions to Goverment agencies to consider export consequences when issuing regulations or considering export controls, (6) expedited treatment by the Justice Department on requests for guidance on international antitrust issues, clarification of antitrust laws concerning foreign joint ventures, and guidance on the enforcement of the Foreign Corrupt Practices Act, (7)

limiting the establishment of environmental requirements to only a small fraction of U.S. exports, and (8) reconstituting the President's Export Council.

In the same vein, Congress extended the life of the Export-Import Bank to September 30, 1983, and increased its overall lending authority from $25 billion to $40 billion and its authority to issue guarantees and insurance from $20 billion to $25 billion. It also authorized the Commodity Credit Corporation to provide intermediate credit terms of up to 10 years for exporting breeding animals, building up reserve grain stocks, constructing facilities for imported agricultural commodities, and meeting credit competition from other countries.

One other significant change involved the taxation of Americans working overseas. Congress deleted the general exclusion of $15,000 in Section 911, replacing it with a $5,000-a-year deduction under a new Section 913 for individuals living in qualified hardship areas. Other deductions for determining adjusted gross income are now allowed for cost-of-living, housing, schooling, and home leave travel.

CHAPTER 3

IS THERE A COHERENT INTERNATIONAL TRADE POLICY?

The United States must have an international trade policy which is consistently applied, well articulated, and easily understood in order to redress U.S. trade and current account imbalances, factors the President has proclaimed of primary importance in the fight against inflation and to strengthen the dollar.

The 1977 Congressional Research Service study, "United States Government Involvement in International Economic Activities," states that:

> "Trade policy affects the extent, composition and direction of U.S. exports and imports of goods and services. Both export-oriented and import-competing producers and workers as well as consumers are directly affected by major trade policy decisions."

U.S. policy is phrased in the Trade Act of 1974 as "to promote the development of an open, nondiscriminatory and fair world economic system, to stimulate fair and free competition between the United States and foreign nations, to foster the economic growth of, and full employment in, the United States* * *." Many observers believe the United States has no trade policy; at least it is not well understood by the business community. This perception probably stems from the feeling that there is neither a definitive approach to attaining U.S. objectives nor a real consensus on how other policies, such as those on foreign military sales, antitrust, human rights, environment, corrupt practices, export controls, aid, import restriction, and foreign investment, fit into plans to achieve these objectives.

Business is in the difficult position of being encouraged to engage in international trade with no clear understanding of how far it can legitimately proceed without running afoul of one of these competing policies. Without an integrated approach to international trade, we doubt this situation will improve. On the contrary, the situation could worsen, with each agency pursuing policies that conflict with others and little, if any, administrative guidance for business use in interpreting these policies.

In 1972 the Council on International Economic Policy was created as a policymaking group to help achieve consistency between international and domestic economic policy, including trade. Since 1977, it has been extremely unclear as to whether there is an effective international economic policy coordinating mechanism in Government. The Council has been essentially replaced by the Carter Administration's reliance on the Economic Policy Group, made up of cabinet-level officials, to coordinate international and domestic economic policy. Also, the Trade Policy Committee under direction of the Special Representative for Trade Negotiations has been prominent in the recent Multilateral Trade Negotiations--an effort which executive branch officials point to as a clear demonstration of how effectively agencies with diverse interests can work together under strong leadership.

HOW IS "POLICY" BEING HANDLED?

The Government's role in export trade has been to create an appropriate environment in which trade can take place while leaving the private sector to take advantage of whatever opportunities are afforded. This basic role has been modified in recent years with the realization that export trade is vital to a sound U.S. balance-of-payments position. At the same time, however, the Government has maintained old obstacles to U.S. exports and instituted some new ones. Thus, the U.S. international trade environment has been shaped not systematically but by domestic and international political considerations and needs.

Our November 1973 report, "Ways to Improve U.S. Foreign Trade Strategies" (B-172255), dealt with the implementation of U.S. trade policy and recommended that the executive branch develop trade strategies to guide U.S. commercial activities in foreign countries. It stated that:

> "We were unable to find any clearly stated objectives for foreign markets which reflected coordinated consideration by Federal agencies involved in establishing U.S. trade objectives and agreement among the agencies on the activities needed to attain such objectives. No Government mechanism exists to coordinate U.S. trade strategies for individual countries and market areas; therefore, each agency conducts its activities according to its own objectives."

Strategies developed by the Departments of State and Commerce for many market areas of the world still do not

reflect the broad range of commercial activities conducted incountry, such as in the agricultural and investment areas.

In September 1978, the President noted it was important for this Nation's economic vitality that both the private sector and the Federal Government place a higher priority on exports. As evidence of the administration's commitment, the President announced a "National Export Policy" containing a series of measures for assisting exporters and reducing export barriers. However, the announcement is more a statement of concern than a comprehensive trade policy with specific strategies for increasing exports. Implementation of the measures raises questions as to the degree of commitment generated from the President's concerns. For example, the Justice Department seems reluctant to provide more definitive guidance to exporters concerning its enforcement policies for antitrust and antibribery legislation.

The lack of a coherent, comprehensive, and effectively implemented trade policy is only one part of the larger problem of U.S. international economics. Also lacking is a discipline concerning acceptable levels of trade and current account surpluses and deficits. Policy actions might be guided, for example, by some notion as to what level of current account deficit or surplus is sustainable. Certain actions, such as the declaration of the National Export Policy and the Federal Reserve Board's intervention in the money market, are evidence of the administration's greater awareness of the importance of trade and international payments; however, as examples of U.S. policies, they are reactive rather than comprehensive and forward-looking.

Henry C. Wallich, member of the Board of Governors of the Federal Reserve System, remarked in January 1979 that:

> "In a few circles, balance of payments discipline has indeed been a dirty word* * *.
>
> "As concerns the United States, it is noteworthy that the Employment Act did not list balance-of-payments equilibrium among U.S. economic objectives, which were broadly defined as high growth, full employment, and price stability. It is perhaps significant that the German counterpart of this Act does list external equilibrium as an objective, in addition to growth, full employment, and price stability. During the early 1960's, when the balance-of-payments

> problem was much in the foreground, some private groups aiming to specify U.S. economic goals examined the possibility of including payments equilibrium among the nation's economic objectives. Only in 1978, with the passage of the Humphrey-Hawkins (Full Employment and Balanced Growth) Act did an improved trade balance become a formal objective of national policy."

Defining just how far the United States would be willing to go in terms of acceptable levels for trade and current account surpluses and deficits (bilaterally and multilaterally) would be a logical starting point for any concerted Government action.

CHAPTER 4

IS THE GOVERNMENT'S ORGANIZATION ADEQUATE FOR HANDLING TRADE MATTERS?

Many in business and Government are concerned whether the present Government organization is adequate for integrating the numerous diverse components of an international trade program into an effective response to U.S. trade and payments problems. A spokesman for the Asia-Pacific Council of American Chambers of Commerce put it in perspective on May 1, 1978, before the Senate Governmental Affairs Committee. He said that persons in international trade have defined the major defects in U.S. Government organization as:

> "First, different from our trading partners, we lack in the U.S. a coordinating mechanism to focus the entire resources of our government on international trade problems. Uncoordinated, independent initiatives from a multitude of agencies, each with some interest in international commerce, result in confused programs with limited effectiveness. Vested and conflicts of interests preclude consistent policy and aggressive leadership toward committed national trade and investment goals.
>
> "Second, there is no policy formulating mechanism with authority in the government to establish international economic objectives and to evaluate the impact of existing and proposed legislation on these objectives."

These views are not new. In 1964, a Presidential task force on programs to improve the worldwide competitiveness of American business reported that one reason the United States had failed to develop an integrated international business policy was that various departments were not organized or coordinated for this purpose. Moreover, not enough "focal point" leadership was given this vital objective. Our work in the areas of agriculture, manufactures, East-West trade, export promotion, and export controls tends to reinforce these views.

Organizationally, no one seems to be in charge of the trade area. Many agencies are involved, each with its own view as to what is best for its programs and constituencies. Moreover, no effective means exists for integrating individual objectives within a framework of a generally acceptable

definition of national export policy. Interagency coordinating committees established to provide forums for coordinated decisionmaking often appear unable to work effectively on a continuing basis.

RECENT ORGANIZATIONAL EFFORTS

In the past, attempts have been made to establish organizational units within the Executive Office of the President to deal with international economic interests. Under the prior administration, the Economic Policy Board took the lead role together with the Council on International Economic Policy. The present administration has the Economic Policy Group. Since the Trade Act of 1974, the President's Special Trade Representative has played a significant role in multilateral and bilateral trade negotiations. The organization of the Office of the President relative to trade is shown in the chart on the next page.

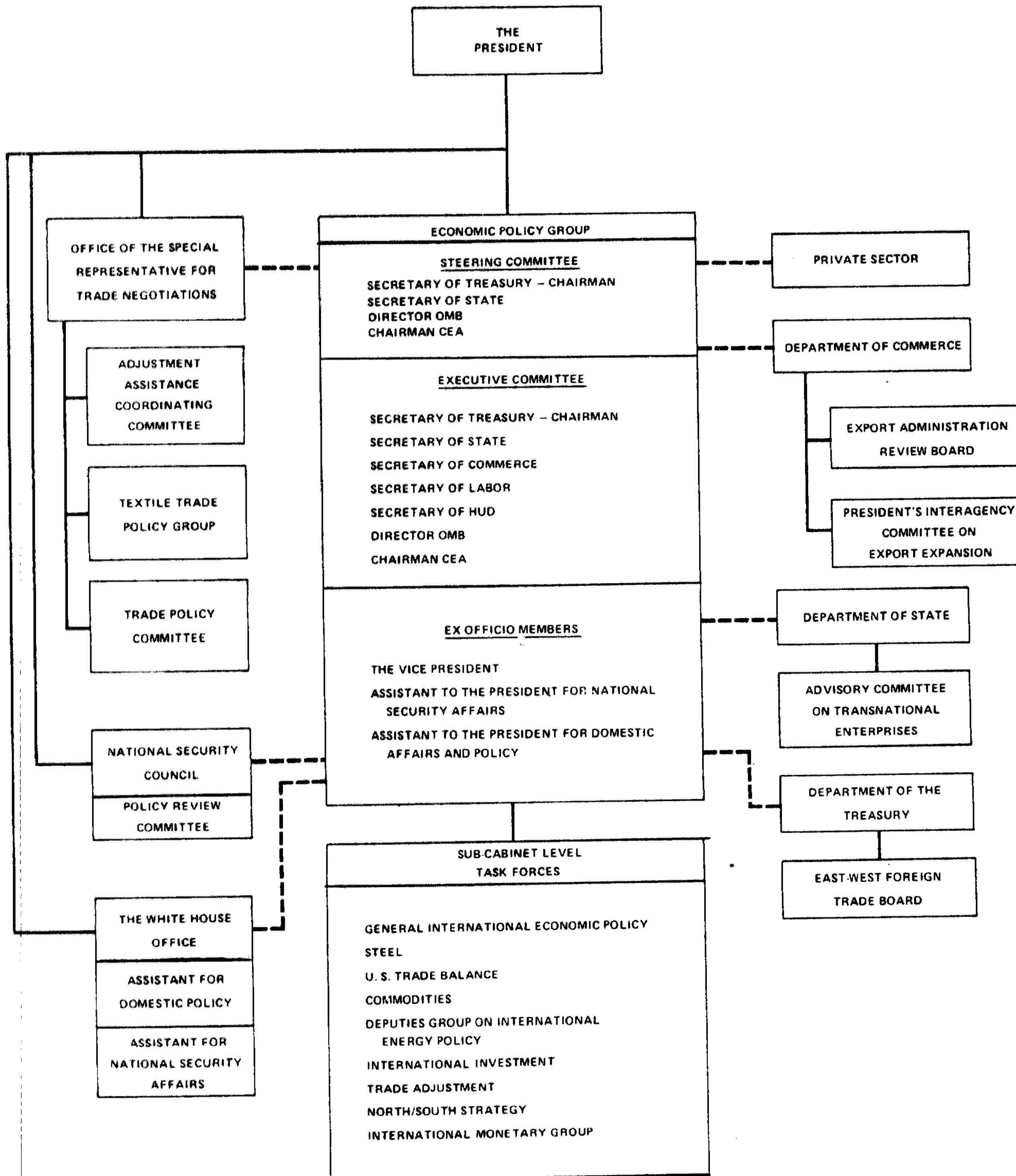
Senate Bill 1990 to consolidate Federal efforts into a separate Department of International Trade and Investment was introduced in the 1st session of the 95th Congress but was not passed. Several pieces of similar legislation aimed at reorganizing the Federal trade bureaucracy are being considered by the the 96th Congress and some form of a reorganization plan seems likely to be passed.

Ultimately, fragmentation of responsibility and lack of direction manifests itself in U.S. Embassy organizational arrangements for commercial activities.

An example, relevant even today, is the observation in our November 1973 report, "Ways to Improve U.S. Trade Strategies" (B-172255). The U.S. Embassy in Mexico City, with at least 34 individuals in 12 sections who could have assisted in achieving U.S. commercial objectives, was not organized in such a way as to carry out a well-defined strategy.

A recent example, cited in our October 1978 report, "Administration of U.S. Export Licensing Should be Consolidated to be More Responsive to Industry" (ID-78-60), shows that Government administration of export licensing is potentially damaging to the export business because management is fragmented among agencies. Because the resulting lack of accountability and the delay and uncertainty in the decionmaking process can cause exporters to lose sales, we recommended that the Congress direct that export license application management responsibilities be centralized in the Department of Commerce's Office of Export Administration.

