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Export Trading Companies and S. 734

INTRODUCTION

On April 8, 1981, the U.S. Senate unanimously passed Senate Bill 734, announced by the legislative clerk as "a bill to encourage exports by facilitating the formation and operation of export trading companies and export trade associations, and the expansion of trade services generally."[1] The bill, sponsored by Senator John Heinz of Pennsylvania, is essentially the same bill as S. 2718, which passed the Senate unanimously in September 1980 but which died in the House of Representatives at the end of the year due to inaction.[2] S. 734 is expected to pass the House and become law this year. The bill could be an important step in improving the balance of payments deficit.

This development examines the content of the enactment, the circumstances which produced the initiative for the bill and to which it is addressed, and pro and con views of its utility. A critique of the prevailing arguments will then be made and a conclusion reached.

SUBSTANCE OF THE BILL

In brief, S. 734 confronts the capital problems of Export Trading Companies (ETC's) by providing for limited bank investment in ETC's. With respect to the antitrust issue, the bill makes a procedural reform in the existing Webb-Pomerene Act of 1918.[3] The language of the title, however, does not modify substantive antitrust law.[4]

Among the most important Title I provisions, section 104 directs the Secretary of Commerce to promote export trading companies by providing information on such companies to U.S. producers.[5] Section 105 permits banks to make limited investments in export trading companies.[6] Section 106 directs the Export-Import Bank to develop an improved guarantee program to support commercial loans to U.S. exporters, such

1. 127 CONG. REC. S. 3622 (daily ed. Apr. 8, 1981) [hereinafter cited as 127 CONG. REC.].
2. S. 2718, 96th Cong., 2d Sess. (1980).
3. 15 U.S.C. §§ 61-66 (1976).
4. 127 CONG. REC., *supra* note 1, at S. 3623.
5. S. 734, 97th Cong., 1st Sess. 104 (1981). An export trading company is defined under section 103(5) as:

> [a] company . . . which does business under the laws of the United States or any State and which is organized and operated principally for the purposes of
> (A) exporting goods or services produced in the United States, and (B) facilitating the exportation of goods or services produced in the U.S. by unaffiliated persons by providing one or more trade services.

6. *Id.* § 105. Such investments could not exceed five percent of the banking capital, and all controlling investment and all investments over $10 million would be subject to prior approval and conditions imposed by federal bank regulatory agencies.

loans to be secured by export accounts receivables or inventories of exportable goods.[7]

Title II revises the Webb-Pomerene Act in order to clarify antitrust provisions applicable to export trade associations and export trading companies.[8] It provides a certification procedure which would enable such associations and companies to obtain antitrust preclearance for specified export trade operations. The clearance procedure attempts to facilitate exports by permitting firms to determine in advance exactly which export trade activities would be immune from antitrust suit. Administration of the certification procedure would be shifted to the Commerce Department, which would also be given the responsibility of monitoring for violations.

INITIATIVE FOR BILL

A. *Background and Source of the Problem*

Increased U.S. imports in the past few years, led by massive increases in the cost of oil, have expanded the trade deficit dramatically.[9] American companies have traditionally neglected export markets and the U.S. Government has given little incentive to enter them.[10] Former Undersecretary of Commerce Robert E. Herzstein has noted that only 10% of the 250,000 American manufacturers currently export.[11] Less than 1% of manufacturers are responsible for 80% of all exports.[12] Additionally, exports of goods account for only about 7.5% of the U.S. gross national product, the lowest of any industrialized nation.[13] U.S. trade competitors have used exports much more effectively in offsetting their imported energy bills.[14]

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7. *Id.* § 106.

8. *Id.* §§ 201-207. For a good summary of the certification procedure, see Neill, *Export Trade Associations*, 37 J. Mo. B. 55, 56 (1981).

9. Although the ratio of exports to GNP rose from 4.2% in 1972 to 7.5% in 1979, U.S. imports grew equally as fast, increasing in importance relative to GNP from 5.1% to 8.7% in the same years. Because imports have expanded since 1972 from a higher base than exports, the trade deficit has expanded sharply. 127 CONG. REC., *supra* note 1, at S. 3622 (remarks of Senator Heinz).

10. The importance of exports to our economy is well summarized by former Secretary of Commerce Phillip Klutznick:

> Exports are essential to the strength of the U.S. and contribute significantly to U.S. jobs, production, and economic growth. Exports enable important economies of scale, thereby contributing to the most efficient use of U.S. resources. Exports provide the most constructive way of paying for U.S. imports of petroleum and other essential commodities, and thus keep the dollar firm.

