U.S. Trade Laws Harm U.S. Industries

James Bovard

Advocates of free trade are frequently derided for holding a *"Consumer uber Alles"* philosophy—caring only about shoppers saving a few dollars at the checkout counter. In reality, protectionism imposes some of its greatest costs on American *producers*. U.S. trade policy has consistently sacrificed leading industries and manufacturers to floundering companies that have bought political clout in Washington.

According to U.S. trade law, dumping occurs when a company charges a lower price for a product in an export market than in its home market, or when a foreign company sells products for less than the cost of production plus a large profit. In the past 19 years, Congress and the Department of Commerce have repeatedly expanded the definition of dumping. In recent years, Commerce has found 97 percent of all foreign companies it has investigated guilty of dumping.

While American politicians lecture the world on fair trade, our dumping laws are an inquisitorial nightmare for foreign companies, making a mockery of due process and justice at every turn. The crime of dumping most often occurs as the result of the American government's bureaucratic manipulation of numbers rather than actual foreign business practices.

Dumping laws, while allegedly meant to protect U.S. industries, increasingly prevent American businesses from getting vital foreign supplies and machinery. Commerce Department officials now effectively have direct veto power over the pricing policies of thousands of foreign companies. Dumping laws mean potential price controls on almost $500 billion in imports a year.

Though the U.S. government is supposed to be fair and objective in its judgment of foreign companies' prices, Commerce officials sometimes make their biases blatant. In a 1991 speech, Marjorie Chorlins, deputy assistant secretary of commerce for import administration, thanked the American Wire Producers Association (AWPA) for its frequent use of the antidumping law against wire imports and declared, "The partnership which the AWPA and Import Administration have enjoyed over the past 10 years has been active and rewarding." If a judge in a criminal case publicly announced his "partnership" with the prosecutor, a public uproar would result. But with trade cases the standard of fair treatment is much lower.

The U.S. price of an imported product is "fair," not according to whether a foreign seller and an American buyer voluntarily agree on it, but according to whether the foreign company can pass dozens of arbitrary tests imposed by the U.S. government.

The Commerce Department convicted Mazda for dumping minivans—after Commerce compared the price of new minivans sold in Japan

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with the price of used minivans in the United States. Commerce penalized two Korean sweater makers in 1990 because their U.S. selling price was not inflated to account for charitable donations they made in Korea. Commerce convicted a Hong Kong sweater maker of unfair trade because it made only a 2 percent profit on its exports to the United States. (The U.S. dumping law says that foreigners are effectively cheating unless they earn an 8 percent profit—even though most American companies earn less than 8 percent profits.) Commerce convicted a Taiwanese company of dumping because the company's factory had burnt down and the company could not answer all the questions in the 100-page questionnaire that Commerce sent it. Commerce penalized a Japanese company for selling typewriters in the United States for one cent less than the typewriters sold in Japan. Commerce penalized New Zealand farmers because small New Zealand kiwis sold for less in the United States than larger New Zealand kiwis did in Japan.

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U.S. trade law requires that, before antidumping duties can be imposed, the U.S. International Trade Commission (ITC) must determine that the allegedly unfair imports have injured a competing American industry. Congress commands the ITC to consider domestic prices, output, sales, profits, productivity, return on investment, market share, capacity utilization, cash flow, inventories, employment, wages, growth, investment, import volume and prices, and underselling by foreigners. With such a laundry list, ITC commissioners can usually find some reason to claim a U.S. industry is being injured.

In 1979 Congress prohibited the ITC from considering other possible causes of injury to a domestic industry in dumping cases. If there are four or five conditions harming the domestic industry—such as its own incompetence, a decline in demand for its product, a worldwide decline in prices for the product, technological breakthroughs, and imports—the ITC usually looks only at the imports. The ITC is prohibited by Congress from considering the public interest in its judgments; instead, it focuses solely on the interests of the U.S. industry competing against imports.

The ITC can find injury even when the competing American product is starkly inferior to the foreign product, such as it did in the 1990 case of mechanical transfer presses (MTPs) from Japan. (An MTP is a massive milling machine that functions as a self-contained production line, producing a high volume of identical parts.) Mechanical presses are sold primarily to the auto industry, and there were only two U.S. producers. According to John Scicluna of Ford, Japanese MTPs worked two or three times faster than American MTPs, and with a much higher quality result. American companies could not even produce the size of MTP that Ford needed. Stephen Sharf, a former Chrysler vice president, told the ITC that, "If the U.S. press manufacturers have been injured, it is the result of their own failure to commit the resources to develop the technology and expertise to compete." ITC commissioner Anne Brunsdale noted in her dissent to the commission's decision that a U.S. firm "described one of the domestic MTP makers as inadequate in designing certain parts, late with automation delivery and start-up, inexperienced in the production of various systems, and generally not very interested in the business." By imposing dumping duties on Japanese MTPs, the ITC handicapped the American auto industry.

