



Free Trade Bulletin

No. 42 • September 28, 2010

“Consumer Safety” Bill Could Boomerang against U.S. Manufacturers

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Introduction

Barriers to trade can be straightforward and transparent, even if wrongheaded, such as a 27.5 percent tariff that certain members of Congress threatened to impose on imports from China. Or barriers can take the form of rules and regulations proposed in the name of protecting public health and safety but that have a secondary effect of restricting trade. An example of such a non-tariff barrier is legislation now before Congress called the Foreign Manufacturers Legal Accountability Act (FMLAA).

The sponsors of the legislation claim that their principal goal is to protect American consumers from unsafe foreign products, but there are warning signs that the bill may be more about restricting trade than protecting the public.

Introduced earlier this year in the House and the Senate, the FMLAA would require any foreign producer selling goods in the U.S. market to designate a legal agent located in the United States who could be served papers in a product liability suit. The agent would be required to register in a state with a substantial connection to the importation, distribution, and sale of the product. By registering an agent, the foreign producer would agree to accept the jurisdiction of the state and federal courts of the state where the agent is located.

If a foreign producer fails to designate a registered agent, the Act would ban the importation to the United States of any products made by the producer. Determining which foreign producers meet the minimum size requirements for falling under the Act would be left to agencies such as the Consumer Product Safety Commission and the Food and Drug Administration. As written, the bills would cover pharmaceuticals and cosmetics, biological products, consumer products, chemical substances, pesticides, and motor vehicles and their equipment and parts.

The safety issues behind the bill are real enough. In 2007, the Consumer Product Safety Commission sought the recall of 473 different products. More than 80 percent involved imported products, and three-quarters of those products came from China.¹ The concern raised by advocates of the legislation is that American consumers harmed by such products will not be able to collect damages if the foreign-based producer has no legal presence in the United States. Domestic companies by definition have a legal presence in the United States and can thus be sued for damages caused by their products, which arguably puts them at a competitive disadvantage against foreign competitors allegedly operating outside the reach of the U.S. legal system. Hearings in June 2010 highlighted the case of contaminated drywall imported from China and the inability of U.S. homeowners harmed by the product to seek damages from the producer.

Americans damaged by faulty products, whether made abroad or domestically, should be able to seek compensation through the courts. But the approach advocated by supporters of the FMLAA would not solve the problem. It would create a false hope of collection for damages while bypassing existing procedures that have proven to work in most cases. The approach would potentially violate constitutional protections available to citizens and non-citizens alike as well as existing commercial agreements with other nations. It could potentially disrupt global manufacturing supply chains, putting American production and employment in jeopardy.

Remedies already available

Initiating legal action against a foreign-based entity is a common, established procedure. Efforts to serve process on foreign manufacturers are currently subject to the Hague Convention on the Service Abroad of Judicial and Extraterritorial Documents in Civil and Commercial Matters, a multilateral treaty governing the channels of transmission of judicial documents across borders to which the United States (and China, since May 1991) is a party. Under rules of

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the convention, each member agrees to serve legal papers on its citizens through the central authority of the state where the person or corporation being served resides. Papers can also be served through the mail, through consulates, and through other diplomatic channels. According to a Convention document, two-thirds of requests are processed within two months.²

Even if the original foreign-based producer cannot be served, the parties seeking damages can bring legal action against importers, distributors, and retailers who do have a legal presence in the United States. At a congressional hearing in June 2010, Jeremy Baskin of the Office of Compliance in the U.S. Consumer Product Safety Commission (CPSC) testified that:

In most cases, CPSC has been able to work with domestic partners of foreign manufacturers, such as importers or retailers, on enforcement activities to obtain relief for consumers without resorting to adjudicative proceedings. One example of this is a \$50,000 settlement with a Hong Kong corporation with offices in the United States that imported toys manufactured in China that violated the Commission's lead paint ban.³

An exception to the rule was the case of imported drywall from China. After homeowners reported significant health problems connected with the drywall, the CPSC was unable to obtain any response from the producer in China. According to the testimony, attempts by the CPSC staff to send requests for information to the company were returned to the commission, "refused and unopened."⁴

Requiring foreign companies like the Chinese drywall producer to designate a legal representative in the United States would not guarantee collection of damages from the producer. Even if papers could be served in such a case, the plaintiffs would still need to win the case and be able to collect damages in order to be made whole. If the foreign producer ceases to operate or files for bankruptcy, collection of actual damages becomes virtually impossible even if papers can be served. Merely having a designated agent in the United States would not guarantee access to the resources of the original manufacturer to pay for the damages ultimately awarded in a court case.