Hearings on H.R. 7436 Before the Subcomm. on Financial Institutions of the House Comm. on Banking, Finance, and Urban Affairs, 96th Cong., 2d Sess. (1980) (statement of Phillip M. Klutznick) [hereinafter cited as *Hearings on H.R. 7436*].

11. NAT'L J., June 21, 1980, at 1018.

12. *Id.*

13. *Hearings on H.R. 7436*, note 10 *supra*.

14. 127 CONG. REC., *supra* note 1, at S. 3622. According to a study performed by the National Association of Manufacturers in 1980, "[o]ur industrial competitiveness is declin-

The situation is not, however, as unmanageable as it may seem. It has been observed that if U.S. exports were to increase by only one percentage point of the GNP, that would represent nearly $3 billion—a significant portion of the merchandise trade deficit.[15] Former Secretary of Commerce Phillip Klutznick has pointed out that "enormous as its oil bills are, the U.S. could be paying for imported oil without running a balance of trade deficit if it had maintained the same share of world exports (22.8%) as it had in 1960."[16]

A major reason for the lack of interest in exporting is that U.S. firms find it easier to sell domestically, with the large markets, familiar customs, native language, and efficient distribution system.[17] The numerous and confusing documentary, financial, and legal constraints associated with exporting have also been a major factor in discouraging businessmen from entering export markets. Letters of credit, exchange rates, ocean shipping documents, export licenses, import certificates, certificates of origin, currency hedges, shipping differentials, and a great number of related concepts, must be understood and applied by the administrative or non-income producing staff of a manufacturing corporation.[18] Usually, this is too much for small businesses to absorb, and executives decide to forego the profits associated with an export operation to avoid the problems.[19]

B. *Proposed Solution—Encourage Export Trading Companies*

The approach conceived to surmount these barriers is to encourage the development of export trading companies. These service-providing companies would perform some or all of the functions that intimidate small businessmen. The range of services offered by an ETC could vary. A larger ETC might buy the goods from the domestic source and then sell them abroad itself, assuming all the risk and responsibility.[20] A smaller ETC might merely act as an agent, providing marketing advice by finding a market and helping arrange a purchase, but leaving the seller on his own to complete the transaction.[21]

An ETC could also provide a wide range of other services to the ex-

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ing measured both by increased import penetration here, and loss of export markets elsewhere." The U.S. has lost market share in eight European Community countries, and in twelve of the thirteen OPEC countries. While U.S. manufactured goods trade has stayed in rough balance, Japan and West Germany had surpluses of $70 and $60 billion, respectively. *Id.* The U.S. share of world markets declined from 21.3% to 17.7% over the past ten years, the largest relative decline among major industrial exporters. *Hearings on H.R. 7436*, note 10 *supra*.

15. *Hearings on H.R. 7436*, note 10 *supra*.

16. *Id.*

17. NAT'L J., *supra* note 11, at 1018.

18. Neill, *Export Trade Promotion Legislation*, 36 J. Mo. B. 449 (1980).

19. *Id.* at 449-50.

20. 127 CONG. REC., *supra* note 1, at S. 3622.

21. *Id.*

porter. For example, it could help an exporter obtain necessary government licenses and approvals, arrange financing for transactions, or locate and engage transportation for the shipping of goods.[22] There are any number of possible variations of services that could be offered, but all function to remove or reduce risk and unfamiliarity of foreign marketing for the domestic businessman.[23]

ETC's are already in common use by European and Japanese companies. Most European and Japanese companies have access to large, sophisticated, general purpose trading companies that perform the full range of services for exporters or potential exporters.[24] Such companies are purported to be highly effective at opening new markets to small and medium sized businesses.[25] Those ETC's thought to be the most effective are usually closely associated with major banking institutions in these countries, the association ranging from a close working relationship to actual bank ownership and control of an ETC.[26]

C. *Proposed Legislative Action to Encourage ETC's*

In examining why ETC's today do not exist in adequate numbers, the sponsors of S. 734 determined that there are two major problems which could be addressed through legislation: undercapitalization and antitrust uncertainties.[27] It was decided that the goals of export trading company legislation, among other things, would be to encourage capital investment in ETC's, and to reduce the fear and doubt of antitrust prosecution for potential export trading companies.

