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The President of the Senate
The Speaker of the House of Representatives
The U.S. Trade Representative-designate

This transition report is one in a series of reports that addresses important policy, management, and program issues facing Congress and the new administration. The issues, the problems associated with each, and recommended actions are based primarily on the results of past GAO work. Some of the issues are relatively new, while others represent long-standing and unresolved problems.

This summary report identifies five important issues in the area of international trade and economic policy. They are (1) conducting economic policy in an interdependent world, (2) trade negotiations and agreements, (3) improving the management of export promotion and market development programs, (4) improving export controls, and (5) foreign direct investment in the United States. While there are undoubtedly many other issues that will demand attention, we believe those outlined in this report should be included at the top of the agendas of the Secretaries of Commerce, Agriculture, and Treasury, and the United States Trade Representative.

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Conducting Economic Policy in an Interdependent World

The magnitude and duration of the U.S. trade deficit and the transformation of the United States from a creditor to a debtor nation have generated concern that the U.S. economy is in long-term decline. While the United States remains a rich nation and continues to generate jobs at an impressive rate, some fear that it is becoming "deindustrialized," with lost manufacturing employment being replaced with lower paying service-sector jobs, and the burden of servicing our international debt harming the U.S. standard of living.

These developments highlight the increasing interdependence of the U.S. and other nations' economies.

The new administration must formulate economic policies that balance domestic goals of steady growth, full employment, and price stability with the fact that the U.S. economy is part of an interdependent global economy. This balance of domestic goals and international realities is a permanent feature of U.S. economic policy making.

The trade deficit and the fact that the United States is a debtor nation are both principally attributable to U.S. macroeconomic policy decisions and how these policies differed from decisions made elsewhere. The United States has run persistent and large federal budget deficits and, being unable to finance them from domestic saving, has had to borrow from other nations. As a result, the United States consumed more than it produced and imported the difference—hence the trade deficit.

Substantial reductions in the trade deficit will occur only if the macroeconomic conditions that have generated the deficit are addressed. The new administration must address the imbalance between savings and the budget deficit, specifically by reducing the federal budget deficit in a manner that does not endanger long-term economic growth.

Trade Negotiations and Agreements

Negotiation and implementation of international trade agreements are central to U.S. trade policy. The aim of U.S. trade negotiations is to remove foreign barriers to imports and unfair governmental incentives to exports, thus encouraging the free flow of international trade.

The principle multilateral organization for negotiating and implementing trade agreements is the General Agreement on Tariffs and Trade (GATT). Although the GATT cannot solve all international trade problems, there are few advocates of abandoning it.

The United States, along with its major trading partners, is at the midpoint of the Uruguay Round of multilateral trade negotiations that seeks to improve and expand the GATT. The U.S. government's agenda for the Uruguay Round centers on strengthening the GATT system, making the current rules work better, expanding world market access, and extending GATT coverage to services, investment, and intellectual property rights. The negotiations are scheduled to end in 1990.

The United States has historically provided strong leadership in the GATT and, to keep the current negotiations moving forward, the new U.S. leadership must quickly develop its positions and clarify any changes it desires to make in current U.S. proposals.

The United States has been able to remove foreign barriers to U.S. exports through bilateral negotiations and agreements. The recent U.S.-Japan Market-Oriented Sector-Selective negotiations, which were undertaken to address all barriers facing several specific industries, achieved some success. This can be attributed to the direct involvement of very high-level U.S. and Japanese government negotiators as well as the characteristics of the industry sectors selected for negotiation, i.e., a history of clearly identified foreign government barriers to trade, a competitive U.S. industry with a small share of the Japanese market, industry support for negotiations, and a coincidence of interest between the two sides to the negotiations.

The new administration should keep in mind lessons from successful past negotiations when choosing future subjects for bilateral trade negotiations.

A vigorous and effective system to monitor and enforce trade agreements is essential to realize the benefits of such agreements. Even after other countries agree to trade reforms, it is often difficult to change long-standing practices; it takes time to establish new policies and procedures; there are frequently differences in interpreting the requirements of new agreements; and there are likely to be significant pockets of resistance to complying with new agreements.

Our reviews of past trade agreements found many examples in which follow up enforcement was necessary to achieve an agreement's benefits. We also found that delaying tactics and drawn out dispute settlement often frustrated U.S. efforts to gain satisfaction.

The Omnibus Trade and Competitiveness Act of 1988 strengthened the ability of the U.S. Trade Representative to enforce trade agreements and placed specific time limits on the length of efforts to settle trade disputes. Failure to gain timely satisfaction can now trigger a unilateral U.S. response.

The new administration should show strong resolve to vigorously use these new powers.

Improve Management of Export Promotion and Market Development Programs

The U.S. merchandise trade deficits reached $159 billion in 1987. Even agriculture exports, historically a significant positive factor in the overall U.S. trade balance, dropped dramatically during the first half of the decade. Government and business leaders agree that one measure to help address the trade problem is to expand U.S. exports. The United States has export promotion and market development programs designed to enhance exports. However, management problems and, in the case of Commerce, resource limitations have significantly limited their effectiveness.

