

FORMATION AND OPERATION OF EXPORT TRADING COMPANIES

DEPOSITORY

HEARING
BEFORE THE
SUBCOMMITTEE ON TRADE
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
NINETY-SIXTH CONGRESS

SECOND SESSION

ON

H.R. 7230

A BILL TO ENCOURAGE AND FACILITATE THE FORMATION
AND OPERATION OF EXPORT TRADING COMPANIES

JULY 21, 1980

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FORMATION AND OPERATION OF EXPORT TRADING COMPANIES

MONDAY, JULY 21, 1980

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, D.C.

The subcommittee met at 10:02 a.m., pursuant to notice, in room 1100, Longworth House Office Building, the Honorable Charles A. Vanik (chairman of the subcommittee) presiding.
[Press release announcing the hearing follows:]

[Press release of Monday, July 14, 1980]

CHAIRMAN CHARLES A. VANIK (D., OHIO), SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES PUBLIC HEARING ON H.R. 7230 AND OTHER EXPORT TRADING COMPANY LEGISLATION AND A CHANGE IN TIME FOR BEGINNING THE SECOND DAY OF OVERSIGHT HEARINGS ON U.S. TRADE POLICY, MONDAY, JULY 21, 1980

Representative Charles A. Vanik, Chairman of the Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee on Trade will hold a public hearing on Monday, July 21, 1980 on H.R. 7230, as reported by the Committee on Foreign Affairs on July 1 and on other bills introduced in the House to encourage and facilitate the formation and operation of export trading companies. The hearing will begin at 10:00 A.M. in Room 1100 Longworth House Office Building. The second day of oversight hearings on U.S. trade policy previously announced (press release #67, July 11, 1980) to begin at 10:00 A.M. on July 21 has been rescheduled to begin at approximately 12 noon on that day.

Due to the very limited time available to the Subcommittee, testimony on export trading company legislation will be received from Administration and private sector witnesses by invitation only.

In order to maximize time for questioning and discussions, witnesses will be asked to summarize their statements. The full statement will be included in the printed record. Also, in lieu of a personal appearance, any interested person or organization may file written statement for inclusion in the printed record.

Persons scheduled to appear and testify should submit 30 copies of their prepared statements to the Committee the morning of the hearing. These statements are for the use of the Subcommittee Members and staff. Persons who wish their statement distributed to the press should bring to the hearing at least 30 additional copies.

Persons submitting a written statement in lieu of a personal appearance should submit at least three (3) copies of their statement by the close of business Friday, July 25, 1980. If those filing statements wish to have their statements distributed to the press and the interested public, they may submit 30 additional copies for this purpose if provided to the Committee during the course of the hearing.

Each statement to be presented to the Subcommittee or any written statement submitted for the record must contain the following information:

1. The name, full address and capacity in which the witness will appear;
2. The list of persons or organizations the witness represents, and in the case of associations, their total membership list; and
3. A topical outline or summary of the statement.

Mr. VANIK. The subcommittee will be in order. We have a very full day today, two hearings, and a long list of witnesses. Considerable and increasing attention, long overdue, is being given to the need to develop and place a much higher priority on overall U.S. export policy, to create incentives and means for U.S. business, particularly small- and medium-sized companies, to engage in export trade and to overcome the difficulties of access and marketing overseas. Numerous bills have been introduced and hearings held this Congress in recognition of the vital importance of increased exports to restoring a healthy domestic economy and our international competitive position.

We will begin today with testimony from administration officials followed by witnesses invited from the private sector who have taken an active interest in the development of H.R. 7230, as reported by the Committee on Foreign Affairs on July 1, and other proposed legislation to encourage and facilitate the formation and operation of U.S. export trading companies.

We are interested in how this legislation would address the needs and overcome the difficulties currently facing small- and medium-sized business in exporting—at the same time maintaining appropriate limits and safeguards for our domestic economy, and to what extent it may enable foreign export trading companies to compete in overseas markets. We will give particular attention to the proposed DISC and subchapter S corporation tax incentives, which are within the legislative jurisdiction of the Committee on Ways and Means. At about noon, we will resume the oversight hearing we began June 26 on U.S. trade policy to complete testimony today from private sector witnesses.

Due to the large number of witnesses and the limited time available, we ask you to summarize your testimony briefly in order to maximize time for questions and discussion, on the understanding that your statements will be printed in full in the hearing record.

Ambassador Askew, we are very pleased that you are able to appear before us today as the leadoff witness from the administration on export trading company legislation. As you know, members of this subcommittee were instrumental in including section 1110 in the Trade Agreements Act requiring the President to submit two reports to the Congress by July 15 on a review of the export promotion activities of the executive branch, and export disincentives, and a study of U.S. factors bearing on and programs required to strengthen U.S. competitiveness in world markets. Given the importance of this subject matter, we were disappointed to learn on July 15 that the reports are not ready. I hope that each of the agencies involved will give their completion a high priority to enable submission in the near future.

Mr. Ambassador, it is good to have you with us. We are happy to have you proceed.

STATEMENT OF AMBASSADOR REUBIN O'D. ASKEW, U.S. TRADE REPRESENTATIVE

Ambassador ASKEW. Mr. Chairman, thank you very much. It is a pleasure to be here with you and Mr. Gibbons and Mr. Frenzel on H.R. 7230. I believe that the need for the expansion of exports in

this country is clear and unassailable, so the statement that I have prepared, Mr. Chairman, I will simply ask to have included in the record.

Mr. VANIK. Without objection, the entire statement will be placed into the record, as submitted, and you may excerpt from it in any way you see fit.

Ambassador ASKEW. The key question is how we can do a better job of creating an atmosphere more conducive toward export.

The Department of Commerce estimates there are anywhere from 10,000 to 25,000 companies in this country which are capable of engaging in some form of export but do not now do so. We need to see if we can provide some additional mechanisms to expand the corporate community's participation in export.

H.R. 7230 provides authority for forming trading companies, and the administration recognizes the need for this type of legislation and I strongly support its concept. I would point out that when the Congress passed the Webb-Pomerene Act that created certain exemptions of the antitrust laws, it did so with the idea of trying to permit our business people to become more competitive. However, there is substantial apprehension in the business community as to the exemption created by Webb-Pomerene, and so one of the most important challenges of this piece of legislation is to try to give clear authority to those companies willing to involve themselves in export trading. It also permits bank participation in trading companies, and extends the Webb-Pomerene Act, in effect, to services.

These are the three big things that the bill does. It further provides the Export-Import Bank with authority to have guarantee programs to support commercial loans. These then are the areas in which we feel the bill would be very helpful. The Webb-Pomerene trading associations have played an important role, but not nearly as large a role as we think they could in terms of expanding our export capabilities.

We have spent a great deal of time within the administration on this legislation; however, there are certain concerns that we have with H.R. 7230. It lacks a needs test in the consideration of whether an antitrust exemption should be granted an export trading company.

In addition, it lacks a 30-day suspension of the effective date of an exemption, in those cases in which either the Attorney General or Federal Trade Commission advise the Secretary of Commerce that they disagree with the Secretary's determination to issue a certificate. These two items, plus somewhat ambiguous language intended to grandfather Webb-Pomerene associations, give us some problems with the antitrust provisions of H.R. 7230.

We have carefully worked out the antitrust provisions in the Stevenson-Roth bill, S. 2718, with the Department of Justice. The companion bill to S. 2718 was introduced in the House by Representative Reuss, and is more along the lines we have been discussing.

While the administration strongly supports the trading company concept, the antitrust provisions of H.R. 7230 which I have cited are unacceptable to the administration. In addition, the DISC provisions and the provisions allowing an export trading company with corporate shareholders to qualify for subchapter S treatment

if the corporate shareholders are also subchapter S corporations are problems for us.

I was a legislative preacher for 12 years in a somewhat less distinguished body than the U.S. Congress, but I happened to have worked with the distinguished Congressmen from Florida and from Minnesota—although I had not had the privilege of working with the distinguished Congressman from Ohio. As a legislative preacher, my instincts tell me that some of these provisions, which the Committee on Foreign Affairs and the bill's sponsors feel absolutely convinced are necessary to expand further our export capability, will make it very difficult to eventually pass this piece of legislation which would permit banking participation in trading companies, clarify the antitrust exemption, and extend the exemption to the area of services. Some of these provisions would endanger its passage by this Congress. We must face that we take a chance with provisions that are desirable to some, but because of the lateness of the hour, might make it difficult to pass the legislation.

Of course, we have some substantive concerns about the DISC and subchapter S provisions on which Deputy Assistant Secretary of the Treasury Daniel Halperin will be testifying more specifically.

Mr. Chairman, I would like to do all that I can to help the American business person compete on more even terms in the marketplace. I would like to see this session of the Congress come out with trading company legislation and recognize that the committee has to weigh the various provisions as to the justification and as to whether or not they might, in fact, impair the passage of this legislation.

[The prepared statement follows:]

STATEMENT OF AMBASSADOR REUBIN O'D. ASKEW, U.S. TRADE REPRESENTATIVE

The case for increased exports of American goods and services is clear and unassailable.

In 1980, the United States will pay more than \$80 billion for imported oil. The high cost of oil imports is the principal cause of the continuing deficits we have recorded in our balance of trade in recent years.

In the first five months of 1980, as compared to the first five months of 1979, we reduced our consumption of imported oil by 9.7 percent. But during that same period this year, we paid 71 percent more for imported oil overall than we did last year. Thus, even with our recent successes in energy conservation, we have, because of inflation and because of repeated OPEC price increases, been unable to reduce our ever-rising oil bill. The result is a diminished dollar and a declining economy.

We could do a better job of paying this increasing oil bill without running such large trade deficits if we enjoyed a larger share of overall world trade. Once we were dominant in the world marketplace. We are still a very major economic force. But now we have many competitors for the world product.

In 1970, the Federal Republic of Germany replaced the United States as the world's leading exporter of manufactured goods. Today, Japan threatens to drop the United States into third place. At the same time, newly industrializing countries around the world have presented us with increasing competition from a new quarter, for these countries are also becoming exporters of manufactured goods.

In part, these developments are understandable. The years immediately following World War II were really an unnatural time for the world and a time in which natural conditions prevailed. The United States could not have legitimately expected to sustain our position of unquestioned preeminence in the world economy.

Japan and Western Europe were certain to rise in time from the ashes of war to regain their previous prominence as competitors for world markets. This resurgence was hastened by our own enlightened efforts to help them rebuild their economies as insurance against the spread of Communism. Furthermore, once the chains of colonialism were removed from the nations of what we have since come to know as

the Third World, it was only a matter of time before their economies, too, began to develop to the point where they could compete effectively for a larger share of world markets.

Not all the reduction in the American share of world trade, however, can be traced to these historical developments. In truth, we must do a much better job of improving our competitiveness and promoting our exports. Some of our competitors apparently understand far better than we do the need to be diligent in pursuit of trading interests in our increasingly interdependent world economy.

At one time, foreign markets were of little consequence to the United States, principally due to the vast size of our domestic market. But now, as we all know, not even our domestic market is immune from foreign competition. And this makes the case for export promotion even more compelling.

Markets for our exports of goods and services now have become essential to the American economy. Exports account for one out of every eight U.S. manufacturing jobs, the production of one out of every three acres of American farm land, and, along with the international activities of American firms, almost \$1 out of every \$3 of U.S. corporate profits. About one-sixth of all we grow or make in America today is sold abroad.

Exports are essential to growth. U.S. manufactured exports expanded at nearly twice the rate of total U.S. production of manufactured goods between 1972 and 1978. Agricultural exports grew even faster—at three times the rate of growth in total U.S. farm production.

A healthy and expanding export sector is essential for the long-range stability of our external accounts and thus of the dollar. Exports are crucial to our efforts to diminish our continuing trade deficits. Exports are one of the most constructive ways to pay for imported oil and other products which the American economy demands and American consumers desire.

In addition, exports can help stimulate improved productivity, and they can help reduce prices in the American economy through greater economies of scale in production. In these and many other ways, a thriving export trade can help improve the competitiveness of our ailing economy and strengthen our position in world trade.

We are persuaded in the administration that one constructive means of facilitating increased exports of goods and services by American producers is through the development and use of export trading companies. The administration strongly supports the principle and purpose of export trading company legislation. We endorse the concept of export trading companies and changes in the Webb-Pomerene Act to clarify the application of the antitrust laws to export trade activities.

In my own view, the enactment of this one piece of legislation may well be the best hope we have this year of sending a positive signal to private enterprise that we are indeed serious about promoting American exports.

One significant reason why American exports have fallen short of our expectations is that the vast majority of American companies are simply not engaged in exporting. One hundred companies account for half of all U.S. exports. Two hundred companies account for 80 percent of our exports. The fact is, less than 10 percent of the 250,000 manufacturing firms in the United States export any of their goods to foreign countries. Yet economists in the Department of Commerce estimate that at least 10,000 and perhaps as many as 25,000 American firms are competitive enough—in terms of price, quality, and delivery schedules—to engage in exporting.

Most of these potential exporters are small and medium-sized businesses. These firms do not export now principally because they lack the financial resources and the know-how to do so. They do not have the funds to invest in needed market development abroad or the time or personnel to master customs documents, shipping, packaging, marketing, and the myriad details involved in exporting. These companies often lack the incentive to export as well, simply because our domestic market is as large and as open as it is. For them, foreign markets are a forbidding terrain fraught with uncertainties. Unless we make exporting a more attractive and more feasible proposition for those firms, they are unlikely to expand their operations into overseas markets.

These companies need a partner capable of taking their products and doing the exporting for them. They need a means of spreading among many firms the risks and costs they cannot afford on an individual basis. In short, they need an export trading company.

This is precisely the approach adopted with great success by many of our trading partners, including West Germany, France, Japan, Korea, and Hong Kong. All use some form of a sophisticated export trading entity to represent their manufacturers abroad. Many of these countries also promote consortia of companies to undertake

large overseas projects. Use of these consortia makes such ventures more practical and spreads the risks intrinsic to them.

Aside from the major international grain companies, we do not have large export trading entities in the United States. To be sure, there are between 700 and 800 export management companies in the United States, many of them well-managed and successful businesses. Most are quite small, however, and cannot provide the full range of services needed by the novice exporter.

In contrast, export trading companies, as envisioned in the legislation pending before Congress, could provide all export services—including financing, transportation, warehousing, packaging, marketing, banking services, and legal services—for an array of products in a variety of markets. They could be effective instruments for channeling an increasing flow of American goods and services to foreign markets.

Export trading companies could provide a "one stop" facility for any sized firm interested in exporting. They could seek out American products which are appropriate for markets they have discovered overseas. With sufficient capital, they could achieve significant economies of scale and, thus, reduce the capital outlay required of participating firms engaging in exporting for the first time.

In the first instance, export trading companies with these characteristics are most likely to be formed by those who already operate in international markets. For example, manufacturers who export their own products may find the export trading company concept helpful in using their existing overseas network for selling some products of smaller U.S. companies which do not export on their own. Over time, companies which do not currently export would be likely to take advantage of export trading companies.

