# Cato Institute Foreign Policy Briefing No. 15: Washington's Iron Curtain against East European Exports

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**Executive Summary**

In the late l940s the Marshall Plan poured millions of dollars into Denmark, the Netherlands, and other European nations to help them rebuild their dairy industries. Then, in l95l, when Europeans were getting back on their feet, Congress bushwhacked aid recipients by imposing quotas that slashed European cheese and butter imports.[1] Today, Washington has developed a similarly hypocritical policy--government aid, but not free trade, for the new democratic nations in Eastern Europe.

Western government aid to Eastern Europe is proliferating. The International Monetary Fund disbursed approximately $5 billion throughout the region in 1991, and the World Bank plans to lend $3 billion to Eastern Europe over the next three years. The United States provided almost $2 billion in aid to East European governments in 1990 and 1991.[2] Washington has created Enterprise Funds (with a total capitalization of $360 million) to promote the development of the private sector in Poland, Hungary, and Czechoslovakia. The U.S. Export-Import Bank is financing export sales of American goods and services through loan, guarantee, and insurance programs; and the Overseas Private Investment Corporation is subsidizing U.S. private business investment in the region with direct loans, loan guarantees, and political risk insurance. Eighteen separate federal agencies are conducting assistance programs in Eastern Europe.

Unfortunately, America's trade policy has made a mockery of those efforts to "aid" Eastern Europe. While Washington is donating billions of dollars to governments in the region, it is maintaining pervasive trade barriers that will prevent significant increases in East European exports to the United States. While President Bush publicly proclaims the generosity of the United States toward Eastern Europe, those trade barriers are stifling the chances of Eastern Europe's 130 million citizens to build better lives.

**Barriers to Textile Imports**

As a 1991 U.S. International Trade Commission (ITC) report observed, East European "exports to Western countries were generally dominated by clothing and raw materials, reflecting in part the poor performance of consumer goods and more technologically advanced merchandise in Western markets."[3] Yet Washington continues to impose stranglehold clothing and textile export quotas on most East European countries. Wool clothing is one of Poland's strongest industries. Yet this year Poland is allowed to sell Americans only 144,000 women's and girls' wool coats, 198,000 men's and boys' wool suit coats, 132,000 men's and boys' other wool coats, and 210,000 men's and boys' wool suits.[4] (Such quotas are haggled out by U.S. trade officials and foreign government officials; there is no consistent rule for determining them.)

Czechoslovakia was forced to sign an agreement restricting its clothing exports to the United States, although Czech exports amount to only 0.05 percent of the U.S. clothing market. Czechoslovakia is allowed to ship only 198,000 men's and boys' wool coats and 160,000 men's and boys' suits to the United States each year.[5]

Hungary is allowed to export only 50,000 women's and girls' wool suits, 155,000 men's wool suits, and 168,000 men's wool coats to the United States each year.[6] Yugoslavia is allowed only 93,915 women's and girls' wool suits and 2,268,450 pounds of blankets.[7] Bulgaria is allowed to export only 140,000 women's wool coats each year,[8] and annual Romanian exports to the United States are restricted to 32,665 women's and girls' wool suits, 82,512 men's and boys' wool coats, and 75,182 pounds of wool bathrobes, nightshirts, pajamas, underwear, ski suits, shawls, mufflers, hats, ties, and other miscellaneous wool apparel.[9]

Even when import quotas do not close the borders to East European clothing, the U.S. tariff code often does. The tariff is 22.3 percent on women's wool suit jackets, 24.3 percent on men's wool overcoats, 22.6 percent on women's overcoats and cloaks, 21.5 percent on men's wool trousers, and 24.1 percent on women's blouses.[10]

The 1989 Economic Report of the President concluded that the tariff and quota restrictions on apparel imports, all told, produce an average effective tariff charge of over 50 percent.[11] William Cline of the Institute for International Economics estimates the combined costs to American consumers of textile tariffs and Multifiber Arrangement quotas (for all countries) at $20.3 billion on the wholesale level and as much as $40 billion on the retail level.[12]

**Steel Import Quotas**

In 1984 President Reagan imposed import quotas, formally termed "voluntary restraint agreements" (VRAs), on most major steel-exporting nations. Even though East European countries were not major players in the American steel market, the Reagan administration pressed them, too, into surrendering market access through the negotiation of VRAs.