Organization of the Office of the President-
Relative to International Trade



ALTERNATIVES

In view of the problems discussed above, the following alternatives for improving Government organization for dealing with trade matters have received some attention.

1. Establishing a separate trade organization, similar to that of Japan.

2. Reconstituting a policy formulation group like the Council on International Economic Policy.

3. Expanding the functions of Commerce or the Special Trade Representative to include additional trade-related activities.

4. Establishing an expanded trade-coordinating committee at a high level, possibly in the Executive Office of the President.

5. Establishing an export corporation.

Each of these, and any other alternatives, has pluses and minuses which need to be carefully assessed before a decision is reached. The key point being stressed is that the Government organization needs some modification if the United States is to achieve a forward-looking treatment of trade and payments matters. Reorganization alone, however, will not be sufficient. Organizational moves must be buttressed by strong central leadership, clear objectives, and adequate resources--goals which are certain to be difficult to obtain without strong congressional support.

CHAPTER 5

WILL THE DOLLAR EXCHANGE RATE REDRESS THE TRADE IMBALANCE?

The exchange value of the dollar has fluctuated widely since the advent of floating in 1973. Of particular concern has been the dollar's sharp depreciation from the fall of 1977 until the November 1, 1978, announcement of administration and Federal Reserve measures to strengthen it. Following these actions, the dollar appreciated significantly against the major currencies. When viewed against a base period of September 1977, however, the dollar's value at July 1979 vis a vis the mark, yen, and Swiss franc still declined from about 18 to 30 percent.

Percent Change, U.S. Dollar Versus

	Deutschmarke	Yen	Swiss franc	Canadian dollar
From September 1977 to:				
October 1978	-24.2	-32.6	-35.9	+7.5
July 1979	-21.6	-18.9	-30.3	+7.5

Economic theory suggests that a depreciated or "cheaper" dollar should improve the competitive position of U.S. exports, decrease its imports, and move the imbalances between countries into appropriate equilibrium. Up to about early 1978, the Carter administration seemed confident that a cheaper dollar would improve the price competitiveness of U.S. products and was reluctant to take any major policy actions to redress the imbalance. Eventually, that position was modified with the continued decline of the dollar and a worsened trade position. In April 1978 the sales of gold were increased, and in November 1978 a massive intervention program was implemented to stabilize the dollar.

Treasury estimates that the lag between business movement in exchange rate values and adjustments in the trade balance is about 18 months. The Federal Reserve estimates that the full impact of depreciation in the dollar on exports will take over 2 years. Thus, the declines in the value of the dollar in late 1977 would be expected to show up in mid and late 1979.

The expected improvement in U.S. export performance began to show up in the first quarter of 1979. The U.S. merchandise trade balance deficit of $6.1 billion in that quarter improved from about a $6.4 billion deficit and a $11.9 billion deficit in the fourth and first quarters of 1978. Merchandise exports grew about 34 percent in the first quarter of 1979 versus the same quarter of 1978, while imports grew about 15 percent during the same period. The implication of these figures is that U.S. businessmen are taking advantage of improved price competitiveness through a depreciated dollar here and abroad.

There seems to be little doubt that some improvement in the U.S. trade balance is associated with a cheaper dollar domestically and abroad. The key question is, to what extent should floating exchange rates be relied upon solely to redress U.S. trade imbalances? In this connection, we are less sanguine than some and are inclined to believe that only modest improvement can be expected in the short term. Treasury and Commerce have indicated that the U.S. trade deficit could narrow by about $9 billion in 1979, partly due to a depreciated dollar, but recent OPEC price increases make any projections suspect.

After considering the question of exchange rate depreciation and its effect on U.S. exports, the Subcommittee on International Finance, Senate Committee on Banking, Housing, and Urban Affairs, concluded:

> "* * * it is unrealistic to expect rapid and significant improvement in the U.S. trade balance due to exchange rate depreciation, because: (1) dollar depreciation will improve U.S. price competitiveness only if reinforced by relatively low U.S. inflation rates; (2) trade flows will respond to relative price changes only belatedly; (3) the U.S. deficit will decline only if growth rates are higher abroad than in the U.S.; and (4) U.S. trade performance is not closely related to relative price considerations for structural reasons."

The Subcommittee, in its February 1979 report cited numerous observations for its conclusion, many of which are shared by other analysts. A few of the more salient reasons are highlighted below.

1. Improvement in price competitiveness and convergence in relative growth rates may

reduce the trade deficit, but export levels may be determined more by government policies and nonprice considerations than by market-determined export prices. The principal trade competitors of the United States--Germany and Japan--pursue policies which systematically counteract improvements in price competeiveness by U.S. suppliers. Furthermore, the structure of U.S. trade, especially on the export side, may minimize sensitivity to price considerations.

2. The export orientation of the economies of some foreign countries makes exchange rate stabilization and policies to preserve comparative advantage in export markets mandatory. Thus, if the exchange rate begins to move upward, monetary authorities in these countries are likely to intervene in the markets to discourage further currency appreciation. At the same time, monetary and fiscal policy instruments are used to suppress the rate of inflation, thereby offsetting movements in the exchange rate to the largest possible degrees.

3. According to the National Association of Manufacturers, the composition of U.S. exports and the nature of export markets abroad, combine to make U.S. export performance relatively insensitive to price movements.

4. The volume of agricultural exports, which account for roughly 20 percent of U.S. exports, does not automatically reflect relative price competitiveness. U.S. agricultural exports to the European Community, for example, benefit little from relative price improvements because the Community's Common Agricultural Policy is specifically designed to offset such movements.

5. Manufactured goods exports are presumably more sensitive to changes in price competitiveness; but the disappointing performance of the United States for such exports compared with those of Germany and Japan, whose currencies have been appreciating and whose price competitiveness via-a-vis the United States has deteriorated, implies that trade in manufactured goods may be less price-sensitive than is commonly assumed.

6. International trade is increasingly characterized by marketing strategies and pricing policies which focus on market penetration or market share and denigrate price considerations. Marginal pricing, and even dumping, may explain some of the relatively strong Japanese and German export performances.

7. In the case of large capital items for which the United States generally has a comparative price advantage, sales often hinge upon such variables as credit terms, offset purchases, and non-monetary factors, including government decisions to favor specific foreign enterprises or investors as trading partners. Much international trade also occurs within multinational corporations and is less sensitive to price considerations than to corporate strategies.

8. The lack of improvement in the U.S. trade balance may also be partially accounted for by the foreign market composition of U.S. trade. Canada is the principal U.S. foreign market, and there has been no relative price improvement for the United States in the Canadian market. For most non-oil-producing developing countries, exchange rates have not changed relative to the dollar and improvement in U.S. price competitiveness relative to domestically produced goods in such countries has been minimal.

9. Existing trade relationships, perceptions of quality, and assurances of timely delivery account for export success in many markets. Germany, Japan, and Switzerland have reputations as dependable suppliers, and they have continued to export successfully despite deterioration in the price competitiveness of their products.

One aspect of a depreciated dollar is that U.S.-produced goods become more price competitive and foreign goods become more expensive in the U.S. market. However, the response of U.S. imports to dollar depreciation, in terms of possible lower import levels, is reduced because (1) 22 percent of U.S. non-oil imports are agricultural products and raw materials, which respond slowly to price changes, (2) many imports, such as Japanese cars and television sets, are

perceived as being of superior quality and, thus, less price-responsive, (3) many products are supplied almost entirely by imports, (4) foreign producers may absorb part or all of the cost of exchange, and (5) some exporters may not increase their dollar export prices by the full extent of dollar depreciation because many imports used to produce their exports are priced in dollars and have become cheaper.

Additionally, U.S. producers could possibly mitigate the impact of depreciation on reducing U.S. imports by increasing prices for domestic substitutes. The increase in steel prices and the frequent auto price increases may be illustrative of this phenomenon.

The Citibank of New York forecast for the U.S. Economy 1979-84, April 1979, cautions that care should be taken not to overestimate the benefits from improved price competitiveness of U.S. goods. Like the Subcommittee report, this forecast points out the importance of nonprice factors (quality and service) to competitiveness and notes that U.S. improvement will be eroded over time if U.S. inflation outpaces that of Germany and Japan and the dollar continues to appreciate. Moreover, countries like South Korea, Brazil, Taiwan, Mexico, and Hong Kong are increasing their shares of world manufactures. Thus, the use of floating exchange rates in the future as the vehicle for completely adjusting the U.S. trade imbalance is very unlikely.

CHAPTER 6

CAN EXPORT CONTROLS BE ADMINISTERED BETTER TO SUPPORT U.S. EXPORT GOALS?

Under the Export Administration Act of 1969, as amended, the Government, principally through the Commerce Department, can limit the export of American products for short supply, national security, and foreign policy reasons. Similar laws authorize the Departments of State and Defense to regulate munitions exports, the Nuclear Regulatory Commission to control nuclear exports, and other agencies to regulate the export of specific items.

Export controls are applied by requiring that exports be licensed by the Government. Each agency publishes a list of items that must have specific export licenses prior to shipment; items not on the lists are shipped under general licenses whereby the exporters simply note the export contents on the shipping documents.

About 90 percent of American exports move under general licenses, but controlled items are vitally important to the trade balance. Administration of export controls on these items can adversely affect the trade balance in three ways. First, disapproval of export licenses precludes the legal export of the item, resulting in the loss of sales. Second, uncertainty and delay in the licensing process can give U.S. exporters a reputation for unreliability, in some instances, causing foreign buyers to seek alternative supply sources. Third, implementation of U.S. unilateral controls limits access to the international market, leaving foreign suppliers in a favored position.

Timely processing of export license applications seems to be a problem in each of the agencies having export control responsibilities. However, most business concerns about the negative impact of export controls are directed to strategic products and technologies and their licensing by the Department of Commerce. Several agencies, including Defense and State, participate with Commerce in deciding whether to issue a license. In these cases, of far greater significance to U.S. trade interests than denials is the delay and uncertainty in the administration of controls and the subtle, longer term affects this has on trade relationships.

The Government has no obligation to approve an export license application, and there are legitimate reasons for

prolonging a decision. However, the Government does have an obligation to exporters to insure that the decisionmaking process itself does not unnecessarily damage new or continuing export relationships. If the exporter is left in uncertainty about how the decision is being made, then that uncertainty may be transferred to the buyer, with damaging results.

Similarly, the Government has an interest in involving the exporter to a greater degree than he currently is in the process of determining which items are to be controlled and which ones should be decontrolled. Exporters sometimes wait over a year without answer while the Government deliberates their requests to decontrol products, even products readily available from foreign sources.

Management authority for the export licensing process is diffused among many Federal agencies. This has resulted in a lack of responsiveness to exporters and potential losses to them because of failure to meet commitments. In our October 31, 1978, report, "Administration of U.S. Export Licensing Should Be Consolidated To Be More Responsive To Industry" (ID-78-60), we recommended that the Congress direct that export license application management responsibilities be centralized in Commerce and a multiagency group be established to provide policy guidance to Commerce. The major assumption underlying these recommendations is that the Congress must involve itself more in defining the kind of decisionmaking structure it believes will promote the policy goals of export control.

The aspect of export controls probably most vexing to exporters is the fact that the United States controls some items which its trading partners do not control. The United States and its major trading partners coordinate national controls of strategic exports through the multilateral export control coordinating committee known as COCOM. These controls are for national security purposes only and are based on a unanimously agreed upon control list. The list is updated every 3 years, with the majority of proposals to decontrol products being made by the other members. The United States views the control list as the miminum degree of control and, after careful consideration of national interests, has added 38 items to create its own national control lists. The United States has agreed to the decontrol of some items from the COCOM list while retaining them on its national list.

Under the reexport licensing procedure of U.S. export controls, the licensing of an item is a continuing process, requiring Government approval for any transfers during the

life of the product. The United States is the only COCOM country to require reexport licensing. The potential cost and inconvenience of this procedure to both the buyer and the seller inhibits export transactions.

Foreign policy controls often benefit U.S. competitors who are usually not subject to this type of action by their governments. Furthermore, implementation of foreign-policy-related controls is unpredictable and often negates the exporters' development of international markets. For example, export licenses for oil equipment to the Soviet Union were unexpectedly required in August 1978, after the exporter had completed the sale, and the exporter was suddenly faced with a risk to the transaction.

While exporters now know that future oil and gas equipment sales will have to be licensed, foreign-policy-related controls aren't always announced by the Government and licensing may be "informally suspended." Generally, the use of controls in this situation is to permit surrogate sales to supply the foreign demand and still achieve U.S. diplomatic goals. The goals, however, are met at the expense of American exporters.

CHAPTER 7

CAN FOREIGN TRADE BARRIERS/IMPORT RESTRICTIONS BE REDUCED?

Foreign trade barriers, notably non-tariff barriers, are pervasive and in some cases operate so subtly that they are not distinguishable as actually inhibiting trade. It is inherently difficult to quantify their trade-limiting impacts.

In testimony before the Senate in May 1978 on U.S. export policy, the Deputy Special Representative for Trade Negotiations cited two studies containing estimates of the amount of U.S. exports and jobs that had been lost because of foreign trade barriers. A Department of Labor study based on 1974 trade data indicates that tariff barriers of the principal U.S. trading partners cost the United States about 425,000 jobs and $7.5 billion in export sales in 1974. A Brookings Institution study notes that the United States exported $8.7 billion worth of agricultural products to the European Economic Community and Japan in 1974. Had these countries not imposed agricultural non-tariff barriers, U.S. agricultural exports to them would, conservatively, have been $1 billion greater.