REACTION TO THE BILL

A. *Proponents*

Sponsors of the bill in the Senate believe that ETC's will significantly increase U.S. exports, particularly those of small and medium sized businesses.[28] They believe that by encouraging the development of such intermediaries, the barriers inhibiting U.S. firms from exporting will be lowered.[29] ETC's, they contend, will benefit companies wishing to export, through creation of economies of scale and by diffusion of risk.[30] Senator Bentsen stated in the Senate that ETC's have been an essential ingredient in the commercial success of countries like Japan, which "have emerged as consistent winners in the battle for exports."[31] He contends

22. *Id.*
23. *Id.*
24. Neill, *supra* note 18, at 450.
25. *Id.*
26. *Id.*
27. 127 CONG. REC., *supra* note 1, at S. 3622.
28. 127 CONG. REC. S. 257 (daily ed. Jan. 19, 1981).
29. *Id.*
30. *Id.*
31. 127 CONG. REC., *supra* note 1, at S. 3661 (comments of Mr. Bentsen). The top 10

that:

> The provisions of S. 734 would encourage thousands of smaller and medium sized U.S. businesses—currently put off by the risk and complexity of exporting—to go after international markets. Trading companies of the type envisioned by this legislation will help spread out the risks of foreign trade and absorb currency fluctuations. They will help identify emerging market opportunities, assist in organizing joint construction projects abroad, and handle the logistics of foreign trade that presently deter so many potential exporters.[32]

Senator Bentsen additionally points out that this legislation helps clarify many of the longstanding antitrust ambiguities that hinder the formation of American consortia to bid on significant export projects."[33]

Proponents also argue that allowing banks to invest in ETC's would be a very effective way to encourage the growth of ETC's. It is argued that banks bring to bear their investment capital, international networks, and international financial expertise. Consequently, these institutions have the best chance of making export trading companies significant contributors to increased American exports.[34] Senator Bentsen points out that while the United States has traditionally discouraged relationships between banks and trading companies, other countries have not had such laws, and have frequently gained a competitive advantage over U.S. exporters.[35] As he maintains, "by permitting U.S. banks to acquire ownership in export trading companies under specified conditions and with appropriate safeguards, S. 734 would provide an important new asset in our drive to restore competitiveness to the American economy."[36]

B. *Opponents*

The AFL-CIO opposes S. 734, claiming that the bill ends the traditional U.S. legal separation between banking and commerce.[37] They warn that allowing banks to invest in ETC's is "a risky move where government banks are already 'loaned-up.' " In other words they fear that bank failures might be precipitated.[38] They contend that allowing the lender and exporter to become "one" under this legislation would be "a damaging change in U.S. law."[39]

Another argument of the AFL-CIO is that allowing banks to invest in

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Japanese trading companies, the so called *sogo shoshas*, account for over 50% of that country's total trade, which involves thousands of products worldwide. For an excellent work on the *Sogo Shosha* see A. YOUNG, SOGO SHOSHA: JAPAN'S MULTINATIONAL TRADING COMPANIES (1979).

32. 127 CONG. REC., *supra* note 1, at S. 3661.

33. *Id.*

34. 127 CONG. REC., *supra* note 1, at S. 3627 (comments of Mr. Tsongas).

35. *Id.* at S. 3662.

36. *Id.*

37. *Id.* at S. 3624.

38. *Id.*

39. *Id.*

ETC's will result in an increased competition for funds and dimunition of capital for productive investments, at a time when banks and commercial enterprises in the United States are claiming capital shortages.[40] They fear that such a misappropriation of capital funds would cost U.S. jobs.

The Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) testified before the Senate that bank investment in export trading companies posed unacceptable risks to the U.S. banking system.[41] Their recommendation was that exports could best be served by banks continuing their role as financiers, but not allowing investments which would jeopardize bank capital in the highly leveraged, risky operations of an export trading company.[42]

Senator Proxmire objects to the provisions of the bill which would switch to the Commerce Department the responsibility for administering antitrust statutes with respect to the ETC's. He points out that the Commerce Department has no expertise in administering antitrust statutes.[43] He fears that this legislation will result in inconsistent, wasteful, and overstepped bank regulation instead of a consistent and coherent bank regulatory policy, and will result in less competition "while price fixing in domestic and international markets gets a wink from the Commerce Department."[44] He believes that the Commerce Department will find itself in a position of fundamental conflict of trying to balance effects on domestic price and overseas trade.[45]

It has also been argued that the goals of the bill are contradictory and self-defeating.[46] On the one hand, smaller companies are encouraged to get into the export business themselves in that the Export-Import Bank is authorized through the bill to provide loan guarantees when secured by export accounts receivable or inventories.[47] On the other hand, the bill recognizes the benefit of pooling resources and obtaining economies of scale and strong financial backing in the formation of large, bank-dominated trading corporations.[48]

The effectiveness of some of the bill's provisions has also been challenged. The U.S. Department of Commerce is already charged with the responsibility of providing information and advice on exports.[49] Allowing

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40. *Id.*

41. *Id.* at S. 3625.