Similarly, because of their expertise and financial resources, banks could play an important role in the successful development of export trading companies. Many banks already have global coverage by agents or correspondent banks. These banks are already in the business of evaluating risks, understanding foreign markets, and providing financing. They are ideally qualified for facilitating exports through participation in export trading companies.

For all these reasons, we feel that bank participation in export trade activity should be encouraged.

The administration supports the purpose of H.R. 7230, as amended and reported out by the House Foreign Affairs Committee, in permitting bank equity in export trading companies. We recognize that allowing Banks and Edge Act Corporations to invest in commercial operations requires a change in the longstanding national policy of separating banking from other commercial activities. Even so, the administration believes that the bill's purpose of promoting bank participation in export trading companies can be realized while safeguarding the integrity of our financial institutions. This can be accomplished by providing for broad oversight of banking participation by the appropriate regulatory agencies.

It is worth noting that this legislation would bar any banking organization from taking a controlling interest or making any investment over \$10 million without prior approval of the appropriate regulatory agencies. Further, the bill as drafted would prohibit aggregate investments by any banking organization of more than five percent of its consolidated capital and surplus in one or more export trading companies. In addition, the bill would prohibit the total of a banking organization's historical direct and indirect investments in a trading company and loans to such a company and its subsidiaries from exceeding ten percent of the bank's capital and surplus.

These provisions will help assure that the continued integrity of our banking institutions is not in any way endangered by their involvement with export trading companies.

Of equal importance is how this legislation might affect the antitrust policies of the United States. For this legislation to be successful in promoting exports, businessmen will need certainty that their participation in the activities of export trading companies will not expose them to liability under the antitrust laws. At the same time, we must make certain that our efforts to promote exports abroad, and thus make this Nation more competitive in world trade, do not lend to anti-competitive developments within the United States.

In amending the Webb-Promerene Act, trading company legislation introduced by Mr. Reuss (H.R. 7436) establishes a procedure—supported by the administration—for an export trading company to present to the Department of Commerce a reasonably detailed statement of the export trade activities it plans. The Commerce Department, in consultation with the Attorney General and the Federal Trade Commission, would certify these activities as immune from the antitrust laws only if: (1) They would promote export trade; and (2) they would not result in a substantial lessening of competition within the United States.

Once certification was granted, the certified entity would be exempted from antitrust liability for the activities described in the certification. This immunity would not extend to activities not covered in the certification. The Department of Commerce could revoke the certification if the entity's activities ceased to conform to the statutory standards. The Attorney General and the Federal Trade Commission would be empowered to seek decertification in court on their own initiative.

Some changes were made in this proposed procedure during consideration of export trading company legislation by the House Foreign Affairs Committee. I want to impress upon you the need, as we see it within the administration, to reconsider these changes as reflected in H.R. 7230, as amended and reported out by foreign affairs. I agree with Secretary Klutznick, Attorney General Civiletti, and with others who feel that one criterion in the consideration of possible antitrust exemptions should be whether granting the exemption would serve a specified need in promoting export trade.

We also oppose in the House Foreign Affairs Committee version of the legislation another significant change that would modify the procedure through which justice could seek preliminary relief.

Also of importance is the fact that trading company legislation, in addition to allowing export trading companies to take advantage of the antitrust exemption in the Webb-Pomerene Act, would also expand the coverage of that act to include trade in services.

Despite the fact that this law has been in our statutes since 1918, in 1979 only 33 export trade associations qualified for Webb-Pomerene treatment. Altogether, their share of total U.S. exports was less than two percent. It is almost an understatement to say that this antitrust exemption is rarely utilized.

In part, this is because the exemption is so narrow. By definition, export trade is limited under the Webb-Pomerene Act exclusively to the export of "goods, wares and merchandise" from the United States. This provision has been interpreted consistently as precluding the export of services. Expanding this statutory definition to include trade in services could do much to promote American exports, for the area of services is a vitally important part of our foreign trade.

H.R. 7230 also contains a provision on the DISC. While I will leave the tax policy and revenue implications of this provision to Deputy Assistant Secretary Halperin, I do want to address its international implications.

As this committee well knows, the DISC has been a contentious issue internationally, and the intent of the negotiators of our MTN subsidies code was not to affect the DISC at all. Ambassador McDonald testified on that before this subcommittee in no uncertain terms.

The particular DISC expansion in H.R. 7230 would not likely be any more cause to result in a finding of a U.S. violation of our obligations than the present DISC. However, the expansion could raise the topic again, and I would not relish that unless it were clearly useful. Yet, this is not the most important question before this subcommittee.

What you have to decide is whether it makes sense to discriminate in favor of export trading companies by expanding their DISC eligibility. I do not believe that this is necessary, nor that it will prove to be sufficiently advantageous to justify the discrimination and revenue loss.

The American economy is becoming more and more service oriented. Almost seven out of every ten working Americans are employed in services. About 65 percent of our gross national product is derived from services. Trade in services—such as advertising, accounting, banking, insurance, leasing, franchising, construction, engineering, shipping, communications, and so many others—is a significant factor in reducing our trade deficit. The latest available U.S. Government estimate put the value of overseas sales by foreign branches and the subsidiaries of U.S. service industries at about \$50 billion in 1974, since then, this figure has probably doubled.

The United States is still the largest service economy and the largest exporter of services in the world. Between 1969 and 1976, however, our percentage share of world trade receipts for services fell by one-fifth, from 25 percent to 20 percent of the global total. Our services industries face strong competition from industrialized countries such as Japan, Germany, and France. Moreover, the more advanced developing countries, such as Brazil and Korea, are daily making inroads into international service markets.

Expanding the Webb-Pomerene exemption to cover services would help meet this competition by enabling export trading companies to engage in trade services as well as trade in goods without fear of prosecution under the antitrust laws.

Clearly, there is no single model for an American export trading company. We cannot and should not simply copy the devices or practices of other countries.

Instead, we must isolate the essential characteristics of successful exporting entities and blend them with our necessary traditional principles of sound banking and economic competition. I am confident that we can do this in a way which will allow the creation and the successful operation of export trading companies such as are envisioned in this legislation. These trading companies will, in turn, help us achieve increased exports, increased competitiveness, and, thus, increased prosperity.

Mr. VANIK. I see some very serious problems. I support the idea of trying to develop export trading companies——

Ambassador ASKEW. Mr. Chairman, with your indulgence, there are only going to be three of us testifying, and I do not believe the others' testimony will be very long.

Mr. VANIK. You would like to have the rest of the panel give their statements?

Ambassador ASKEW. Would it be acceptable?

Mr. VANIK. That would be perfectly all right. So we can proceed to Mr. Katz, the Assistant Secretary for International Economic Policy for Commerce. We would be happy to hear from you, Mr. Secretary.

We do not have copies of your statement. Do you have any for distribution?

Mr. KATZ. My statement, I thought, was ready for distribution and if I can submit it for the record.

Mr. VANIK. Go ahead.

STATEMENT OF ABRAHAM KATZ, ASSISTANT SECRETARY OF COMMERCE FOR INTERNATIONAL ECONOMIC POLICY

Mr. KATZ. Let me hit a few of the points. Governor Askew covered most of it, and, bearing in mind your stricture about brevity, let me supplement a few of the things that he said. Our study in the Commerce Department of the companies that export show more shocking statistics. We calculate that only 100 companies account for 50 percent of our manufactured exports, and only 10 percent of the approximately 260,000 manufacturing firms in the U.S. are exporters. The objective quite clearly of the administration, and of this legislation, is to get more companies to export.

The key to achieving this objective, we feel, is to get the smaller and medium-sized companies to work through a firm that will take a quality product manufactured by the smaller company and itself do the exporting.

Our hope was to learn from the experience of many of our successful trading partners, including West Germany, Japan, France, and Hong Kong. All of these countries use some form of a sophisticated export trading entity to represent their manufacturers abroad.

In analyzing the requirements of the export trading company we decided that there were three essential characteristics for an American trading company. First, it must provide a one-stop facility for firms of any size interested in exporting. It must provide market analysis, distribution, services, documentation, transportation arrangements, financing, and after-sales services abroad.

Second, a successful export trading company must seek out U.S. products for which it has discovered marketing overseas. It is not to stand passively by, waiting for overtures from U.S. companies interested in exporting their products.

Third, the export trading company should limit the capital outlay and risk that any individual company would have to assume to begin exporting.

In trying to achieve these three essential characteristics, we recognize that we needed several changes in existing legislation. The first change was a change that permitted banks to hold equity positions under carefully controlled conditions in the new entity. I will not repeat the essential provisions of the export trading company legislation which permits this, except to say that there has been extensive discussion over the issue of whether holding an equity position is indeed necessary. Mr. Chairman, I submit that in many cases it is the banks that would take and can take large numbers of smaller and medium-sized companies by the hand and get them out there and export, and I am not only talking about the large money center banks. We are aware of a number of banks in the South, for example, that have extensive contacts overseas who are prepared to form export trading companies in the textile area, which is one of our areas of strength due to our technological improvements. These banks are waiting for legislation that would enable them to form export trading companies with a number of textile firms that are not able to bear the expense and the risk of going into foreign markets now.

In addition to the changes in regulations affecting bank equity participation, there is the very important question of certainty with regard to antitrust provisions. Governor Askew covered this point, and I can only second what he has to say: That the antitrust provisions in the legislation as it comes from the Senate is very, very carefully worked out. We need the legislation, and we should stick to the elaborately worked out compromise on the antitrust certification.

Finally, Mr. Chairman, we support Governor Askew's statement about the need to remove the modifications of the DISC and Subchapter S provisions proposed in H.R. 7230 and the other export trading company bills before the subcommittee, but I am sure our Treasury colleague will go into that aspect in somewhat greater detail.

To sum up, Mr. Chairman, with the changes in the antitrust section to which I just alluded, and the changes in the tax section, we urge the adoption of H.R. 7230. Removal of the various differences will allow the administration and congressional supporters to work together toward passage of export trading company legislation in 1980.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF ABRAHAM KATZ, ASSISTANT SECRETARY FOR COMMERCE FOR
INTERNATIONAL ECONOMIC POLICY

I am pleased to appear this morning before the Subcommittee on Trade to present the Administration's views on legislation to authorize the formation and operation of export trading companies. H.R. 7230 and other export trading company bills before the Subcommittee seek to encourage exports of goods and services by American industries by promoting the formation of export trading companies.

The Administration strongly supports the principle and purpose of these bills. The Administration endorses the concept of export trading companies and changes in the Webb-Pomerene Act to clarify the application of the antitrust laws to export trade activities. An increase in exports is of utmost importance to the Nation's economic well-being, and this legislation will provide an effective incentive for

increasing our exports. This legislative session is growing short. If we are to have this vehicle for facilitating our exports, we must act quickly.

THE ROLE OF EXPORTS IN A STRONG U.S. ECONOMY

Improving the export performance of the United States remains a major objective of Administration policy. Exports are essential to the strength of the U.S. economy, and contribute significantly to U.S. jobs, production and economic growth. Exports enable important economies of scale, thereby contributing to the most efficient use of U.S. resources and to lower prices. Exports provide the most constructive way of paying for U.S. imports of petroleum and other essential commodities, and thus keep the dollar firm.

Enormous as our oil bill is, we could be paying for imported oil without running a balance of trade deficit if we had maintained the share of world exports in manufactured goods that we enjoyed in 1960. The U.S. share of world markets for manufactures was 17.4 percent in 1979, an improvement over 1973, but still below the 1970 share of 18.4 percent and 1960 share of 22.8 percent. The post-war growth of Japan and our European allies, welcome as it has been, has given the United States stiff competition. So too, the newly industrializing countries have become important exporters of some manufactured goods. Yet the strengths of other countries do not tell the whole story. Another factor is the traditional disinterest of most American companies in exporting.

We do not have precise figures on the makeup of the U.S. exporting community. It is significant that a small number of U.S. firms account for a very large portion of U.S. exports. As much as 50 percent of our manufactured exports are accounted for by only 100 companies, and only 10 percent of the 260 thousand manufacturing firms in the United States are exporters. Thousands more could export, but do not.

Exports of goods presently account for about 7½ percent of our gross national product, the lowest percentage of any industrialized nation. Compare this figure with that of France—16.7 percent, Germany—22.6 percent, Italy—22.3 percent, the Netherlands—38.3 percent, Canada—25.1 percent, or the United Kingdom—23.1 percent. Even Japan, with its large domestic economy and negligible agricultural exports, ships abroad 10.2 percent of its GNP. Of course, our economy has been and is quite different from the economies of these countries. Yet if U.S. exports of goods and services were to increase by only one percentage point of our gross national product, that would represent nearly \$3 billion. This is a significant portion of our merchandise trade deficit.

Export trading company legislation would increase significantly the attractiveness of export marketing to thousands of small and medium-size firms. These firms are among our most innovative and venturesome and produce far more than their proportionate share of the Nation's new jobs—in recent years small companies have provided almost nine of each ten new jobs in the United States.

The successful conclusion of the Multilateral Trade Negotiations brings outstanding new opportunities for U.S. exports through the reduction of foreign barriers. Average tariffs will fall by about 30 percent over the coming six years, and roughly \$35 billion in government purchasing here and in other countries will be opened up to international competition. It is for this reason that the Administration has worked with Congress in developing the Export Trading Company legislation, which would put thousands of small and medium-size companies into position to take advantage of the new opportunities for profitable business in foreign markets. Let me now discuss how export trading companies can help us towards this export growth.

THE ROLE OF EXPORT TRADING COMPANIES

Favored with a large and growing domestic market, most small and medium-sized companies have little incentive to export. They also frequently lack know-how, management time, and financial resources. Exporting may seem too much of a management burden, too costly, and too risky for the uncertain return it promises.

Clearly, one of the best ways for the non-exporting American company to get into foreign marketing is to work through a firm that will take a quality product manufactured by that company and itself do the exporting. We should learn from the experience of many of our most successful trading partners, including West Germany, Japan, France, and Hong Kong. All use some form of a sophisticated export trading entity to represent manufacturers abroad.

Aside from the major international grain companies, and a few firms that are either foreign owned or are subsidiaries of large multinational companies, we do not have large export trading entities. To be sure, there are some 700-800 export management companies in the United States, many of them well-managed and successful businesses, and another 3,000 or so small export merchants. Many of

these export companies are not adequately financed or managed, however, and cannot provide the full range of export services required by the novice exporter. We also have about thirty Webb-Pomerene export associations, handling U.S. exports ranging from movie and TV films to textile machinery. Most of the associations export bulk commodities such as sulfur, fertilizer, agricultural products and forest products.

I believe there are three characteristics that are essential for a successful U.S. export trading company. First, it must provide a "one stop" facility for firms of any size interested in exporting. It must provide market analysis, distribution services, documentation, transportation arrangements, financing, and after-sale services abroad. In performing these services, the export trading company will develop a thorough knowledge of the laws and customs of the foreign markets in which it sells. As exporting specialists, of course, these companies will achieve economies of scale beyond those an individual company could hope to achieve.