In 1987 the ITC investigated imports of steel crankshafts weighing between 40 and 750 pounds, used primarily in diesel truck engines and large agricultural machinery. Wyman-Gordon, the U.S. producer, faced almost no competition in the U.S. market until foreign crankshafts arrived in the early 1980s. Like most monopolies, the American company was apathetic and fell behind on technological developments. Dick Saletzski, a purchasing manager for Caterpillar, told the ITC that "poor quality [crankshafts] greatly increase production costs by slowing the machining processes and breaking machine tools. . . . Wyman-Gordon's rejection rate for the small volume of crankshafts it still provided to Caterpillar [in 1987] was about

47 times that of the combined foreign suppliers." David Patterson, a vice president of Cummins Engine Company, one of America's largest diesel engine manufacturers, testified that West German suppliers were "much more [technologically] advanced in the opinion of our engineers" than Wyman-Gordon. As ITC commissioner Susan Liebeler noted in her dissent: "Representatives of [Wyman-Gordon] appearing as witnesses admitted the inferior quality of their crankshafts. Despite the general recognition of these quality problems, purchasers testified that petitioners have been unwilling to work with end users to improve the quality of the domestic product." The ITC's injury determination effectively gave Wyman-Gordon back its monopoly.

In a 1989 antifriction bearing case, the ITC sacrificed hundreds, if not thousands, of American companies to a small number of relatively incompetent, complacent U.S. bearing manufacturers. The dominant U.S. petitioner, Torrington Company, was criticized for its poor service and unreliable bearings. At an ITC hearing, a parade of representatives from American manufacturers begged the ITC not to cut off their supply of high-quality foreign bearings. Jacki Doxey, a bearings buyer for Stowe Manufacturing Company, complained that "we have to build Torrington's notorious unreliability into our production schedules." Michael Dykstra, a bearings buyer for Caterpillar, said, "We've repeatedly slipped our production schedule to work around Torrington's string of broken promises. . . . We have customers with Caterpillar equipment shut down in the field, waiting for replacement bearings from Torrington." Thomas White, manager for international purchasing for Deere and Company, observed that "bearing imports have been necessitated by the ongoing inability of Torrington to provide a reliable supply." The ITC accepted a very expansive definition of "like product" that had resulted in some types of bearings that were not produced in the United States being hit with heavy dumping duties. Prices for bearings were rising and U.S. producers were telling U.S. customers they must wait over a year for delivery.

Recent dumping duties imposed on tungsten from China could hurt several U.S. industries, while aiding the very foreign producers it means to punish. After the Commerce Department announced a 151 percent dumping duty on Chinese tungsten, the government of China banned the export of tungsten. One Chinese official declared that the antidumping decision made Chinese producers "very happy. The dumping tariffs are on the raw material ore . . . but China also produces [finished tungsten products]. If U.S. factories cannot import the raw material because of the extremely high duty, they will have to buy the higher value-added [tungsten products] or close down." Wayne Segren, president of Mi-Tech Metals of Indianapolis (a producer of high-density tungsten-based alloys, copper tungsten, and silver tungsten), complained to the ITC: "We really do not have adequate supply and reserves of tungsten raw materials in the United States, and if we restrict the free flow of concentrations, etc., into this country, it would give foreign producers of tungsten-related materials a tremendous raw material cost advantage over domestic producers. If producers in the United States are not able to buy raw material at the same cost as our foreign competition, the result would be the eventual demise of domestic tungsten product producers."

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Even the cutting edge of American high-tech production is not immune from harm from the Commerce Department. In July 1991, Commerce ruled that Japanese advanced computer flat panel imports were being dumped at a 62.67 percent margin. Commerce concocted the 62.67 percent margin largely by using a cost-of-production analysis that vastly overestimated research costs, thereby "proving" that a profitable Japanese company was actually taking big losses on its exports. Computer flat panels are a key component of laptop and notebook computers, and there are no viable U.S. manufacturers of such parts.

Apple, IBM, and Compaq begged the ITC not to impose prohibitive duties. Since there was no viable U.S. producer of advanced computer flat

panels, American computer makers could either buy Japanese or abandon the cutting edge of their industry. Yet a majority of ITC commissioners discovered injury largely because Japanese imports prevented would-be U.S flat panel producers from raising the capital to begin manufacturing. (Even if U.S. companies had raised the necessary capital, it would have taken them three or more years to supply the U.S. computer industry's needs.) The ruling added as much as $1,100 to the price of a computer made in the United States.