The fact that a foreign producer may not have a legal representative in the United States does not change the fact that Customs officials, the FDA, CPSC, and agencies retain broad powers to bar the entry of tainted or defective products. American-based retailers, wholesalers, and others who have paid to import the products are accountable to those agencies and subject to a range of civil and legal penalties for failing to comply with U.S. health and safety laws.

Violates existing trade agreements, including WTO

The legislation as written also violates a broad array of international agreements—which themselves provide avenues for service of process. The proposed legislation would not only circumvent the procedures set forth under the Hague

Service Convention of 1965. Its provisions also appear to violate Articles III and XI of the General Agreement on Tariffs and Trade (GATT), and abrogate U.S. commitments to key trading partners under the WTO Agreements.

A fundamental principle of international trade law is non-discrimination. Nations are discouraged from maintaining a more lax set of standards for domestically produced products while enforcing a more stringent set of standards for imported products. The FMLAA appears to fail this test. A recent briefing paper by Hogan Lovells points out that "No corresponding registration, jurisdiction, and acceptance of liability requirements are imposed on U.S. manufacturers of like products, parts, or components, or their corporate parents."⁵

Indeed, H.R. 4678 explicitly exempts from its provisions American-owned foreign manufactures, and foreign-owned manufacturers with American subsidiaries, so long as the subsidiaries assume any liability on its foreign parent companies behalf. As the Hogan Lovells analysis suggests, those exemptions are discriminatory because foreign manufacturers with a U.S. parent preserve their right to defend themselves from legal liability. The rules of the World Trade Organization, of which the United States is a founding member, appear to prohibit that sort of discrimination.

If the safety regime is applied in a discriminatory manner—setting different and more rigorous conditions on foreign manufactured goods once they crossed the border, compared to domestically-produced goods—then it would likely constitute a non-tariff barrier to trade (NTB). NTBs are subject to rules in the World Trade Organization, rules that jurisprudence has clarified and lawmakers would be wise to consider. Indeed, at least some lawmakers sponsoring the bills have recognized the legal can of worms the new rules could open: S. 1606, for example, states in Sec. 1002 (9), that "United States laws and the laws of United States trading partners should not put burdens on foreign manufacturers and importers that do not apply to domestic competitors."

Those words are a nod to "national treatment," one of the guiding principles of the WTO. National treatment is essentially the recognition that, once past the border, imported goods should be accorded as favorable treatment to goods made domestically. The formal language pertaining to national treatment can be found in Article III:4 of the General Agreement on Tariffs and Trade, the largest and arguably most important treaty administered by the WTO, which states:

The products of the territory of any [WTO member] imported into the territory of any other [member] shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of *all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use . . .* [emphasis added]

Rules that apply to foreign manufacturers but not to domestic manufacturers—such as those in H.R. 4678 requiring foreign manufacturers to designate a U.S. agent for pur-

poses of U.S. service of process—would presumably fall under the definition of the types of policies covered by Article III, and therefore would be subject to its disciplines. In a recent briefing paper, trade lawyer Russell Smith quoted a GATT ruling on Italy’s restrictions on agricultural machinery, which stated that Article III includes “not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products in the internal market.”⁶

Presumably the new requirements to establish an agent in the United States would modify, to the foreign manufacturers’ disadvantage, the conditions of competition between domestic and imported goods and thus violate Article III.

