An Overview of the US Foreign Trade Legal Environment with an Example

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Introduction

Changes to the Global Economy

The economies of individual nations have begun to merge into a global economy as companies large and small have begun to reach beyond national borders for customers. As the global economy has begun to move from the colonial exploitation of the eighteenth and nineteenth centuries to the truly participative economy of the Twentieth Century, international trade has changed. The cyclic movement of raw materials from undeveloped colonies to developed countries where value adding transformations created manufactured goods that were then sold back to the undeveloped countries created a dependency relationship that was good for neither the colony nor the manufacturing nation.

Today, the only countries that are undeveloped are the countries so burdened by corruption or strife that their economies are unable to prosper due to the economic consequences of their internal problems or the countries that have little communication with the world outside of their national borders and don't care to participate in the global economy.

With the increased number of global competitors, countries that contain once globally dominant industries have begun to feel the competitive pressure. The classic example is the automobile industry of the United States which came under such terrible competitive pressure from the Japanese during the 1970's and 1980's that many people were ready to bury the corpse of a once thriving industry, prematurely as it turns out.

There are a couple of books mentioned in the bibliography which capture various aspects of the changes in the global economy. Perhaps the best is <u>The Prize</u>, [YERGIN] an in-depth look at the oil industry from its roots in the United States to a major player in the global economy today, an industry as basic as the steel industry without which modern industrial economies would cease to exist.

Another basic industry is the machine tools industry. The machine tools industry makes the tools which allows manufacturing to make the products. Every manufactured article depends in some way on the machine tools industry. The industry is so basic that the machine tools industry uses machine tools to make other machine tools.

This paper looks at the history of one particular US machine tools company, Burgmaster. Through the history of that company, we will look at the impact of the global economy on a selected industry within the United States. The Burgmaster story is also interesting in that it indicates that any industry that is hurt by foreign competition is probably already in trouble.

The description of the US automobile industry as described in [INGRES] provides information for a similar assumption. [INGRES] provides a history of the US automobile industry when it was hit hard by Japanese competition during the late 1970's through the 1980's and how the US automobile industry was able to recover through sound management by the early 1990's. What is also interesting is how the Japanese first entered the US automobile market through low cost (including operating cost) vehicles targeted at the sub-compact market segment the US manufacturers considered uneconomic. Japanese auto manufacturers then penetrated into the market segments with better margins after building the technology and operational (manufacturing, logistical, and marketing) processes required to successfully compete in those markets.

A Brief History of Burgmaster

The Burgmaster machine tool company was started by a Czechoslovakian immigrant, Fred Burg, in his garage during 1945. Burg's first product was a tool holder which allowed a machinist to reduce downtime by reducing the time for tool changes. The company, though small and with only a single product, prospered. In 1947, Burg adapted the idea of a turret lathe to the drill press introducing the turret drill into the machine tools marketplace.

The end of World War II flooded the machine tool market with war surplus machine tools. Despite the large supply versus demand, Burg Tools continued to prosper because they offered products that were genuine innovations which helped a machinist to be more productive. The major impact to Burg Tools, was the slowdown in orders from the major users of machine tools due to reduced government orders.

During the 1950's, the Korean War along with a generally good economic environment from the rapidly developing Military/Industrial complex fueled by the Cold War, made for good business in the machine tool market. The late 50's saw the development of Numerically Controlled (NC) machine tools, a market segment into which Burg Tools rapidly moved staying in the lead of those manufacturers exploiting the new technology.

In May of 1961, Burg Tool made a public stock offering which was snapped up by investors. The additional capital was used for manufacturing floor improvements as well as R&D into additional innovations for the Burgmaster Turret Drill. Burgmaster also started selling a lower cost, less featured version of their turret drill.

At this time Burg Tool had their first taste of Japanese competition when they discovered that a Japanese company was selling a turret drill so like a Burgmaster model that the major difference was the manufacturer's name plate. Burg Tool successfully defended their patents in Japan and secured an injunction against the Japanese manufacturer. The Japanese Ministry of International Trade and Industry (MITI) assisted in negotiating licenses from Burg Tools to allow the Japanese manufacturer to make and market several of the smaller Burgmaster machine tools.

Soon after the Japanese incident, a Spanish company was discovered making a similar patent infringement. Burg Tool decided to go international and become a global competitor. By the end of 1964, Burg Tools had license arrangements with machine tool companies in England and Germany, exporting Burg technology to the world as were other US manufacturers. In the 1960's, US machine tool technology was the best in the world.