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. J. Brown, Export Trading Corporations (Nov. 5, 1980) (unpublished memo for the Manville Corporation).

47. *Id.*

48. *Id.*

49. *Id.* Brown feels that the problem in this area is with budget and staffing, which has been grossly neglected in comparison to other countries. Robert Herzstein has also written:

> The corps of commercial officers in the foreign service of the United States is only 250, while the Japanese have that many in a single country. The French

banks limited investment in ETC's will not necessarily give the banks great incentive to do so.[50] Finally, the question has been raised whether the procedural reform of the Webb-Pomerene Act in Title II will change industry attitudes significantly toward Webb-Pomerene Associations, since in the past they have been used almost exclusively by commodity-type industries having product homogeneity.[51]

CRITIQUE OF ARGUMENT

In weighing the strength of the arguments of the proponents and opponents of the bill, one is immediately struck by the fact that the Senate voted *unanimously* in favor of the bill. In these political times of factious interest groups, this is a fairly strong indication that the bill has not been received as very controversial.

The fears of the AFL-CIO, the Federal Reserve, and the FDIC seem a bit exaggerated. The bill contains adequate safeguards to ensure that banks will not overextend themselves by investing in ETC's. The amount banks are permitted to invest in ETC's is not of such a magnitude as should breed concern of a capital shortage that would hurt American productivity. Besides, investment in ETC's would be an investment in American companies and would create American jobs.

The bill has been criticized for simultaneously encouraging small, fragmented export operations and the development of large export trading companies. This writer believes, however, that there are legitimate needs for both. Some specialized product lines will probably be better served by their own specialized marketing system than by using a large ETC. Moreover, the choice given to a potential exporter of either developing his own system with the aid of the export-import bank loan guarantees or using an ETC will force ETC's to be competitively priced and efficiently operated.

Banks will have incentive to invest in ETC's if the return appears worthwhile in view of the risks. The banking industry will welcome the relaxation of the rule concerning bank investment in industry. Banking is a very competitive industry and new sources of revenue are graciously received. One should not be concerned that banks will blindly and overzealously start to invest in ETC's. The traditionally conservative

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> have more commercial officers in the U.S. than we have worldwide. The U.S. has a commercial service approximately the size of Hong Kong's.

NAT'L J. *supra* note 11, at 1020.

50. J. Brown, note 46 *supra*. Brown believes there are still so many restrictions on the amount of investment and control of the ETC that such investments may not be so attractive.

51. *Id.* Brown points out that in the past, WPA's have been used most widely in commodity-type industries having product homogeneity: fungible nontrademarked goods such as minerals or agricultural products. According to Brown, industries which stress product differentiation and brand names have not found WPA's to be attractive. There would seem to be no new incentive in S. 734, he says, to change this traditional use pattern.

banking industry still would subject any potential investment in an ETC to the same strict financial scrutiny it uses in its other operations.

As to the Webb-Pomerene reforms in Title II of the bill, only time will tell whether the changes made will remove antitrust ambiguity and encourage Webb-Pomerene Associations. Perhaps exporters will feel more comfortable with Commerce Department administration of the antitrust laws and less inhibited about moving into export marketing.

In support of the bill, there can be no argument that export legislation is badly needed. The concept of encouraging ETC's is a good one; ETC's may well convince firms that never considered doing so to export. The question remains, however, whether the present bill has enough teeth to viably further the goals.

The most important aspect of this legislation is that the Senate has at least begun to realize the importance of export legislation. The bill has attracted congressional attention to the issues, and has received unanimous support, albeit in a diluted form. If the bill becomes law and proves ineffective, which it may, it will still lay the groundwork for stronger and more effective legislation.

CONCLUSION

In conclusion, as this bill is being considered by the House of Representatives, this writer aligns himself with the view of Senator Heinz:

> In my judgment this [final form of bill] is an overly conservative approach designed to calm unrealistic fears. However, the bill is a product of a good deal of compromise—compromise with two administrations, compromise with bank regulatory agencies, and compromise between numerous Senators, and . . . I can say they are compromises I am prepared to support. I do not feel, however, there is much more room for compromise if we are to have a bill that has any meaning.[52]

The bill has been substantially diluted through compromise since its original conception, and may not dramatically resolve the trade deficit by itself, but it represents an important step in the right direction.

David K. Schollenberger

52. 127 CONG. REC., *supra* note 1, at S. 3623.