After the ITC's decision, Toshiba announced plans to move its U.S. computer-making operations abroad, Dolch Computer Company of San Jose announced plans to transfer jobs to Munich, and IBM announced on November 7, 1991, that it may shift its laptop manufacturing business to Japan. An IBM spokesman described the ITC's decision as "an eviction notice from the U.S. government to the fastest growing part of the U.S. computer industry." Jim Berger of Apple Computer observed: "We were going to produce our new Powerbook laptop computer in Colorado—but instead we are producing them in Cork, Ireland. That is entirely because of the flat panel dumping duty." Joe Tasker of Compaq declared, "The Compaq Portable 486C is being made in Scotland now instead of Houston—and that is because of these dumping duties." The dumping penalty sacrifices a $42-billion personal computer business to a tiny segment of the industry with less than $100 million in revenues. An industry expert estimated that the decision will cost the American computer industry thousands of jobs in the coming year.

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Although U.S. trade laws are often defended as protectors of American jobs, some trade cases are hazardous to American workers. In 1988, the United States was suffering a severe shortage of aluminum redraw rod. One American company, Southwire, filed a complaint against its Venezuelan competition. The Venezuelans were exporting a low-value, unfinished product that was transformed into higher value products in the United States. Roy Albert, a director of the Aluminum, Brick, and Glass Workers' International Union, told the ITC: "It is extremely clear to us that far more jobs would be lost than preserved if antidumping or countervailing duties were imposed on imports of [aluminum] rod from Venezuela. . . . The reality is that we are talking about the loss of 500 to 600 jobs, or even more jobs in the event the flow from Venezuela is cut off through the imposition of duties." Jim Robertson, a contracting agent for General Electric, told the ITC that Southwire was not even able to supply the amounts or types of aluminum rod needed by GE. Several U.S. aluminum producers opposed imposing penalty duties on Venezuelan imports, and Southwire itself was already working at over 100 percent capacity. Yet the ITC voted to penalize Venezuelan imports.

The ITC's decisions sometimes amount to a "reverse industrial policy," according to Ron Cass, former vice chairman of the ITC. The weaker the American industry, the more likely it is that the ITC will blame foreign companies for its problems. Since falling profits are taken as a sign of injury, the ITC tends to sacrifice the strongest, most profitable American industries to the weakest. Any industry that has fallen behind technologically can come to the ITC for a bailout, thereby forcing other American industries to pay the price of its lethargy. Over half of the ITC's unfair trade investigations have focused not on consumer goods, but on products used by American businesses, such as semiconductors, steel, cement, railroad rails, and chemicals. Kenneth Kumm, trade manager for 3M Corporation, complained that the antifriction bearing case increased the price that 3M had to pay for bearings by between 120 percent and 150 percent, undercutting the competitiveness of 3M's exports. The government often cannot protect some American companies without making others less competitive.

It would be difficult to imagine a more foolish way to make economic policy than the ITC's current injury methodology. The ITC focuses only on the group of U.S. producers whining about imports and simply makes believe that the rest of the U.S. economy doesn't really exist. Current American trade law assumes that the government can make the economy stronger by relieving every industrial straggler from the

necessity of competing.

Shorting Steel Users

The United States has imposed import quotas on steel off and on since the late 1960s. Quotas have made American steel far more expensive than foreign steel. Bill Lane of Caterpillar observed, "In 1985, U.S. steel prices were significantly higher than world prices, 59 percent greater than competitors in Germany, 22 percent greater than those in Japan." Jon Jensen of the Precision Metalforming Association said, "In April [1989], some hot rolled grades were running 32 percent in price above the price in January 1987 . . . 300 series stainless steel sheet was up 69 percent over the same period." The New Orleans *Times-Picayune* observed in 1988 that "some [ship]builders fear they will lose their chances at new business because they can't get the steel at affordable prices. Steel plate prices have risen nearly 50 percent in the last six months." Stanley Tools, one of America's premier toolmakers, was hurt by the quotas because steel accounts for 58 percent of the materials cost of a hammer, 21 percent of that of a screwdriver, and 38 percent of that of a saw, as Robert Samuelson reported. Former ITC chairman Paula Stern noted, "Inflated U.S. steel prices were an important factor in the erosion of U.S. manufacturing preeminence and employment from the 1960s to the mid-1980s." The ITC concluded that the steel import quotas actually increased the U.S. trade deficit, causing a significant increase in imports of manufactured goods containing steel and a decrease in U.S. exports of steel products. The Institute for International Economics estimated that steel quotas cost U.S. consumers $6.8 billion a year.

Steel shortages have had even more devastating impacts on American manufacturers than have higher steel prices. By 1987, lengthy delivery delays by American steel companies were commonplace. Bill Lane of Caterpillar observed: "In late 1987 we ran out of large special section steel. This is the steel that we use to make our undercarriage, or track shoes. There are no U.S. suppliers, yet this product is covered by the quotas." Even General Motors was hurt by quotas: GM Vice President James D. Johnston complained to the White House that steel shortages "have jeopardized vehicle assembly at the company."