Second, a successful export trading company will seek out U.S. products for which it has discovered markets overseas. It will not stand by passively, awaiting overtures from U.S. companies interested in exporting their products.

Third, the export trading company should limit the capital outlay and risk that any individual company would have to assume to begin exporting. The exporting company must be sufficiently capitalized to allow operations on a scale that would achieve the economies mentioned earlier.

Export trading companies with these characteristics are most likely to be formed by entities that already operate in international markets and that have sufficient capital available. A manufacturer that is already exporting its own products has a ready-made overseas network to sell products of smaller U.S. companies that will not export on their own. Similarly, many banks have national and foreign coverage by branches, agents, or correspondent banks. These banks are already in the business of evaluating risks, researching foreign markets, and providing financing. Banks also have existing relationships with many domestic manufacturing companies. They are logical candidates to form and participate in export trading companies. No matter what the origins or ownership of the export trading company, its aim will remain the same—to export products of U.S. companies that do not now export in significant quantities.

THE NEED FOR LEGISLATION

If export trading companies have this potential, why has the private sector not already seized upon the opportunity, formed them, and equipped them with know-how and financial backing? The answer may lie largely in the inhibiting effect of some of our regulatory mechanisms. With the exception of bank holding companies, which can purchase up to five percent of the shares of any U.S. company, our banking laws and regulations do not allow bank investments in export trading companies. On the other hand, foreign banks are either sponsors of, or closely identified with, many of the successful export trading companies in other countries. There is also uncertainty in some segments of the business community over application of the antitrust laws to export activities associated with their domestic competitors.

The time has come to enact legislation removing the inhibiting effect of these regulatory systems. We need legislation that provides flexibility in the regulatory mechanism to allow successful export trading companies, while not undermining the banking and antitrust laws. The banking provisions of H.R. 7230 reflect an appropriate accommodation of the export trade interests to be promoted by the legislation, with important safeguards. We believe bank ownership, carefully limited and controlled, is essential if our ETCs are to flourish. Although the antitrust provisions of H.R. 7230 are generally consistent with the Administration's position, we remain convinced that the provisions of S. 2718 and H.R. 7436 reflect a more appropriate accommodation of conflicting policy goals and strike a fair balance between export enhancement on the one hand and important competitive concerns on the other.

Let me now address briefly the major provisions of the export trading company legislation.

1. Bank equity participation

Because of their expertise and financial resources, banks can play an important role in the successful development of export trading companies. The Administration believes that the banking provisions of H.R. 7230 adequately meet the concerns of safety and soundness for our financial system while permitting a leading role for bank participation in export trading companies.

H.R. 7230 permits a banking organization to make aggregate investments up to 5 percent of its capital and surplus in export trading companies. Regulatory approval would be required for: (1) Aggregate investments in one or more export trading companies of more than \$10 million; (2) investments that cause the export trading company to become a subsidiary of the investing bank organization; or (3) investments that would cause more than half the voting stock of any export company to be owned or controlled by banking organizations. Aggregate bank investment and credit extensions to export trading companies would be limited to 10 percent of a banking organization's capital and surplus. The provisions address specific regulatory concerns over parent bank exposure to trading company operations, potential commodity speculation and the need to avoid preferential credit regulations.

Export trading companies with non-controlling bank investments could take title to goods and hold inventory, with the exception of positions taken in commodities other than as may be necessary in the course of normal trading relations.

2. Financial provisions

H.R. 7230 recognizes the need of many small and medium size businesses and agricultural concerns for financial help in launching a new export venture. The export trading company may need support with initial investment and operating expenses in getting under way. The Administration approves using existing authorities such as those provided by the Economic Development Administration and Small Business Administration to help export trading companies meet start-up costs.

The Administration does not object to authorizing the Export Import Bank to guarantee commercial loans to export trading companies secured by inventories of exportable goods or export accounts receivable. However, as provided in section 103 of H.R. 7230, this authority should be conditioned on a finding in each case by the Eximbank's Board of Directors that the private credit market is not providing adequate financing and that the guarantees would facilitate exports which would not otherwise occur.

3. Antitrust

The Administration remains committed to the standards and procedures for an antitrust exemption contained in Title II of H.R. 7436 and S. 2718. This approach is the result of careful and prolonged consultation within the Administration and between the Administration and Congress. It strikes a careful balance between the need to provide businessmen with the certainty that their export trade activities will not lead to antitrust liability and the need to prevent anti-competitive developments within the United States.

Title II establishes a procedure for an export trading company or export association to present to the Department of Commerce a reasonably detailed statement of the export trade activities it plans. The Commerce Department, after consultation with the Attorney General and the Federal Trade Commission, would certify these activities as immune from the antitrust laws only if they would promote export trade and would not result in a substantial lessening of competition within the United States.

Once certification was granted the certified entity would be exempted from antitrust liability for the activities described in the certification. The immunity would only extend to activities covered in the certification. The Department of Commerce could revoke the certification if the entity's activities ceased to conform to the statutory standards. The Attorney General and the Federal Trade Commission would be empowered to seek decertification in court on their own initiative.

We urge the adoption of the approach in H.R. 7436 and S.2718. As you know, the Foreign Affairs Committee amended the antitrust provisions of H.R. 7230. We disagree with removing the requirement that the antitrust immunity will help promote exports and with providing automatic certification for existing Webb associations. We also believe that the detailed procedures set forth in S. 7436 and S. 2718 for consultation with the antitrust enforcement agencies will benefit all parties by clarifying the manner in which they offer formal advice to the Commerce Department.

4. Tax provisions

The Administration remains firmly opposed to the modifications of the DISC and the Subchapter S provisions of the Internal Revenue Code proposed in H.R. 7230 and the other export trading company bills before the subcommittee. Most export trading companies should be able to meet the requirements of present DISC legislation. Thus, the creation of export trading companies will effectively expand DISC coverage without changing the statute itself. However, extending DISC benefits to "services produced in the United States" and to "export trade services" would be costly. The revenue cost of the bill cannot be precisely estimated, in part because

the proposed language is general and open-ended. We are convinced, though, that the additional cost could run into the hundreds of millions of dollars. Present budgetary restrictions simply do not permit a revenue loss of that proportion at this time. Even if Federal budgetary conditions were less stringent, we would have serious doubts about the scope of the proposed amendments. Many of our large service firms already have substantial international operations. These firms could incorporate ETC's simply to qualify existing operations for DISC benefits. The result would be a substantial revenue loss without any demonstration that exports would be appreciably increased.

Finally, we note that under the recently negotiated International Subsidies Code, the United States was able to secure at least a temporary "grandfathering" of the present DISC program. Substantially enlarging the legal scope of the DISC program would raise questions about U.S. observance of our international obligations.

With respect to the Subchapter S provisions, we support eliminating the present requirement that a qualifying corporation earn at least 20 percent of its income within the United States. We believe, however, that this and other reforms of Subchapter S should be part of a broader reform of Subchapter S. We call the Committee's attention to the report of Subchapter S reform recently issued by the Joint Committee on Taxation. We urge the taxwriting Committees to take up consideration of subchapter S reforms as soon as is feasible. Because few export trading companies are likely to be owned by individuals as Subchapter S requires, this provision is not a critical element of support for export trading companies.

To sum up, with the changes in the antitrust section to which I alluded earlier, the Administration urges the adoption of the banking, financing, and antitrust provisions of H.R. 7230. We also urge the deletion of the revenue provisions in H.R. 7230 and the other ETC bills. Removal of these differences will allow the Administration and Congressional supporters to work together toward passage of export trading company legislation in 1980.

Mr. VANIK. The next witness is Mr. Daniel Halperin, Deputy Assistant Secretary of the Treasury for Tax Policy.

Mr. HALPERIN. Thank you, Mr. Chairman.

Mr. VANIK. Do you have a statement here? I don't see a copy of your statement.

Mr. HALPERIN. Yes, it should be up there.

Mr. VANIK. We have it. Thank you.

STATEMENT OF DANIEL I. HALPERIN, DEPUTY ASSISTANT SECRETARY OF THE TREASURY (TAX LEGISLATION)

Mr. HALPERIN. I am here to comment primarily on the tax provisions in the bill. As you heard from the prior administration witnesses, there is support for the general concept of the legislation before you, and I want to emphasize that our objections to the tax changes do not imply opposition to the basic thrust of the legislation. The tax changes are not essential to accomplish the goals of the bill, and we believe that the goals can be accomplished without it.

Essentially, the tax provisions would expand the present DISC legislation to encompass additional kinds of income. As you know, a portion of DISC income is not subject to current taxation; the tax on the DISC income is deferred perhaps permanently. This income is primarily from sale of goods exported overseas. However, a DISC may receive favored income in connection with certain kinds of services.

We have listed those kinds of services in the testimony at the top of the second page.

Under the present DISC provisions a significant portion of export trade companies will qualify for DISC, and the creation of export trading companies will effectively expand the numbers of DISC without any modification in the tax legislation.

Obviously, to that extent, we have no objection. However, what we do object to is the extension of the category of service income entitled to DISC benefits. The bill before you would amend the Internal Revenue Code, and by cross-reference to the basic substantive nontax legislation before you, it would count gross receipts from the export of "services produced in the United States" as defined in the act, or from "export trade services," as defined in the act, as good receipts for DISC.

These are extremely open-ended terms. They encompass a lot of services, and we have estimated that the revenue involved may be as much as \$300 to \$600 million per year.

We obviously cannot afford a tax break of this magnitude at this point for this type of thing. Even if we could, and we were looking to tax relief in general, we do not believe that this change would be cost-effective. There would be, as perhaps with the DISC legislation in general, substantial revenue losses without demonstrable growth in U.S. exports. For that reason we oppose the changes in the DISC legislation.

Also, there are at least two important subchapter S changes before you. One would permit a subchapter S corporation to have 100 percent of its income from foreign sources. Under present law it can only have 80 percent of its income from foreign sources. That particular change is recommended in the Joint Committee staff recommendations for changes in subchapter S and is generally supported by the Treasury. However, we believe it would be better to have a general change in that area as part of subchapter S legislation, rather than one limited to export trade companies.

We do not favor the other subchapter S change, which would allow corporate shareholders in subchapter S corporations. Essentially benefits of subchapter S are intended for small business with 15 or fewer shareholders. If you have a corporate shareholder, you obviously permit 15 corporations with 15 corporate shareholders on top of that and expand the type of entity we are talking about. For that reason we oppose the change to allow corporate shareholders in subchapter S.

Let me emphasize that we support the general concept of export trade corporations. We believe the objectives can be obtained without modification of the tax laws, and that the existing tax benefits will inure to the new entities. Changes in the tax law are not needed to accomplish the goals of the bill.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF DANIEL I. HALPERIN, DEPUTY ASSISTANT SECRETARY OF THE
TREASURY (TAX LEGISLATION)

Mr. Chairman and members of the subcommittee, I am please to be here this afternoon to present the views of the Administration concerning the tax issues raised by H.R. 7230.

The Administration strongly supports the concept of encouraging the formation of export trading companies as a means of stimulating exports, especially by small and medium size U.S. firms. Further improving the export performance of the United States remains a major objective of Administration policy. Exports are essential to the strength of the U.S. economy, to U.S. jobs and U.S. production. They help enable economies of scale, and thereby assist our fight against inflation. And exports are necessary to pay for U.S. imports of vital commodities.

To help accomplish these objectives, H.R. 7230 proposes carefully drawn, narrow exceptions to current banking regulations to permit bank equity participation in

export trading companies; an Eximbank guarantee program to support commercial loans to ETCs; changes in the Webb-Pomerene Export Trade Act to clarify the application of the antitrust laws to export trade activities; and modifications to DISC and Subchapter S provisions of the Internal Revenue Code with respect to export trading companies. The Administration supports the provisions on bank participation, as well as the Eximbank guarantee program. The Administration also supports the adoption of the antitrust provisions, with some modifications, as my colleagues have discussed.

However, the Administration remains opposed to the modifications of DISC and Subchapter S provisions proposed in H.R. 7230. I would like to comment specifically on these aspects of the bill.

A DISC is generally allowed to defer an incremental portion of its export income. This export income is generated by the DISC through the sales, investment and services performed in connection with its exporting business. Presently, a DISC may receive export income in connection with: (1) Services related and subsidiary to the sale of export property by the DISC; (2) engineering and architectural services for foreign construction projects; or (3) managerial services which further the production of export receipts for the DISC. Other income from services does not qualify for tax deferral under the DISC provision. Under the present DISC provisions a significant portion of export trading companies will qualify for DISC treatment. The creation of export trading companies will effectively expand the number of taxpayers being entitled to DISC coverage without actually modifying the qualification requirements of a DISC. To this extent we have no objection. However, H.R. 7230 would expand the category of service income entitled to DISC benefits. The extension of DISC benefits to "services produced in the United States" and to "export trade services" could create a substantial revenue loss, which the present budgetary restrictions simply would not permit.

Even if Federal budgetary conditions were less stringent, we have serious doubts as to whether the intent of the legislation would be achieved by providing such DISC benefits. Many of our large international service firms (for example, law and accounting firms) would create export trading companies simply to qualify for DISC benefits provided by H.R. 7230. The result would be a substantial revenue loss without demonstrable growth in U.S. exports.

With respect to the Subchapter S provisions, we support the elimination of the present requirement that a qualifying corporation earn at least 20 percent of its income within the United States. However, we believe that this change should be part of a broader reform of Subchapter S. We call the Committee's attention to the report on Subchapter S reform recently issued by the Joint Committee on Taxation and urge the tax writing Committees to consider these reforms as soon as it is feasible. We do not, however, favor allowing corporate shareholders in Subchapter S corporations.

While strongly supporting the general concept of encouraging the formation of export trading companies through bank participation and clarification of the application of antitrust laws to export trade activities, we believe that the objectives of the legislation can be attained without modification of the tax laws—and, indeed, that export trading companies will benefit equally with other U.S. exporters from present DISC legislation.

Mr. VANIK. I want to say that I am particularly concerned about the tax aspects and the revenue losses that are inherent in the modification of the DISC. In 1974, I released a General Accounting Office report which raised serious questions about the effectiveness of the DISC, but the revenue estimates were the critical things. The Treasury, I think, told us it would cost \$250 million for the year ended 1973, and the Treasury estimated \$100 million, and so on, and the Treasury losses are really there. I think they are going to be very significant, and I quite agree with the concern that you have expressed about extending subchapter S to include corporate shareholders. I think that would pyramid beyond calculation the revenue losses that could be compounded.

Mr. Gibbons?

Mr. GIBBONS. First, Mr. Chairman, I would thank you for holding these hearings. This is an important set of hearings, and I believe this is legislation that we are going to have to act on this year. I believe the tax provisions of this, Mr. Chairman, will probably

come over from the Senate, and we will have to take them up in conference unless we take some action here and send a bill over to the Senate.