Under authority of the Trade Act of 1974, the Special Trade Representative has been carrying on Multilateral Trade Negotiations aimed at eliminating tariff and non-tariff obstacles to trade. New codes of conduct negotiated in 1979 cover such non-tariff barriers as product standards, customs valuation, general procurement, subsidies, and countervailing duties and safeguards. General tariff reductions were negotiated as well. The results of these negotiations are supposed to provide large benefits to the United States. For example, in return for U.S. access to the $20-billion foreign government market, the United States will suspend Buy America preferences for $12 billion of its purchases. However, in view of the extensiveness of such obstacles and what will entail massive compliance monitoring the negotiations will not eliminate the need for continuing U.S. attention to many non-tariff barriers.

The President's January 4, 1979, message to the Congress included major U.S. trade barriers which foreign governments might wish to pursue in future negotiations. These include construction and operating differential subsidies for U.S. ships; tax deferrals on export income of Domestic International Sales Corporations; and removal or relaxation of Food and Drug Administration regulations for registering, licensing, and testing various imported drugs.

Our January 1974 report, "Need For Better Identification and Analysis of Non-tariff Barriers To Trade" (B-162222), reviewed the executive branch system for identifying and analyzing non-tariff barriers and recommended that efforts be increased to identify such barriers through Embassy, industry, and other available sources. We also recommended improved consultative procedures with private industry and trade associations so that action could be taken to protect U.S. interests. These principles are appropriate for future U.S. consideration because some countries may merely substitute new barriers for old ones.

In some cases, it may be appropriate to deal with trade problems on a bilateral basis. For example, the Joint U.S. Japan Trade Facilitation Committee and the Trade Study Group were established to deal with the trade imbalance, the major source of trade problems between the two countries. The January 1979 Task Force Report on United States-Japan Trade of the Subcommittee on Trade, House Committee on Ways and Means, said, however, that only slow progress was being made on trade barrier cases and that it was necessary for agreements to be reached at the highest political levels to provide faster resolutions. The report stated:

> "The problem of our $12 billion trade deficit with Japan is immediate. It cannot wait on the time it will take the U.S. Congress to consider approval of the MTN [Multilateral Trade Negotiations], nor the months and years which will be involved in implementing the MTN's various codes and tariff reductions. Further, many of our trade problems with Japan seem uniquely 'bilateral' or 'Japanese,' and may not be addressed by the MTN process, although the MTN codes, if effectively implemented, will be a big help. The urgency of the situation justifies this approach."

Concern about foreign trade barriers does not mean that the United States itself has no major impediments to trade. To the contrary, it has an extensive network of industrial and agricultural barriers.

The Labor Department study mentioned earlier calculated that without U.S. tariffs, U.S. imports in 1974 would have been $6 billion greater and the increased imports would have displaced 361,000 jobs. Although the United States would gain more in exports and jobs from elimination of

foreign tariffs than it would lose from elimination of U.S. tariff barriers, the net gains would be small.

We addressed U.S. agricultural non-tariff trade barriers in several earlier reports. "Marketing Order Program--An Assessment of Its Effects on Selected Commodities" (Apr. 23, 1976, ID-76-26) and "U.S. Import Restrictions: Alternatives to Present Dairy Programs" (Dec. 8, 1976, ID-76-44) recognized the important ramifications on both sides of the issue--large-scale disruption in the agricultural sector if the present protection were eliminated on the one hand; higher consumer costs and continued domestic employment on the other hand. An essential point made in the reports was the need for better attention to the tradeoffs between domestic and international objectives.

CHAPTER 8

SHOULD SOMETHING BE DONE ABOUT IMPORTS?

A major factor in the current U.S. trade deficit is the rapid growth of U.S. imports--a growth so sizeable that between 1975 and 1978 it more than doubled that of U.S. exports. U.S. merchandise trade, on a balance-of-payments basis, during this period was as follows.

	1975	1976	1977	1978
	(billions)			
Exports	$107.1	$114.7	$120.5	$141.8
Imports	-98.0	-124.0	-151.7	-176.0
	$ 9.1	$ -9.3	$-31.2	$-34.2

The frequent Presidential admonitions to limit energy imports demonstrate the importance the executive branch places on petroleum imports. However, petroleum products accounted for about only 19 percent of the $78 billion growth in U.S. imports between 1975 and 1978. The OPEC oil price increases announced in late 1978 and mid-1979 will greatly increase the pressure to improve U.S. export performance. The petroleum and petroleum products import bill for 1979 could be about $65 billion as compared with about $43 billion in 1978. The 1979 figure is based on the present OPEC oil price structure and a continuation of petroleum and petroleum products imports for the last 6 months of 1979 at levels similar to the first 6 months. Also, OPEC is scheduled to meet again in September, raising the prospect of further price increases.

The other 81 percent of the growth in imports is also important quantitatively but receives far less attention. Energy imports received the only mention in the President's September 1978 announcement of steps to help the U.S. trade position. A not so obvious fact in the rise of imports is that the United States is increasingly importing more expensive processed minerals. Such imports increased from $7 billion in 1972 to $19 billion in 1978.

The substantive import growth from 1975 to 1978 in major product categories is shown below.

	1975	1976	Percent change	1977	Percent change	1978	Percent change
	(billions)			(billions)		(billions)	
Agriculture products	$ 9.5	$11.2	18	$13.5	20	$15.0	11
Crude materials	5.6	7.0	25	8.5	21	9.3	9
Mineral fuels	26.5	34.0	28	44.5	31	42.1	-5
Chemicals	3.7	4.8	30	5.0	4	6.4	28
Manufactured goods	14.7	17.6	20	21.4	22	27.2	27
Machinery and transportation equipment	23.4	29.8	27	36.4	22	47.6	31
Misc. manufactured goods	9.2	12.6	37	13.8	10	19.1	38

The above commodity groups accounted for $74.1 billion, or about 95 percent, of the $78.0-billion increase in import growth between 1975 and 1978.

It is worth noting that, in competition for the U.S. market, U.S. producers face an international trading regime which has many motivations for exporting to the United States. Accordingly, the regime constitutes a different set of conditions to cope with, principally the (1) need for many countries, including centrally planned economies, to earn foreign exchange, (2) commitments on the part of many industrialized countries to sustain high domestic levels of employment, and (3) desire by less developed countries to add value to their basic raw materials through processing. The vehicles for much of this activity are national marketing enterprises, such as those in Europe selling the Airbus and the steel companies in the United Kingdom and elsewhere.

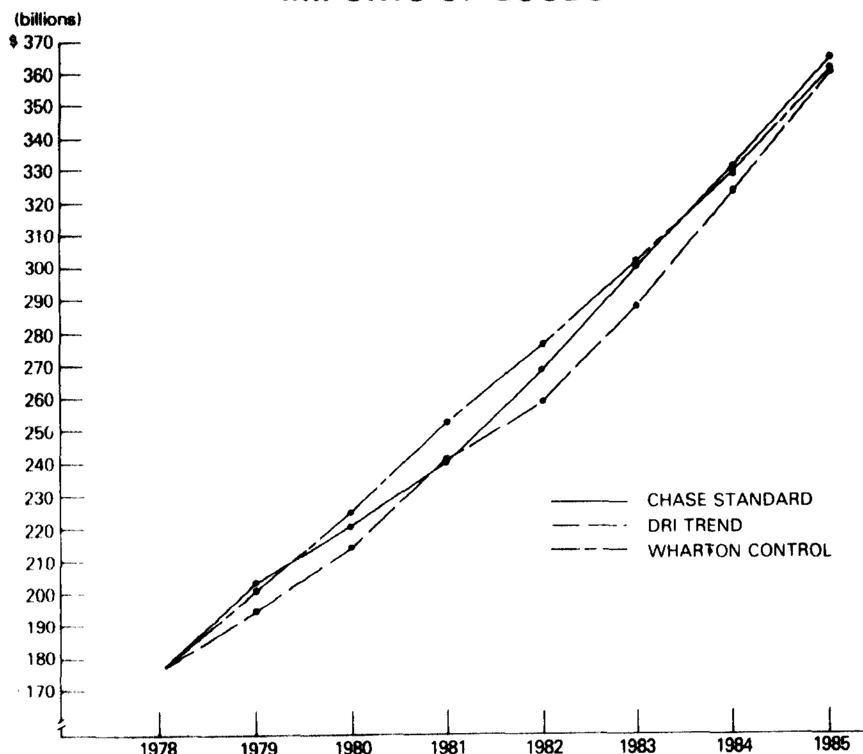
Over the years, criticism has been directed at the United States for such import restrictive Government purchasing policies as the Buy American Act and other buy-national legislation. However, the United States is not

more restrictive than Great Britain, France, Germany, and Japan, which often rely on subtle administrative guidance and practices which effectively preclude most foreign competition.

Much Government procurement is not subject to foreign competition, not because of buy-national practices but because domestic suppliers have tremendous inherent practical advantages--language, proximity, and familiarity.

Under the Multilateral Trade Negotiations, reciprocal access to one another's markets by trading off domestic preference legislation has been agreed to. It may be years, however, before the real significance of these agreements, in terms of ensuring equitable reciprocity for U.S. firms, is fully understood.

The trend in U.S. imports is expected to continue, as shown below.



Industrialized countries continue to seek expansion of export markets, while greater access to U.S. markets is accorded to (1) lesser developed countries under the Generalized System of Preferences, (2) centrally planned economies through increased barter transactions and through granting most-favored nation status, and (3) other industrialized

countries as a result of the Multilateral Trade Negotiations. Theoretically, there are advantages associated with the larger freedom of choice among imports and the transfer of resources from less to more efficient industries because of imports. On the other hand, there are possible disruptions of domestic industry, loss of jobs, and large dollar outflows. Notwithstanding these prospects, there seems to be no systematic or continuing analysis of the tradeoffs involved in specific commodities or product lines. Such analysis is of critical importance in addressing the question of the real economic costs of adjusting to changing trade patterns. For example, more research needs to be done regarding what happens to people when an industry or plant declines or goes out of business.

The United States recently passed legislation to increase its Strategic and Critical Materials Stockpile which could result in purchases amounting to several billion dollars, many of the items to come from other countries. Our report and earlier testimony on stockpile legislation 1/ pointed out that serious consideration was not being given to alternatives to physically acquiring materials for the newly established stockpile goals, such as development of substitute items.

Our report on the reasons for the shift in mineral-processing capacity from the United States to other countries 2/ pinpoints environmental control costs as a primary cause. It raises the dual issues of increasing balance-of-payments costs because of the value added overseas as well as whether materials in the U.S. stockpile can be processed domestically to meet U.S. mobilization objectives.

Some lesser developed countries have instituted import-substitution programs designed to conserve foreign exchange by producing previously imported goods domestically. The United States has no such programs except, to some extent, for energy.

The U.S. position is that free and liberalized trade is all right, as long as the competition is fair. Two basic statutes, the Anti-Dumping Act of 1921 and the countervailing duty provisions of the Tariff Act of 1930, provide remedies in the event competition is "unfair."

1/"The Strategic and Critical Materials Stockpile Will be Deficient for Many Years," July 27, 1978 (EMD-78-82).

2/"Government Actions are Hurting the Domestic Mining and Mineral Processing Industry," (ID-79-40).

Our work on antidumping, 1/ however, demonstrates the cumbersomeness and substantive limitations of the Anti-Dumping Act in protecting legitimate corporate interests.

The Trade Act of 1974 has among its purposes the extension of Government assistance to firms and workers (loans, replacement of wages) injured by "fair" import competition. But again, our work shows that most of the firms helped have not adjusted to being more competitive in their industries or changed to industries where they could be competitive.2/ It is impossible to determine whether competition from centrally planned economies is fair or unfair. Yet at least in a regional, micro-employment sense, U.S. industries are jeopardized through the loss of domestic market sales to such competition.

1/"U.S. Administration of the Antidumping Act of 1921," Mar. 15, 1979 (ID-79-15).

2/"Adjustment Assistance to Firms Under the Trade Act of 1974--Income Maintenance or Successful Adjustment?" Dec. 21, 1978 (ID-78-53).

CHAPTER 9

ARE CHANGES NEEDED IN U.S. INVESTMENT POLICIES?

Where investment takes place is a crucial factor in the U.S. trade and payments condition. It not only affects the flow of dollars to and from the United States but also dictates whether goods are produced domestically or abroad and, consequently, whether such goods traded internationally are imports or exports. U.S. Federal investment policy is based on four premises.

1. International investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces.

2. There is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest.

3. Unilateral U.S. Government intervention in the international investment process could prompt counteractions by other governments, with adverse effects on the U.S. economy and foreign policy.

4. The United States has an important interest in seeking to assure that established investors receive equitable and nondiscriminatory treatment from host governments.

U.S. policies on foreign investment have been more liberal and open than those of U.S. industrial allies and developing countries, whose policies range from complicated restriction to extensive monitoring. This lack of reciprocal national treatment includes such practices by foreign countries as limiting capital flows to the United States and obtaining concessions from U.S. investors that distort the free competitive flow of trade.