Davis-Walker, the largest fabricator of wire and wire products on the West Coast, with 750 employees, was bankrupted by the Voluntary Restraint Agreements (VRAs) on imported steel, according to the company's CEO, Ed McNew. Even though the ITC had concluded in 1984 that domestic steel wire rod producers were not being injured by imports, wire rod imports were restrained by VRAs. Because of raw material shortages, Davis-Walker ceased all production of nails. McNew complained, "It is clear that U.S. rod manufacturers simply do not have sufficient capacity to supply the U.S. market."

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To mollify opposition to steel quotas, the 1984 Trade and Tariff Act contained a short-supply provision intended, as a congressional conference report noted, "to protect domestic purchasers of steel products from undue hardship due to an inability to obtain adequate supplies from domestic sources." Under that provision, U.S. manufacturers could petition Commerce to allow additional imports of specific types of steel in short supply.

The short-supply program exemplified the dichotomy of rights between protected and unprotected producers. The Commerce Department decided that no burden was too heavy, no price too high, and no quality too low in order to force American manufacturers to bankroll U.S. steel producers. Even if American-made steel cost far more than foreign steel, the Commerce Department forced American manufacturers to pay shakedown prices for it. Rep. Sam Gibbons (D-Fla.) observed, "In effect, we have the government, namely the Department of Commerce, on one side of American industry, and they were just out shafting the other side of American industry."

Commerce's short-supply program allowed some American steel makers to take other steel producers hostage. The steel quotas covered a vast array of semifinished and "raw" steel products. American steel companies that needed more unfinished steel accounted for roughly 70 percent of all the steel requested under the short-supply provi-

sion. Commerce's policy was that if any U.S. steel company would pledge to supply the type of steel requested under a short-supply provision, then that type of steel was automatically not in short supply.

Gulf States Steel of Gasden, Alabama, made a short-supply request in early 1987 for 104,000 tons of steel slabs. Commerce denied the request because Bethlehem Steel and USX promised to supply sufficient steel slab to the company. But Bethlehem delivered nothing and USX delivered a steel much lower in quality than what Gulf States needed, and delivered it late. Commerce denied a short-supply request by Lone Star Steel of Texas after USX promised to supply the steel; but USX failed to honor its contract.

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Frequently, USX and Bethlehem were in direct competition with the company to which they promised to provide additional steel. They repeatedly failed to fulfill their promises to supply their competitors and thereby got a larger share of the market themselves. The General Accounting Office (GAO) concluded that the VRAs and the abuses of the short-supply mechanisms gave some companies monopolies of certain types of steel in the U.S. market.

Berg Steel Pipe Corp. of Panama City requested permission to import 24,200 tons of specialty steel under the short-supply program in July 1987. Berg used a high-grade steel plate to produce pipes, and domestic steel companies told Berg that delivery time would be at least five months down the pike. Commerce dallied for eight months before partially approving Berg's request; in the meantime, Berg was forced to lay off 40 workers just before Christmas because of insufficient supplies.

In late 1987, there was a severe shortage of wire rod used to make steel wire. Only one U.S. company produced the high-quality steel rod that American wire producers needed—and it was rationing deliveries to wire producers, providing only 60 percent of the amounts ordered. The American Wire Producers Association filed a short-supply request, and Commerce let the association hang in the air for eight months before making a decision. One Commerce official justified the delay by claiming that before determining whether to grant the request, he had to personally go to Europe to see whether Europeans might be able to ship a few thousand tons of wire rod under existing VRAs. While the Commerce official was enjoying a European gallivant, American wire producers were laying off hundreds of workers because of steel shortages.

Commerce announced on July 7, 1988, that wire producers would be permitted to import 820 of the 2,820 tons of special steel they had requested. Commerce denied most of the request because, it claimed, the Baltimore Specialty Steel Company could supply the other steel wire rod needed. But Baltimore Specialty at that time was having severe quality problems and was running far behind on delivery. The president of the Baltimore company, when asked by the *American Metal Market* newspaper about his company's problems, declared: "I don't think any mill has its quality at a level it wants it to be, and I won't comment on the number of pounds we've had rejected. Every mill has its quality ups and downs." That is the kind of industrial winner that federal steel policy championed.

The short-supply program was highly arbitrary. As Allan L. Mendelowitz of the GAO noted: "We found no regulations or comprehensive guidance on the program's operation or petition requirements. Commerce does not make public the reasons and results of its review." In 1986, Commerce took an average of 236 days to decide a short-supply request. Mendelowitz noted: "They [Commerce] viewed it as their responsibility, under the law, to keep foreign steel out of the United States, and that is how they administered the short-supply program. One of the reasons why the decisions took so long, particularly in the early years, was specifically to create obstacles to acquiring steel through the program."

The GAO, in a briefing report to Congress, observed that "some petitioners have tried to justify their requests by claiming that available domestic steel is less efficient to use than foreign materials. . . . Commerce has never

approved a short-supply petitioner because it judged that the efficiency achieved in using the domestic steel would be too low."

