Missing the Boat on Export Trading Companies

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EXPORT EXPANSION is increasingly recognized as one key to the long-term recovery of the U.S. economy. In the past decade the American share of the world export market has declined significantly, and gains in U.S. industrial productivity have dropped in like measure compared with the gains in other leading trading nations. Most recently, our imports have outstripped our export sales by a steadily increasing margin, worsening our balance of trade and encouraging protectionist demands for new import restrictions. Realizing how damaging such restrictions would be in causing retaliation and overall shrinkage in world trade, many observers have argued that expanding exports would be the more palatable, economically efficient way to shrink trade deficits and promote jobs.

"Export trading companies" have been anointed as the champions of the export expansion campaign. These are trade intermediaries that finance and market the export sales of one or more domestic producers, in effect promoting exports by domestic firms that otherwise might not have participated in international trade. Trading companies have played a vital role in furthering the export successes of our major trading partners, particularly Japan. So far, however, they have been much less significant among U.S. exporters.

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Some observers have blamed this backwardness on laws that prevent banks from investing in trading companies and that subject joint export activities to possible antitrust challenge—obstacles that are not placed in the way of European and Japanese trading firms. The Export Trading Company Act of 1982, signed in October, is aimed at eliminating these regulatory obstacles. Ironically, however, it actually imposes *new* regulatory encumbrances on trading company activities and falls far short of accomplishing its other intended goals.

The Provisions of the Act

By making it possible for bank holding companies to own trading companies and establishing an antitrust "safe harbor" for export trade activity, the Export Trading Company Act seeks to promote the development of trade intermediaries that will aid export-shy U.S. companies in marketing their goods and services abroad. These intermediaries are defined in the act as export trading companies established

"principally" to undertake, or facilitate, the export of a full range of goods *or* services. (Thus, they may engage primarily or even exclusively in such service activities as consulting, engineering, communications, and insurance.) The act creates an office within the Commerce Department to support the formation of trading companies—manifesting congressional lack of trust in the ability of the market to "get across" the export promotion message or, more charitably, the notion that bureaucratic involvement is vital to overcome initial uncertainty on the part of trading company promoters.

The heart of the act is set forth in its provisions on bank export services (Title II), on certification of antitrust immunity (Title III), and on other antitrust improvements (Title IV).

Bank Export Services. The key provision of Title II (section 203) authorizes a bank holding company to invest up to 5 percent of its capital stock and surplus in acquiring or forming an export trading company. But there are conditions. The Federal Reserve Board must be notified of the planned investment sixty days in advance, and may disapprove it on two grounds —that it threatens the holding company's "financial or managerial resources" or that it may lead to "unsafe or unsound banking practices, undue concentration of resources, decreased or unfair competition, or conflicts of interest." The buzzwords, "undue concentration of resources" and "unfair competition," suggest populist concerns about corporate size that conflict with efficiency-based theories of antitrust enforcement and that could impede the formation of efficiency-seeking liaisons or joint ventures between large bank holding companies and export trade firms. Given its lack of antitrust expertise, the Federal Reserve Board cannot be counted on to apply these vague guidelines in an economically sound manner. This is particularly ironic in view of Congress's intent, as expressed in the conference committee report, to make it possible for U.S. firms to compete with the large foreign export trading companies that enjoy favorable bank relationships and are subject to little antitrust restraint.

The irony is compounded by a clause barring a bank holding company from lending money "on terms more favorable than those afforded similar borrowers in similar circumstances" to an export trading company in which it has invested. This provision, which is squarely aimed at preventing banks from "unfairly" discriminating in favor of their own export subsidiaries, ignores the fact that a parent bank may find it less costly to lend to its "captive" trading company than to its unaffiliated customers. The bank may well, for example, be better able to evaluate the financial risks of its subsidiary's transactions than those of its independent customers—which should in theory justify giving more credit to the former, but in practice may be hard to demonstrate to the satisfaction of Federal Reserve Board officials. To the extent that bank holding company officials believe the "no discrimination" clause would effectively bar them from realizing such efficiencies, they will be less inclined to invest in export trading companies. This is particularly unfortunate, because fears of "unfair discrimination" are, in all probability, illusory: there are so many banks competing to offer export-financing services that an independent trading company could surely line up financing at market rates from one or another of them. In short, access to favorable financing with all its advantages is denied to U.S. export firms under the terms of the new act.