The text of many of the VRAs concluded in 1984 begins, "The purpose of the Arrangement is to create a period of stability in steel trade between the United States of America and" the foreign country. The fine print explains that "stability" can be achieved only by severely reducing im- ports. The arrangement between Washington and East Germany mandated that exports of steel plate would fall from 80,000 tons a year in the first year to only l3,000 tons in 1989.[13] In 1990, when East and West Germany officially merged, the U.S. Customs Service celebrated the event by abolishing the East German quota on steel exported to the United States rather than by combining the steel export quotas of East and West Germany. Washington also commanded Czechoslovakia to reduce its steel exports by 40 percent between 1985 and 1989.[14] Poland, in turn, was commanded to reduce its exports of barbed wire from 2,500 tons in 1985 to 1,500 tons in 1989 and to reduce its exports of nails from 29,000 tons in 1985 to 11,000 tons in 1989.[15] Yugoslavia, too, was forced to restrict its steel exports, even though they amounted to only 0.02 percent of American steel consumption.[16] U.S. quotas currently dictate that Poland may export only 350 tons of alloy tool steel, that Czechoslovakia may export only 100 tons of stainless steel bars, and that Hungary may export only 200 tons of stainless steel rod to the United States each year.[17]

The Institute for International Economics has estimated that U.S. steel import quotas cost American consumers $6.8 billion a year.[18] Nevertheless, in 1989 the Bush administration announced its intention to extend steel import quotas through March 1992. Such quotas provide a substantial disincentive to foreign investment that could help retool manufacturing capacity in Eastern Europe. And many foreign governments fear that the U.S. government will extend steel quotas once again when the current quotas expire in 1992.

**Agricultural Quotas**

Eighty years ago Romania was the world's fourth largest exporter of corn and wheat. Hungary and Poland were also leading agricultural exporters. Today Poland and Hungary have good potential as dairy exporters. Unfortunately, trade barriers in the United States and the European Community thwart the natural revival of agriculture in Eastern Europe.

Washington prohibits East European nations from selling a single pound of butter, dry milk, or ice cream to American citizens. The U.S. Department of Agriculture estimates that the dairy import quotas cost American consumers between $5 billion and $7 billion a year. East European countries could also be hindered by the U.S. quota on beef imports, which cost consumers $873 million in 1987.[19]

The ITC reported earlier this year, "Bulgaria ranks as the world's fourth largest exporter of tobacco and the world's largest exporter of cigarettes."[20] Yet under the current U.S. tariff regime, that nation has no prospect of trying its hand in American markets; Washington maintains a 458.3 percent tariff on tobacco stems, a 34.9 percent tariff on tobacco, and a 32 percent tariff on cigarettes.[21]

**The Anti-Dumping Maze**

One of the least known barriers to East European exports is America's anti-dumping law. U.S. law will penalize the imports from most nations if the U.S. sale price is 1) lower than their home-market sale price or 2) lower than the cost of production plus an 8 percent profit. However, American bureaucrats cannot find an easy way to judge the export prices of nations with nonmarket economies, and prices are usually assumed to be unfair. Prices in such economies are set by administrative fiat rather than by market competition. The Commerce Department, which administers the law, solves that problem by randomly selecting other nations as surrogates and estimating how much it would cost the second country to produce the same product. That peculiar system of judging prices has resulted in anti-dumping penalties against Czech steel wire rod; Hungarian roller bearings; Romanian urea and ball bearings; Polish steel; and Yugoslavian ball bearings, animal glue, and nitrocellulose.