GAO's Mendelowitz explained: "There was one case involving a fellow who made little metal pins that the magnetic tape is drawn over in video cartridges, and he needed a certain very high-quality steel for those pins, so that the videotape would not be damaged. For this very specialized kind of specialty steel wire, there was only one supplier, in Japan. That supplier could not get an export approval because the VRA in the category had been exceeded, and the U.S. producer went in and asked for a short-supply petition for 100 tons, an infinitesimally small amount of steel. There was an American supplier who said that he could supply it, but only one-third of the order. When he supplied it, it did not meet specifications and it did not meet quality. The U.S. metal pin producer . . . went back to Commerce and said—this is not going to do it, we cannot maintain our position as a quality supplier in the world market with this steel. We have to get what we need. Commerce went to the U.S. supplier, and the U.S. supplier said, 'We do not have any objection to your granting a short-supply approval for this purchaser.' Commerce asked, 'Well, in other words, are you telling us that you cannot supply the steel?' But the U.S. steel supplier would not say that. And as long as the U.S. supplier would not say he could not supply it, there was a long period before Commerce would grant approval for a short-supply petition for just a small order of specialty steel."

Commerce officials did not view steel shortages as a problem. Deputy Assistant Secretary Gilbert Kaplan, who ran the program, declared in 1988 that a short supply is "not a negative situation . . . that's a positive situation," meaning the industry is "doing very well." Kaplan observed: "The amount requested [under short-supply provisions] doesn't have much to do with the amount granted. People come in very, very high." Federal steel policy routinely gave one man authority to judge whether American manufacturers really needed the steel for which they were begging.

The government cannot protect steel manufacturers without handicapping all steel users. Jon Jensen of the Precision Metalforming Association told the House Ways and Means Committee: "We have documented nearly 100 specific examples of where our members lost jobs, lost contracts to our competitors in Europe and in the Pacific [because of the steel quotas]. And for the first time in the history of the United States, the United States has become a net importer of the products of our industry in 1986, 1987, and 1988. . . . In each of the past several years, 20 percent to 25 percent of the companies responding to our profits survey showed net losses. We lose about 3 percent to 5 percent of the companies in our industry each year."

Jerry Maahs, a spokesman for the National Association of Equipment Manufacturers (NAFEM), testified: "NAFEM opposes the VRAs because they have established a virtual cartel of the steel mills producing stainless steel sheet and strip in this country. This has caused an increase in price of approximately 75 percent in the past 16 to 18 months. Since the VRAs went into effect, delivery times have also stretched out, disrupting 'just in time' production. This has made our industry increasingly noncompetitive with foreign food equipment manufacturers."

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Steel quotas have destroyed far more jobs than they have saved. Caterpillar led the fight against the extension of steel quotas in 1989 with buttons proclaiming, "Steel VRAs Steal Jobs." Professor Hans Mueller estimated that the quotas resulted in 13 jobs lost in steel-using industries for each steelworker's job saved, while a 1987 study by the Center for American Business estimated that steel quotas resulted in three jobs lost in steel-using industries for every job saved in the steel industry. Because of the VRAs' impact on steel prices, shopping carts that were previously produced in California are now being produced in Taiwan. The Institute for International Economics estimated that quotas were costing the equivalent of $750,000 a year for each steel job "saved." A 1984 Federal Trade Commission study by Morris Morke and David

Tarr estimated that steel quotas cost the U.S. economy $25 for each additional dollar of profit for American steel producers.

Steel imports have not been the primary cause of the U.S. industry's problems. The GAO concluded in July 1989 that "poor financial performance has long plagued the U.S. steel industry. . . . Causes of the competitive problems include slow productivity growth brought on in part by slow implementation of new technologies and little effort at research and development, disproportionately high labor costs, global overcapacity, foreign subsidies, falling international shipping costs, air pollution abatement costs, and deterioration of the U.S. advantage in raw material costs." Large steel makers are also being trounced in the marketplace by smaller U.S. minimills. The smaller mills have double the output per worker, much lower costs, and are highly profitable.

American steel is widely perceived as inferior in quality to foreign steel. Ford Motor Company's rejection rate for U.S.-made steel during the 1980s was, at one point, five times higher than its rejection rate for foreign steel. A 1988 ITC report concluded that U.S. steel is sometimes not flat enough for use in fenders and other items, thereby putting American auto companies at a competitive disadvantage to the Japanese. A 1991 ITC survey of steel buyers found that, of U.S. machinery producers, 60 percent rated Japanese steel quality as excellent, while only 8 percent rated U.S. steel as excellent. Fourteen percent of fabricated metal producers said U.S. steel was excellent, while 44 percent complained that U.S. steel quality was "less than satisfactory." In contrast, 60 percent of the same industry rated Japanese steel as excellent, and no U.S. fabricated-metal producer judged Japanese steel as "less than satisfactory." To force American fabricated metal producers to use U.S. steel instead of Japanese steel is to cripple their ability to compete on world markets.