The *de minimus* exceptions in the proposed regulations—those that would exempt small foreign manufacturers from the rules—are also problematic. They would appear to violate the obligation under GATT Article I to treat “like products” from all trade partners equally (the so-called “most favored nation” obligation). If some products are exempted from application of the new rules because they come from manufacturers that are deemed by regulators to be sufficiently small, they would necessarily be treated differently from like products from larger manufacturers, as though Americans deserved less protection from products made by small firms.

In fact, the bill may have the opposite effect on public safety from that which was intended by discouraging sourcing from larger, more reputable firms with long-established safety records. With the *de minimus* exceptions discussed above, there is the possibility for a perverse effect on foreign manufacturers: would making an exception for small producers/importers (practical though it may well be for implementation purposes) increase the likelihood of fly-by-night operations? It doesn’t take too much imagination to conceive of foreign entities deliberately keeping themselves small, “below-the-radar” operations in order to escape the reach of the law. Larger, more prominent firms (with an interest in protecting their reputation and brand integrity) would be at a disadvantage. Surely such a result would be opposite to the one intended.

The United States may try to argue that there is no discrimination between “like products” produced by firms of comparative size, and therefore any *de facto* discrimination between trade partners is incidental. But then the United States would in effect be arguing that it is discriminating on the basis of production and processing methods (or “PPMs” in the trade policy jargon), an equally contentious basis of discrimination, and one the United States itself has rightly argued against vigorously in trade law and policy fora.

Another legal flaw of the FMLAA is its resort to a complete ban on the imports in question if the producer fails to designate a domestic agent.

Article XI of the GATT, which covers the general prohibition in the WTO of quantitative restrictions, states in paragraph 1:

No prohibitions or restrictions *other than duties, taxes or other charges*, whether made effective through

quotas, import or export licences [sic] or other measures, shall be instituted or maintained by any [member] on the importation of any product of the territory of any other [member].(emphasis added)

Establishing an agent for service of process, and notifying that agent to a regulatory agency may well violate Article XI. It is certainly not a duty, tax or other charge, the only allowable restrictions by the terms of the Article.

The United States may, in defense of its action should the Act pass into law, invoke various parts of Article XX of the GATT, which allows WTO members to deviate from the normal rules, including Articles I, III and XI, in order to achieve public policy objectives such as “protect[ing] human, animal or plant life or health” (Article XX[b]) or those that are “necessary to secure compliance with laws or regulations” which are not inconsistent with the other provisions of the GATT (Article XX[d]). However, those exceptions are allowed only under certain conditions, one of which is that the measure must be the least trade-restrictive option available to achieve the objective.

A GATT Panel on Thailand’s restrictions on imported cigarettes ruled in 1990 that

a contracting party cannot justify a measure consistent with other GATT provisions as necessary in terms of Article XX(d) *if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it*. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party *is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions*.⁷ (emphasis added)

A WTO Appellate Body ruling (on EU trade restrictions on asbestos) has reaffirmed that the same “necessity test” applies in the WTO era.⁸

For the purposes of the current discussion, the United States would have to demonstrate that the establishment of an agent—and the associated forfeiture of legal rights to defense under an alternative jurisdiction—is necessary for consumers’ rights to be respected, and that no less discriminatory alternative is available. They would have to prove, in other words, that the Hague Service Convention is insufficient to meet the legitimate public policy objective.

Warning shots in the potential trade war have already been fired. The Canadian and EU governments recently wrote to congressional leaders and sponsors of the bill, alerting them to its legal implications and urging caution. The EU ambassador’s letter to Speaker Pelosi, for example, points to the draft bill’s potential for introducing “an additional layer of burden on . . . foreign enterprises. . . . Establishing a registered agent in the U.S. for any potential damage claim of a U.S. consumer seems disproportionate in terms of costs.” and explicitly refers to Article XI of the GATT, calling the

Act “questionable with regard to its compatibility with the WTO.”⁹

Any benefits of the bills provisions must be weighed against these risks to the smooth functioning of the international trading system, in which the United States has a clear interest. The U.S. government cannot credibly complain that other governments are not “playing by the rules” when it is enforcing a law that violates our own international commitments.