The "fairness" of East European prices depends almost entirely on which nation Commerce arbitrarily chooses as a surrogate. An East European company never knows which other country Commerce will use as the surrogate and therefore cannot set its own prices to avoid violating U.S. trade law. Gary Horlick, deputy assistant secretary of Commerce for import administration from l98l to l983, described the process to the Senate Finance Committee: "I can tell horror stories about how one goes about choosing a surrogate; it is usually done about l0 at night when one has run out of any reasonable alternative. Just to take an example, for Chinese shop towels we [considered], in order: Pakistan, Thailand, Malaysia, Hong Kong, the Dominican Republic, Colombia, and wound up with a hypothetical Chinese factory in India. It just doesn't make any sense."[22] Former ITC commissioner Ron Cass and lawyer Stephen Narkin observed in November 1990, "Selection of the surrogate country provides boundless opportunity for biasing the outcome, and there is more than a little evidence that Commerce has availed itself of this opportunity on several occasions."[23]

While Commerce officials can insist on hundreds of thousands of pages of documentation to justify a foreign company's prices and production costs, in cases of nonmarket economies they sometimes rely on only a slim thread of evidence to support a charge of dumping. In 1987 Commerce compared the price of Hungarian tapered roller bearings with an estimate of the cost of production of bearings in Portugal. As a result Commerce estimated a "dumping margin" of 7.42 percent.[24] The only information Commerce had gathered on Portuguese production costs came from an official at an American consulate who had telephoned an engineer at a Portuguese factory and gotten an estimate of the factory's cost of production for steel pipes, small motors, and steel hand tools.

The American official in Portugal also reported that he had heard that overhead for that factory was 40 to 45 percent of materials and 30 to 33 percent of labor. As Peter Ehrenhaft, former deputy assistant Treasury secretary under President Carter and counsel to a Hungarian company during the 1980s, has observed, the evidence Commerce possessed was "only one miserable cable from the embassy in Lisbon in l987."[25] When counsel for an American importer requested assistance from the American embassy in Lisbon to more accurately determine Portuguese production costs, the American embassy refused to respond.[26] Though East European nations are striving to dismantle central planning, Commerce officials have no plans to change the way they judge export prices.

The Soviet Union, too, has recently come under fire. In November 1991 American uranium producers filed a complaint with federal trade officials charging that the Soviet Union was dumping uranium on the U.S. market. The U.S. uranium industry has been steadily losing domestic market share to more efficient and lower cost producers in Canada, Australia, the Soviet Union, and other nations. If the Commerce Department and the International Trade Commission rule in favor of the U.S. industry, the Bush administration will find itself slapping trade sanctions on the Soviet Union with one hand while delivering billions of dollars in foreign "aid" credits and grants with the other.[27]

Once East European nations make the transition to a market-oriented economy, their exports will be "sitting ducks" for America's countervailing duty law, which penalizes foreign government subsidies, because Commerce will still be able to penalize companies for government subsidies received as much as 15 years earlier. (Nonmarket economies are exempt from the countervailing duty law.) Commerce investigators will probably be able to justify the imposition of countervailing duties on the products of nearly any factory built in Eastern Europe during the 1980s.

**Other Barriers**

The U.S. International Trade Commission reports: "[Hungary's] chemical and pharmaceutical sector, with 20 percent of the country's industrial output, is a major growth area for Hungary and its largest industrial exporter, with one-fifth of total exports. It accounted for 5 percent of the world market in pharmaceuticals."[28] Hungary is handicapped by high U.S. tariffs on chemicals and pharmaceuticals. As the American Association of Exporters and Importers noted in 1989, hundreds of chemicals are hit with tariff rates of 20 percent or higher.[29] Aspirin carries a l0.2 percent tariff; the tariff on anti-depressants and tranquilizers is 16.6 percent; and the tariff on sulfathiazole, an anti-infective agent, is 15 percent.