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Machine Tool Quotas

Since 1986, the United States has imposed import quotas on Japanese and Taiwanese machine tools. Machine tools are automatic power-driven tools such as electric lathes and punch presses that are used to cut, drill, and stamp the metal that becomes cars, airplanes, missiles, and the like. Machine tools can function as automated production systems. Naturally, since machine tools are vital to American manufacturing competitiveness, the United States government intervened to drive up their price and create an artificial shortage.

In May 1986, the United States announced plans to impose quotas on machine tools from Japan and Taiwan. The machine tool industry employs roughly 70,000 American workers, while industries relying on machine tools employ millions of workers. Commerce secretary Malcolm Baldridge, in announcing the quotas, assured listeners that the trade restrictions "will certainly increase employment."

It would be difficult to design a quota system that inflicted more damage both on U.S. machine tool buyers and on many machine tool producers. The Institute for International Economics estimated that the import quotas boosted the profits of foreign machine tool exporters by $320 million.

In 1989, Caterpillar Inc. needed Japanese machine tools to produce components in the United States which it was then buying in Japan. But Caterpillar was stymied because that year's quotas had all been allocated. Caterpillar representatives eventually persuaded Japan's Ministry of International Trade and Industry (MITI) to reallocate portions of Japan's machine tool export quota to Caterpillar's Japanese supplier. Bill Lane of Caterpillar observed: "The quotas put MITI in the position of determining which American companies would be winners and losers. In our case, it worked out okay—but, as a result, some other American company faced delays in getting the types of machine tools that it needed." (The quota levels for Japanese tools are set at far higher levels than for Taiwanese tools and are probably not binding at the present time).

By disrupting the supply of foreign low-priced, low-tech inputs for high-tech U.S. machines, the quotas helped bankrupt at least two American machine tool makers—Bayer

Industries, Inc., of Phoenix and MHP Machines, Inc., of Buffalo. The quotas, by boosting the production costs of American machine tools, have undercut U.S. companies' efforts to maximize exports. Brian McLaughlin, president of Hurco Companies, Inc., of Indianapolis, one of America's premier machine tool exporters, estimates that the quotas have cost his company $5 million a year.

The Bush administration's 1991 decision to extend the import quotas evoked a hailstorm of criticism from American manufacturers. Jacob Grainger, president of Grainger Manufacturer, a Massachusetts manufacturer of computer and electronic components, complained to the White House that the VRAs covered a type of machine tool that is not even produced in the United States. Largely as a result of the VRAs, the price for the machine tools Grainger imports from Japan increased by 80 percent, thereby preventing Grainger from hiring more workers.

Donald Houck, product manager of Warn Industries, a Milwaukee producer of automotive parts, complained, "After an extensive search for quality machine tools, we were unable to locate machine tools with the necessary equipment, quality, and productivity level made in the U.S.A. and were forced to purchase Japanese made machines." Warn Industries was hurt because the quotas restricted its ability to buy the tools it needed.

D.E. Nicolaides, president of Western Machining Company, an Anaheim, California, producer of aircraft and missile components, complained: "Most of our machine tools and accessories are manufactured in Japan. Our domestic manufacturers have not properly addressed our needs in their machines. Most U.S.-manufactured machine tool controls are clumsy to use and slow in functioning."

Bradley Lawton, vice president of Star Cutter Company, a Michigan drill producer, observes that the import quotas "give a false impression to the U.S. machine tool makers and allow them the opportunity to delay their product development."

Even several tool producers oppose extending the quotas. John P. Nicholl, president of Dynapath Systems, Inc., of Detroit, warns that VRAs, by distorting investment and adjustment, can be "the death knell to small manufacturers." Nicholl concludes, "The more we distort our markets, the less we will be able to go toe-to-toe in global competition, and we will become less competitive here at home."

Advocates of quotas claim that the continued protectionism is necessary for our national defense. But, as Rep. Lee Hamilton (D.-Ind.) observes: "Many downstream industries may be harmed by VRAs, including manufacturers of the aircraft, missiles, guidance system, and armaments used by our servicemen in the Gulf War. Those industries need access to the best equipment available in the world."

While advocates of industrial policy insist that government officials have the vision to command the heights of the American economy, the gritty details of trade cases show otherwise. The machine tool import controls amount to a potential stranglehold on the building blocks of American manufacturing. Yet a 1990 GAO report indicated that the Commerce employees administering the quotas had little or no idea what they were doing. The GAO noted that Commerce "does not have written policies or procedures for monitoring the agreements and does not maintain complete records of the monitoring it does." American businesses, desperately trying to get advanced equipment to enter the computer era of manufacturing, are at the mercy of government employees who cannot even keep written records.