Additional regulatory constraints hinder parent bank involvement in export trading company activity. A bank holding company "may be required . . . to terminate its investment" in an export trading company or be subject to "limitations or conditions" specified by the Federal Reserve Board, if the board finds that the holding company has taken "unnecessary" positions in commodities, securities, or foreign exchange. Understandably, some bank holding companies may find that the costs of regulatory supervision of their transactions in commodities, securities, and foreign exchange outweigh any likely advantages from investing in export trading companies.

Moreover, the act bars export trading companies from the potential benefits of diversification. Not only must these companies be "principally" involved in export-related endeavors (as required under Title I), but they must eschew all investment banking activities denied to bank holding companies under U.S. law, as well as agricultural production and manufacturing. These strictures ignore the fact that major U.S. manufacturers are setting up—as their foreign competitors did some time ago—their

own trading companies. (Sears Roebuck, General Electric, and Peabody International are among the pioneers.) Prohibiting potentially valuable affiliations between bank holding companies and the export affiliates of dynamic American corporations undercuts the cause of export expansion.

Fortunately, Title II does provide some incentives for banks to take part in export trading company activities. One provision (section 207) amends the Federal Reserve Act by allowing banks to trade more fully than they do now in bankers' acceptances (IOUs that run for less than six months and are used in export financing). Previously, a bank's participation in acceptances was limited to 10 percent of the value of its capital stock and surplus; the new limit is 150 percent (or, with Federal Reserve Board approval, up to 200 percent). This change will encourage smaller banks to start doing export financing, thus making it easier for smaller exporters and trading companies to obtain short-term funds. In addition, agreement corporations ("bankers' banks," which are owned by and do business solely with other banks) and Edge Act corporations (which aid the foreign operations of U.S. banks) are authorized, if they are subsidiaries of bank holding companies, to invest in export trading companies (section 203). Finally, the Export-Import Bank is empowered to guarantee loans to export trading companies, providing this would spur export expansion or make up for "inadequate" financing in the private credit market (section 206). This provision may not be of much effect, since the amount of guarantees will depend on the level of appropriations for Eximbank activities.

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Certifications of Antitrust Immunity. According to the promoters of the new act, many U.S. firms would have already set up export trading companies were it not for the fear of antitrust challenge. Title III attempts to alleviate this fear. Instead, it creates a regulatory quagmire that may, paradoxically, expose companies to greater antitrust risk than before. Fortunately for export trading companies, they can take advantage of the act's banking provisions (Title II) without having to apply for certification.

Section 303 authorizes *any* person, not just export trading companies, to apply to the Commerce Department for an "export trade certificate of review" intended to establish a "safe harbor" of antitrust immunity for designated activities. The secretary of commerce, with the concurrence of the attorney general, shall issue such a certificate if the applicant establishes that the conduct specified in its application—

> (1) will not substantially restrain trade or lessen competition within the United States, or substantially restrain a competitor's export trade;
> (2) will not unreasonably "enhance, stabilize, or depress prices within the United States" of items being exported;
> (3) does not involve "unfair methods of competition" against export competitors; and
> (4) does not include acts which "may reasonably" result in the reimportation into the United States of items being exported.

In short, an applicant must demonstrate in advance not only that its specified future conduct will not be anticompetitive, but that it will not treat competing exporters or export companies "unfairly"—a standard much more solicitous of the welfare of individual competitors than of the health of the competitive process. Export groups interested in undermining competitors might even be tempted to forestall the granting of certificates by concocting claims of "unfairness," given the breadth of the "unfairness" language.

Once an applicant receives a certificate, it faces a new set of regulatory impediments. It must report to the Commerce Department any changes in matters relevant to the certificate and, if it wishes to expand its range of certified activities, must go through the whole application process all over again (section 304). Furthermore, it can lose its certificate if either the Commerce Department or the Justice Depart-

ment deems that its export activities no longer meet all four section-303 tests, or if it refuses to comply with a government request for information (section 304). In addition, it must report annually to the Commerce Department (section 308), and may subsequently find the commercial or financial information contained in its reports made public upon a request by Congress, or in a judicial or administrative proceeding, or pursuant to agency regulation (sections 309 and 310). Given these hazards, a certificate will presumably be worth obtaining only if it provides substantial benefits to the holder.

Surprisingly, the antitrust protection offered by a certificate is very limited (section 306). In general, no criminal or civil antitrust action may be brought against a certificate holder "based on conduct which is specified in, and complies with, the terms of" the certificate. It follows that individuals or the government are perfectly free to bring suits against certificate holders based on the contention that their activities were not within the scope of the certificate or, even if they were, did not comply with the certificate's requirements. Moreover, assuming the challenged conduct did arguably comply with the certificate, any "injured" individual may bring a suit for actual damages, plus interest and attorneys' fees, based on the four standards set forth in section 303. These rights of private action go beyond those available under existing federal antitrust law, which allows the Federal Trade Commission, but not private parties, to assert a claim of "unfair methods of competition." Finally, even conduct that actually complies with a certificate is entitled only to a "presumption" that it meets the four section-303 tests. The only clearly positive clause is one that discourages sham suits by awarding attorneys' fees to defendants who are found to have complied with the section 303 standards.