Commerce Department Programs

The Commerce Department's International Trade Administration (ITA) provides a variety of services—on a cost-recovery basis—to assist U.S. businesses, particularly small- and medium-sized firms, in exporting U.S. goods and services. Most of the activities are carried out by ITA's U.S. and Foreign Commercial Service through a network of 67 domestic offices and 126 overseas posts in 66 countries. They include one-on-one business counseling, notifying U.S. firms about trade opportunities, representing U.S. firms' interests in trade and investment disputes overseas, and staging exhibitions and trade missions.

Unfortunately, the effectiveness of Commerce's export promotion activities is weakened by significant organizational and management problems which have resulted in

- a lack of accountability for program results,
- internal disagreements over roles and responsibilities,
- coordination problems for activities requiring joint efforts, and
- programming trade promotion activities with little export potential.

The Secretary of Commerce needs to streamline ITA's organizational structure and establish clear lines of authority and responsibility.

ITA's efforts to assist small- and medium-sized U.S. firms have also been weakened by conflicting goals within the agency.

In line with reduced budgets and its objective of reducing the federal role in export promotion, ITA has turned over some overseas trade promotion events to private sector organizations and no longer subsidizes the cost of participation in ITA-sponsored events.

Since the private sector has shown interest in taking over only the most profitable events, ITA is left in the difficult position of trying to recruit participants for overseas events in developing markets on a full-cost reimbursable basis. Not many small- and medium-sized firms can afford these costs.

The Secretary of Commerce must reconcile the conflict between the U.S. export promotion policy objective of helping small- and medium-sized U.S. firms and policy objectives aimed at privatization and full cost recovery for each event.

We have discussed the organizational and management problems in ITA in somewhat more detail in the transition series report entitled Commerce Issues (GAO/GGD-89-11TR). A forthcoming report provides a comprehensive analysis of ITA's export promotion programs.

Agriculture Department Programs

The Department of Agriculture's Foreign Agricultural Service (FAS) administers all market development and export promotion programs for agriculture products. FAS has staff in Washington and 75 locations overseas and is responsible for implementing about $7.2 billion in agricultural export programs each year.

FAS programs typically seek to increase agriculture exports by (1) helping to fund private sector market development efforts and (2) directly supporting export sales with loans, credit guarantees, and subsidies to reduce export prices.

FAS administers agricultural export programs with a "hands-off" approach, believing that the private sector should manage export programs with little or no government supervision or controls. FAS' lack of management control opens its programs to widespread abuse. For example, a recent investigation of tobacco exports receiving FAS export credit guarantees found that large quantities of foreign tobacco were exported under the program as U.S. tobacco.

The Secretary of Agriculture needs to improve FAS market development and export promotion program management and to put in place controls to assure accountability for public funds.

Commerce's efforts to oversee and administer the export control system for civilian products with military applications need to be more efficient and effective.

The export control list (which determines which items require government approval for export) should be streamlined to allow export control authorities to concentrate on the most sensitive technologies. It is difficult to effectively control the full range of products and technologies subject to export control because of the huge volume of goods moving in world trade. By limiting the size of the control list, the entire system should be more effective.

The Omnibus Trade and Competitiveness Act of 1988 provides for the elimination of export licensing requirements for items at the lowest level of technological sophistication that are exported to most free world destinations but does not remove them from the control list. The Act also eliminates other licensing requirements for selected countries that control exports to the satisfaction of the United States. Under this change, the Secretary of Commerce must determine which countries are eligible for this treatment by determining that they have effective export control systems. The extent to which these provisions of the trade law reduce the burden of export controls and permit Commerce to concentrate on enforcing the most important items depends, in part, on how the Secretary of Commerce implements the act. It is important that the Secretary act expeditiously.

While Commerce administers the export control system of militarily significant commercial items and issues export licenses, the Export Administration Act of 1979, as amended, also authorizes the Defense Department to review certain license applications. Defense reviews licenses for exports to proscribed destinations and to certain free world destinations. For the latter, it currently makes license reviews assessing the potential for diversion to a proscribed destination that are similar to Commerce's evaluations.

Defense's role in making licensing decisions has been a highly contentious subject of debate in recent years. The debate centers around Defense's (1) role in reviewing licenses for the export of items to free world destinations, (2) interpretation of export control policy, and (3) evaluation of evidence used in making decisions. The issue will be vigorously debated during the next reauthorization of the Export Administration Act of 1979, as amended, and the new administration needs to establish a position on the issue.

We have found little difference between Defense recommendations on disposition of export license applications and Commerce licensing decisions with respect to exports to free world destinations. Commerce should work with Defense to eliminate unnecessary duplication at Defense.

Most export controls used to further foreign policy objectives are largely symbolic and should be used only as a last resort when diplomatic and other economic alternatives fail. The Export Administration Act of 1979, as amended, authorizes the President to establish export controls for foreign policy reasons. When these controls are symbolic, they do not prevent the targeted country from getting the controlled products from other countries. Instead, their costs are borne by American businesses in the form of export sales lost to firms in other countries. Moreover, removal of such controls without some quid pro quo is difficult even when the controls are not expected to change the objectionable behavior that precipitated them. Finally, use of such controls merely heightens perceptions that the United States is an unreliable supplier.