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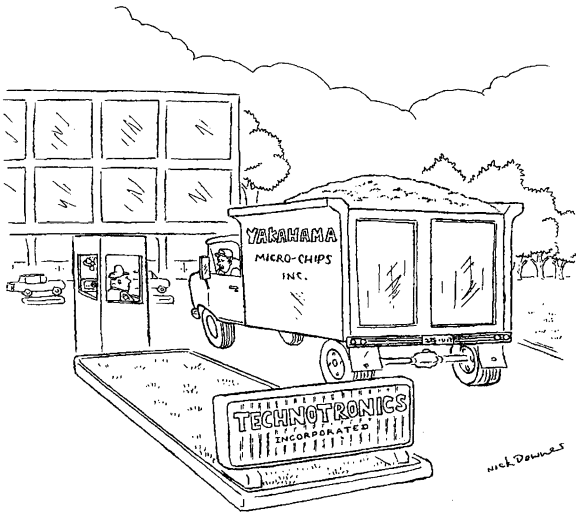
The Slaughter of the Computer Industry

U.S. government officials have long claimed the right to retaliate against foreign governments for alleged unfair trade practices. While imposing punitive tariffs on foreign nations appears to be extremely gratifying to American politicians' sense of righteousness, previous retaliations have severely harmed key American industries. Considering the growing likelihood that the Clinton administration will impose punitive tariffs on Japan and other countries, an examina-



"Where you want 'em dumped?"

tion of the most controversial and costly trade retaliation in recent American history is in order.

The Semiconductor Arrangement, signed with Japan in July 1986, made it an official act of trade war if a foreign government does not force private foreign companies to rapidly increase their purchases of American products. President Reagan declared upon announcing the agreement that it "represents an important step toward freer and more equitable world trade. . . . By holding to our free-market principles, but at the same time insisting on fair trade, we have created a climate in which the U.S. semiconductor industry should substantially increase its sales position in Japan." In reality, the Semiconductor Arrangement illustrates how an artificial, arbitrary definition of fair trade sows the seed for future unfair trade allegations based on misunderstandings, vague phrases, and political finagling.

The Semiconductor Arrangement sacrificed a huge section of American industry to benefit a few semiconductor producers. There were two million Americans working in industries reliant on semiconductors, and only 240,000 Americans working in semiconductor production.

In early 1985, U.S. officials warned the Japanese government to pressure Japanese companies to reduce semiconductor chip production in order to avoid a sharp fall in world chip prices. In mid-1985, U.S. companies brought dumping suits against Japanese semiconductor exporters of 64K chips, and a few months later, the Commerce Department initiated suits against Japanese exporters on 256K and larger chips. Though Japanese chips were higher priced in the United States than in Japan, Commerce created high dumping margins by using a cost of production analysis that was widely derided as totally inappropriate for a high-tech industry. The high dumping margins were then used as a lever to force Japanese companies and the Japanese government to submit to U.S. government controls on semiconductor trade.

As part of the arrangement, the Commerce Department acquired the power to set prices for Japanese chips sold in the United States. In August 1986, Commerce announced its first "fair market values" for chip imports. American computer and electronics companies—the primary chip users—were stunned as Commerce's decree raised chip prices by 300 percent, far more than even the highest alleged dumping margins. American chip users were outraged. As one computer industry expert observed: "There was great hostility throughout the computer industry to Commerce's method of fair market value calculations. People thought that chips were being singled out for some bizarre, irrelevant method. People did not realize that this is how Commerce normally does business."

Commerce put American electronic companies at a disadvantage, since they were severely hampered from getting the most advanced chips to test for their new products. Commerce even prohibited Japanese companies from giving their chips to American companies, who needed to see how the latest chips would work with their new test equipment. The market solved that problem with the proliferation of "chip loaners."

The Semiconductor Arrangement sacrificed a huge sector of American industry to benefit a few semiconductor producers. There were 2 million Americans working in industries reliant on semi-

conductors and only 240,000 Americans working in semiconductor production. Author George Gilder, who writes often on high-tech industries, noted that "to attack the U.S. computer industry in order to save the U.S. semiconductor industry is simply crazy." Arthur Denzau of the Center for the Study of American Business observed: "The pact creates lower relative costs for the Japanese electronics firms that make computers. The arrangement raised the price of DRAMS [chips] to American computer firms, but could not directly affect the real cost of chips to computer subsidiaries of the Japanese Integrated Circuit firms." Denzau estimated that the Semiconductor Arrangement resulted in up to 11,000 jobs lost in companies using chips. The *Journal of Commerce* reported in 1988, "The supply crunch has left U.S. electronics makers wringing their hands over lost sales and profits, delayed product introductions, and worsened relations with customers."