Inflicts self-damage by disrupting supply chains

Even if the FMLAA approach were consistent with international trade law, it would not be wise economic policy. Requiring foreign producers to designate a domestic agent under the threat of an import ban would invite our trading partners to adopt copycat legislation and would disrupt the international supply chains that have become an important component of American manufacturing.

Whether adopted in retaliation or sincere imitation, the rise of FMLAA-type laws in foreign countries would be bad news for American exporters. It would impose a significant new cost of production on U.S. exporters if they were required to employ agents in every country where they plan to sell their products. Designating such agents would also invite lawsuits over product liability that may or may not have merit but would be difficult to defend, especially in emerging markets and less developed countries where the legal systems are under-developed as well. The temptation may prove irresistible to sue a deep-pocketed U.S. multinational through a poor country’s legal system that may be both opaque and corrupt.

By discouraging and complicating imports to the United States, the FMLAA approach threatens to cut American producers off from critical supplies and components they need to produce final products for sale at home and abroad. The legislation as written ignores the complexity of global supply chains, where a final product may contain components made in dozens of other countries. Those components can cross borders multiple times, and can contain subcomponents from multiple suppliers. The law could be easily read to require that each supplier of any part that makes its way into the final product be required to appoint a legal representative in the United States.

The requirements of a FMLAA law would be especially onerous for small and medium sized enterprises that do not have the expertise or legal representation to protect themselves from the ramifications of such a law. An imported product or component can contain parts from smaller, domestic suppliers in the country of origin who do not export directly themselves. Those smaller suppliers abroad would find it difficult to comply with the requirement to establish a legal presence in the United States, and SMEs in the United States would find it a daunting task to monitor the origin of every imported component and subcomponent they might use in their production process.

The inability to access lower-cost, made-to-order, just-in-time components from global suppliers would drive up costs for American manufacturers, rendering them less com-

petitive in global markets and less able to export their finished products. In this way, the FMLAA would be working in direct cross purposes with the Obama administration’s National Export Initiative.

The requirements of the FMLAA would also impact major sectors of the U.S. economy such as the automobile industry. The inclusion of motor vehicles as covered products is somewhat puzzling given the fact that the major foreign-name-plate automakers already have production facilities and affiliated dealers spread throughout the United States. The law would reach under the hood to require a legal representative for every supplier of parts that go into an imported car, creating a huge non-tariff barrier. As the analysis by Hogan Lovells points out,

tracking the registrations for each and every part and component in an imported motor vehicle will be an administrative nightmare for U.S. Customs and for U.S. and foreign auto makers, since a car and its various components contain thousands of parts from multiple import and domestic suppliers.¹⁰

The globally integrated auto industry in the United States depends on access to imported parts from East Asia and our NAFTA partners Canada and Mexico. The provisions of an FMLAA-type law could delay the movement of containers across borders as Customs agents inspect each shipment for compliance. In a letter to Congress in September 2010, the Embassy of Canada offered a friendly warning:

Canada is particularly concerned that a requirement to identify the foreign agent for each of the numerous shipments on every single truck could delay shipments of component parts, thereby stalling U.S. assembly operations. This would be especially true for just-in-time shipments, such as for the auto industry, which depend on immediate delivery. This bill could also hamper commercial shippers and importers as trucks that contain goods shipped by hundreds of manufacturers could be stopped or be delayed at the border for the non-compliance of a single parcel.¹¹

Advocates of requiring a U.S.-based agent claim they are trying to protect U.S. producers from unfair foreign competition, but a large swath of U.S. manufacturers see more harm than good in the approach. The National Association of Manufacturers warned Congress in a July 2010 letter that passage of legislation as currently written would damage the ability of its members to export American-made products to global markets. According to NAM, the proposed policy change:

is counterproductive to U.S. manufacturing interests because it indiscriminately risks severing critical supplier relationships benefiting U.S. manufacturers and supporting hundreds of thousands of U.S. jobs. It invites other countries to reciprocate by imposing mirror legislation against U.S. exporting companies

and imperils President Obama's announced goal of doubling U.S. exports within the next five years.