There is concern on both the domestic and international fronts as to the level of incentives being offered. While the United States is willing to rely on the dictates of the private market to get its share of international direct investment, many other governments are not so inclined. One problem in determining what the U.S. response should be is the lack of transparency as to the incentives offered the investor. Many States actively seek foreign investments and offer special incentives--e.g., tax abatements, revenue bonds, and technical training for prospective employees.

The growth in foreign investment in the United States has remained largely free of regulation. A 1976 Commerce report prepared pursuant to the Foreign Investment Study Act concluded that there is no reason for concern over foreign direct investments (either stocks or flows) and that existing U.S. laws pertaining directly to foreign investments or to domestic business in general (e.g. anti-trust and export controls over natural resources) are sufficient to safeguard U.S. interests against any major problems which could arise.

Nevertheless, there is continuing concern about the effects of foreign investment--e.g., U.S. farms and U.S. banking operations. Information on these types of investment is incomplete and public concern has persisted. It should be noted that this concern applies to a small proportion of inward investment.

Legislation was enacted to increase monitoring of both inward and outward investment, to require reporting of foreign investment in U.S. farmland, and for Federal regulation of participation by foreign interests in banking operations in the United States.

Foreign assets in the United States as of December 31, 1977, totaled $311.3 billion, consisting of OPEC official deposits ($35.0 billion), other countries' official assets ($108.1 billion), other foreign direct investments ($34.1 billion) and non-official foreign assets ($134.1 billion). Of the nonofficial foreign assets, $66.3 billion, or about 49 percent, was in U.S. Treasury securities and other short-term liabilities.

European countries and Canada held most of the $34.1 billion in other foreign direct investment, which was concentrated in the manufacturing and trade investment areas.

Foreign investment can provide a net economic benefit to the domestic economy. The capital, jobs, increased competition created, and technology transferred into the country may far exceed any negative effects. This seems to be particularly true for establishing new manufacturing facilities, or expanding and modernizing existing projects.

One expert witness testifying before a congressional committee commented that there is greater possibility of adverse economic consequence in a case of a takeover of a U.S. firm by a foreign competitor. First, an attractive tender offer by a foreign firm may catch the U.S. owner unaware and induce him to sell out at an uneconomic price.

Second, it would then reduce the number of firms competing in the U.S. market. The witness noted that additional information and monitoring of the takeovers of local firms may be useful.

National security must also be considered. Although such danger is generally perceived to be minimal, during a domestic crisis, decisions which are made abroad may not be sufficiently responsive to U.S. Government-directed actions. An added cause for concern is that, in the event of significant shifts in foreign investor attitudes toward the U.S. economy, U.S. assets could be sold precipitously.

Federal restrictions are imposed on foreign investment in certain sectors of the economy. These include radio communications, nuclear energy, domestic air transport, mining on Federal lands, fishing, and coastal and inland shipping. In addition, some States impose restrictions on foreign investment, particularly in banking, insurance, and land ownership.

Our October 7, 1977, report, "Controlling Foreign Investment in National Interest Sectors of the U.S. Economy" (ID-77-18), recommended that regulatory and other agencies assess the reliability of their foreign investment data and periodically summarize it for U.S. policymakers.

Foreign-owned firms in the Unites States generally have the same rights and responsibilities under the law as U.S. firms. They are permitted to compete for procurements by U.S. Government agencies, subject to clearance procedures involving classified contracts, and no restriction is placed on their repatriation of capital and remittance of earnings. Investment by both domestic and foreign investors is encouraged by the investment tax credit and the accelerated depreciation allowance privileges of the Federal income tax law.

The Foreign Investment Study Act of 1974 (Public Law 93-479) and the International Investment Survey Act of 1976 (Public Law 94-472) provide for studies of foreign investment in the United States. Some of the information sought (e.g. beneficial owners) may not be known by foreign-owned firms in the United States. This information may be difficult to obtain if it is held only by foreign firms who are in turn owned by other foreign firms.

INVESTMENT FLOWS FROM THE UNITED STATES

U.S. assets abroad as of December 31, 1977, totaled $381.3 billion. Direct investments ($148.8 billion) constituted about 39 percent of this amount. U.S. investment was concentrated in Canada and Europe in manufacturing and petroleum.

U.S. policy recognizes the right of each country to determine the environment in which foreign investment takes place in that country. Some foreign countries discriminate against U.S. firms or do not give them opportunities comparable to those given their firms in the United States.

Developing countries also are becoming more selective about the type and magnitude of foreign investment permitted in the domestic economy and are requiring compliance with more stringent terms of entry and operation. In some cases, the result is expropriation of foreign investment or other actions which may have similar effect, such as coerced change, equity ownership, cancellation or forced renegotiation of contracts, or concession agreements and confiscatory taxation. A Department of State survey of 168 such actions, which may or may not amount to expropriations, shows that 79 arose between February 1, 1975 and February 28, 1977; 64 of the 168 disputes, some of longstanding duration, were settled, leaving 104 cases active at the end of the period.

Some companies in the developing countries have shifted from direct equity investment to management or service contracts or other forms of nonequity participation. This approach leaves American multinationals less vulnerable economically to restrictive practices and is responsive to the desire of many developing country governments to maintain sovereign control over natural resources.

Some governments actively intervene in the investment process in an effort to benefit their national economies. Intervention usually combines incentives to attract investors and performance requirements to assure that firms do in fact contribute to the priorities and social goals of the host governments. These performance requirements usually focus on job creation, technology transfer, buy-national requirements, value added, and export levels.

U.S. officials are critical of incentives that adopt industry-specific, or even firm-specific, measures that redistribute existing investments or divert to a different

location an investment that would have been made in any event. Examples include:

--A recent Canadian offer of $68 million to the Ford Motor Company to build a plant in Ontario instead of Ohio.

--The British enticement of Hoffman-LaRoche, the giant Swiss pharmaceutical firm, with an incentive package approaching $100 million.

--Brazil, Mexico, and other countries' requirements that foreign companies produce locally up to 100-percent of the value as a condition of participation in automobile industries; this is equivalent to a zero import quota on parts and other imports and is relaxed only as the companies expand their exports.

All such arrangements have the effect of shifting the location of investment across national borders. If these measures continue to proliferate, more and sharper conflicts between governments appear inevitable. The conflicts will also be harder to resolve in the absence of international arrangements which address these problems.

Other matters causing discord include:

--Host governments assert the right to control foreign-owned subsidiaries as a normal exercise of jurisdiction over their nationals. Although U.S. laws, regulations, and policies affecting multinational firms have been carried out unilaterally without full consideration of their international dimensions, home-governments feel a responsibility for protecting the foreign-property interests of their nationals.

--Governments, because they can observe affiliates of foreign firms located only in their jurisdictions and not the multinational enterprises as a whole, are concerned that they are unable to assess the real impact of the firms. This concern arises in the context of investment levels, taxation, competition, and labor relations as well as in other areas.

--Governments also clash over efforts to influence the behavior of an affiliate in another country's

jurisdiction, efforts that sometimes involve commands to the parent to be relayed to a subsidiary.

--U.S. investment opportunities are substantially reduced in Japan because of the Japanese practice that enables a firm to be acquired by another domestic or foreign firm only when it is on the verge of bankruptcy. This means that U.S. companies cannot acquire a successful or even moderately successful Japanese manufacturer. It is a very long and arduous process to establish a 100-percent owned subsidiary in Japan.

--Until recently, the United States was unsuccessful in negotiating income tax treaties with developing countries, many of whom, contrary to U.S. policy, want tax treaties to contain some form of U.S. tax incentive for investments in their countries. Some developing countries have come to recognize that a treaty with the United States, even without an explicit tax incentive element, can make a valuable contribution to their economic development.

Our May 20, 1977, report to the Congress, "Nationalization and Expropriations of U.S. Direct Private Foreign Investment: Problems and Issues" (ID-77-9), stated that the success of efforts to protect private foreign investments against expropriation and nationalization by developing countries are inconclusive, mainly because of developing countries' objections to establishment of international investment codes. Also, some capital-exporting countries are not willing to join in any unified effort that would appear to confront the developing world on which they depend for raw materials and as markets for their exports. We recommended that the Secretary of State initiate a broad-based effort to negotiate treaties of friendship, commerce, and navigation emphasizing protection of private foreign investments with developing countries where significant potential for U.S. private investment exists.

CHAPTER 10

CAN PRODUCTIVITY BE INCREASED TO MAKE U.S. PRODUCTS MORE COMPETITIVE?

The words productivity and competitiveness carry greater emotional content today because of heightened concern over the decline in U.S. productivity growth rates and the deficit position of the United States in merchandise trade.

Generally speaking, productivity reflects the efficiency of the U.S. economy. There are a number of ways of computing productivity, but the one most frequently used for international comparisons is:

$$\text{PRODUCTIVITY} = \frac{\text{OUTPUT (goods and services)}}{\text{INPUT (manhours worked to achieve that output)}}$$

Competitiveness derives from the interaction of a host of factors bearing on whether goods and services are sold or not, including pricing, financing arrangements for production and sales, after-sale service, quality of the goods, availability, and embodied technology.

Thus, increased productivity, although absolutely necessary, cannot by itself ensure increased U.S. competitiveness in international trade.

U.S. productivity gains have slowed to 50 percent of what they were, roughly a 1.6 percent a year increase since 1967 compared to about a 3.2 percent increase during the years 1947-66. The Economist (Jan. 20, 1979) reported that the United States had the lowest annual manufacturing productivity increase of the industrial countries. Japan rated highest, with France and West Germany next.

The 1979 Economic Report of the President stated concerning the effects of slower productivity growth, that:

> "the consequences are well known. With slower productivity growth, our living standards individually and as a Nation cannot rise as fast. Slower productivity growth means that the resources available for carrying out governmental programs become scarcer. It means that large increases in wages and other incomes put greater upward pressure on costs and prices."

FACTORS IN PRODUCTIVITY DECLINE

The reasons frequently cited for the decline in U.S. productivity are (1) fall-off in capital investment in productivity-related technologies and equipment, (2) increase in service occupations, (3) decrease in research and development funds for new technologies, (4) transfer of productive technologies to foreign countries, (5) heavy cost of regulation, (6) slackening in the introduction of new techniques and equipment, and (7) need for a better business environment in general.

Past GAO reports have addressed some of these issues. Our report, "Manufacturing Technology--A Changing Challenge to Improved Productivity" (LCD-75-436), concluded that the United States must make manufacturing productivity a national priority in order to remain internationally competitive and to maintain strong industries. New technology can help by increasing the productivity of industries that produce goods in small lots. Also, we can learn from foreign industrial nations about the ways they diffuse technological advances throughout their manufacturing bases.

Our report, "The Federal Role in Improving Productivity--Is the National Center for Productivity and Quality of Working Life the Proper Mechanism?" (FGMSD-78-26) noted that the National Center was falling short as a means to accomplish productivity goals and that the Federal Government needed a stronger continuing program in this area. The report recommended that the Center's functions be assigned to existing agencies and that these agencies be given adequate funding and support.

WHAT HAS HAPPENED?

It seems that while the United States was resting on past successes, other nations were selecting the best U.S. technologies. These nations were also imitating past U.S. successes with government, industry, university, and labor partnerships; developing their own strengthened version of these relationships; and focusing their energies on applying those technologies to domestic and international markets. Competitor countries have been able to concentrate on nondefense, commercial applications of the best available technologies. Moreover, they have developed a formidable array of planning mechanisms, incentives, and disincentives to support rapid industrial growth. These arrangements are difficult for U.S. industry to compete against.

The U.S. international competitive situation has been complicated by poorly developed operating arrangements between Government and industry. Beginning in about 1925, the United States demonstrated that a close partnership between industry, Government, universities, and labor was essential to rapid, focused, economic growth. In most of these partnerships, the linkage was formed to advance technological change and was most prominent in defense, aerospace, energy, and agriculture. The more recent successful arrangements, however, have been associated with products for which the Government itself has represented a major market share, such as computers, numerical control machinery, and aircraft. Incidentally, these industries contribute to a positive U.S. manufacturing trade balance and have impressive productivity growth records.

It is clear that U.S. partnership arrangements in many areas of manufacturing activity have been conspicuously replaced by an environment which has created an unprecedented level of uncertainty in the dealings between these elements of society. This uncertainty itself has created inordinate risks with innovating new technologies to enhance productive and competitive growth.

The adversary relationship at home and the obvious non-adversary relationship between government and industry abroad has caused domestic industrialists to perceive the marketplace as a far more risky place today. Consequently, they are reluctant to make financial commitments to technological innovations whose profitability will not be known for 8 to 10 years. Industrialists view the confluence of Government control actions as a sign of their inability to influence their own market destinies and, equally important, as a precedent both for further Government market involvement and mandated expenditures of their profits.

The method and degree of Government involvement, regardless of its social merits, appears to have inhibited U.S. innovative economic growth. Federal Government involvement has heightened the perceived risks of bringing innovations into commercial production; reduced commitments to research and development; caused a retrenchment in venture capital; encouraged the foreign licensing of technologies and relocation of manufacturing facilities outside the United States; exacerbated a domestic slowdown in productivity growth; and indirectly fostered an increasing reliance on foreign materials and products.

Alternative productivity simulations

A key determinant of non-inflationary economic growth is an adequate level of productivity. Relatively strong growth in industrywide productivity may positively affect the U.S. trade balance. In an attempt to quantify the effects of increased productivity on the U.S. trade balance, we used the Wharton Annual and Industry Forecasting Model to simulate the effects.