A confidential 1988 report by the U.S. Systems Producers Association concluded that the Semiconductor Arrangement had

- contributed to the shortage in the United States of all types of DRAMS from both foreign and domestic suppliers;
- seriously threatened to make shortages of semiconductors chronic, encouraging continuing underinvestment by U.S. and Japanese semiconductor producers;
- made U.S. systems companies increasingly dependent on vertically integrated Japanese and Korean competitors for supplies of semiconductors;
- required the U.S. systems industry to pay excessively high prices to Japanese and Korean suppliers, enhancing their profitability and giving them access to increased funding for systems research and development;
- increasingly concentrated DRAM production in the hands of a small number of Japanese and Korean producers, encouraging either cartel-like behavior or the structural problems of oligopoly pricing; and
- reduced the quality of semiconductor devices as a result of the lack of competition.

Because Commerce set Japanese export prices extremely high, Japanese exports plummeted, resulting in a severe oversupply of chips in Japan. That caused chip prices in Japan to fall, making it even more difficult for U.S. companies to export chips to Japan. Naturally, U.S. Trade Representative and Commerce Department officials saw that as unfair behavior on the part of the Japanese.

In late March 1987, President Reagan announced that the Japanese had violated the arrangement because third-market dumping was allegedly still occurring and because American companies had not increased their chip sales in Japan. But the Japanese never promised that U.S. chip sales in Japan would automatically increase. At the time the Semiconductor Arrangement was signed in July 1986, the Japanese ambassador sent a side letter to U.S. Trade Representative Clayton Yeutter declaring: "The government of Japan recognizes the U.S. semiconductor industry's expectation that semiconductor sales in Japan of foreign capital-affiliated companies will grow to at least slightly above 20 percent of the Japanese market in five years. The government of Japan considers that this can be realized and welcomes its realization." The letter did not commit the Japanese government to enforcing the purchase of American chips by Japanese companies, and the letter noted, "The attainment of such an expectation depends on competitive factors, the sales efforts of the foreign capital-affiliated companies." The GAO concluded that the arrangement was not clear "with respect to the provisions regarding increased access to the Japanese market. It does not explicitly state how compliance with that aspect of the Arrangement will be determined. . . . The Arrangement does not specify what increase in U.S. market share would be an acceptable intermediate goal, and it does not specify an ultimate market share." The 1989 *Economic Report of the President* admitted: "Tangible evidence of Japanese discrimination against U.S. firms was hard to document. The criteria used for gauging market access was the U.S. share of the Japanese semiconductor market." Japan was punished simply because American companies did not sell as many semiconductors in Japan as the U.S. bureaucrats thought they should be able to sell. (At the time, American chips were widely perceived to be inferior to and less reliable than Japanese chips.)

After 200 years of protection for textiles, and several decades for steel, maybe it is time to stop giving America's laggards the benefit of the doubt.

On April 17, 1987, President Reagan repeated

his ritual assertion that he sought "to enforce the principles of free and fair trade" and imposed 100 percent tariffs on Japanese imports of power tools, computers, and TV sets. American trade officials spoke of the supertariffs as a "shot across their bow" toward the Japanese—but the shot hit American construction companies, which used Japanese power tools. Data General, a Massachusetts company, was badly hurt because it owned an 85 percent interest in a Japanese company that produced laptop computers for the U.S. market. A *Washington Post* article noted, "Penalty tariffs are not being charged on semiconductors themselves because they are needed by many U.S. companies." But if the other products tagged with 100 percent tariffs were not needed by anybody, then why were Americans buying them? The choice of products for retaliatory supertariffs was largely a question of the political clout of possible victims—which group of potential victims got politically organized the fastest to avoid being chosen for the sacrificial altar.

Conclusion

Every trade barrier seeks to redirect capital and labor from relatively more productive to relatively less productive uses. Early American protectionists clearly recognized that principle, and justified it by insisting that protection would be temporary, lasting only long enough to get a new industry's feet on the ground, after which consumers would pay lower prices. After 200 years of protection for textiles, and several decades for steel, maybe it is time to stop giving America's laggards the benefit of the doubt.

Protectionism is a form of economic censorship. Protectionism seeks to obscure the fact that certain sectors of the American economy are not competitive. As Cato Institute scholar Sheldon Richman observes, "Protectionism is an attack on the price system *per se* and its communications function, since the prices set by the market are overridden—distorted, falsified—by bureaucrats with a political agenda." Every trade barrier changes the comparative return on investments in the domestic economy. The effect of trade barriers is to reward Americans for producing less with more capital and more labor. Every trade barrier protecting a low-tech industry creates a disincentive for Americans to invest in high-tech industries. Many of the same politicians who favor government investment in computer research also favor maintaining import quotas on textiles and apparel. Such positions make sense only if one assumes that the United States has an infinite amount of capital. Removing our trade barriers is simply a matter of the government's ceasing to impede the transfer of capital and labor from less productive to more productive activities.

The U.S. government has no right to handicap one American industry in response to some foreign government's denying another American industry "equal opportunity." Every unnecessary trade burden the U.S. government places on American industry means lost exports and reduced income for American citizens. Politicians have shown no learning curve from their experiences in disrupting key American industry. The less power politicians have over imports, the better off America's most competitive industries will be.

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