In 1965, Burg Tool, now Burgmaster, was purchased by Houdaille Industries in a friendly takeover. Houdaille promised few changes but the entrepreneurial/innovative culture of Burgmaster clashed with the by-the-numbers culture of Houdaille. From 1965 until Burgmaster assets were liquidated in 1986 as a part of a restructuring of Houdaille in an attempt to retire some of the large debt created by a leveraged buyout in 1979, the Burgmaster division of Houdaille slowly died. The Burg family left the company executive suite as did many of the experienced machinists due to the culture clash.

Innovation slowed to a trickle. Changes in manufacturing processes such as the introduction of the Houdaille MRP system into Burgmaster caused chaos as well as company jarring production problems.

The Japanese machine tool industry hit the US market with simple, high quality yet low priced machine tools that began to erode the US machine tool industry's market share. US customers switched to the Japanese machine tools which were easier to use, had lower down time due to the better quality of construction and were cheaper. The Japanese targeted a market segment that was well within their capabilities to address and then used it as a springboard into the more sophisticated NC machine tool market segments.

In 1981 Houdaille was caught between three rocks and getting pounded. Japanese competitors were taking larger chunks of the US market, the leveraged buyout required high cash flow to service but Burgmaster as well as other divisions of Houdaille weren't delivering the cash, and Paul Volcker, new chairman of the Federal Reserve, decided to wring inflation out of the US economy by driving up interest rates and drying up bank reserves. Houdaille could no longer count on paying off the debt in less valuable, inflated dollars. The recession that followed the Fed's actions reduced machine tool orders significantly while the dollar artificially increased in value against the Japanese Yen causing Japanese imports to be even better priced than before. Japanese manufacturers increased their share of the machining center market (Burgmaster division of Houdaille) and of the punching machine market (Strippit division of Houdaille) from 4 percent in 1976 to 60 percent and 46 percent respectively in 1982.

Houdaille turned to Washington for relief from Japanese competition through trade barriers.

The United States and the Global Economy

History of the US and International Trade

The United States began as a group of colonies of Great Britain. Colonist resentment of British control of trade coupled with new taxes by an arrogant British Crown triggered a rebellion by those colonies south of the St. Lawrence Seaway in 1775. After a desultory war, the British New World colonies south of the St. Lawrence were given their independence after the British decided to spend more of their military resources on containing French ambitions, an enterprise much closer to home and dearer to the heart.

The Constitution of the United States allocated the power to regulate foreign commerce, as well as commerce between the various states, to the Congress rather than the President. The first Congress authorized the collection of duties on imported goods and established the Bureau of Customs to collect the money. The State Department, a Presidential Cabinet level department within the Executive Branch created by the Constitution, assumed an unofficial responsibility for trade negotiations due to the rigors of travel in the Nineteenth Century. Congress however was responsible for the actual ratification of any negotiated trade agreements and members of Congress often modified such trade agreements in order to satisfy particular constituencies such as sugar, oil, or steel interests.

During the first one hundred years, the United States was, for the most part, inward looking as the nation worked to build itself and its industrial base. During these years, various tariffs and duties were the major funding mechanism for the national government as the US Constitution prohibited the national government from engaging in other taxes such as land taxes, which were used by the various state and local governments.

Tariffs and duties were also used to protect the budding industries of the US from international competition especially from the Nineteenth Century economic powerhouse of Great Britain. The major industrial region was the Northeastern US. The Southern states, burdened by a slave based, agricultural economy were unable to compete with the industrialized Northeast nor with the agricultural Midwest US which used better agricultural implements and techniques than the Southern US.

During this time there was also a conflict over the role of the US national government and the various state governments. There were two major sides, those people who wanted a centralized Federalist government (the Hamiltonians or Federalists) and those who wanted a decentralized national government (the Jeffersonians).

The Hamiltonians, backed by the industrial interests of the North wanted the transportation infrastructure and financial infrastructure that can be provided by a centralized national government in order to support a complex industrial economy. The Jeffersonians wanted an agricultural infrastructure without the complexities of an industrial society. Despite a decade of dancing with the Jeffersonians in the early 1800's, the US showed a steady march towards the Federalist idea within the North and an increasing antipathy for the idea in the South.

After a harsh and bitterly fought civil war during which the United States demonstrated for the European Powers the new realities of warfare, the United States accepted the centralized, Federalist government. From this time, the United States rapidly became the economic power of the world as the older, less entrepreneurial and less flexible European powers waned.