Two simulations were made--a "high" productivity simulation in which manufacturing productivity was assumed to grow at an average rate about 30 percent above the 1979-86 average annual baseline forecast rate and a "low" productivity simulation that assumed that productivity was growing at a rate about 30 percent below the baseline productivity forecast rate. The 30-percent range was chosen because such changes in the growth rate of manufacturing productivity are consistent with historical experience.

Productivity Growth Rates -
All Manufacturing Industries

	Actual	Forecast								
	1978	1979	1980	1981	1982	1983	1984	1985	1986	Annual average
	(percent)									
High scenario	1.6	2.7	3.3	4.0	4.3	3.5	2.9	2.6	3.5	3.4
Baseline	1.6	1.7	2.2	2.9	3.3	2.9	2.5	2.3	3.3	2.6
Low scenario	1.6	1.5	1.8	2.5	2.7	2.0	1.4	1.1	2.7	2.0

The baseline forecast used for comparison purposes is the standard Wharton estimate (March 27, 1979) of long-term trends in the economy. All trade account figures presented are in constant 1972 dollars except the current account balance, which is in nominal dollars (i.e., not adjusted to account for the effects of inflation).

In the Wharton econometric model, the rate of manufacturing productivity growth can be altered by changing the level of labor force participation and the amount of capital investment. The high productivity simulations were run lowering the labor force participation rate, which has the effect of increasing productivity by lowering the number of new, young, and generally inexperienced workers entering the labor force. Business investment was also increased

by altering the provisions of the investment tax credit, which has the effect of increasing the capital to labor ratio (which, in turn, increases manufacturing productivity as well as lowering the unemployment rate). These variables were appropriately adjusted to obtain the desired 30-percent average change in the manufacturing productivity rate.

Changes in productivity alter the U.S. trade balance through the effect on exports and imports of goods and services. Increasing productivity should increase the exports of goods and services by making them more price-competitive. However, the simulations show U.S. exports to be relatively insensitive, on a percentage change basis, to the assumed changes in productivity growth rates. This insensitivity can be seen by comparing the differences in average productivity over the 9-year period between the high and low simulation with the difference in average exports of manufactured goods over the same period. While average productivity was 70 percent higher, the difference in average exports of manufactured goods was only 2.5 percent higher. Over the period, exports increased $16.5 billion in the low scenario and $20.4 billion in the high scenario.

Manufactured Goods Exports

	Actual	Forecast (1972 dollars)							
	1978	1979	1980	1981	1982	1983	1984	1985	1986
	(billions)								
High Scenario	$53.9	$59.2	$60.6	$59.2	$61.5	$64.7	$67.4	$70.4	$74.3
Baseline	53.9	59.1	60.2	58.6	60.7	63.7	66.3	69.7	73.4
Low Scenario	53.9	59.1	60.1	58.3	60.2	62.9	64.9	67.6	70.4

Since net exports of goods and services can only be calculated after deducting imports, it is necessary to measure the effect of productivity changes on imports. Changes in U.S. productivity affect imports primarily by changing the price competitiveness of those industries that manufacture import substitutes.

As shown below, the alternative assumptions regarding productivity have only a marginal effect on imports. Over the 9-year forecast period, a lower growth in productivity would raise imports on the average only 1.8 percent.

Imports of Goods and Services

	Actual	Forecast (1972 dollars)								Annual average
	1978	1979	1980	1981	1982	1983	1984	1985	1986	
	(billions)									
High scenario	$98.6	$104.2	$107.7	$111.3	$113.6	$118.0	$121.4	$126.1	$131.6	$116.7
Baseline	98.6	104.7	108.1	111.7	114.2	118.4	121.4	125.7	130.7	116.8
Low scenario	98.6	104.9	108.4	112.2	115.0	120.0	124.1	129.8	136.4	118.9

Goods and services exports account for only $6.6 billion of the $11.5 billion net export surplus between the two productivity scenarios in 1986 (see table below). The remaining $4.9 billion reflects a net decrease in imports in the high productivity simulation (from what they would be in the low productivity simulation), most of which occur in the lower technology, non-auto, non-aircraft manufactured goods import sectors. Low productivity in import-competing U.S. industries places the products of these industries at a competitive cost disadvantage compared with imports. Fewer exports and increased imports in the low productivity simulation is reflected in a 1986 net export surplus of about one-half of the high productivity scenario.

Net Exports of Goods and Services

	Actual	Forecast (1972 dollars)							
	1978	1979	1980	1981	1982	1983	1984	1985	1986
	(billions)								
High scenario	$8.4	$14.8	$16.3	$15.4	$17.9	$20.2	$22.7	$23.4	$23.9
Baseline	8.4	14.1	15.4	14.3	16.2	18.0	20.3	21.3	22.9
Low scenario	8.4	13.8	15.0	13.6	15.0	15.6	16.1	14.4	12.4

The cumulative net export of goods and services over the 9-year period is $38.7 billion greater, or an average of $4.3 billion larger per year, using the high scenario productivity assumptions. While this is large in absolute terms, it is less than .1 percent of cumulative gross national product over the same period.

Balance on Current Account

Forecast (current dollars)

	1978	1979	1980	1981	1982	1983	1984	1985	1986
	(billions)								
High scenario	$-17.0	$-6.8	$-6.4	$-14.3	$- 8.2	$-2.3	$5.1	$9.3	$12.3
Baseline	-17.0	-7.9	-7.1	-14.9	-10.4	-5.8	0.1	3.6	7.7
Low scenario	-17.0	-8.2	-7.5	-15.4	-11.2	-8.1	-4.6	-5.0	-7.2

The current account of the balance of payments, under the assumption of low productivity growth, remains in deficit throughout the forecast period. However, with higher productivity growth, the balance on current account is forecasted to swing into surplus by 1984 and to remain in surplus to the end of the forecast period, 1986.

PRODUCTIVITY AND COMPETITION REESTABLISHED

The answer to restoring the U.S. productive and competitive edge is deceptively simple; however, implementation may be exceedingly complex.

One of the surest ways is to systematically reestablish the "arms length" partnership and cooperation between the elements of society now separated by an adversary relationship.

Moreover, as technology is a key ingredient in innovation, productivity, and competition, it seems appropriate that a first step in reestablishing the arms length relationship would be to facilitate greater cooperation in the systematic development of technologies which will significantly enhance both productivity and competitiveness of U.S. products. This process would require the cooperative assessment of the technologies, together with the existing array of incentives and disincentives for their innovation, and appropriate mechanisms for translating the technologies into competitive products. It would also require close cooperation with labor as some productivity-related technologies have the prospect of seriously disrupting industry employment levels. Thus, an integrated approach is necessary.

CHAPTER 11

WHAT IS THE RELATIONSHIP BETWEEN TECHNOLOGY TRANSFER AND TRADE?

Export control regulations define technical data (technology) as information that can be used, or adapted for use, in the design, production, manufacture, or reconstruction of articles or materials. The data may be in a tangible form, such as a blueprint, or an intangible form, such as a technical service. The President's report to the Congress, August 1978, under the International Security Assistance Act of 1977 defines technology as essentially know-how--ways of designing, manufacturing, or utilizing things. Technology transfer is the act of conveying know-how from one country to another.

During the past decade the U.S. technological lead has been reduced in some fields due to increased foreign research expenditures and the transfer of U.S. technology abroad through direct foreign investment, licensing, and other channels. These developments have important ramifications for the United States because they affect the composition of future world trade, domestic employment levels and skills, and the continuation of innovative economic growth. Much of the concern about U.S. nonstrategic technology centers around transfers to foreign competitors while U.S. productivity and competitiveness languish.

The United States has long favored an open international economic system, including an open system for technology transfer (except for weapons systems, military equipment, or strategically significant technology). This reflects the basic belief that U.S. economic interests are served by an expanding world economy in which other countries are increasingly able to buy U.S. products and the United States is able to receive and use technological advances made abroad.

U.S. leadership in various technologies is an important source of U.S. political and economic strength. U.S. political relations with other countries have been strengthened through active technological exchange programs, while strong support of research and development by the Government and the private sectors have assured technological advances. Traditionally, U.S. exports of high-technology-intensive goods have been an important factor in a positive trade position.

The United States could not exist in a sophisticated, technologically oriented world with policies which either were unduly protective of its technologies or inhibited the relatively free flow of other countries' technologies to its markets. Nevertheless, a balanced approach requires an awareness of the benefits and costs of policy actions associated with specific industrial technologies. It could be advantageous, for example, for the United States to insure that a specific technology be applied in a domestic industry that is ineffectively competing in world markets rather than be sold abroad to later compete in U.S. markets. Legislation has, in the past, been introduced to restrict the export of such technology.

The United States knows very little about international transfers of its technology and their net effects on the domestic economy. A comprehensive data base and understanding of what is happening is vital. However, because of the varying definitions of technology and technology transfer and the broad array of mechanisms through which technology can be transferred, there is no single set of records or statistics documenting the complete flow of technology to or from the United States. As described in our March 27, 1978, report, "U.S. Statistics on International Technology Transfer--Need for Additional Measures" (ID-78-24), the only national technology transfer data comes from receipts and payments for royalty and licensing fees, which tell very little about the nature of the technology transferred.

It is not clear, therefore, whether the transfer of U.S. technology overseas has, historically, resulted in a net loss of U.S. jobs. Some people fear that outflows and inflows of technology which substantially substitute for U.S. exports can lead to relative gains in other countries' technological capabilities. Others argue that technology exports are not necessarily detrimental to the United States and, in fact, have important economic benefits, such as new export markets or foreign production facilities being located in the United States to market their technologies. Steps could be taken to assess the effects on the U.S. economy by considering the employment and business consequences of such transfers. Unfortunately,

the United States appears to lack a sectoral analysis capability to intelligently make the tradeoff decision. 1/

In response to U.S. technology slowdowns, the administration in early 1978 ordered a domestic policy review of the Government's role in helping or hindering industrial innovation. This review, involving 28 agencies, could produce meaningful options for corrective action by the President, and input will come from private companies, universities, labor unions, and public interest groups.

The Government must address the question of what to do about technology transfers, but it must also address the issue of how to keep advancing its technology. Although demand for U.S. technology remains substantial, there is a clear perception that U.S. innovativeness has declined. The rate of increase in U.S. productivity has slumped severely, while investment in research by both U.S. public and private sectors over the past 8 years has shown essentially no growth in constant dollars.

Spending for U.S. public and private research and development investment has decreased from a peak of 3 percent of gross national product in 1964 to about 2.3 percent today. Although this is comparable to research and development spending in other countries, almost 50 percent of U.S. Government spending is dedicated to defense projects. Total funding for industrial research and development has barely kept up with inflation and increases in private industry funding have been offset by decreases in Federal funding.

There is also growing concern over the diversion of industrial research and development from starting new and improved products, processes and services toward satisfaction of regulatory requirements. For example, the Industrial Research

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1/A December 1976 report, "Government and the Nation's Resources," by the National Commission on Supplies and Shortages identified the need for sectoral specialists to integrate information produced by agencies and departments into a comprehensive picture of how Government policies combine to affect basic industry, and, beyond that, the national interest. Further, the report noted that Government policies developed and implemented without an understanding of how they affect industries and interact with other policies often create more problems than they solve.

Institute reported the following average growth rates during 1974-1977 in research and development efforts devoted to satisfying the requirements of proposed legislation, 19.39%; OSHA, 16.0%; environmental, 15.4%; product safety, 10.0%; and other regulations, 11.9%.

Gross measures, such as R+D expenditures as a percentage age of gross national product, are helpful in measuring funding trends. However, we recognize that there are reservations about this measurement. Despite the differences in methods and data, there is consensus that research and development is an important contributor to economy growth and productivity. More work on measurement is required and our office is currently involved with such an effort.

Other factors have impinged on U.S. innovativeness. Government regulations and red tape have increased. Uncertainty and the long process of obtaining the necessary waiver from the head of an agency to secure an exclusive patent on Government-sponsored research affects the extent to which some technologies are actually applied. Also, investment capital has not been as available to finance the risks of innovation. Between 1969-76, the maximum tax rate on capital gains was increased from 25 percent to a potential 49 percent, cutting the gains on high-risk investments to an effective return of about one-half and dampening enthusiasm for such investment.

Additionally, a 1974 statement by the Financial Accounting Standards Board stipulated that research and development spending must be charged as an expense in the year incurred. This statement reduces the profit for the year the expense is incurred and has had the effect of drying up potential venture capital investments. It has also affected small, technology-oriented companies trying to arrange public financing. According to one Government study of such companies, 204 small technical companies found public financing in 1969 but only 4 were able to raise money publicly in 1974. Established companies have also experienced difficulty in raising venture capital, and some have canceled plans to start small operations built around interesting new technology.

Newsweek (June 6, 1979) reported that venture capital has now become more abundant. However, venture capitalists tend to be more conservative, concentrating their investments in companies with at least a few years of experience and some solid indication of ultimate success.

In summary, U.S. transfers of nonstrategic technologies are neither inherently good or bad. An intelligent policy approach would be to carefully assess the net costs to the U.S. economy from the possible transfer of specific technologies. A data base is needed for identifying the nature of available technologies and a methodology for calculating net economic costs. Most important is the need for a better understanding of the effects of international technology transfer on the U.S. economy, international competitiveness, employment, productivity, and innovation. Continued U.S. technological innovation must be encouraged through increased private funding for research and development stimulated by Government incentives and expenditures if the United States is to remain in the forefront of world trade competitiveness.