As a consequence, we believe that diplomatic and alternative economic measures, such as reducing the size of diplomatic missions or denying favorable tariff treatment, should be used whenever possible in lieu of foreign policy export controls.

Foreign Direct Investment in the United States

Recent widely reported acquisitions of well-known U.S. businesses and purchases of prime U.S. real estate by foreigners have raised public concern about the extent and consequences of foreign investment in the United States. The U.S. government needs to be able to assure the public that all the economic, national security, and political implications of foreign ownership of major U.S. assets have been considered.

The interagency Committee on Foreign Investment in the United States, set up in 1976, reviews selected foreign investments, and the Commerce Department's Bureau of Economic Analysis (BEA) collects data on foreign direct investment. The Census Bureau also collects business information but these data are confidential and are not shared even with other parts of Commerce. The Agriculture Department collects data on purchases of farm land by foreigners.

Despite these data sources, the detailed data needed to fully evaluate the impact of foreign direct investment are not readily available.

A major weakness in BEA's data is that they are collected on an "enterprise" basis, that is, by individual companies. The data are then aggregated by industry. However, only data on sales and employment are collected according to their actual industries. All other data of a multi-product company are included in data on the industry of its dominant economic activity. For example, the purchase of an office building by a foreign oil company would show up in data on the petroleum sector rather than as a real estate investment. Further, BEA does not collect data on an individual plant-by-plant basis. Therefore, the impact on employment in a specific location cannot be analyzed. Additionally, industry definitions for the data that are collected are very broad. For example, foreign investment in the aerospace sector cannot be adequately identified and evaluated because it falls into the broader industry category of "other transportation".

The identity of the real foreign owner is also sometimes difficult to determine. The Agriculture Department's efforts to identify the ultimate foreign investor in agricultural land go only to the third tier of corporate ownership. Its statistics show such "identity havens" as the Netherlands Antilles and Switzerland as having large shares of the foreign investment in U.S. farmland.

Census data, while very detailed, is not focused on tracking foreign direct investment.

Except for general agreement at the macroeconomic level on the policy goal of free flow of investment capital, there are differing views on what the actual economic and political effects have been for specific sectors, communities, and interests. In addition to national security concerns, debate has centered on the following issues.

Competitiveness Effects

Some investments transfer technology and management skills to the United States, but concern exists over the reverse flow of technology when high-technology U.S. firms are purchased by foreign investors.

Trade Effects

Some investments are seen as producing products that replace imports; others are viewed as magnets for imports.

Employment Effects

New foreign-owned plants may create new jobs; however, the jobs may be vulnerable to other than pure business considerations.

For example, shutdowns of foreign-owned plants may be decided on the basis of economic considerations in the home country.

Political Effects

There are concerns that political action committees of foreign-owned firms may exercise undesirable political influence.

State Incentives

Most states have sought foreign investment by offering special incentives to foreign companies, that is, subsidies. Despite the popularity of such incentives at the state level, many question whether they are in the national interest.

As these issues indicate, foreign direct investment in the United States is a complex subject. There are many ways in which the United States can and does benefit from foreign investment—yet there are some reasons for concern.

The first thing the government needs to do is improve its data collection and analysis capabilities. For example, merging available BEA and Census data may provide the information base to analyze many of the issues currently being debated.

Related GAO Products

International Trade: The U.S. Trade Deficit: Causes and Policy Options for Solutions (GAO/NSIAD-87-135, Apr. 28, 1987).

International Trade: Combating Unfair Foreign Trade Practices (GAO/NSIAD-87-100, Mar. 17, 1987).

U.S.-Japan Trade: Evaluation of the Market-Oriented Sector-Selective Talks (GAO/NSIAD-88-205, July 18, 1988).

International Finance: Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom, and the United States (GAO/NSIAD-88-171, June 24, 1988).

Personnel Management Issues in the Foreign Commercial Service (GAO/T-NSIAD-87-12. Mar. 11, 1987).

International Trade: Commodity Credit Corporation's Export Credit Guarantee Programs (GAO/NSIAD-88-194, June 10, 1988).

Agricultural Trade: Review of the Targeted Export Assistance Program (GAO/NSIAD-88-183, May 24, 1988).

Export Licensing: Commerce-Defense Review of Applications to Certain Free World Nations (GAO/NSIAD-86-169, Sept. 9, 1986).

South Africa: Summary Report on Trade, Lending, Investment, and Strategic Minerals (GAO/NSIAD-88-228, Sept. 7, 1988).

Export Controls: Commerce's Assessment of the Foreign Availability of Controlled Items Can Be More Effective (GAO/NSIAD-88-71, Feb. 9, 1988).

Foreign Investment: Growing Japanese Presence in the U.S. Auto Industry (GAO/NSIAD-88-111, Mar. 7, 1988).

International Trade: Synopsis of Recent GAO Reports on Trade Issues (GAO/NSIAD-87-103BR, Mar. 17, 1987).

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