It seems to me that Senator Stevenson and other Members of the Senate have moved very rapidly after 1½ or 2 years of work to get this legislation along as far as they have. I think that whatever tax measure moves this year, and obviously one is going to come from the Senate, motivated, of course, initially by Mr. Reagan's movements, but now by the movement of the Democrats in the Senate makes these timely and important hearings.

Ambassador Askew, of course, you are the head of trade policy in the United States for this Government. What do you see as the role of the relative importance for export trading companies within the overall policy of the U.S. Government?

Ambassador ASKEW. Mr. Chairman, I believe that any moves that we can make that help increase our export capability, we must do.

I am not here to say that if we pass the export trading company legislation that it will be a panacea to the problems we encounter in export expansion, but I believe it is a very constructive step and will provide an additional mechanism for us to do a better job.

From a trade standpoint, it is probably the only major piece of trade legislation that we will have an opportunity to pass at this session of the Congress. From a trade policy standpoint, I would think it would be very important, and I certainly would hope that even though there will be some legitimate differences, that in the process of the congressional compromise, we produce some legislation at this session. I would like to take up on one point that you stated, Mr. Gibbons, to the chairman. The administration is also appreciative of the willingness on the part of the chairman to hold these committee hearings. Without us having this opportunity, we simply wouldn't be able to present the Congress with an opportunity of a final decision at this session.

Mr. GIBBONS. You know, I guess because today is the first day for national registration for males in the United States, it takes me back to military-type thinking, but it seems to me that our trade battles have been fought in the trenches recently. We were on the high ground in the maneuver area, when we were fighting for the adoption of the MTN, but we are now back in the trenches, and I don't think that we can really begin to move off of the rather defensive position we have taken until we have some new initiatives by the administration and by Congress.

I think this is a good new initiative. This gets us out of the slogging trench-type warfare, or stuck on the beach, as used to be the saying in World War II, up to where we are taking the high ground and beginning to maneuver.

While I realize Mr. Halperin always has objection to anything that costs a nickel or more if it comes out of the Treasury, I didn't think his defense of his position was so vigorous that he couldn't, with kind persuasion, be turned around, and I hope I am correct in that.

I am disturbed. I read an article that is in the current Business Week, and it seemed to be somewhat critical of the administration,

saying that export policy is still not high on the White House priority. Can you shed any light on this for us, Mr. Ambassador?

Ambassador ASKEW. Well, Mr. Chairman, I would like for it to be higher than it is. I have been told that it is high. It is a matter really of trying to produce something specifically to justify that it is, in fact, high. I thought your statement that the article was somewhat critical is somewhat of an understatement.

The President places a high priority on it. I would be candid with you that the time for rhetoric has long since passed. I think one of the litmus tests is going to be our 1,110 reports, in terms of how substantial they will be. I also note that I am here representing the administration on trading company legislation. It is legislation on which we have been working, particularly with a small group in the Senate and the House, almost since I have had the privilege of occupying this job.

So I would have to really let you apprise the extent to which export policy is an administration priority. The President says it is a high priority. I think it could be more than what it has been to justify saying that it is high. Personally, I think that both the executive and legislative branches need to come together at this session of the legislature on at least two critical items affecting export—trading company legislation and some funding for Eximbank. Mr. Chairman, until this country is willing to match export subsidies by way of assistance on interest of other countries, particularly the European Community, we will never have the leverage to negotiate export subsidies out of existence. I would hope that at this session of the legislature, we can recover from the lack of an increase, whether it be FFB or direct, on Eximbank, and complete action on trading company legislation.

The Government has got to say to the private sector that besides our rhetoric, these are some specific things that we have done. We have got to send some signals to the private sector that we are serious about assisting it, or I question the extent to which it is going to be willing, with any degree of confidence, to make the investment it has to make in order to become more competitive.

That is why I place such importance upon this particular piece of legislation, together with some type of provision that somewhere along the line gets tacked onto the right bill and puts Eximbank back in business.

Mr. GIBBONS. Mr. Chairman, I have some more questions, but I will yield now my time. I want to come back to my friend Mr. Halperin and talk to him a little.

Mr. VANIK. Is the program the administration recommends feasible without providing a bank involvement in DISC? Our big international banks pay very little Federal taxes, if any.

Ambassador ASKEW. Do you mean bank involvement in the trading company legislation?

Mr. VANIK. I am talking about extending the DISC to the banks. I would like to see whether we would have a meaningful program without getting the banks into the DISC business. Is that a key to it? Is it absolutely essential?

Ambassador ASKEW. You are talking about extending DISC to services and, thereby, extending DISC to banks.

Mr. VANIK. Yes; can we have a feasible program if we somehow eliminated the extension of DISC's to the banks that qualify under the service provisions?

Ambassador ASKEW. Mr. Chairman, I think we are at a point where we want to get what we can get. We think, that permitting bank participation in trading companies is critically important. Now, to whatever extent there should be a limitation in terms of subchapter S is up to the committee. We would just as soon not use the subchapter S provision in the legislation.

Mr. VANIK. I am dealing with the extension of DISC to the banks as a service. Now, my problem with that is that according to our corporate report of 1978, J. P. Morgan-Chemical New York Bank had profits of \$456 million, zero taxes; Chase Manhattan, \$295 million in profits, \$260,000 in taxes. There are many poor Members of Congress who probably pay that much. It is a rate of 1 percent. So what I am worried about is the multiplication of tax breaks for that sector.

Ambassador ASKEW. Mr. Chairman, let me say on that point we agree on not extending DISC in the area of service.

Mr. VANIK. You think we can have a meaningful program without doing that?

Ambassador ASKEW. Yes, sir.

Mr. VANIK. You concur with the Treasury position on that point?

Ambassador ASKEW. Yes, sir.

Mr. GIBBONS. If there are not any taxes, it won't hurt to extend DISC to them.

Mr. VANIK. They might get refundable credits.

Mr. GIBBONS. We don't grant them refundable credit, and they are not paying taxes; DISC won't help them. So it wouldn't hurt to extend them.

Mr. VANIK. It may wash out the 1 percent some of them are paying. It may wash out the 3 or 4 percent. I want to keep some partners in the support of the Government. We have a partnership system here, and I want some contribution by that sector to the cost of running the country.

I yield to Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman. I want to thank the witnesses for their testimony, and you for holding these hearings. I think this is an extremely important bill, and I certainly hope, in some form, and the most effective form, that we can pass it this year. I see no reason why we can't if we can simply thresh through the difficult parts here.

Ambassador, as I understand the objection to the antitrust sections of the House bill, it is that Commerce is the certifier, and the administration's point of view is they want Justice to have a veto over these certifications?

Ambassador ASKEW. What you are talking about is the time to come in and be heard during a 30-day period after such time as Commerce certifies. All I can tell you on this, Mr. Frenzel, is that maybe it shouldn't be that one department of Government has to negotiate with another, but it is no different, really, than one committee negotiating with another as regards substantive jurisdiction.

I think we have to be very careful in the whole field of antitrust. We have to be very careful that we don't provide some exemption that impacts upon domestic competition. The discussing of the antitrust issue with the Antitrust Division and Justice was incidentally carried on at the highest levels and involve myself, Secretary Klutznick, and the Attorney General. Personally, I believe that the inclusion of these windows, in the legislation, together with a certification of need requirement, that is, a requirement that an exemption is going to promote exports, increases the chances for this legislation. Of course, from an export standpoint, the more liberal the legislation is, the greater the support you are going to have from the business community.

Mr. FRENZEL. I agree with that thought, Mr. Ambassador. I do notice in the Senate bill, however, you have two vetoes, one by Justice and one by FTC. It is the administration's position that you need to have Commerce's decision received by both agencies?

Ambassador ASKEW. I don't think the bill provides vetoes so much as the opportunity to these agencies to come in and question and challenge any certification. Again, Mr. Frenzel, I would say that the provisions in the antitrust are an attempt to work out an administration position in a very, very sensitive area. We anticipated that there would be some reaction even within the Congress on this subject. I would leave it to the wisdom of the Congress to determine the extent to which it believes it is necessary to provide a basis for challenge on a certification or any decertification process.

Mr. FRENZEL. Yes, I think we want to get back to where you left us at the end of your last statement, and that is we want something that is usable. We don't want to develop a morass through which a normally competent corporation cannot walk and, therefore, cannot establish one of these trading companies.

I think we can probably figure out a way to give the Justice Department a reasonable amount of influence. As to the FTC, I wouldn't let them walk my dog. To involve them in this situation, I think, would simply destroy it for most companies that I know. They wouldn't even want to think about it.

We will leave that mostly to the Judiciary Committee, to whom this bill has also been referred, but we will be very interested in it.

With respect to subchapter S, Mr. Halperin, does this bill, in its current form—I guess looking at the House bill, which is similar to the Senate bill—provide that subchapter S corporations can have corporate shareholders only if they are subchapter S corporations themselves?

Mr. HALPERIN. Correct.

Mr. FRENZEL. Then why do you object to extending that?

Mr. HALPERIN. I think there are two reasons, Mr. Frenzel. One, as I said in my statement, the requirement that a subchapter S corporation have only 15 shareholders, which is a way of limiting the benefits to essentially small businesses, would be precluded or overridden if you could have a subchapter S corporation and shareholder in subchapter S—

Mr. FRENZEL. You could have 15—

Mr. HALPERIN. Each of those could have 15 subchapter S shareholders, and by the time it got to the individual level, you would

have a lot of shareholders. Just at one level you could go from 15 to 225 by having 15 subchapter S corporations, each with 15 shareholders.

Mr. FRENZEL. Mr. Secretary, what we are trying to do here, I think, is form some companies and get them out there trading. I do not think that the intention here is to make subchapter S as restrictive as possible. It is to expand it so we can get people who have some capability, or perhaps even some experience, into the business. These might well be existing subchapter S corporations. I don't see any more merit in exchanging shareholders between the corporations than there is in putting the corporations themselves in as shareholders. It seems to me that you are making a distinction here that doesn't need to be made, and probably complicating and extending the process that is necessary to put these people into the stream of commerce.

Mr. HALPERIN. Mr. Frenzel, I don't think it would be essential for export trade companies to have a subchapter S shareholder. Most subchapter S corporations have one or two shareholders. They could buy the stock directly in the export trade company. So I don't think that the legislation needs that expansion of subchapter S.

I think the basic question is whether we want to open up subchapter S to large numbers of shareholders. That is the basic question that ought to be considered in connection with subchapter S legislation. We think it would be unwise, and other people would oppose that. There are a number of bills around that would allow 100 to 150 shareholders in the subchapter S corporation.

Mr. GIBBONS. Would you yield?

Mr. FRENZEL. I yield.

Mr. GIBBONS. As I read the statement and the comments, as I understand it, you are not opposed to the subchapter S provision in this legislation. You want it done on general terms rather than just on trading companies. Isn't that the position?

Mr. HALPERIN. There are two provisions, Mr. Gibbons, one of which is that is true of, and the other one is the one Mr. Frenzel and I have been discussing. The second provision in the subchapter S change we referred to in the Senate testimony is to allow subchapter S corporations to have 100 percent income from foreign sources. We do not object to that as a substantive matter.

Mr. FRENZEL. As I understand it, you would like to handle all of these changes as part of a subchapter S bill rather than see it go forward in this context?

Mr. HALPERIN. Yes, that is correct.

Mr. FRENZEL. Well, I think that is a laudable ambition, but I think to strip it from this bill takes out a good deal of the attractiveness that is lodged in the bill.

Mr. Chairman, I yield my time. I would like to ask some questions when the other Members are done.

Mr. VANIK. Mr. Jenkins?

Mr. JENKINS. Mr. Secretary, what do you estimate the revenue loss under the bill to be?

Mr. HALPERIN. We have estimated the revenue loss from the tax changes of, I guess, between \$300 and \$700 million.

Mr. JENKINS. What will the revenue loss be if we eliminate the tax changes that you object to? In other words, a lot of these trading companies would qualify for the DISC, anyway. What will the revenue loss be if we eliminate the changes that you are talking about?

Mr. HALPERIN. I think we would treat that as a zero revenue loss, since that could be obtained in the present law, Mr. Jenkins.

Mr. JENKINS. Wouldn't there—

Mr. HALPERIN. The fact more companies might be DISC's next year than this year obviously costs money, but it is not something that is normally computed as revenue loss.

Mr. JENKINS. You are saying that the \$300 to \$700 million—

Mr. HALPERIN. Is from the expansion of the types of income that could be included in their DISC.

Mr. JENKINS. You have no objection to the 100 percent foreign; what is it now, 80 percent?

Mr. HALPERIN. That is correct.

Mr. JENKINS. You have no objection to the change of that?

Mr. HALPERIN. We have indicated in prior communication that we do not object to that. We have stated we think it would be better to enter all the subchapter S changes together.

Mr. JENKINS. Do you have a revenue loss attributable to that provision?

Mr. HALPERIN. I would assume the revenue loss would not be significant.

Mr. JENKINS. The \$300 to \$700 million revenue loss is coming from what particular change in the revenue?

Mr. HALPERIN. It is the expansion of the DISC provision to services.

Mr. JENKINS. To the service portion? Is that the largest portion of the revenue loss?

Mr. HALPERIN. That is essentially the revenue loss.

Mr. JENKINS. Now, the portion of the tax change that relates to subchapter S corporations being entitled to be a stockholder in a trading company, is that going to produce any revenue loss of any substance?

Mr. HALPERIN. I would assume not. We do not estimate any significant revenue loss from that.

Mr. JENKINS. So you are opposing that simply as a matter of policy, and not on the grounds of any revenue loss?

Mr. HALPERIN. That is correct.

Mr. JENKINS. So really the only real problem that we have from the Treasury standpoint is the part dealing with the services. Is that correct?

Mr. HALPERIN. That is the only revenue problem, Mr. Jenkins. We still feel subchapter S corporations ought to be limited to small companies and not have subchapter S corporate shareholders.

Mr. JENKINS. I understand that, but that is just philosophical; there is no revenue loss involved, so really what we are talking about is services.

I am assuming that the services that you object to primarily would be in the accounting and legal field. Is that the bulk of the services that you fear would be—

Mr. HALPERIN. I think there are also other types of services, banking and insurance services in particular, but we have never been able to find out from the proponents of this legislation the specific services that they expect export trade companies to perform that they are interested in having DISC cover that would not already be covered by present law. We do not favor any expansion of DISC provisions, but at least if we could find out what we are talking about, maybe we could narrow the arguments between us.

Mr. JENKINS. Are there some services that are now included?

Mr. HALPERIN. Yes; engineering and architectural services, and services that are subsidiary to qualified sales.

Mr. JENKINS. You have no objection to those remaining?

Mr. HALPERIN. Those are in the law, and we are not suggesting any changes in the existing law.

Mr. JENKINS. I don't know that I fully understand the services that you do object to. Is it the legal and accounting services primarily that you object to?