The late 1800's saw the rise of the first multinational corporations as oil, steel, banking, and transportation corporations grew and prospered. The Congress passed the first anti-trust legislation in order to curb the growth of trusts used to create monopolies within these crucial industries. The first trust busting using the Sherman Anti-Trust Act was aimed at the Standard Oil trust in order to encourage competition leading to innovation and lower prices within the oil industry at the beginning of the Twentieth Century.

In 1916, Congress set up the US Tariff Commission as an independent, quasi-judicial agency to investigate dumping cases, conduct trade studies, and report to the President and Congress on trade policy. The agency was renamed the International Trade Commission in 1974. The major purpose of the US Tariff Commission was to adjudicate claims of foreign companies dumping or selling goods at artificially reduced prices.

After the armistice of World War I in 1918, the United States was the leading economic power. The European Powers, hard hit by the economic losses of the war followed by the Great Depression were struggling to adapt to a new world order. Their colonies, once a means to economic greatness in a less competitive global marketplace, became burdens their owners were too proud to shed.

The Executive Branch of the United States led by President Woodrow Wilson formulated the League of Nations, a global organization to help prevent further wars. Though embraced by the war weary major European Powers, the United States Congress refused to ratify the League of Nations treaty. This first attempt at an international agency to bind together nations into a common confederation fell apart as the major powers pushed their own agendas during the 1920's and 1930's.

The booming global economy of the 1920's saw the rise of US economic power driven by the upwardly spiraling US stock market. Fueled by highly leveraged investments, Wall Street slammed to a stop in the crash of 1929. Aided by the unwise Smoot-Hawley Tariff Act in 1930 which raised the average US tariff to 60 percent followed by similar responses from other nations, international trade ground to a halt causing an economic jolt to become a slide into a general, world wide depression spurred by unwise economic policies by the major powers (Great Britain's return to the gold standard for instance).

Nazi Germany was the first country to pull out of the depression by the use of a rigidly controlled economy fueled by governmental spending to rebuild the German military. The rest of the world required the impetus of World War II to free itself of the depression.

The end of World War II in 1945 was rapidly followed by the dissolution of the colonial structure of the exhausted European Powers. The United Nations was formed out of a series of negotiations within the international community during the late 40's. The United States, in an effort to rejuvenate the economies of its allies as well as its former enemies created the Marshall Plan which involved economic and industrial aid to other countries. The goal was to prevent the kind of economic woes which allowed fascist governments to form during the 1930's in Germany, Italy, and Japan.

In 1947, the United States and 40 other countries signed the General Agreement on Tariffs and Trade (GATT) replacing bilateral trade negotiations with a multilateral agreement. GATT is updated from time to time as new trade issues or new perceptions of old trade issues are negotiated by the signatories. Those countries that are signatories of GATT are required to subordinate their trade laws and regulations to the provisions of GATT which provides guidelines concerning tariffs and trade barriers. GATT also provides for a process of trade dispute arbitration and negotiation.

In addition to GATT, the US is also signatory to several regional trade agreements such as the North American Free Trade Agreement (NAFTA) which provides for fewer barriers between the trading partners of Canada, the US, and Mexico.

The United Nations Commission on International Trade Law (UNCITRAL) was established in 1966 by the U.N. General Assembly with the general mandate of progressive harmonization and unification of international trade law.

The latest GATT negotiations, the Uruguay Round in 1994, created the World Trade Organization (WTO) in addition to addressing new trade issues such as electronic commerce. The WTO is the next step in further liberalizing foreign trade relationships. The WTO is responsible for implementing and administering GATT along with additional agreements such as Trade Related Intellectual Property Rights (TRIPS) and the General Agreement on Trade in Services (GATS).

The United States Government Trade Agencies

There are several agencies within the US government's Executive Branch that have overlapping responsibilities for international trade helping the Congress administer its responsibilities assigned by the US Constitution.

The major cabinet level agencies, reporting directly to the President, are:

- the State Department (tasked with trade agreement negotiation)
- the Commerce Department (tasked with the development of US industry and trade)

- the Treasury Department (tasked with collection of tariffs and duties while also containing the US Customs agency)
- the Office of the US Trade Representative (USTR) (formed by Congress in 1962 to provide a balance to the State and Treasury departments' tendency to disregard domestic interests).

From time to time other agencies such as the Office of Management and Budget, the Defense Department, or the Council of Economic Advisers may also participate in the resolution of trade issues.