**The Bush Administration's Bogus "Market Opening"**

Vice President Quayle boasted on June 7, 1991, about the openness of America's market. He declared in Bardejov, Czechoslovakia, "The U.S. will open our markets as widely as possible [to exports from East and Central Europe] and we expect the European Community to do the same."[30] On July 12 the White House issued the following announcement: "The United States will provide substantially expanded market access for the Central and East European countries by liberalizing quota programs. . . . We will adjust the quota programs for steel and textiles to meet requests by these countries to the extent possible. . . . Concerning cheese quotas, we will act in conjunction with the results of the Uruguay Round to increase country access for cheeses covered by quotas."[31]

In reality, the U.S. market opening is a slap in the face for struggling East European governments. Washington will consider allowing increased cheese exports from Eastern Europe only when the Uruguay Round negotiations are successfully completed. According to Art Stern of the Commerce Department, "There has been no increase in the total steel import quotas for Eastern Europe, but there is an increase in the willingness to allow countries to use flexibility in shifting steel exports between categories covered by the restrictions."[32] In other words, Washington will allow East European countries to shift unemployment between various steel factories but not to increase their total steel sales to the United States.

**Conclusion**

Our trade barriers against East European products are protecting us from a threat that does not exist. East European nations cannot engage in predatory pricing because their coffers are empty, most of their products are inferior, and their market share in the United States is minimal.

The United States should declare a unilateral end to all trade barriers to East European exports. Washington can establish clear rules of origin to ensure that only products substantially produced in Eastern Europe are granted duty-free entry into the United States. (Rules of origin are the federal regulations that determine the national origin of imported goods.) The rules of origin for East European products could be modeled after similar provisions in Washington's free-trade agreements with Canada and Israel, as well as those contained in the Caribbean Basin Initiative.[33]

Any disruption of American industry occasioned by allowing unlimited imports from Eastern Europe would be slight and temporary. The impact would be greatest on America's apparel industry--an industry that has been one of the nation's laggards for over 200 years.[34] The longer American trade barriers impede Eastern Europe's recovery, the more official aid the governments of that region will seek. American taxpayers should not be doubly taxed--once when they are forced to pay more for the goods they purchase and again to finance U.S. government "aid" programs for Eastern Europe.

Ironically, Poland currently maintains fewer trade barriers than does the United States. As the Financial Times reported: "Poland now boasts an open economy that would do credit to many industrial countries. There are no import quotas . . . and tariffs have been slashed to an average of 8 per cent, with some raw materials allowed in duty free."[35] (By contrast, over 3,600 of the 8,753 categories of the U.S. tariff code are restricted by import quotas).[36] Clearly, Polish politicians have shown far more vision and courage in their trade policy than have American politicians. Rather than sponsor lectures on the proper road to development and democracy, Washington should rise to the Polish challenge and open its borders to that nation's exports.

The psychological benefits of unilaterally offering free trade to East European nations cannot be overestimated. During the dark years of communism, the United States stood as the symbol of freedom for many beleaguered Poles, Hungarians, and Romanians. Now we have the opportunity to make that ideal a living reality in the daily lives of East Europeans.

Unfortunately, while we lecture East Europeans on "the miracle of the marketplace," we offer them only a mirage of a marketplace. We must speedily reform our trade policies to avoid "strangling in the crib" the struggling entrepreneurs of the former Eastern bloc. Jack Saryusz-Wolski, Poland's undersecretary of state for European integration, said that "access to Western markets is the broadest form of assistance the West can give us. . . . For us, this is a question of life or death."[37] Is America so rich that we can afford to give East Europeans shiploads of handouts, yet so fragile that we cannot allow them a chance to honestly earn a few dollars? Charity is no substitute for opportunity.

**Notes**

[1] A New York Times editorial condemned the new dairy quo tas. "We destroy the confidence of our European friends in the consistency--even the sanity--of American trade policy and we violate our own commitments in the GATT." Editorial, New York Times, September l5, l95l.

[2] The White House, Office of the Press Secretary, "Trade Enhancement Initiative for Central and Eastern Europe," July 12, 1991.

[3] U.S. International Trade Commission, "Eastern Europe: An Overview of Economic Reform, Industrial Structure, and Trade," Draft report, February 1991, p. 68.

[4] Federal Register, November 12, 1991, p. 57518.

[5] Federal Register, October 7, 1991, p. 50567.

[6] Federal Register, November 20, 1991, p. 58557.

[7] Federal Register, December 24, 1990, p. 52870.

[8] Federal Register, April 25, 1988, p. 13434.

[9] Federal Register, November 1, 1991, p. 56197.