Mr. HALPERIN. This bill is quite broad. It refers to advertising services, insurance, legal services, transportation services; it also talks about services produced in the United States but not limited to amusement, architectural, EDP, business communication, financial, insurance, legal management, repair—there are a lot of words there, and that could lead to significant expansion of the DISC provision.

Mr. JENKINS. I am sure it would. I would assume that the authors of the bill were attempting to include all services. And I am trying to get an answer as far as your specific objections. Is it legal and accounting, or do you object to transportation services?

Mr. HALPERIN. In some cases transportation services could qualify under the present law as related, subsidiary to a sale which would be a qualified export property under the DISC provision. As I say, Mr. Jenkins, we object to any expansion of the DISC provisions at all.

Mr. JENKINS. You just don't like DISC, do you, Mr. Secretary? Isn't that correct?

Mr. HALPERIN. That is correct. We do object to any expansion, but I think we would be glad to focus on particular types of services that people have in mind, and I think that may advance it.

Mr. JENKINS. I am trying to help you. I thought maybe if we could exclude legal and accounting—

Mr. HALPERIN. I am more interested in what is included, rather than what is excluded. We have learned from years of experience that we are better off trying to put it on the other side. We can never think of everything to leave out.

Mr. JENKINS. You really don't have much problem in excluding a lot of things, regardless of what the statute may say sometimes.

I would hope that we could move on this bill, Mr. Chairman. I think it is a good bill, and I intend to support it.

Mr. VANIK. Mr. Holland?

Mr. HOLLAND. I don't have any questions, Mr. Chairman.

Mr. VANIK. Now we will go back to Mr. Gibbons.

Mr. GIBBONS. Mr. Halperin, you used to have five votes on this committee on DISC. You now have four on DISC. I was the fifth, and now you don't have me anymore. My opposition to DISC goes

back to the early 1970's, when I used to sit in the back of the room over there when we marked up bills, and I have come around the table until we have gotten this far, but I am wrong, and you are wrong, and it is time to change.

Mr. Vanik has proved to me that American businesses doing business overseas don't pay much taxes in the United States, and, therefore, when we give up something, we really haven't given up anything, and if we could expand the American presence overseas in accounting and in legal work and all the other things that you are opposed to, I think those dollars are just as good dollars as dollars from selling Chryslers overseas, if we could ever do that. They help our economy; they help us pay for all that oil we use, and America being the foremost of the service economies, I don't know why Treasury doesn't come out of the woods and get with it.

We have a chance to make money now, instead of lose money by the taxes we don't collect, and I would hope that you would go back to the drawing boards and think this thing through. You know, if it weren't for services, the dollar would be in worse shape than it is today, far worse shape.

I see Ambassador Askew nodding his head affirmatively, and you go back and ask Fred Bergsten, if it weren't for services, this country would be in lousy shape, far worse shape than we are as far as our balance of payments is concerned and our balance of trade is concerned because we excel in service; we are perhaps the first real service economy, the high technology, the think-end of the business rather than the sweat end of the business, and I think we should do all we can to expand our advantages there.

If we are not collecting any money now, we are sure not going to lose any if we don't collect any. So I challenge your figures. I notice they go from \$300 million to \$700 million, and then you said \$600 million, and really you all just don't know what it is costing as far as that is concerned. I can't see your objection, but I will give you a chance to respond now.

Mr. HALPERIN. Mr. Gibbons, we are talking in large part about services performed within the United States for people outside the country. I don't know of any evidence that would indicate that you need tax exemption in order to encourage people to provide that kind of services to outsiders. A good deal of it is going on today, as you have indicated, and a good deal of it will continue whether we have tax exemptions or not, and we are providing tax exemption for people who are paying taxes and who are performing the services, and we will get a lot of revenue loss on any additional—

Mr. GIBBONS. Who?

Mr. HALPERIN. We are talking about law firms in the United States, accounting firms in the United States, banks in the United States.

Mr. GIBBONS. Mr. Vanik says banks don't pay any taxes, anyway.

Mr. HALPERIN. Banks don't pay taxes if they buy tax-exempt bonds.

Mr. GIBBONS. No lawyer is going to be foolish enough to bring the money back here. Lawyers and doctors are not going to bring the money back here subject to taxation when they can keep it overseas and enjoy the benefit of it.

Mr. HALPERIN. There is no requirement that the services be performed overseas. If you are operating overseas and form a foreign corporation to perform the services overseas, you don't pay taxes in the United States and don't need the DISC. These provisions would cover services performed in the United States. Those are certainly fully taxable today.

Mr. GIBBONS. You do that now for services. Why discriminate against these services? Some services are already covered by DISC. They just had better lobbyists here in 1972 than the people we are talking about. That is the real reason.

Mr. HALPERIN. We question whether the revenue loss involved will provide equivalent growth in U.S. exports to be worth the revenue loss—

Mr. GIBBONS. Don't you think we could take a chance and see if it would? We are not doing very well.

Mr. HALPERIN. A good deal of that depends on whether we think that prior changes along those lines have been effective. Second, I think our clear indications are the tax provisions, whether they work or not, never get eliminated. So I think we are taking a big chance with a lot of money, and there isn't that great indication that we will have success. I think it is clear we will lose a lot of money. How much we will gain in additional services, I think, is clearly questionable.

Mr. GIBBONS. On the subchapter S provision now and the 15 shareholders, what you object to, I guess, is that it would allow each of the 15 shareholders to be a corporation. Is that correct?

Mr. HALPERIN. We would object to any of them being in the corporation, because we think the subchapter S corporations ought to be kept small and that the limit is there at 15. Second, you are certainly complicating the accounting with the particular shareholders of corporations, and that has to get passed through again. So we think the basic philosophy of subchapter S is to keep it small and keep it simple, and we ought not to be violating that.

Mr. GIBBONS. Is this because you are worried about the involvement of banks in subchapter S? Is that one of the reasons?

Mr. HALPERIN. No; I don't think so. A bank could be a Subchapter S corporation today if it were small enough.

Mr. GIBBONS. Thank you, Mr. Chairman.

Mr. VANIK. Mr. Frenzel?

Mr. FRENZEL. Mr. Secretary, what kind of bank services would produce income that would be eligible for the DISC?

Mr. HALPERIN. I think, as I understand it, any services that would be produced in the United States for export.

Mr. FRENZEL. Can you think of what some of those services might be?

Mr. HALPERIN. The bill is broad enough to cover interest from financing of trade, any marketing advice the banks gave, financial advice that banks gave in connection with export sales.

Mr. FRENZEL. I presume that advice is not billed separately usually? I suppose you are talking about interest to support exports.

Mr. HALPERIN. Right.

Mr. FRENZEL. That is the principal item.

Mr. HALPERIN. The fees that they receive in connection with letters of credit would also be exempted under this legislation.

Mr. FRENZEL. Since you want the subchapter S matter to be considered separately, with general amendments to that statute, does that mean you would object to handling even the items to which you have no objection within this bill?

Mr. HALPERIN. Mr. Frenzel, I think obviously we prefer that if subchapter S changes are to be made on a broad basis that the whole provision be looked at at one time. You know, the world isn't perfect. If we go ahead and make the change with respect to foreign source income at this point, I do not think it would be something that we would find tremendously disturbing.

Mr. FRENZEL. Our problem is, we would like to pass the bill as soon as possible. We have no idea when the general bill on subchapter S might be passed.

Ambassador ASKEW. If there were a bill passed on subchapter S, limited only to clearing up the provision on qualification, that is, the requirement on 20 percent domestic income, the administration certainly would not be opposed. In fact it would be supportive of it. What I think the Deputy Assistant Secretary is trying to say is that from a tax standpoint it would be far better to do that when you handle the other changes.

Mr. FRENZEL. I do not think any of us would disagree.

On the other hand, there is some urgency about this.

Mr. Ambassador, DISC has been found by a panel to be in conflict with our GATT agreements. If we expand DISC, do we not incur the wrath of our trading partners and get ourselves in more trouble internationally? Or does it give us a little more time to try to negotiate?

Ambassador ASKEW. I think it has been a contentious issue, as I said in my statement, Mr. Frenzel. The panel did find the DISC in conflict with our GATT agreements. Similarly, panels found aspects of the tax programs of the Dutch, Belgians, and French in conflict with the GATT agreements.

What you really have is a sort of a standoff. While the MTN did not attempt to affect the standing of DISC's, I think any expansion of DISC's causes some problems in terms of re-igniting the issue. This could result in a new claim being filed against the subsidies code. I tried to say that as artfully as I could in my statement. I think the committee has to take all this and other factors into consideration in any attempt to expand DISC.

Mr. FRENZEL. Thank you very much, Mr. Chairman.,

Ambassador ASKEW. Let me just say that if it be the decision of this Congress to do this, I can assure you we will vigorously support that position.

Mr. GIBBONS. Would the gentleman yield?

I do not know who negotiated the original GATT, but whoever did from the American side really let us get shafted badly, when they allowed the rebate of sales taxes and failed to allow the compensatory rebate of income taxes at the border. And I do not think we have ever gotten a decent resolution. The Europeans just have refused to negotiate that at all.

I know it is a very valuable selling tool for their products and for the Japanese, too, because they have the same type of value added or same type of border tax in the rebate of the border tax. And frankly, Mr. Frenzel, I think we have to aggressively move out and

improve our bargaining position in this area. We were shafted in the beginning and we have never gotten over it. It has been a burden this country has had to carry for 20-some years.

Additionally, when we dominated all the world trade and had the only factories left in the world, it didn't make a hell of a lot of difference. But today we are competing to save the shirts on our backs. I think we still have to go back to the bargaining table and say we want a better break on tax forgivenesses at the border and rebates at the border.

Mr. FRENZEL. I concur with the gentleman, but it is a little hard to do when the balance between the two areas is so much in our favor. I agree with the gentleman——

Mr. GIBBONS. Not with the Japanese it is not.

Mr. FRENZEL. Not with the Japanese.

Mr. GIBBONS. They have the same sort of experience.

Mr. FRENZEL. At any rate, I thank the panel for their fine testimony.

Ambassador ASKEW. With your permission, let me say I would not find it uncomfortable to defend something that works and that substantially improves the trade situation. I would rather be in the position of defending something that is working than of worrying about something that is not working.

We do have a greater trade surplus with the European Community than we have a deficit with Japan. This next year we project that that trade surplus with the EC will be substantially larger. It is something we have to concern ourselves with.

I am satisfied, Mr. Chairman, that this committee has taken the leadership in so many different areas of this. One thing I would like to leave with you is that it could become contentious; however, if it substantially helps, and it be the decision of this committee to move forward on this, I would not be the least bit uncomfortable trying to defend something that works.

Mr. VANIK. Mr. Holland?

Mr. HOLLAND. No questions.

Mr. VANIK. I have another worry about the banking connection established by the bill. These companies can go bankrupt. If they have a lot of trade outstanding, as they very well might, they could drag down a bank.

For example, the Japanese Trading Co., Ataka, went under in the midseventies and it placed a very tremendous strain on the parent banker Somi Tomo. I was wondering, Mr. Ambassador, whether you might provide us for the record a history of that Ataka case and the problems it created?

Ambassador ASKEW. Yes, sir, we would be happy to do that. I would like to share with the chairman that there are substantial limitations on banking participation in the bill itself. I do not think the exposure would be nearly that great as in the situation which you cite.

Mr. VANIK. Not nearly as great as it was in that case?

Ambassador ASKEW. No, sir; no, sir. I think it certainly is a legitimate concern, and the chairman is quite right in wanting further information on this matter. The trading company concept in the legislation is not along the Japanese model; indeed, we are

trying to make use of various models. We certainly would want to be cognizant of the subject you raise.

[The following was subsequently received:]

INFORMATION REGARDING THE JAPANESE TRADING COMPANY, ATAKA

Question. Does the bankruptcy of Japan's Ataka trading company indicate that U.S. banks could face similar risks in investing in exporting trading companies, as permitted by H.R. 7230?

Answer. The failure of Japan's Ataka Trading Company, as well as Mitsui's difficulties in Iran, highlight some of the potential risks faced by trading companies, but they seem to be of limited applicability to U.S. export trading companies (ETC's) as contemplated in H.R. 7230.

Investment projects abroad led to Ataka's demise as well as to problems for Mitsui. Investment in an unsuccessful oil refinery in Canada resulted in enormous losses for Ataka and led to its 1977 merger with C. Itoh. Mitsui has been involved in a massive petrochemical plant in Iran which required a government bail out when construction was halted due to the Iranian revolution. Such investment projects have been a common Japanese trading company response to declining sales of traditional products in structurally depressed industries (textiles, shipbuilding, steel) and the slow world recovery from the 1974 recession. Coordinating these large projects with their massive exports of machinery and capital equipment is one way of replacing traditional transactions, but exposes these firms to commercial and political risk.

It is to be expected that under H.R. 7230 U.S. companies participating in similar large scale projects may form a trading company to handle the massive export of machinery and capital equipment required by such a project. It is not certain whether or not banks would participate in such ventures. Any bank participation would be subject to the general review of the regulatory agencies. In addition, the proposed legislation specifically limits bank exposure in ETCs.

Bank investment in one or more ETCs would be limited to five percent of the bank's capital and surplus. Total investments and loans to a single ETC would be limited to 10 percent of its capital and surplus. Additionally, the administrative authority provided to regulatory agencies in the bill should allow requirements to be implemented for bank-owned ETC's similar to the present leveraging regulation, for Edge Act Corporations, which requires paid-in capital and surplus to equal at least seven percent of the Edge's consolidated risk assets.

Mitsui also sustained losses as a major investor and creditor in the Toyo Valve collapse in 1976. All indications are that this was a case of lending without adequate screening by trading company officials in order to boost declining sales. U.S. ETCs will not be authorized to assume the risky role of borrowing from banks and lending to uncreditworthy clients. Equity participation by bank owned ETCs in the manufacturing companies whose products they trade is considered by the Senate report on similar legislation to be subject to regulatory prohibition. In any event the limits on bank exposure described about would limit bank risk in such cases.

The Japanese experience with trading companies suggests precisely the need for regulation or close supervision of ETC lending and investment practices (at home and abroad) as already recognized by the Congress and contained in the legislation. It does not, however, make a convincing case for limiting bank participation in ETC's.

Mr. VANIK. Mr. Ambassador, that concludes administration testimony. We appreciate very much your participation and that of Assistant Secretary Katz and Deputy Assistant Secretary Halperin.

Ambassador ASKEW. With your permission, I would like to make a concluding remark, that is, to again stress the critical importance of this legislation—not only substantively to give us this additional trading company mechanism, but also symbolically to send a message to the private sector. They need to be encouraged in the area of foreign trade. In addition, I hope that all the work that has been done on perfecting this legislation will prove productive.

Mr. VANIK. Thank you very much. We very much appreciate your statement.

The next witness is Charles Levy, vice president of the Emergency Committee on American Trade. It will be the program of the

committee to continue this hearing until its conclusion and then proceed in the afternoon with the remainder of the agenda.