CHAPTER 12

WHAT EFFECT DOES GOVERNMENT REGULATION HAVE ON EXPORTS AND IMPORTS?

Government regulations affect both the levels and types of U.S. exports and imports. At times, foreign trade impacts are the direct and intended result of regulations. More often, though, regulations intended to achieve domestic goals have unintended secondary effects on U.S. trade and payments positions.

Today, there are numerous Federal regulatory agencies. Published cost estimates of complying with Federal regulations are in the billions of dollars. The huge budgetary and compliance costs involved cover areas such as energy, environment, health, safety, research and development, antitrust, and tariffs. In an attempt to assess the impact of regulation, the President's Regulatory Council is required to publish a biyearly calendar of Government regulations, listing their goals, legal requirements, and estimated economic impacts.

Many people believe that changes can be made in the regulatory process to achieve the desired goals for the environment, workplace, and consumer products with minimum adverse impact on other important goals, such as more jobs, less inflation, and a sound U.S. trade and payments position. To achieve this would require the balancing of the goals of regulation against these other goals. In general, such balancing requires

--an understanding of the interrelationship of efforts to further national objectives;

--assurance that regulations are soundly developed to achieve their objective in the least burdensome manner; and

--a mechanism for identifying and reconciling conflicting objectives where possible and for mitigating the effects of irreconcilable conflicts.

Environmental, health and safety, and antitrust regulations are among the most important that affect U.S. trade interests.

ENVIRONMENTAL, HEALTH, AND SAFETY REGULATIONS

A variety of Government agencies administer regulations aimed at improving the environment and enhancing worker health and safety. As stated in the 1979 Annual Report of the Council of Economic Advisers:

> "In recent years social regulation has greatly extended its scope and increased its complexity. Much of this heightened activity has been in response to growing public concern about an ever-widening range of environmental, health, and safety problems. It has also been spurred by our increasing ability to detect potentially harmful health effects from chemicals or chemical reactions. Controlling the harmful side effects of economic activity produces substantial benefits to society. But it also imposes costs, and these have mounted significantly as the scope and stringency of regulation have increased."

Although compliance with regulations is costly, compliance with environmental or safety regulations has in some instances encouraged industry to find less costly productive techniques. However, this is not true for all industries and has raised concerns that the benefits derived may be offset somewhat by unforeseen side effects. For example, our work in the minerals area has shown that compliance with environment and health and safety regulations has made investment in U.S. mineral projects less attractive. Regulatory compliance has contributed to the trend toward investment in overseas mineral production. This trend has resulted in the United States becoming more dependent on foreign processed minerals, in lost employment opportunities, and in higher import costs.

In general, other countries have more flexible approaches to regulation for protecting workers and the environment than does the United States. In some countries, the way regulations are applied is part of a deliberate attempt to attract foreign investment; in others it is often an active attempt to minimize the burden that regulations impose on industries by allowing companies more flexibility in the timing and method of compliance. In addition, some countries are willing to support the additional cost of compliance with government authorized grants. Whatever the reasons, the burdens of complying with U.S. regulations are usually significantly greater than burdens of compliance in other countries. For

example, U.S. worker health and safety standards are applied at all locations generally, without regard to circumstances. In contrast, other countries apply their standards case by case, obtaining the level of compliance feasible for each particular facility and seemingly giving priority to the continued operation of the facility. The United States prefers engineering controls (design of processing machinery and facilities to contain emissions) for achieving compliance, while less expensive control methods, such as protective clothing, respirators, and work practices, are acceptable in some foreign countries.

Greater worker safety, fewer accidents to consumers from unsafe products, cleaner air and water, better health, and other improvements are all benefits of Government regulation. On the other hand, the added costs of regulation can deter investment in U.S. production capability, limit modernization of U.S. facilities, restrict funds for research and development of new products and production techniques, add to the price of U.S. goods, and detract from the competitiveness of U.S. business. We did not comprehensively examine the effects of regulations on a broad segment of U.S. industry; but, for minerals, regulations have contributed to accelerating the flight of U.S. processing facilities to overseas locations. One result is that the costs of U.S. minerals imports increase even more as the United States shifts from purchasing raw materials to purchasing processed materials.

Regulations also extend into the international market. Potential exports financed by the Export-Import Bank have been delayed, pending environmental impact statements on the exports' impacts in the foreign countries. This dispute between exporters and environmentalists and their respective agencies was addressed in the President's National Export Policy statement of September 1978. Guidelines were issued by Eximbank on August 30, 1979, clarifying the Bank's procedures for its loan and insurance programs. Until some experience is gained under the guidelines, it is impossible to know the effect that environmental considerations will have on the Bank's financing activities.

ANTITRUST REGULATIONS

U.S. antitrust policy is one of the most extensive and rigorous in the world. The Department of Justice considers that when foreign transactions have a substantial and foreseeable effect on U.S. commerce, they are subject to U.S. law regardless of where they take place. Where foreign

activities would have no direct or intended effect on either U.S. consumers or export opportunities, Justice's Antitrust Guide indicates that the U.S. antitrust laws do not apply. Despite Justice's statements that joint ventures and other forms of cooperative arrangements can be formed for export purposes without violating antitrust laws, business remains very leery of the possibility of violations. Whether or not business' perceptions are valid, there is little doubt that these perceptions limit the desire of more businesses to form cooperative export arrangements.

These perceptions have the effect of limiting trade, and present indications are they will continue to do so. The President spoke to this problem in his National Export Policy statement when he instructed Justice, in conjunction with Commerce, "to clarify and explain the scope of the antitrust laws in this area, with special emphasis on the kinds of joint ventures that are unlikely to raise antitrust problems." Justice's response to this direction has been to agree to the reprinting of its Antitrust Guide For International Operations; however, its reprinting raises a question as to what other changes, if any, can be expected in resolving this problem.

One area needing clarification concerns the Webb-Pomerene Export Trade Act of 1918, which provides qualified exemptions from antitrust laws to export trade associations. The Act was intended to provide a means of placing U.S. exporters on an equal competitive footing with foreign business combines and to allow small U.S. enterprises to share in foreign markets. In our August 1973 report, "Clarifying Webb-Pomerene Act Needed To Help Increase U.S. Exports" (B-172255), we concluded that the potential of the Act will not be fully realized until the antitrust implications have been clarified and the goods, wares, and merchandise provision expanded to specifically include the export of technology-related items, including architectural, engineering, and management services. This would create an environment in which U.S. firms might more readily join together and present a complete package, including financing, technology, equipment, and commodities, in competing for large-scale projects abroad.

The Act has not realized its goal of increasing U.S. exports and presently is not very useful. There is considerable difference of opinion as to why this situation exists. On the one hand, Commerce believes that the failure to clarify the Act to include the export of services, technological know-how, and other intangible property has

fostered a costly, competitive disadvantage for U.S. exporters as these types of activities have become a larger part of the international market. Even if these activities were included in the Act, Commerce and the Federal Trade Commission believe that the laws' provisions will not be fully used due to U.S. exporters' inhibitions concerning Justice's application of the antitrust laws in international trade.

For its part, Justice does not think that the Webb-Pomerene exemption is needed. Under current antitrust law, an export association can be formed as long as it does not interfere with domestic competition or inhibit competition in third markets. Justice's analysis shows that the Act has not been a means of getting the small business sector to export.

Antitrust laws may be important to attaining U.S. trade objectives. The continuing debate between Government and business concerning the application of such laws to certain aspects of international commerce demonstrates the problem of agencies with differing views on how to achieve national objectives and the absence of a means to ameliorate the conflicts. Trade promotion and market development agencies have not been able to persuade regulatory agencies of the national importance of trade, and perhaps rightly so. But, neither have they been persuasive enough to achieve a desirable level of coordination. The new National Export Policy does little to resolve this problem, and, under these circumstances, export programs will continue to achieve less than full results.

CHAPTER 13

WILL GOVERNMENT PROMOTION INCREASE U.S. EXPORTS?

Trade promotion is carried on principally by the Departments of Commerce and Agriculture. Commerce provides such direct promotional aids as trade fairs and exhibitions, overseas selling missions, and fixed and flexible trade center facilities, together with related services such as market surveys, listings of trade and investment opportunities, statistical and general information reports, and reference material.

Agriculture provides essentially the same types of services for agricultural products; however, it basically relies on private marketing groups, called cooperators. Agriculture and the cooperators agree on a marketing scheme and, with agricultural attaches overseas, work to carry it out. Commerce, on the other hand, works to create the environment in which trade can take place but relies on the private sector to take advantage of the opportunities thus afforded. Department of State commercial officers at U.S. Embassies help out overseas in creating the environment for trade, protecting U.S. interests, and providing information on foreign economic conditions.

The October 1978 Congressional Research Service study, "Export Stimulation Programs in the Major Industrial Countries; The United States and Eight Major Competitors," provides a comparative profile of the countries and points out that, while there are many similarities, there are some significant differences in the export promotion systems.

PROGRAM EXPENDITURES

The United States does not place as much emphasis on promoting exports as does its major competitors. When measured by export volume--that is, the relation between promotional spending and actual exports--the U.S. program of about $64 million (1976 figures) ranks fifth behind the United Kingdom, Italy, France, and Japan. On the basis of total dollars spent, the United States ranks third behind the United Kingdom and France.

In his September 1978 National Export Policy statement, the President directed the Office of Management and Budget to allocate an additional $20 million for Commerce and State export development programs to assist firms, particularly small and medium-sized firms, in marketing abroad.

It is difficult to gauge the success of U.S. programs in stimulating exports. Agency budget justifications carefully detail successes in establishing products in particular countries, number of business contacts made, trade leads disseminated, and projects won by U.S. companies, etc. There can be little doubt that promoting U.S. products is of some help, but no one knows the real value and the extent to which promotion contributes incrementally to the growth of exports.

Our November 1971 report, "Opportunities for Increasing Effectiveness of Overseas Trade Exhibitions" (B-135239), took issue with Commerce's heavy emphasis on developed countries and old export firms. Commerce has since created a more balanced approach between developed and developing countries and has established regional promotional centers in the Middle East and elsewhere. Additional emphasis has also been given to new-to-market, new-to-export firms.

Our April 1975 report, "The Agricultural Attache Role Overseas: What He Does and How He Can Be More Effective For The United States" (ID-75-40), pointed out the need for more effective use of promotional resources. A series of recommendations were made to aid in selecting the agricultural products and markets which would enhance U.S. trade interests. Agriculture has addressed some of our concerns, but, like Commerce, still lacks a fundamental focus on where the payoff is greatest and has not successfully integrated its other activities (export financing, for example) into an effective market development program.

APPROACHES TO TRADE PROMOTION

Commerce takes the position that the purpose of export promotion is to maximize U.S. exports on a long-term basis, and not to serve as a device for dealing with short-term trade imbalances. It is questionable, therefore, whether conventional promotional means can substantially improve U.S. export performance (when weighed in terms of the dimensions of the immediate problem, a $34-billion trade deficit). Commerce and Agriculture continue to emphasize the vehicles by which products can be sold. Commerce, for example, facilitates appearances at trade fairs where U.S. manufacturers show their wares. Agriculture helps cooperators to promote their products in market areas where exposure is needed. These efforts result in some sales that otherwise would not be made, but there is no causal relationship between the expenditure of government promotional funds and the export performance of a country.

The real potential for increasing U.S. exports lies not in the mere expenditure of promotional funds but in the basic Government-industry relationship for affecting changes in export levels. In that sense, it is worthwhile to contrast U.S. methods with those employed by other industrialized countries.

The United States has not identified specific target industries or companies that it is in the national interest to help nor worked with representatives to attain those objectives in a major market area. To the extent that Commerce worked with industry in the past, planning for such coordination tended to be ad hoc. In short, the United States has had no "export contract" relationship.

In response to the President's export policy statement, Commerce has started to reshape its trade promotion activities. Important internal organizational changes have been made and the budget increased to allow for more specific attention to domestic and foreign promotional needs. Commerce's current plans are to concentrate on and to work more closely with industries having both export potential and a need for its services. It plans to undertake Specialized Assistance Campaigns, focusing on industries with export potential through a variety of activities and assistance overseas and domestically. In contrast to Commerce's approach, which places primary emphasis on industry initiative, governments in European countries and Japan consciously decide which industries and companies they will help and how. In many cases, this closer working relationship is motivated by a desire to retain vital infrastructure industries and to stabilize domestic employment levels; in other cases, it is to prevent developing undue dependency on imports.

Foreign government involvement in these matters should not be presumed to lead to unfair competition for U.S. firms, but it must be recognized that such participation does increase the potential for the use of foreign national interest as an enterprise goal. To the extent these relationships are established and fostered by foreign interests, the United States risks having its markets seriously undercut. It may be that the United States should consider how to address this issue, not only to protect its markets but also because changes in export levels can be fundamentally altered by close Government-business cooperation.

Although U.S. industry is represented by the numerous business advisory groups to the Government, these relationships are not a hallmark of U.S. promotional efforts as they

are in many European and Far East countries. The United States Government does not intervene in the marketplace to maximize U.S. competitive advantage in particular products, product lines, industries, or companies nor is serious thought given to creating "export industries" as a national economic objective. If conventional promotional wisdom cannot affect major changes in the levels of export activity, new and innovative ideas are worth pursuing.

CHAPTER 14

WHAT EXPORT FINANCING ASSISTANCE SHOULD BE MADE AVAILABLE TO EXPORTERS?