In summary, Title III appears to go out of its way to encourage participants in export trade *not* to apply for certification. In return for incurring significant supervision and reporting costs, certificate holders are rewarded by antitrust exposure that is not only broader than before but greater than that faced by other companies. At the same time, all activity that does not fall within a certificate's narrow confines enjoys no antitrust protection whatsoever. It follows that export promoters who want operational flexibility at a minimum of regulatory expense will have every incentive to avoid certification. Overall, then, Title III can be expected to have a neutral impact on exports at best.

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Foreign Trade Antitrust Improvements. Title IV, like Title III, attempts to banish the specter of antitrust uncertainty, but by a different method. Unfortunately, the one effort is no more successful than the other.

The approach of Title IV is to provide that the Sherman Act and section 5 of the Federal Trade Commission Act do not apply to foreign non-import-related trade or commerce that does not have a "direct, substantial, and reasonably foreseeable effect" on domestic commerce, import trade, or the trade of other U.S. exporters. This is not, however, a bold departure from the existing state of affairs. It merely codifies the present firmly held federal policy, expressed in the Antitrust Division's international antitrust guidelines, not to challenge international transactions that do not "substantially and foreseeably" harm U.S. consumers or competitors by affecting export markets or artificially restricting export opportunities.

Of course, Title IV's main aim is to ease exporters' fears of *private* antitrust actions, which are not subject to government control. As a prerequisite to private suits, section 4 of the Clayton Act provides that a private party can file suit for antitrust damages only if he is "injured in his business or property by reason of anything forbidden in the antitrust laws." But, because that section does not define antitrust injury, it was arguable before the new law's passage that attenuated, indirect effects of competitive behavior could cause injury and give rise to private suits. Title IV precludes this argument by saying flatly that export trade activities give rise to private suit only if their domestic effects are "direct, substantial, and reasonably foreseeable." As a result, potential problems for exporters posed by judicial hold-

ings such as *Dominicus Americana Bohio* v. *Gulf & Western Industries, Inc.*, (Southern District of New York, 1979)—which reasoned that an "effect on foreign commerce . . . [need not] be both substantial and direct as long as it is not de minimis"—are totally eliminated.

Nonetheless, the extent to which this change will reduce antitrust uncertainty should not be overestimated. Many courts have required some showing of a direct effect on Americans in private antitrust cases, and private plaintiffs usually manage to allege that the effects of defendants' actions were "direct," "substantial," and "foreseeable." Moreover, as a practical matter, if a private plaintiff is able to show antitrust injury, he probably will be able to convince a court that the injury was suitable for litigation under the Title IV standards. Legal commentators who support the use of a "direct and substantial" effects test admit that this standard is quite broad. Thus, the factual setting of each case, rather than the choice of particular legal buzzwords, will continue to determine whether an antitrust case goes forward. It follows that Title IV cannot be counted on to reduce significantly the incidence of private antitrust suits and the risk of damage assessments, facts which undoubtedly soon will become known in the export business.

Paradoxically, Title IV may offer the most antitrust protection not to U.S. exporters, but to foreign firms doing business abroad. For example, consider Yankee Widgets, an American-owned Ruritanian subsidiary of a U.S. multinational firm. Locally owned Ruritanian widget producers would like to freeze out Yankee Widgets by forming an exclusive cartel and getting Ruritanians to boycott Yankee's sales. But until now they have held off, for fear that Yankee or the Justice Department would bring antitrust suits against them in the United States, where the Ruritanian producers have a jurisdictional presence *plus* substantial assets. Now, however, Title IV may in effect legalize their effort to exclude Yankee Widgets. The U.S. lawyers for the Ruritanian cartel will be able to argue convincingly that the injury to Yankee's Ruritanian sales does not have a "direct, substantial, and reasonably foreseeable effect" on either domestic U.S. commerce or U.S. import or export trade (widgets are not a significant component of American foreign trade). Before the new law was passed a sympathetic American judge could have subjected the cartel to U.S. antitrust laws on the grounds that Yankee's American parent suffered a greater than *de minimis* (although less than "direct" or "substantial") injury. Now, however, this way of protecting Yankee from foreign ravages is gone.