Mr. Levy, your entire statement will be admitted into the record as submitted. You may read or excerpt from it, whichever you see fit.

**STATEMENT OF CHARLES S. LEVY, VICE PRESIDENT, EMERGENCY
COMMITTEE FOR AMERICAN TRADE**

Mr. LEVY. Thank you very much.

Legislation designed to promote and facilitate the formation of export trading companies and export trade associations provides the means for U.S. businesses, particularly small- and medium-sized companies, to realize their export potential.

An essential element of export trading company legislation is the provision for ownership of export trading companies by banks. Banking organizations have two resources which are essential to establishing a viable export trading company:

First, through their retail banking operations, banking organizations are able to reach out to large numbers of small- and medium-sized companies who manufacture exportable products.

Second, through their international operations and foreign banking relationships, banking organizations are in an excellent position to identify potential foreign markets and customers.

An equally important part of export trading company legislation is the provision which would increase the financial leverage of small and medium-sized export trading companies by providing guarantees for the financing of export accounts receivable and inventories. However, if this new program is to be utilized effectively, the standard by which the administering agency evaluates the needs for guarantees or loans must be more clearly defined than it is in the present legislation.

As presently drafted, this provision requires the administering agency to determine whether the guarantee, would facilitate expansion of exports which would not otherwise occur. This standard relates primarily to the financing of sales and not to the creation of working capital, the principal purpose of the program. Without clarification, export trading companies, particularly small- to medium-sized companies, may encounter difficulties in demonstrating their need for assistance under this program.

[The prepared statement follows.]

STATEMENT OF CHARLES S. LEVY, VICE PRESIDENT, EMERGENCY COMMITTEE FOR
AMERICAN TRADE

I am Charles S. Levy, Vice President of the Emergency Committee for American Trade (ECAT). ECAT is an organization of 64 U. S. companies with extensive international business operations. A list of these companies is attached to this statement. In 1979, worldwide sales by these companies totalled \$450 billion and they employed nearly 5 million people.

Because ECAT member companies are among the largest U. S. exporters, they are well acquainted with the difficulties involved in establishing a viable export operation. ECAT members are also very much aware of the importance of exports to our national economic security.

Because of the complexity and cost of developing an international marketing structure, arranging for export financing and overseas transportation, and understanding foreign laws, tens of thousands of U. S. businesses compete only in our vast domestic market. Our ballooning balance of trade deficits would be substantially alleviated if these United States firms would take advantage of overseas market opportunities. Legislation designed to promote and facilitate the formation of export trading companies and export trade associations provides the means for U.S. businesses to focus on export opportunities.

The body of legislation introduced in the House and Senate provides constructive mechanisms to encourage and aid the entry of American business firms into international export markets. The legislation being considered by this Subcommittee would facilitate the formation of export trading companies. These companies would provide the export-related services which thousands of U. S. businesses, particularly small and medium sized companies, need in order to realize their export potential.

An essential element of export trading company legislation is the provision for ownership of export trading companies by banks, bank holding companies, and international banking corporations. Banking organizations have two resources which are essential to establishing a viable export trading company. First, through their retail banking operations, banking organizations are able to reach out to large numbers of small and medium sized companies who may manufacture exportable products. Second, through their international branches and foreign correspondent banking relationships, banking organizations are in an excellent position to identify potential foreign markets and customers.

Some concern has been expressed that export trading companies with bank ownership will have an adverse competitive effect on small trading companies. This has not been the case in Japan where there are nine (9) dominant export trading companies which are interrelated with major commercial banks. In spite of this concentration, Japan has, according to the U. S.-Japan Council, approximately 6,000 trading companies.

As Jerry L. Hester, President of International Trade Operations, Inc., a small export trading company, pointed out to the Senate Banking Subcommittee on International Finance:

"The biggest single exporting deterrent to an active growing export management firm is its ability to have readily available short-term capital reserves in order to bid competitively and move goods quickly."

In short, without adequate and timely financing, U. S. exporters are at a serious competitive disadvantage. To a limited extent export financing can be made available through the Export-Import Bank. However, the bulk of export financing must come from private commercial banks. Export trading companies with commercial bank participation provide an appropriate and efficient mechanism to increase the availability of private export financing. In this regard, many small and medium sized export trading companies could benefit from bank participation through joint ventures.

While we wholeheartedly endorse the enactment of export trading company and export trade association legislation, we do offer the following specific comments:

1. Export trading company legislation, or its accompanying legislative history, should clarify the extent to which an export trading company has the authority to engage in the business of importing goods and services into the United States. For example, a growing volume of international trade now involves barter arrangements and third country trade. Without clear legislative authority, a U. S. export trading company could find itself at a distinct disadvantage in participating in barter and third country transactions.

2. A number of the bills under consideration include provisions which would increase the financial leverage of existing export trading companies and stimulate the formation of new export ventures by providing guarantees for the financing of export accounts receivable and inventories. If this new program is to be utilized effectively, the standards by which the administering agency evaluates the need for guarantees must be more clearly defined.

As presently drafted, the provisions require the administering agency to determine whether the assistance provided would "facilitate expansion of exports which would not otherwise occur." In addition, the agency would have to determine whether "the private credit market is not

providing adequate financing to enable otherwise creditworthy export trading companies or exporters to consummate export transactions." These criteria fail to recognize that the financing of inventory and accounts receivable relates primarily to the creation of operating capital and not to the financing of sales.

Without clarification, export trading companies may encounter difficulties in demonstrating their need for assistance from the administering agency. As a result, the agency may either be reluctant to use its new authority, or alternatively the administrative burden on applicants would be so great that export trading companies would not apply for the guarantees.

From time to time, President Carter has highlighted the importance of exports to the future health of the U. S. economy and announced his dedication to developing a coordinated national export policy. To date, little has been done by the Executive Branch.

U. S. business is looking to the Congress to play a major role in formulating a national export policy. The legislation before this Subcommittee is an important first step in developing such a policy.

It is not clear how many export trading associations or export trading companies will be formed under the proposed legislation. But it is clear that for those companies which utilize either form of doing business, these two mechanisms will be important and immensely useful in enhancing their competitiveness in world markets.

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F.W. Woolworth Company

Mr. C. Peter McColough
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Xerox Corporation

Mr. B. John Mackin
 Chairman, Chief Executive Officer and
 President
Zapata Corporation

Mr. LEVY. I would be more than happy to answer any of the member's questions at this point.

Mr. GIBBONS. Thank you, Mr. Levy. I assume that you would essentially support the legislation.

Mr. LEVY. Very much so, Mr. Gibbons.

Mr. GIBBONS. And you think it should be strengthened by clarifying that provision that facilitates the financing of inventories and of—

Mr. LEVY. And accounts receivable, yes.

Mr. GIBBONS. You think as it is presently drafted it is hazy on that point?

Mr. LEVY. As presently drafted, I am not sure how the program can be used effectively. As I pointed out, the key to a small- and medium-sized export trading company is generating adequate working capital, particularly for the purchase of goods. As presently drafted, I do not see how companies could use the guarantee program since it is linked to sales which would not have otherwise occurred. A company would have to prove it lost the sale before it can get the guarantee.

Mr. GIBBONS. I do not believe that provision is before this committee.

Mr. LEVY. No, it is not before this committee.

Mr. GIBBONS. Are you bringing that provision to the attention of the other committees that are considering this legislation?

Mr. LEVY. Yes, we are.

Mr. GIBBONS. Fine.

Let me ask you, do you support the tax provisions as included in this proposal?

Mr. LEVY. I think with respect to the DISC, U.S. law presently permits U.S. companies to form DISC's for the purpose of expanding exports of certain types of products. Given the existence of the statute, it would be inequitable to deny service companies the opportunity to form DISC's.

Mr. GIBBONS. I agree with you.

I know the Treasury is opposed to anything that costs money and the Treasury ever since, in the Carter days, has always been opposed to DISC's. As I say, they used to have five votes on this committee to support their position. They only have four now, and I am not sure they have four. But I cannot really understand their opposition. Perhaps it needs some tightening up but I do not really understand the shotgun approach to the opposition, because they are going to get beat anyway on that issue. They had better come in with some new language that tightens it up.

Mr. LEVY. This is particularly true in view of this fact that services are among our fastest growing export sectors.

Mr. GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you for your testimony, Mr. Levy. May I commend you for your brevity. By the time I got back into the room you were all done. We should have you come often.

Mr. GIBBONS. We put his entire statement in the record.

Mr. LEVY. Thank you. I know the subcommittee has a lot of business to attend to today.

Mr. FRENZEL. Our problem with this legislation is that we would like to have it be effective. We often pass bills around here and tell

people how nice they are and we find they do not work. As the House bill is presently constituted, is it going to put people in the trading company business?

Mr. LEVY. I think, as reported out of the House Foreign Affairs Committee, it will for two reasons.

First, I think the banks are key to forming export trading companies. The banks have the financial resources; they have the experience of doing business abroad, and the experience in financing exports.

Second, the provision which offers to guarantee for financing of inventories and accounts receivable, if adjusted, will help the small and medium-size export trading companies generate capital. In addition, there is the provision that would provide startup costs for the small trading companies. I think it is a gamble. I do not think anyone can sit here and say we are going to see hundreds of trading companies created as a result of the legislation. However, it is a start. We need the legislation before we know what the effect will be.

Mr. FRENZEL. I do not disagree with you there. On the other hand, is a necessary part of the legislation the ability of the banks to be able to defer from income all loans that might be considered as going for export?

Mr. LEVY. I do not know if that is necessary. I think it is equitable and, since we provide DISC's for other types of companies, there is no reason not to provide it for service companies.

Mr. FRENZEL. I guess, as Sam points out, we are all interested in the export incentives; nevertheless we would like to get at least a little pop for our buck.

One of the valid criticisms of DISC was that it gave away Treasury revenues as an incentive to people already in the export business, and successfully, in the export business, rather than standing as an incentive to those companies who might not otherwise be exporters. If we are going to give away Treasury revenues, we would like to see them have a maximum impact on export enlargement.

That section, the services section, bothers me a little bit because it seems to me that the payoff is all going to be to people who are doing it already. Here I am talking about bank loans, advertising, accounting services, management personnel services, et cetera. Those are being merchandised very aggressively overseas already and very profitably. Are not those the people who are going to get the biggest advantage of that service feature?

Mr. LEVY. I would think if you form an export trading company, hopefully the company is going to reach out to the smaller and medium-sized service firms that are not already doing business in the export market.

Mr. FRENZEL. The more you say that, the more you tempt us to limit it to small- and medium-sized companies. I would prefer not to do that.

Mr. LEVY. An export trading company could be a small- or medium-sized company or it could be a large company. If you limit the size of an export trading company or the size of companies which an export trading company could represent, you will be

handicapping the ability of an export trading company to be competitive.

Mr. FRENZEL. Can we go back to antitrust. You support the Senate provisions rather than the Foreign Affairs Committee version?

Mr. LEVY. We support the Senate provision as reported out. The House provision does track the Senate provision in a number, but not all respects. The Senate provision represents the administration's position and is the most viable approach.

I understand the administration is working with the House Foreign Affairs Committee and House Judiciary Committee to try and refine the antitrust provisions so as to make them more compatible with the Senate bill.

Mr. FRENZEL. So you are supporting the Senate section?

Mr. LEVY. Yes.

Mr. FRENZEL. And you think that incipient trading companies can get along just fine under that?

Mr. LEVY. I think that the antitrust provisions would help export trading companies. But I think they apply more to export trade associations. There is a distinction between the two.

An export trade association under the Webb-Pomerene Act is made up of companies in the same industry and therefore they need a limited antitrust trust exemption. An export trading company may not need the exemption if it is representing a diverse group of companies. But if they need the exemption, it would be available to them under both the House and Senate bills.

Mr. FRENZEL. The Senate version, how long does it allow the Justice Department to comment on certification?

Mr. LEVY. Thirty days.

Mr. FRENZEL. And if they do not speak in that period, then the certification is a permanent one?

Mr. LEVY. The certification goes into effect, but there is a provision certainly in the Senate bill, that the Justice Department can sue to seek removal of the certification if the export trading company or export trade association violates the terms of the certification.

Mr. FRENZEL. OK. Is the FTC in the Senate version too?

Mr. LEVY. Yes.

Mr. FRENZEL. If there is anything sueable, the FTC will sue it.

Mr. LEVY. I hope the provision in the Senate bill with respect to consultations between the Commerce Department and the Justice Department and the FTC will result in a consensus which will avoid lawsuits.

Mr. FRENZEL. Can we go to subchapter S, which was the other objection of Treasury and of the administration in general. The rub is, I guess, that corporate shareholders would be allowed in a chapter S company which was also a trading company. Do you have any objection to that? It seems to me that that would be critical to getting this bill moving in a hurry or achieving the good effects that we hope to achieve from it.

I was surprised by the administration's objections to it. I would like to know if you think that is as beneficial a feature of the bill as I do or whether I have made a mistake?

Mr. LEVY. ECAT doesn't have a position on the subchapter S provision so I am afraid I can't be of any help to the committee on that issue.

Mr. FRENZEL. Thank you very much.

Mr. GIBBONS. As I remember, it was the Karth amendment on the DISC the last time we took it up, that severely limited the tax deferral or tax cost of the DISC by just applying it to the incremental increase in business done overseas. So I do not see if we used the same base, in other words if we just take DISC as it presently is and expand it to the services that we write in, it would not apply to Arthur Anderson or Arthur Little, all foreign business already; it would only apply to the incremental increase of that business.

Mr. FRENZEL. I think the gentleman is correct.

Mr. GIBBONS. So I really cannot understand Treasury's opposition except they are opposed to anything that has the word "DISC" in front of it.

Mr. FRENZEL. I yield back my time.

Mr. GIBBONS. Mr. Holland?

Mr. HOLLAND. No questions.

Mr. GIBBONS. Thank you, Mr. Levy.

Mr. LEVY. Thank you.

Mr. GIBBONS. Our next witness is our fine friend, I started to call him an old friend but he is not old, he is a very young friend, Mr. Tom Rees, who is the Chairman of the Task Force on Small Business and International Trade for the White House Conference on Small Business.

I am informed that you don't have a prepared statement but, having known you for many years, I know you are always prepared. We salute our former colleague who retired to go back into a business he was already an expert in.

Tom, you may proceed as you wish.

STATEMENT OF THOMAS REES, CHAIRMAN, TASK FORCE ON SMALL BUSINESS AND INTERNATIONAL TRADE, FOR THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS

Mr. REES. Thank you very much. I was going to work on my statement last week but I became so excited with the Republican Convention I just could not concentrate.

So—

Mr. GIBBONS. You don't have to elaborate on that, Tom. We understand.

Mr. REES. Especially Wednesday night.