Financial assistance can involve direct credits, financial guarantees, or insurance aginst commercial and political risks. Unlike other factors which account for an export sale, such as price, delivery, and service, export financing is the one area where government assistance is considered extremely important. Although the United States provides such financial assistance, it does not place as much emphasis on officially supporting exports as do other countries. For example, in 1977 Japan supported about 42 percent of its exports, France about 30 percent, and the United Kingdom about 34 percent, while the United States supported only about 7 percent.

The Export-Import Bank is the U.S. Government's primary financier for industrial exports. It (1) partially assumes commercial and political risks against nonpayment of loans, (2) provides longer term loans than commercial lenders, and (3) helps U.S. exporters to meet foreign, officially supported export credits. The Commodity Credit Corporation is the principal U.S. Government financier for agricultural exports. It offers short and long-term credits at prevailing market rates for approved agricultural commodities and countries.

Export financing issues generally center around industrialized countries' competition for sales of manufactured products. It is important to note, however, that in 1978 the Commodity Credit Corporation's budget was increased by $950 million to $1.7 billion for financing U.S. agricultural exports. Thus, the Corporation could be an important agricultural market development force in the future.

EXIMBANK'S MANDATE

Eximbank operates under conflicting policies. It is directed to meet the competition, so that U.S. exporters are not disadvantaged by foreign firms which receive more preferential credit support in making export sales, and to report to Congress on its competitiveness each 6 months. Eximbank, however, is also a self-sustaining institution. To cover its cost of borrowing, Eximbank must lend at rates that, in some cases, are not competitive with the lower interest rates

offered by other official foreign government lending institutions, despite its offical mandate to match the competition. Under a recent more liberalized lending philosophy, Eximbank has made loans at less than market rates to meet this competition. Officials believe, however, this cannot be done on a sustained basis. Accordingly, Government and industry officials believe the United States is losing export sales to other countries.

INTERNATIONAL EXPORT FINANCING AGREEMENT

In April 1978, the United States and 21 other members of the Organization for Economic Cooperation and Development (OECD) implemented an agreement covering government-supported export credits. The "Arrangement", as it is commonly called, provides a common set of financing standards. It covers minimum cash payments, maximum repayment terms, and local cost financing and makes the credit terms of member nations visible. For instance, if a country offers terms and conditions outside those prescribed under the Arrangement, it must notify other signatories 10 days prior to contract signing.

Eximbank officials say the Arrangement needs improvement because it does not:

--Apply to financing for nuclear reactors, agricultural commodities, and aircraft, which comprise about 40 percent of Eximbank's business.

--Prohibit mixed credits.

--Address certain insurance programs.

--Prohibit financing terms more favorable than those in the Arrangement.

--Address financing offered by commercial sources.

--Apply to non-OECD countries, such as Brazil, South Korea, and Mexico.

--Have a policing mechanism.

Eximbank and Treasury officials have participated in a series of bilateral and multilateral negotiations to strengthen the Arrangement. It was hoped that these meetings with officials from a number of OECD countries, including France, Germany, and the United Kingdom, would result in an agreement

to bring mixed credits and currency devaluation and inflation insurance programs under the Arrangement and that an understanding would be reached that credits extended by commercial banks and covered by official export insurance programs would comply with the terms and conditions of the Arrangement. These efforts met with little success.

ADMINISTRATION AND CONGRESSIONAL ACTIVITIES

Eximbank's loan authorizations increased from $1.2 billion in fiscal year 1977 to $3.4 billion for 1978. The Bank asked Congress for $4.1 billion in direct loan authority for fiscal year 1980.

Congress has generally supported Eximbank while at the same time emphasizing the need for Eximbank to participate only in transactions where it is necessary to make a sale. Congress has also emphasized the need to reach an effective international agreement which will eliminate unfair export financing competition between countries.

EXIMBANK PROGRAMS

Eximbank finances exports through five programs.

1. Exporter credit insurance--The Foreign Credit Insurance Association (FCIA), a group of private insurance companies, in conjunction with Eximbank, insures export credit provided by the exporter. FCIA insures commercial risks, while Eximbank handles political risks and reinsures FCIA aginst excessive commercial losses.

2. Commercial bank guarantees--Eximbank guarantees the repayment of medium-term (5 years or less) export credits extended by U.S. banks to foreign buyers without recourse to U.S. exporters. The commercial bank retains a share of the commercial risk and Eximbank guarantees the remaining commercial and political risks.

3. Direct loans and financial guarantees--Through direct loans to foreign buyers, Eximbank finances a large portion of the cost of major capital equipment exports requiring repayment over 5 years. Commercial banks generally provide the remainder of the financing. In some instances, Eximbank will not provide a loan but will provide a guarantee to a private lender.

4. Discount loans--Eximbank provides standby assurance to U.S. commercial banks which finance exports at fixed interest rates. Eximbank agrees that, during the life of the loan, it will extend credit against the remaining value of the loan at a fixed interest rate. The program seeks to overcome commercial bank reluctance to extend medium-term, fixed-rate financing.

5. Cooperative Financing Facility--Eximbank lends funds to foreign financial institutions on terms of from 1 to 5 years which they, in turn, relend to local companies to finance approximately one-half of a U.S. export sale. The foreign bank finances the other half and assumes the credit risk for the entire loan.

PROGRAMS UNAVAILABLE THROUGH EXIMBANK

In view of the large 1977 and 1978 trade deficits, the United States cannot afford to lose export sales due to noncompetitive export financing. Yet, according to Eximbank, private industry, and commercial bank officials, that happens in some cases.

It is unclear how important the following programs are to a more competitive Eximbank. However, export financing and insurance programs offered by foreign governments, but not by Eximbank, include:

--Inflation insurance programs which protect the exporter from significant cost increases brought on by inflation.

--Exchange rate insurance programs which protect the exporter from losses associated with currency devaluations.

--Bid and performance bond insurance programs that protect the exporter from risks involved with bonds that are callable on demand by a foreign customer.

Inflation insurance, used primarily by the French but also offered by the United Kingdom, protects exporters from exceptional cost increases occurring during the construction period. Thus, foreign exporters can quote either a fixed price or one with only a modest price escalation. U.S. exporters must cushion against similar cost increases by building higher profit margins into the price.

Exchange rate insurance, protecting exporters against losses from exchange rate fluctuations, generally above certain minimum thresholds, can also contribute to lower prices. It is used primarily by companies who are being repaid in currencies that may substantially depreciate in value over the repayment period.

Foreign export financing agencies also participate in projects containing significantly more foreign content than does Eximbank. An extreme case of foreign content financing involved British participation in a $500-million sale which included 80 percent non-United Kingdom items. The United Kingdom assistance agency financed the British-manufactured portion and guaranteed the loan for the foreign content. Generally, Eximbank does not finance foreign content through its direct loans or Cooperative Financing Facility. Under its insurance and guarantee programs, Eximbank does allow FCIA and private banks, on medium-term transactions, to insure or quarantee the foreign content value for up to 10 percent of total contract price. FCIA can insure foreign content for up to 50 percent of contract price on short-term transactions.

LEGISLATIVE RESTRICTIONS AFFECTING EXIMBANK

A number of constraints prevent Eximbank from fully supporting U.S. exports. Such constraints include:

--Human rights considerations; direct loans to a number of countries have been denied or delayed due to the human rights issue.

--Limitations on financing in Communist countries, except for Poland, Romania, Hungary, and Yugoslavia.

--A requirement to consider its average cost of funds; some foreign agencies receive annual government subsidies.

--Requirements to submit all transactions involving $100 million or more for congressional consideration and to consider the adverse effects of its financing on the domestic economy.

These constraints, together with current high interest rates, restrict Eximbank's efforts in competing with foreign export financing agencies.

Chapter 15

CAN U.S. PAYMENTS POSITION BE IMPROVED THROUGH BETTER ADMINISTRATION OF COLLECTIONS AND PAYMENTS?

Most concerns about U.S. trade and payments problems involve imports and exports of manufactures, agricultural products, and services or the inflow and outflow of various types of investment. However, many other U.S. international activities affect the U.S. payments position. Despite the fact that they are important as alternatives to increasing exports and creating beneficial investment flows to offset adverse trade and current account balances, they are largely overlooked as such. Our reviews (see app. II) have demonstrated the prospect of improving the U.S. payments position through these other activities by hundreds of millions of dollars, which represent only a portion of what might be done. These amounts, spread over many countries and through many different programs may appear to be insignificant, but collectively they are substantial.

The following sections discuss, as examples of our concern, (1) collecting debts owed, such as for foreign military sales, and (2) limiting U.S. Government spending overseas, such as for payments to foreign nationals employed by the United States and payments to pensioners living abroad. If actions, such as these, were taken, the current account deficit could be reduced, which would also lessen the possible pressure for more stringent corrective measures. A comprehensive examination of other U.S. international activities would likely surface other areas for improving U.S. performance.

REQUIREMENTS FOR COST RECOVERY

Prior to the dramatic growth of the Foreign Military Sales Program, the bulk of arms transfers to foreign countries was carried out through the Military Assistance Program, which provided military goods and services free of charge. In the latter half of the 1960s, congressional support swung toward selling defense articles and services to countries able to pay, when such sales would further U.S. security objectives.

Under The International Security Assistance and Arms Export Control Act of 1976 (90 Stat. 729):

--Articles sold from Defense inventories to foreign governments must be priced at either

(1) actual value, if the article will not be replaced in the Defense inventory, or (2) estimated replacement cost, if the article is to be replaced; this price includes administrative costs, costs of using plant and production equipment, and other indirect costs.

--Articles procured by Defense for foreign countries must be priced to cover the full amount of the contract and insure the United States against any loss on the contract.

The Congress intended these cost-recovery provisions to insure that foreign sales prices include a fair share of all indirect costs so that there would be no elements of subsidy in the foreign sales program.

The effect of these increases was a shift from a net outflow of $876 million in 1975 in the Military Transactions account to a net inflow of $1.3 billion in 1977, over a $2-billion swing. The United States, however, has not benefited to the extent it should; hundreds of millions of dollars in costs of selling military goods and services to foreign governments have not been recovered.

Before passage of this Act, the provisions of the Foreign Military Sales Act of 1968 (82 Stat. 1320) required that foreign countries be charged the value of items purchased. To satisfy this requirement, Defense should have included all direct and indirect costs in sales prices.

FAILURE TO RECOVER COSTS

Defense's continued failure to properly price and bill for foreign military sales has resulted in hundreds of millions of dollars in subsidies to the sales program and has adversely affected the U.S. international payments position. For example, in one case Defense, in producing items sold to other countries, did not charge the $107-million costs for the use of Government-owned plant and equipment (FGMSD-77-20, Apr. 11, 1978). In another instance, Defense failed to recover an estimated $370 million during the last 6 fiscal years for quality assurance services on items sold to foreign governments (FGMSD-79-16, Mar. 22, 1979).

The major reason for Defense's failure to insure that prices of items and services recover all costs is that there has been a general lack of effort to insure that its policies are properly implemented by the military services. In addition, Defense, aside from occasional audits, lacks personnel

to prepare and update its pricing policy and to make sure this policy is effectively implemented.

FOREIGN COMPENSATION COSTS

The United States pays billions of dollars each year in compensation to foreign nationals. These payments represent a direct dollar loss and, consequently, adversely affect the U.S. balance of payments.

The basic problem lies with the fact that in many countries the United States is paying higher salaries than it is required to pay by law and, thus, is also obligated to pay higher benefits. Moreover, Social Security pensions are being paid overseas to aliens who improperly earned wages in the United States.

Foreign employees

The Foreign Service Act of 1946, as amended, provides that compensation plans for alien employees, including retirement benefits, be based on prevailing wage rates and practices for corresponding positions in the locality, to the extent consistent with the public interest.

The Department of Defense payroll for foreign employees at Federal facilities overseas adds about $1.5 billion annually to the U.S. balance-of-payments account. About 152,000 foreign nationals were employed at overseas installations at the start of 1978, primarily in Germany, Italy, Japan, Korea, and the Philippines.

For these five countries, annual wage costs were $37 million and accrued separation liabilities were $132 million greater than they would be (based on 1977 data) if foreign nationals were consistently paid at prevailing local rates. This overcompensation aggravates an already alarming deficit, which is magnified by dollar depreciations in such high-cost countries as Japan and Germany.

If increased use of available Americans were permitted in these countries, payroll costs would decrease and the United States would benefit because a substantial portion of dependent income remains in the American sphere (post exchanges, commissaries, etc.).

Defense plans to implement several of our report recommendations and is currently making its own review of foreign national wage-setting. It has placed considerable emphasis on reducing pay and benefits, with notable success with labor cost-sharing actions in Japan recently. Defense believes,

however, that opportunities to implement some of our recommendations may be limited because of host-country sensitivities, including resistance to the hiring of more Americans in foreign national positions. The Departments of Defense and State believe that renegotiation of the problem provisions of applicable agreements would open the door to renegotiation in other areas of Defense and mutual assistance, with an overall loss by the United States.

PENSION PAYMENTS

As of May 1978, more than 304,000 beneficiaries overseas (about 90,000 U.S. citizens) were receiving some $624 million annually in Social Security benefits. According to the Social Security Administration,it is required to make payments to beneficiaries if earnings are based on wages from covered employment, regardless of the individual's citizenship or the legality of residence or employment in the United States; it is immaterial whether a worker was in the country legally or illegally.