[10] Office of the U.S. Trade Representative, U.S. Proposal for Uruguay Round Market Access Negotiations (Washington: USTR, March 15, 1990), p. 208. (This document is labeled "secret" on the cover.)

[11] The White House, Economic Report of the President (Washington: Government Printing Office, 1989), p. 172.

[12] William R. Cline, The Future of World Trade in Textiles (Washington: Institute for International Economics, 1987), p. 193.

[13] Office of the U.S. Trade Representative, "Arrangement Concerning Trade in Certain Steel Products between the Government of the German Democratic Republic and the Government of the United States of America," 1985, p. 2.

[14] Office of the U.S. Trade Representative, "Arrangement Concerning Trade in Certain Steel Products between the Government of Czechoslovakia and the Government of the United States of America," 1985, p. 5.

[15] Office of the U.S. Trade Representative, "Arrangement Concerning Trade in Certain Steel Products between the

Government of the Polish People's Republic and the Government of the United States of America," 1985, p. 3.

[16] U.S. International Trade Commission, "Monthly Report on the Status of the Steel Industry," ITC publication no. 2102, August 1988, p. vii.

[17] U.S. International Trade Commission, "Quarterly Report on the Status of the Steel Industry," ITC publication no. 2386, June 1991, p. H-11.

[18] Gary Hufbauer, Diane Berliner, and Kimberly Elliott, Trade Protection in the United States (Washington: Institute for International Economics, 1986), p. 179.

[19] U.S. Department of Agriculture, Estimates of Producer and Consumer Subsidy Equivalents, Government Intervention in Agriculture, 1982-87 (Washington: USDA, 1990), pp. 310, 298.

[20] U.S. International Trade Commission, "Eastern Europe," p. 72.

[21] Office of the U.S. Trade Representative, U.S. Proposal for Uruguay Round Market Access Negotiations, p. 57.

[22] U.S. Congress, Senate Committee on Finance, Nonmarket Economy Imports Legislation (Washington: Government Printing Office, May 7, 1984), p. 18.

[23] Ronald A. Cass and Stephen J. Narkin, "Antidumping and Countervailing Duty Law: The United States and the GATT," Paper presented at Conference on the Commerce Department's Administration of the Trade Remedy Laws, Brookings Institution, November 29, 1990, p. 22.

[24] Federal Register, May 8, 1987, p. 17428.

[25] Interview with Peter Ehrenhaft, February 16, 1990.

[26] Ibid.

[27] Thomas W. Lippman, "Soviets Accused of 'Dumping' Uranium on U.S.," Washington Post, November 13, 1991, p. G-1.

[28] U.S. International Trade Commission, "Eastern Europe," p. 72.

[29] American Association of Exporters and Importers, Submission to the Trade Policy Staff Committee, October 18, 1989.

[30] International Trade Reporter, June 12, 1991, p. 893.

[31] The White House, Office of the Press Secretary, "Trade Enhancement Initiative for Central and Eastern Europe," July 12, 1991.

[32] Interview with author, July 24, 1991.

[33] It would be preferable simply to abolish all rules of origin at the same time that we abolish our trade barriers on products from all nations. But it does not appear likely that Congress will do that in the next year or two. Rules of origin have frequently been abused by politicians and bureaucrats to create nontariff barriers to trade. As Washington lawyer David Palmeter observes, "Customs' more recent country of origin determinations smack more of protectionism than of consumer protection, as the agency contorts, gyrates, and twists its way to one restrictive ruling after another." N. David Palmeter, "The U.S. Rules of Origin Proposal to GATT: Monotheism or Polytheism?" Journal of World Trade, April l990, p. 28ff.

[34] James Bovard, "Mismanaged Trade," National Review, August 12, 1991, p. 40.

[35] "The Squeeze That Made Them Export," Financial Times, November 20, 1990.

[36] James Bovard, "Customs Service's Fickle Philosophers," Wall Street Journal, July 31, 1991. For more details, see Bovard, The Fair Trade Fraud (New York: St. Martin's Press, 1991).

[37] International Trade Reporter, June 12, 1991, p. 893.