I am here in a pro bono capacity as Chairman of a Presidential Task Force on Small Business and International Trade. This was one of the eight task forces that comprised the President's White House Conference on Small Business, which I believe they had last February. The task force was made up basically of people in the export field; there was one international banker, three export brokers, and I was the attorney, although I used to be an exporter. The task force was a working group, it wasn't people theorizing about trade; it was composed of people that had been in trade for at least 20 years.

We defined as a small business any business under the Fortune 1000 guideline. That would be any business with sales of less than \$100 million a year. In our experience we found that the Fortune 500 generally were exporters, they were sophisticated, and they had the resources to deal with the problem.

We emphasized medium businesses, not mom and pop shops. Mom and pop shops, unless they are service companies such as I used to have in my company, *Companie del Pacifico*, are generally too small to export effectively. We are talking about fairly substantial manufacturing companies.

I think this is where the real dynamic thrust is in American industry. I do a lot of work in "silicon valley," Santa Clara County in California. I find these high technical companies, the companies that are really moving would come under our definition of what we call small business.

We came up with a report; here is the overall report of the White House Conference on Small Business, interspersed through the report are the various recommendations from our task force.

One of the major recommendations was to really create a dynamic framework for an export trading company. Most of the exporters are small. Their debt-equity ratios never get much over 1.5 to 1. They really don't have the ability to borrow extensively. The Exim-bank stresses how they love small business, but they seem to prefer large loans to companies exporting airplanes. In terms of helping out the small businessmen and intermediate businessmen in your districts, whether Tampa, Minneapolis or Charleston, they are not effective. They only have one office, on Vermont Avenue in downtown Washington.

We also find that small and medium businessmen don't go into the export field because of the very difficult jumble of disincentives we have on the statutes today. If you do business in the Middle East, you worry about the Arab boycott. If we had one law on the Arab boycott, it would be one thing, but we have two of them, one passed by this committee and the other passed by the Foreign Affairs Committee, dealing with the boycott, and administered by two different agencies.

The Foreign Corrupt Practices Act is a chiller because neither the SEC nor Justice will come up with rules and regulations. Since the act carries a 5-year penal clause in the law, many potential exporters decide not to go into business with country ABC, although they do not intend to engage in foreign corrupt practices. But we cannot foresee the future.

We were concerned about sections 901, 903, foreign tax credits, because it was so complex, very complex. For a small medium person to try to figure this out is becoming almost impossible.

Sections 911 and 913, the taxation of citizens working abroad; they of course ask for a change in sections 911 and 913. We very much appreciate the legislation that has been introduced by Members to do this. Small business found that it was just about impossible to keep one or two of their own people overseas.

I have a client for example, Morgan Equipment, of San Francisco; they brought back 15 people, mechanics, operators of heavy equipment. Now these are being operated by Filipinos, New Zea-

landers, people from other countries where they don't pay taxes on overseas income.

We did get involved with DISC. In the legislation before you there are two changes in DISC.

No. 1, the present law prohibits a bank from becoming a DISC. Therefore, section 993, as amended, states that if the bank owns an export trading company, the export trading company could have DISC benefits.

Then in section 993, DISC is expanded to services. I would think, though, in looking at this definition of services, that many of the services that are defined in the bill are already exempt under the specific statute.

Let me just give you an example and read from the statute, if I can find it.

The statute states in 993 that qualified export receipts for—those are exempt, export receipts—“which are related and subsidiary to any qualified exchange sale or lease or disposition of excess business, gross receipts from the sale, exchange or other disposition of qualified export assets.”

Then you get into the next page, “gross receipts for engineering or architectural services for protection of services for projects outside the United States, managerial services.”

I would suspect most of those listed as services in the trading company bill would already be exempt under section 993.

I would like to suggest to this committee though a further broadening of DISC. The major problem with DISC, one of the reasons that the medium-sized companies in the Santa Clara Valley in California don't use the DISC, is that it is a very complex law. The Federal Register rules are almost incomprehensible and it means that you have to have two or three attorneys to try to figure out what your qualified export receipts are.

You take a small or medium-sized DISC, let's say \$300,000 in their DISC, if they have 2 percent off, or 1 percent off in 95-percent test of their export receipts they have a deemed distribution of all of the assets of that DISC. I think that is just terrible to have that severe penalty.

You could have 10 or 15 years of accumulation of a DISC go by the boards because IRS might come in and say that one transaction isn't considered a qualified export transaction.

I would suggest that you soften that and you say if someone misses the 95 percent criterion, perhaps the penalty should be 1 year of deemed distribution but don't unravel the whole corporation.

I was talking to one medium-sized businessman from a high technical firm out in McLean, Va. He said it cost him \$17,000 in legal and accounting fees to get his DISC straightened out and the deemed distribution penalty was \$19,000. He said it was worth it because at least it got the DISC straightened out because they are so complex you must have to have that type of legal and accounting help to make it work.

I would really hope that the committee could try to simplify the procedure because it doesn't do small business any good if they go broke because of legal and accounting fees; \$17,000 is a lot of

money to spend for legal and accounting fees on one item of a growing business.

There is another amendment that has been recommended and this is in Congressman Schulze's bill; there is a small DISC exemption of \$100,000 of adjusted taxable income. The recommendation, and this is also the recommendation of our White House Conference, would be to raise that to \$1 million and then have a phaseout between \$1 million and \$2 million. So that you allow a little bit more growth. I think \$100,000 is a bit too restrictive.

We are trying to get new people in and I think that we should do everything we can to stimulate new entry into the export field.

Congressman Frenzel was mentioning that when DISC's first came in the people who got the benefits were people already selling overseas, a bonus for what they were already doing.

I think by increasing the exemption for small DISC's, it will be an incentive to bring in new DISC's so we can increase our exports and I would hope at that medium enterprise level of business.

Also, in the definition of gross receipts for engineering and architectural services, I believe this ought to be strengthened, by adding management supervision, procurement, and financial services which are incurred in the construction of a project overseas.

The IRS is so nitpicking and so tough and so difficult on DISC's that you have to have a Philadelphia lawyer to sit down and figure out what you are going to do. A construction company might also provide management and supervision but if the code states gross receipts for architectural and engineering services, IRS would come in and say no, we would disallow management, supervision, financial, and clerical.

It is a war, a war between IRS and anybody who has a DISC. If you want the small medium businessman who can't afford all these legal and accounting fees to use the DISC, I think it is time to simplify it.

One of the reasons people do not go into the export business, that we don't have that dynamic middle slice of the American economy out there exporting, is we have put too many roadblocks in the way. Even when we give business an incentive, we make it so difficult that for the small and medium-size person it is almost impossible.

On section 911, I have been working for 2 years, for a large company which can afford my services but I will tell you a small and medium-sized company could not.

I talked with other tax attorneys about DISC problems, about 901, 903, 911 clients, and they say we cannot take as clients these small and medium people because they can't afford us. A large corporation can afford to have three or four tax attorneys around, a small or medium exporter really can't. I will confine my remarks to that.

If you want to go further into the legislation before you, I would be happy to discuss it.

It is a pleasure to be here. It has been a while but it is good to see that you are all surviving well in the Washington summer heat.

Mr. GIBBONS. Well, thank you, Tom. It is good to see you looking so well. I know that before you came to Congress, you had had a lot

of experience in the export business and we appreciate your practical experience on this.

How about the subchapter S provision, you think we ought to—is that a viable provision in this bill? Do you think it would help export trade?

Mr. REES. Oh, yes. I think Treasury was nitpicking in their approach.

Mr. GIBBONS. They usually are. That is not a change.

Mr. REES. Yes.

I have a professional corporation—I do not have a subchapter S, I know I did some subchapter S work, wondering if I should go into it or not. I think it is a very good vehicle. I think if you have a small corporation and you get taxed twice, it makes for a lot of difficulties.

I see no reason why there should be that restriction on foreign trade or foreign receipts in the subchapter S law as it is now. I really don't think it would have any impact at all on the Treasury.

I also think that their estimates on the DISC changes are really a bit much.

Mr. GIBBONS. I have found any time they don't like something, they give it a real high estimate. If they like it, they give it a real low estimate. That is not just a partisan statement. Every Treasury official that I have ever known gives you that opportunity.

How about the use of banks in these trading companies?

Mr. REES. I would think that the major controversy in this legislation is allowing a bank to own an export trading company. Under the one Bank Holding Company Act, a bank can hold up to say 5 percent of a company that is not functionally related to the business of banking.

The last decision, the last major decision by the Fed that really defined export trading companies and the Bank Holding Company Act came out about 6 years ago when Lloyds was going to purchase First Western Bank in California. Lloyds had four different export trading company subsidiaries, two of them basically financing subsidiaries, the others were bona fide trading companies. They had to pull back on the trading companies but they were able to keep their export financing subsidiaries.

One day I think the bank provision is good, the next day I think it is bad. I am not very bullish about the ability of banks to act as business institutions. I think they tend to be rather negative-type people. I found that out in 11 years serving on the Banking and Currency Committee, that they have generally not been nearly as aggressive as they should be in the foreign area.

I do not know if this will cause them to become aggressive or not. You don't have to have a bank as a partner to be an export trading company. The restrictions in the bill on banks are such that I do not think a bank would go wild and go broke as some nearly did with REIT's a few years ago. There are limit restrictions on capital which can be committed.

Mr. GIBBONS. Let me ask you about 911. What should we do about section 911? Should we just repeal it?

Mr. REES. If we wanted to be more or less at the same level as all of our foreign competition we should repeal it because most countries do not tax income of their citizens working abroad. They tax

the person in the country. We tend to tax the taxpayer if he is in the country or out of the country. The problem is, when you try to repeal all of 911, and I think it should be repealed, you get into the Hollywood star syndrome. They say Elizabeth Taylor, or someone—

Mr. GIBBONS. She can't make any money living with Senator Warner.

Mr. FRENZEL. She makes money for us being Elizabeth Warner.

Mr. REES. But you do have the problem of expatriate movie stars. Every time that happens, everyone goes after section 911. I would think that the best of all possible worlds you would put a reasonable exclusion like \$50,000 but still allow the deductions in section 913. That would give you a way to keep up with the problem of inflation in terms of your reimbursable expenses on 913.

Of course I appreciated your \$75,000 limit and I certainly appreciate Congressman Frenzel's no limit at all. It is a political problem. It probably will have a better chance with a limit. If you can get it through without a limit, that would be best.

Mr. GIBBONS. I was being conservative when I put the \$75,000 limit on. I would prefer no limit. I had not thought about the movie star problem.

Mr. REES. It is what they will throw at you, Treasury will have that in their first paragraph of their statement on 911.

Mr. GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Tom, thank you for your testimony. We appreciate it as usual.

When you were talking about raising the exemption from \$100,000 to \$1 million, were you thinking just for export companies or for everybody?

Mr. REES. No, this would be for everybody. I would say the majority of DISC's are owned by manufacturers and this would allow all DISC's to go up to that.

Mr. FRENZEL. Would you suggest putting it in this bill as a standard so that we might then have an incentive to go back into the general DISC legislation?

Mr. REES. As you know, we both served on the Banking and Currency Committee, and I would leap at any bill that was germane that went through that committee to try to put something on that I thought should go in.

Mr. FRENZEL. It would be hard to attach 911, but we will try.

Mr. REES. The DISC's are very controversial. Every time there is a tax reform bill, they want to knock off DISC. Therefore, both sides are afraid to bring up legislation. The people who like it are afraid it might be knocked out or amended.

I find if you have a bill where the DISC section is open for amendment, you might as well make it a better bill, if you believe in small DISC's, small manufacturers, and small export trading companies. If you believe the DISC's ought to be more broadly defined, their functions, such as engineering should also include those things tied up with a major engineering project abroad, that should be put in.

Mr. FRENZEL. Tom, in general, do you believe the bill as it is now structured in either House will be of help to our export expansion program?

Mr. REES. I think it will. Our task force got so excited about export trading companies that even though four of them had export trading companies they were thinking of forming another one. Webb-Pomerene clarification, which is in the bill, would help because of the antitrust implication.

I also think actually grants and concessionary loans from the Eximbank, from Commerce, and Small Business Administration, which are in the bill, would help.

Mr. FRENZEL. So this is only one part of the picture but it is an important one. I get worried about the antitrust thing.

If Commerce certified and either the Commission or the Secretary disapproved, and the certificate was awarded anyway, then the trading company or association is going to be in danger of being sued by either or both, I suppose?

Mr. REES. This is the problem with a lot of laws on the books.

Mr. FRENZEL. It really scares me.

Mr. REES. You have the same thing in the Foreign Corrupt Practices Act where you might be able to pass the muster of the Justice Department, and 2 years later someone comes in from the SEC, drags you before the Federal district court on a criminal charge.

The Webb-Pomerene Act was passed at the beginning of the twenties, at a time when there were very huge cartels which really don't exist any more. It was an attempt to try to compete with those.

You have this problem because the act is administered by the Federal Trade Commission, but Justice is always the one that is putting their thumbs down on any attempt to change the act. The act is really to allow several companies to get together and bid say on a foreign project; it does not affect the commerce clause in terms of domestic commerce, it only deals with foreign commerce which does not directly affect the United States.

That was the original intent of the Webb-Pomerene Act. For example, it does not include services, and here we have a huge multibillion-dollar service industry and they are restricted because of the Webb-Pomerene Act. What I think businessmen want is to be sure of something. They don't want one guideline from one agency and another guideline from another agency. They don't want to have the Sword of Damocles forever hanging over their head. They might not like the law, but at least they want rules and regulations that clarify the law so they know they can do this and they can't do that.

Mr. FRENZEL. This bill doesn't give it to them?

Mr. REES. Well, I do not like simplistic solutions, I do not think they work. If you pass this bill tomorrow, you are not going to see 500 export trading companies blossoming out. It just means that it is a little bit more ammunition that people who want to get into the field of trade can use.

Mr. FRENZEL. Is there any way we can simplify the certification so that there would be more certainty, or less uncertainty, by potential trading company promoters.

Mr. REES. Well, I have not been privy to the negotiations on this. I have been working with the task force that is coordinated over at the Department of Commerce that is supporting this legislation.

This has been a hangup; because there are some of those in Justice who do not want any change made now or in the future in the Sherman and Clayton Acts, even though our economy has changed a great deal since the Sherman and Clayton Acts were passed. This rather complex procedure you have in the bill is what they worked out.

Mr. FRENZEL. For the moment, you would like to see the bill go forward in hopes that if it proves difficult we can make modifications after experience.

Mr. REES. Yes; that is my feeling. The laws are there to be changed. You are there to make laws reflect what the needs are.

Again, people worry about banks starting export trading companies but, really, banks can own export financing companies. I do not think more than one or two banks out of the thousands in this country have export financing companies. I think it gets to be very symbolic more than anything else, because banks are generally not that entrepreneurial. They are people who loan you an umbrella when it is sunny and take it away from you when it starts raining.

Mr. FRENZEL. They like to be entrepreneurial when times are good, however.

Mr. REES. They sure do.

Mr. FRENZEL. Thank you very much, Mr. Chairman.