The legislation would also interrupt important supplier relationships and subject U.S. companies to the jurisdiction of foreign courts, including countries with less developed judicial systems, should other nations adopt similar requirements, thereby adding additional barriers for U.S. exporters.¹²

Imposing new, regulatory burdens on foreign producers who import to the United States will not protect U.S. industry. Global manufacturing has evolved away from a simplistic "us vs. them" model in which goods wholly made in the United States must compete with goods wholly made abroad. Today, most manufactured products, especially higher end items such as consumer electronics, motor vehicles, civil aircraft and sophisticated equipment and machinery, are composed of components made in a number of countries. The future of American manufacturing depends on the ability of American companies to supply the design, engineering, and higher-end components for increasingly complex global supply chains.¹³

That new reality for American manufacturing means that U.S. companies must not only export to expand revenue but also import raw materials, capital machinery, and intermediate components to control costs and remain profitable. Capital goods and industrial supplies together accounted for more than half of the imported goods Americans purchased in 2009. Consumer goods excluding automobiles accounted for only about a quarter of imports.¹⁴

Any effort by the U.S. government to discourage imports generally, through a general tariff hike, an intentionally depreciated dollar, or new non-tariff regulatory barriers, will impose real costs on American producers as well as consumers.

Notes

1. Subcommittee on Commerce, Trade, and Consumer Protection Staff, Memorandum, "Re: Hearing on H.R. 4678, the 'Foreign Manufacturers Legal Accountability Act,'" June 11, 2010, <http://energycommerce.house.gov/documents/20100612/Briefing.Memo.ctcp.06.16.2010.pdf>
2. Outline of the Hague Service Convention, prepared by the Permanent Bureau of the Hague Conference on Private

International Law, November 2009, available on the "Service Section" of the Hague Conference website, at <http://www.hcch.net/upload/outline14e.pdf>.

3. Jeremy Baskin, Office of Compliance, U.S. Consumer Product Safety Commission, Testimony before the House Committee on Energy and Commerce Subcommittee on Commerce, Trade, and Consumer Protection, Hearing on H.R. 4678, the Foreign Manufacturers Legal Accountability Act, June 16, 2010.
4. Ibid.
5. Warren Maruyama, "Proposed FMLAA Importer's Declaration also Violates WTO Rules," Hogan Lovells, of counsel to Daimler, copy in authors' files, p. 2.
6. Russell Smith, *Briefing Paper: H.R.4678: The "Foreign Manufacturers Legal Accountability Act,"* Willkie Farr & Gallagher, of counsel to Mazda North American Operations, copy in authors' files, p. 4.
7. Panel Report on "Thailand—Restrictions on Importation of and Internal Taxes on Cigarettes, WT/DS10/R, adopted on 7 November 1990, 37S/200.
8. Appellate Body Report, European Communities—Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/AB/R (adopted 5 April 2001).
9. Letter from Joao Vale de Almerida, appointed ambassador of the EU to the United States to Nancy Pelosi, speaker of the House of Representatives, July 23, 2010.
10. Hogan Lovells.
11. Letter from Gary Doer, Ambassador of Canada to the United States, to Sen. Sheldon Whitehouse, chairman, and Jeff Sessions, ranking member, of the Senate Judiciary Subcommittee on Administrative Oversight of the Courts, September 9, 2010.
12. National Association of Manufacturers, Association of International Automobile Manufacturers, and Organization for International Investment, Letter to Rep. Henry Waxman, chairman, and Rep. Joe Barton, ranking member, Committee on Energy and Commerce, U.S. House of Representatives, July 21, 2010.
13. See Daniel J. Ikenson, "Made on Earth: How Global Economic Integration Renders Trade Policy Obsolete," *Cato Trade Policy Analysis* no. 42, December 2, 2009.
14. U.S. Commerce Department, "U.S. International Trade in Goods and Services, Annual Revision for 2009," Exhibit 12a, "Imports of Goods by Principal End-Use Category," June 10, 2010, <http://www.bea.gov/newsreleases/international/trade/2010/pdf/trad1310.pdf>.