The Social Security system and its overseas benefits program need to be reassessed because (1) the beneficiary population overseas has grown rapidly and at a rate faster than the general population, (2) there is considerable evidence that, compared with income levels in some foreign countries, benefits are so lucrative that they are and will continue to be the target of widespread efforts to obtain them through abuse and fraudulent means, and (3) so many aliens earn wages improperly in the United States that future benefit claims raise the spectre of massive increases.

The Social Security Administration estimated in a 1973 study that 3.9 million aliens between the ages of 18 and 44 earned wages improperly during the year. The Immigration and Naturalization Service in 1976 testified before the Congress that 6 million illegal aliens were in the United States, of which 3.8 million were improperly earning wages. Current estimates are that 250,000 to 500,000 aliens enter the country illegally each year. The Social Security Administration's statistics, as of September 1978, indicated there were about 305,550 aliens with Social Security cards who were not authorized to work, of which 82,417, or about 27 percent, had earnings posted to their account.

Under the Social Security Amendments of 1977, the President is authorized to negotiate so-called totalization agreements. Under a totalization agreement, social security insurance credits earned by a worker in two or more countries are combined for consideration in each country to determine if the worker meets that country's requirements to be insured for benefits. Social Security benefits under totalization are generally computed on a pro rata basis using the period of coverage in each country. Each country computes a theoretical benefit amount based on the total work in both countries. The amount of the actual benefit paid is in relation to the percentage of work in each country.

A totalization agreement is in effect with Italy and another will soon be in effect with Germany. While these agreements are in the U.S. interest, agreements with countries that have had a large migration of illegal aliens to the United States could accelerate and enlarge benefits paid on wages earned improperly because illegal aliens could become eligible for benefits with as little as 6 quarters of coverage.

TRADE AND PAYMENTS LEGISLATION

During the 95th Congress, a number of laws directly affecting trade and international payments were enacted. The most important laws are summarized below.

RECENT LAWS

Amendments to the Export-Import Bank Act of 1945 (Public Law 95-630, Nov. 10, 1978)

This new legislation extends Eximbank's charter to September 30, 1983, and increases its total loan, guarantee, and insurance authority from $25 to $40 billion.

Of greatest significance to Eximbank users is the amendment which lessens present restrictions on the Bank's lending policies except in cases of Presidential determinations; prohibits credit, guarantees, and insurance to South Africa unless proper authorizations are obtained; authorizes matching of foreign predatory financing of exports to the United States; and finances support sales made by U.S. suppliers to other U.S. firms in cases where imports are being supported by predatory financing from other official export credit agencies.

Agricultural Trade Act of 1978 (Public Law 95-501, Oct. 21, 1978)

This act recognizes the need to strengthen the U.S. economy through increased sales abroad of agricultural commodities. Particular emphasis is placed on improved export financing and additional organizational support.

The Commodity Credit Corporation (CCC) is authorized to finance exports on intermediate credit terms for 3 to 10 years and to provide short-term (3 years or less) financing to exporters for deferred payments sales. The People's Republic of China was made eligible for the existing short-term export credit sales program and the new deferred payments sales program. The act authorizes a new overseas position of Agricultural Counselor and the establishment of U.S. agricultural offices in foreign countries. In the Department of Agriculture, a new position of Under Secretary of Agriculture for International Affairs and Commodity Programs is established. Agriculture is required to submit an annual report to Congress on its activities and accomplishments in developing, maintaining, and expanding foreign markets for U.S. agricultural commodities.

Foreign Earned Income Act of 1978
(Public Law 95-615, Nov. 8, 1978)

This act changes the tax treatment of income earned abroad by U.S. citizens and residents. It repeals the current exclusion from taxation of a maximum,in most instances, $15,000 in income of Americans working abroad. Instead, they are allowed deductions for qualified cost-of-living, housing, education, and annual home-leave costs and hardship duty. The act retains the general requirement of bonafide residence or physical presence in foreign countries.

International Banking Act of 1978
(Public Law 95-369, Sept. 17, 1978)

This act provides for Federal regulation of foreign banks participation in establishing, acquiring, operating, or controlling banks, branches, and agencies in the United States.

The act is designed to end the disparity in treatment of foreign and domestic banks. American banks abroad can and should play a significant role in supporting American exports. There is concern that the restrictions on American banks in foreign countries, in contrast with the open reception foreign banks have been given in the U.S. domestic market, may have had an important effect on the U.S. balance of trade.

Section 9 of the act requires a study, headed by the Secretary of the Treasury, on the extent to which American banks are denied national treatment in their banking operations abroad, the effects of such discrimination on U.S. exports of goods and services, and recommendations for elimination of such foreign laws and practices. This study has begun.

Export Administration Amendments of
1977 (Public Law 95-52, June 22, 1977)

This act amends the Export Administration Act of 1969 to extend the authority of the act, improve the administration of export controls, and strengthen the antiboycott provisions.

The 1977 amendments require that:

--U.S. export policy for a controlled country be based not exclusively on the country's Communist or non-Communist status but rather

on the country's relationship to the United States and its ability and willingness to control retransfers of U.S. exports in accordance with U.S. policy.

--The President, with few exceptions, no longer imposes export controls on items for national security purposes where such items are available outside the United States.

--Agricultural commodities can now be stored in the United States and later exported, even if export controls have been imposed between the time of purchase and export.

--Any export license not approved or disapproved within the 90-day limitation shall be deemed to be approved and the license issued, unless the Secretary of Commerce finds that additional time is required, in which case the applicant is to become a participant in the decisionmaking process.

--U.S. businesses adhere to foreign boycott provisions, consisting of several "prohibitions" which are offset by several "exemptions"; such provisions are a limited attempt to extricate U.S. business from the complexities of secondary boycotts while recognizing that the United States cannot legislate primary boycotts, or all aspects of secondary boycotts, out of existence.

The 1977 amendments require reports to the Congress on multilateral export controls, unilateral and multilateral export control lists, domestic economic impacts of U.S. exports of industrial technology, and transfer of technical data to any country to which exports are restricted for national security purposes.

Foreign Aid and Military Assistance

We did not attempt to individually summarize the extensive foreign aid and military assistance legislation affecting the U.S. balance of payments. However, the net effect of foreign aid operations on the balance of payments has been increasingly favorable and has brought about net annual dollar inflows of several billion dollars in recent years. In contrast, direct defense expenditures abroad have been increasing and have recently been a main contributor to the

U.S. balance-of-payments deficits, although their impact has been mitigated by receipts from military sales contracts.

Some categories of foreign aid and defense expenditures include (1) U.S. contributions to international organizations, (2) foreign military assistance and sales programs, (3) economic development assistance programs, (4) international security assistance, and (5) Government loan, credit, guarantee, and insurance programs.

LEGISLATION NOT PASSED IN THE 95th CONGRESS

Export Administration Act Extension

Trade Adjustment Assistance Act

Meat Import Act

Textile Tariffs Amendment

Buy American Act Amendments of 1977

International Unfair Trade Procedural Reform Act (amending Antidumping Act of 1921)

Countervailing Duty Waiver Extension

SELECTED GAO REPORTS ON TRADE AND INTERNATIONAL PAYMENTS
(ISSUED SINCE JULY 1973)

IS THERE A COHERENT INTERNATIONAL TRADE POLICY?	DATE
THE UNITED STATES AND INTERNATIONAL ENERGY ISSUES (EMD-78-105)	Dec. 18, 1978
COMMENTS ON HR 13531 ESTABLISHING A REASONABLE AND FAIR PREFERENCE FOR DOMESTIC PRODUCTS AND MATERIALS IN GOVERNMENT PROCUREMENT (PSAD-78-145)	Sept. 19, 1978
COMMENTS ON S. 3284 WHICH ESTABLISHES A REASONABLE AND FAIR PREFERENCE FOR DOMESTIC PRODUCTS AND MATERIALS IN GOVERNMENT PROCUREMENT (PSAD-78-144)	Sept. 15, 1978
DEEP OCEAN MINING--ACTIONS NEEDED TO MAKE IT HAPPEN (PSAD-77-127)	June 28, 1978
CARGO PREFERENCE PROGRAMS FOR GOVERNMENT-FINANCED OCEAN SHIPMENTS COULD BE IMPROVED (CED-78-116)	June 8, 1978
IMPACT ON TRADE OF CHANGES IN TAXATION OF U.S. CITIZENS EMPLOYED OVERSEAS (ID-78-13)	Feb. 21, 1978
STANDARDIZATION IN NATO: IMPROVING THE EFFECTIVENESS AND ECONOMY OF MUTUAL DEFENSE EFFORTS (PSAD-78-2)	Jan. 19, 1978
MORE ATTENTION SHOULD BE PAID TO MAKING THE U.S. LESS VULNERABLE TO FOREIGN OIL PRICE AND SUPPLY DECISIONS (EMD-78-24)	Jan. 3, 1978
THE COSTS OF CARGO PREFERENCE (PAD-77-82)	Sept. 9, 1977
OPPORTUNITIES TO REDUCE THE OCEAN TRANSPORTATION COSTS OF P.L. 480 COMMODITIES	Sept. 7, 1977
SHARING THE DEFENSE BURDEN: THE MULTINATIONAL F-16 AIRCRAFT PROGRAM (PSAD-77-40)	Aug. 15, 1977
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BALANCE OF PAYMENTS DEFICIT FOR FISCAL YEAR 1974 ATTRIBUTABLE TO MAINTAINING U.S. FORCES IN EUROPE HAS BEEN OFFSET (ID-75-75)	July 1, 1975
LOW U.S. SHARE OF WORLD BANK-FINANCED PROCUREMENT (ID-75-7)	Oct. 17, 1974
GRAIN RESERVES: A POTENTIAL U.S. FOOD POLICY TOOL (OSP-76-16)	Mar. 26, 1976
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IS THE GOVERNMENT'S ORGANIZATION ADEQUATE FOR HANDLING TRADE MATTERS?	
THE CRITICAL ROLE OF GOVERNMENT IN INTERNATIONAL AIR TRANSPORT (ID-77-50)	Mar. 17, 1978
U.S. OIL COMPANIES' INVOLVEMENT IN THE INTERNATIONAL ENERGY PROGRAM (HRD-77-154)	Oct. 21, 1977
GRAIN MARKETING SYSTEMS IN ARGENTINA, AUSTRALIA, CANADA, AND THE EUROPEAN COMMUNITY: SOYBEAN MARKETING SYSTEM IN BRAZIL (ID-76-61)	May 28, 1976
ASSESSMENT OF THE NATIONAL GRAIN INSPECTION SYSTEM (RED-76-71)	Feb. 12, 1976
THE GOVERNMENT'S ROLE IN EAST-WEST TRADE--PROBLEMS AND ISSUES (ID-76-13a)	Feb. 4, 1976
RUSSIAN WHEAT SALES AND WEAKNESSES IN AGRICULTURE'S MANAGEMENT OF WHEAT EXPORT SUBSIDY PROGRAM	July 9, 1973
WILL THE DOLLAR EXCHANGE RATE REDRESS THE TRADE IMBALANCES?	
NO REPORTS ISSUED.	
CAN EXPORT CONTROLS BE ADMINISTERED BETTER TO SUPPORT U.S. EXPORT GOALS?	
ADMINISTRATION OF U.S. EXPORT LICENSING SHOULD BE CONSOLIDATED TO BE RESPONSIVE TO INDUSTRY (ID-78-60)	Oct. 31, 1978
U.S. ACTIONS NEEDED TO COPE WITH COMMODITY SHORTAGES (B-114824)	Apr. 29, 1974
IMPACT OF SOYBEAN EXPORTS ON DOMESTIC SUPPLIES AND PRICES (B-178753)	Mar. 22, 1974

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SHOULD SOMETHING BE DONE ABOUT IMPORTS?	
GOVERNMENT ACTIONS ARE HURTING THE DOMESTIC MINING AND MINERAL PROCESSING INDUSTRY (ID-79-40)	
U.S. ADMINISTRATION OF THE ANTIDUMPING ACT OF 1921 (ID-79-15)	Mar. 15, 1979
CONSIDERATIONS FOR ADJUSTMENT ASSISTANCE UNDER THE 1974 TRADE ACT: A SUMMARY OF TECHNIQUES USED IN OTHER COUNTRIES (ID-78-43)	Jan. 18, 1979
ADJUSTMENT ASSISTANCE TO FIRMS UNDER THE TRADE ACT OF 1974--INCOME MAINTENANCE OR SUCCESSFUL ADJUSTMENT? (ID-78-53)	Dec. 21, 1978
CUSTOMS' CLASSIFICATION OF AUTOMOBILE TRUCK IMPORTS--A CONTROVERSIAL ISSUE (CCD-79-19)	Dec. 13, 1978
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WORKER ADJUSTMENT ASSITANCE UNDER THE TRADE ACT OF 1974 TO NEW ENGLAND WORKERS HAS BEEN PRIMARILY INCOME MAINTENANCE (HRD-78-153)	Oct. 31, 1978
THE STRATEGIC AND CRITICAL MATERIALS STOCKPILE WILL BE DEFICIENT FOR MANY YEARS (EMD-78-82)	July 27, 1978
ADJUSTMENT ASSSISTANCE UNDER THE TRADE ACT OF 1974 TO PENNSYLVANIA APPAREL WORKERS OFTEN HAS BEEN UNTIMELY AND INACCURATE (HRD-78-53)	May 9, 1978
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1/Presently being drafted.

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