In sum, in its zeal to eliminate antitrust threats to American exporters, Congress has unwittingly jeopardized the antitrust protection enjoyed by U.S. firms doing business abroad. Because the "antitrust ethic" is more deeply engrained in this country than overseas, foreign firms are more likely than American exporters to increase their anticompetitive activities as a result of Title IV. Thus, it would not be startling if the benefits accruing to American exporters as a result of the Title IV "reform" were more than outweighed by the costs imposed on U.S. business worldwide—which is surely both undesirable and unintended.

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International Trade Practices

The Export Trading Company Act should not be viewed in a vacuum. Even legislation that provided strong export incentives might not have held out much hope of success in boosting exports. Perhaps most fundamentally, it is not obvious that U.S. firms are passing up export opportunities because of a shortage of American trade intermediaries. According to the National Association of Export Companies, there are already—before the new law has taken effect—about 2,000 firms serving as export distributors and representatives for 10,000 small and medium-sized American producers, as well as other American trading companies that help arrange agricultural and raw materials exports. In addition, some foreign trading companies arrange matches between foreign importers and American exporters. All told, these entities may account for almost a third of American exports.

Large U.S. corporations also use trading companies, although many find it more cost-effective to handle their own export arrangements directly. Thus trading companies already play a prominent role in American export trade, and presumably have every incentive not to leave profitable export opportunities untapped.

A recent National Foreign Trade Council study suggests that, even if export trading companies do fill an important niche, institutional factors may continue to limit their role within the United States (Patricia E. Barrett and Donald B. da Parma, *The U.S. Export Company Legislation—A Tip of the Export Expansion Iceberg*, March 1982). Large "money center" banks, which by virtue of their extensive foreign contacts, are best equipped to assist export trading companies, traditionally have not done business with the smaller firms that could benefit most from export trading company assistance. And the banks that do not have extensive foreign contacts may not wish to incur the expense of matching foreign importers and American exporters. Moreover, American bankers have shied away from financing foreign receivables in the past and, in the absence of special guarantees, may not be tempted at all by the opportunity to hold equity stakes in trading companies. Indeed, the risk-averseness of the U.S. bankers and the risk-seeking entrepreneurial style of the successful export trading company seem an unlikely fit. Finally, the new act does not deal with a problem noted in the council's report—the fact that U.S. trading companies are barred from entering a highly profitable field open to competing foreign export trading companies, the provision of freight brokerage services for profit. Indeed, Federal Maritime Commission rules not only deny them the right to perform this service for others but also require them to absorb their own freight forwarding service costs instead of hiring an outside firm. This restriction puts them at a competitive disadvantage and, in so doing, diminishes their attractiveness to bank investors and export promoters.

It must also be remembered that any dramatic growth in exports will require both a change in American incentive structures and increased willingness by our trading partners to admit American goods. If the dollar remains strong relative to foreign currencies—whether because of explicit national macroeconomic policies or because of a continued flight of foreign capital to this country—it may be impossible for U.S. producers to increase their penetration of foreign markets. Perhaps just as important, other countries will have to ease their subtle and not-so-subtle foreign nontariff barriers. Barriers such as Japan's longstanding, hideously complex distribution system and the use of implicit "buy domestic" directives for subsidizing domestic industries may be particularly hard to dismantle. Foreign countries may also enforce their laws so as to deter our export trading companies. U.S. trading company practices having an anticompetitive impact outside the United States may be free from American antitrust challenge, but can of course be prosecuted under the antitrust laws of Common Market countries and of the Common Market itself (which embody many American antitrust principles). Because antitrust suits in foreign countries are brought only by governments, decisions to file are more heavily influenced than here by policy considerations—such as the overall state of trade relations. The United States may have a difficult time securing substantial changes in all of these export-restrictive policies.

Conclusion

The Export Trading Company Act goes only a small part of the way toward loosening the regulatory shackles binding U.S. export trade. More should be done. Specifically, and most important, export trading companies should be allowed to receive freight brokerage fees; banks' involvement in export trading companies should be restricted only to the extent necessary to guarantee financial soundness; and antitrust uncertainties should be minimized by guidelines providing well-defined "safe harbors" for efficiency-seeking activities (including export joint ventures) that pool risk. Such changes would not be a panacea: on the international plane, more trade negotiations and bilateral antitrust accords would still be needed to hasten the dismantling of chronic non-tariff trade barriers and to define the scope of trading company antitrust immunity. But a more ambitious attempt to help export companies would go a long way toward fulfilling the promise that —wrongly—some have perceived in this year's act. ■