When trade issues arise, these agencies get together to hammer out an inter-agency agreement which allows them to provide a recommendation to the President as to any action to be taken.

The United States, a signatory to GATT, has a body of laws and regulations concerning international trade. The more important are [STIGL]:

- Sections 201 and 406 which address market surges,
- Section 232 which regulates imports that threaten national security,
- Section 301 which deals with foreign trade barriers and violations of trade agreements,
- Section 337 which addresses unlawful marketing of imports such as patent infringements,
- Section 701 which governs countervailing duties, and
- Section 731 which contains the antidumping statute

Market surges are trade shocks. The US recession of the early 1980's provided such a market surge when Japanese imports became cheaper due to the higher dollar. GATT recognizes the reality of temporary market surges and allows for safeguards to be imposed when import surges inflict serious injury on a domestic industry.

Trade barriers are deliberately set barriers which prevent or discourage foreign competition such as laws which prevent or discourage purchase, distribution, or consumption of foreign goods. High tariffs is one example.

Countervailing duties are duties imposed on goods from a foreign country to counterbalance similar duties by the foreign county on US goods of the same type.

Dumping is selling a product at a lower price in the targeted foreign market than in other markets or selling at below average total costs. Antidumping actions in the US no longer require evidence of predatory behavior or other efforts to drive competitors out of a market.

The most commonly invoked codes by US companies attempting to obtain relief from foreign competition within the US domestic marketplace are Section 301 and Section 731.

A company that believes itself the victim of unfair foreign competition can apply simultaneously to the Department of Commerce and the US International Trade Commission (ITC) for redress. The Commerce Department determines whether an unfair practice has in fact occurred and the ITC determines whether the unfair practice has caused injury to US industry. The result of an affirmative decision by both bodies is generally the imposition of a higher tariff designed to counter the alleged unfair practice.

Over the years, Congress has made a number of changes to the trade laws which are intended to make the laws easier to apply and their criteria as to an infringement of the law easier to satisfy.

Burgmaster and the US Trade Agencies

In the case of Houdaille and Burgmaster, the issue of Japanese competition was addressed through a little used part of the trade code, Section 103, which was intended as a sanction against countries that discriminated against US exports. Houdaille attempted to use this section in concert with trying to build a case that MITI and the Japanese machine tool industry had created a cartel to attack the US machine tool industry in general and Burgmaster in particular.

Due to the weakness of the case, which had practically zero legal basis, the lawyer hired by Houdaille to prosecute their case within the US trade agencies created documentation to bolster the case. One of the most powerful documents was a video tape of interviews with Japanese officials within MITI which, with suitable editing, made a powerful statement of a Japanese conspiracy to take over the US machine tool market. The Houdaille case moved from the obscurity of the corridors of the US trade agencies into the full glare of television.

Despite the attempt by the lawyers to create the public outcry needed to push the Reagan Administration into implementing protection for the US machine tools industry, the media circus failed in its goal. After a year of inter-agency politics accompanied by several Congressional inquiries into US/Japan trade relations, President Reagan denied Houdaille's petition. The telling action was a personal letter from Prime Minister Nakasone that was hand delivered by the Japanese ambassador the day of the decision and the absence of an agreement between the US trade agencies as to the sufficiency of Houdaille's petition.

Summary

International trade is a remarkably complex business. Take the complexity of interstate commerce and multiple it by a factor of one hundred due to cultural and social differences.

Every nation has a vested interest in maintaining some degree of autonomy. Allowing foreign trade to destroy a nation's domestic industrial base is tantamount to national suicide. It is fairly clear however that foreign trade and global commerce is a necessity. Countries such as Japan require foreign trade due to their limited natural resources. One of the triggers to Japanese aggression against the United States in 1941 was the perception that the US was deliberately strangling Japan by restricting US exports of oil and steel to Japan.

Foreign trade also provides new ideas and technologies. Japan was able to become the major economic power that it now is due to foreign trade which brought new technologies and new processes into Japanese industry.

Perhaps the one thing that this author learned during this research was that industries that fail due to foreign competition already contain the seeds of their own destruction. The Burgmaster story is a classic example in which a company moves from innovation to stasis and then to liquidation.

[DRUCK] provides an excellent introduction to innovation providing basic strategies for creating new knowledge, technology, and processes that help a company to remain competitive. When the history of Burgmaster is compared against Drucker's basic strategies, it is easy to understand why the company, failing, reached for governmental protection against competition. By the time of the petition, Houdaille was no longer capable of competing.

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