Mr. GIBBONS. Mr. Holland?

Mr. HOLLAND. No.

Mr. GIBBONS. Thank you, Mr. Rees.

Mr. REES. Thank you. I appreciate the opportunity

Mr. GIBBONS. Our next witness is Mr. Chew, president of the National Association of Export Companies.

You may proceed as you wish, Mr. Chew. If you have a statement, it will be made a part of the record.

STATEMENT OF RALPH CHEW, PRESIDENT, NATIONAL ASSOCIATION OF EXPORT COMPANIES

Mr. CHEW. Thank you, Mr. Gibbons.

I am president of an export trading company and also of the National Association of Export Companies. Within the national association we are export trading companies and export management companies. For the purposes of definition, export management companies have always considered themselves the elite of the American export trading companies, but they are disregarded in this legislation. So we will talk about export trading companies.

Mr. Frenzel has said several times how urgent this piece of legislation is. We find that a subject of great concern because we think it is a bad bill and we think it is a very dangerous bill, and it doesn't do anything for existing American export trading companies.

There is no question that the DISC legislation, in the 9 years it has been in existence, has been an important help to export trading companies. My company is a DISC.

We look at this piece of legislation—Export Trading Company Act of 1980—and it seems to imply that you have to have this legislation in order to make an export trading company a DISC, which is not the case. This legislation seems to be directed toward enabling banks to become DISC's. We understand the motives for

the legislation. We have a very serious adverse balance-of-trade problem.

As a representative of the American export trading industry, I would like to say that we are not the great failure that everybody seems to regard us. American exports have grown very rapidly. We did almost \$200 billion last year. It is one of the fastest growing industries in the United States.

The American export industry has kept the American economy going through bad times. I think the Congress—and the urgency Mr. Frenzel relates to—is trying to tamper with the very excellent industry and risking doing great damage to it.

Our roads are full of foreign cars, our gas pumps are full of foreign oil, and because of this urgent situation, because of the urgency Mr. Frenzel comments on, I think that a piece of legislation is going through in a great hurry, which does nothing for existing export trading companies and really doesn't provide many incentives except for the DISC's to help new bank-owned trading companies.

I think the banks are very anxious to have this legislation. They see it as a very important opening for getting out of the restrictions. We think Congress is losing its head a little bit.

We think that the legislation, if it is going to sponsor and support export trading companies, should remove the disincentives which have kept American export companies small and provide incentives for ETC's.

My company does \$50 million; we are a small company. The apparent ambition of this bill is to create American Mitsubishis or Mitsuis by having banks own trading companies. The objective is to have banks provide more accounts receivable financing for exports. That objective can be realized without letting the banks own these companies, without letting banks come in, and without letting foreign banks come in and own U.S. export trading companies.

We think the banks owning ETC's is unnecessary. We also think some of the motives are disingenuous or spurious. It is unnecessary because the objective of financing of export accounts receivable does not require banks to own trading companies. The banks in the United States lend very little money for export financing. They can be encouraged to do so in many other ways besides allowing them to own bank export trading companies.

Banks overseas will lend 5, 6, 10 times capital. American banks will lend 2, 2½ times capital. Many members of my association have had to go to foreign banks to finance exports receivable because American banks are limited. American banks can be encouraged to finance accounts receivable export without this urgent bill. When Congress has acted urgently, very often they have acted erroneously, Mr. Frenzel will agree.

This bill is unnecessary because banks can finance overseas accounts receivable without having to own the companies. It is also dangerous, we think.

Our association is made up of many small companies. We don't regard the prospect of negotiating a renewal of our credit lines next year, which is a very important thing to us, with a bank that is going to own us, is trying to buy us, or one of our competitors, or

has set up their own ETC. It will have an immediate adverse effect on the American balance of trade rather than a positive effect.

We also think if you are going to have an export trading company piece of legislation, you should provide incentives to the export trading company, to our existing companies perhaps, or to the bank trading companies and remove many of the disincentives.

In my prepared statement, I have listed 10 suggestions for what an American export trading company might receive in the nature of the removal of disincentives or incentives.

I also think this bill is somewhat spurious. The legislation itself says banks are going to get small American companies into the export business. This is what I do for a living and I have been for 25 years, putting American manufacturers into the export business. Bank-owned trading companies are not going to do business with small manufacturers. They can't afford to. Our kind of business is a lean, 18-hour-a-day, hard-working kind of business. A bank trading company must be, because of its nature, somewhat more staffed and elegant. They will have the financing, which we don't have, enough, but it is not possible for bank-owned trading companies really to do very much for small manufacturers; it is not the nature of their operation.

Our association is made up of 150 trading companies around the United States. We call ourselves national. We are trying to be national. I do not think we have ever unanimously voted on anything. We are a bunch of individual entrepreneurs.

Last month we voted unanimously in opposition to this legislation. I was instructed to testify concerning DISC's. I think DISC's are a symbol of congressional involvement in support. I favor DISC's, which have been very useful for me, increasing my own company over 20 times in the last 9 years since it went into effect.

We also had a subchapter S corporation, but the DISC was very important. The DISC is symbolic because it has been effectively the only export incentive, and because it has been the only export incentive you really have in your bill. We think there should be others but DISC is the only one.

It is also symbolic because when Congress worked on DISC, they overlooked our industry and almost destroyed it. We were very fortunate in getting into the legislation at the last minute the provision that made American export trading companies survive. Congress—and you will excuse me, gentlemen, I am a businessman, not a politician—Congress got involved in this area where there is not too much expertise, and you almost legislated us out of business when you created DISC. If we hadn't been able to get in at the very last minute, American export trading companies would have been destroyed, just by congressional oversight. I know that means something else, but in this case it meant disaster for the industry, and I suggest in this piece of legislation that you are doing the same kind of thing, that without proper consideration of the industry, that you are going to do great damage to our American export trading companies.

I am sorry to say that, because you all seem very emotionally committed to this piece of legislation. You want to have a piece of foreign trade legislation, but the one you are contemplating will do

damage rather than do good things to the American balance of trade.

Needless to say, I haven't followed my prepared statement. I will be glad to answer any questions with the proviso I am a businessman, not an association financed by banks in order to encourage this legislation.

Mr. GIBBONS. Mr. Chew, first of all, we appreciate your coming here and telling us this.

Mr. CHEW. I had to cancel a selling trip overseas, because I was invited last Wednesday, but I appreciate the opportunity to come, because we don't feel we have been consulted on this legislation.

Mr. GIBBONS. That is the purpose of asking you to come here. Unfortunately, when DISC was conceived, it was conceived in this room when the doors were all closed and no one was here except the Treasury Department, and they were promoting DISC at that time, and it was through our lack of knowledge that we perhaps did that, and I am glad that you caught it at the last minute.

Mr. CHEW. It was a terrifying experience, Mr. Gibbons. To some extent our association was formed around that experience, because Congress was legislating in our field, export trading, and almost destroying our business.

Mr. GIBBONS. I don't have a copy of your statement.

Mr. CHEW. It is right here.

Mr. GIBBONS. We will make it a part of the record as if you had delivered it in whole, and I appreciate the opportunity of reading it.

[The prepared statement follows:]

STATEMENT OF RALPH H. CHEW ON BEHALF OF THE NATIONAL ASSOCIATION OF
EXPORT COMPANIES (NEXCO)

My name is Ralph Chew - I am president of the National Assoc. of Export Companies, NEXCO, and also president of an Export Trading Company, Chew International Corp., which is based in the World Trade Center in New York. Our company has been in business for many years & specializes in exporting agricultural products and processed foodstuffs, although we also have divisions in other fields.

NEXCO is the association in the United States for independent export trading and export management companies. We have 150 members nationwide from what we estimate are over 3,000 U.S. export trading companies.

Myself and our Association have strong feelings about the Stevenson or Export Trading Co. bill. I will here insert a unanimous resolution of the NEXCO Board of Directors of June 17, 1980.

"Be it resolved that NEXCO, through its Board of Directors unanimously votes to oppose passage of the so-called Export Trading Company Act of 1980.

"While the bill recognizes the importance of Export Trading Companies, and the need for improved export financing, the Export Trading Company Act of 1980 also provides for bank ownership of Export Trading Companies. NEXCO feels that this would have adverse effect on the industry and on export in general and on the U.S.

balance of trade. NEXCO feels that the encouragement of Export Trading Companies and of an export expansion does not require that banks be permitted to control Export Trading Companies.

"Instead, an Export Trading Company Act should have provisions for the encouragement and development of Export Trading Companies, which the present legislation lacks almost entirely"

Any legislation intended to foster and develop American trading companies should concentrate on first understanding why our indigenous, native, American version of the international trading company is often small and how it can be made bigger and better.

U.S. Export Trading Companies are often small and many are privately held, although some of them have in recent years been purchased by foreign trading companies and foreign banks, which tend to appreciate the nature of trading companies more than American commercial world does.

U.S. ETC's are small in the U.S. commercial world for several reasons. One often cited is because of the structure of industry in this country; many larger companies manufacturing products suitable for export. This does not seem to preclude the Japanese manufacturers from taking advantage of their trading company services. Secondly, but most importantly, because we are not a trading country, the resources of our banking world are not available to American ETC's except in rather awkward balance sheet financing of Accounts Receivable. There are too few special financing programs for products of the nature we export. U.S. Banks will lend 3 or 4 times

capital to trading companies; Japanese trading companies borrow up to 50 times capital, European 10 times, Brazilian 6 - 8 times. The financing of overseas receivables by U.S. banks is based on actual negotiable documents and ownership of the cargo. The banks actually collect the receivable and so is further secured. This bill should authorize banks to have extra capacity to advance money on overseas shipments through trading companies with guarantees or whatever support the banks require.

This bill tries to deal with the real need for greater export financing, by allowing banks to own ETC. The giant banks will thus probably buy or form ETC's, which will have large credit facilities. This competition could kill existing U.S. ETC's. These special credit facilities must also be made available to independent ETC's or this bill will destroy and disrupt more than it will create. The Senate bill does require credit must be offered by banks to all ETC's on the same basis as to their own ETC, but there is little credibility in this clause.

While this historical lack of export or traders financing has limited the size of U.S. ETC companies, as has the structure of the American commerce and industry, there are other important biases against America ETC's; rules and regulations which have evolved over the years for various reasons.

It certainly is a disruptive thing that if my company sets up an export operation of a manufacturer, that after we build it to a certain size, we lose the whole thing to the staff of the manufacturer, because he has the resources and the tradition of

managing his own sales. In our commercial world of overseas sales, American companies are infamous for the lack of consistency of export policy, for their changes in sales programs, even for their irrational behavior, and for their unfair treatment of the local distributors, as well as ETC's. There exist laws against this American style of doing business - Broker Protection Laws, Importer Protection Laws, in 18 different countries.

Some of these changes in policy result from terminations of relationships with export trading companies, which of course also do great damage to our trading companies. Therefore, some favorable systemic advantage to these trading companies is necessary for them to develop importantly.

We therefore have a present situation where the U.S. export trading companies, members of my Association, do not have the bank credit and are limited in their ability to help increase U.S. exports because of the structure of our economy and these biases against them. With the right kind of support, our own company could double or triple its business every year. We have good people; experienced, qualified, talented trained people; we are a resource that can be an important contributor to the expansion of U.S. exports and the balancing of trade.

We, therefore, suggest that besides recognition of export trading companies as important and the recognition of accounts receivable financing as a problem area, it is desirable that your legislation contemplate special support for existing export trading companies and the new ETC's you are inventing and the correction or removal

of existing biases, restrictions and limitations on American ETC's.

For example, the FCIA programs of insuring political and credit risk overseas are at the present time structured against the independent export trading company, and in favor of multipliers like banks or financial groups.

Of course, the FCIA's problem of the political interference in what should be commercial matters, like the elimination of disfavored nations from the FCIA credit insurance, injures both the manufacturing exporter as well as the export trading company, but as this credit insurance and political risk insurance perhaps is more crucial to the ETC, this policy of withdrawing FCIA coverage from nations who have earned our political displeasure is more harmful to export trading companies. The Exim bank participation in the FCIA program, in the area of political risk insurance, is also prejudicial to export trading companies, because whenever there is trouble in market country, which is just when we need political risk insurance most, we find the political risk coverage withdrawn.

We could pay higher premiums, commensurate with a higher risk, in problem markets like Lebanon or Salvador or Libya, but the Ex-Import Bank is unable to help us.

Our Association feels that many other discriminations against U.S. ETC's should be corrected, as follows:

I. Freight Commissions. Some 20 years ago, the Federal Maritime Commission in an effort to protect the forwarding companies, which

prepare export documentation for shipment, ruled that only those forwarding companies could receive the freight brokerage which is customarily paid by steamship companies. ETC's were lumped with the manufacturers and are unable to receive this freight brokerage.

Few trading companies abroad are similarly prejudiced. We agree that forwarders must be protected against their clients to some extent, by the manufacturers not being able to receive the export freight brokerage, but the ETC's must get this brokerage to compete with trading companies around the world, and to have an advantage or strength in relation to the manufacturer.

II. ETC's should also be authorized to act as NVO's.

III. ETC's should be allowed to earn insurance commissions on Marine insurance. (Items 1 - 3 were recommended by Hay Report in 1977 - A study of the feasibility of U.S. ETC's).

IV. U.S. Export Promotion Programs: Shows-In recent burst of economy, the U.S. government started to charge more for participation in export trade shows around the world to the participants to cover a larger part of the expense. I remember one run-in I had with a gentleman for the OMB, who said they were evaluating the performance fo the export development shows around the world on just how much revenue they could develop from the participation of the U.S. manufacturers or traders. It seems so obvious to me that the more important measurement would be the amount of trade which is developed on a short or long term basis. These trade shows are a

Trade Development tool and therefore, ETC's should have a special status in these shows rather than being limited as to the number of principals whose products they can exhibit. The ETC should not be required to pay fees which compensates all the expenses of these shows, as it is a major function of ETC's to introduce new manufacturers to export, and trade shows are an important technique in this effort.

A U.S. policy objective has been getting many U.S. manufacturers newly into the export business. ETCs are traditionally a vehicle for a manufacturer to enter newly into exporting. We do not necessarily agree with Commerce's projections that there is a great volume of exports available to that large percentage of American manufacturers whose products are not exported. If a product cannot be sold widely throughout the U.S., it probably can't compete overseas, but there certainly are some such manufacturers whose products can be newly exported.

Incidentally, our association has been active in running, with Commerce, "match-making conferences", where the SBA or Commerce has rounded up a group of manufacturers, new or relatively new to export, and we have provided members of our organization to meet with these prospective exporters.

Similarly, the World Trade Institute, which is part of the World Trade Center in N.Y., has received a grant from the Economic Development Administration to put about 100 manufacturers newly into export, and our Association is cooperating with WTI and many of these manufacturers, it is contemplated will work with our ETC companies.

V. Entering the export market is an expensive undertaking, even for an export management company or export trading company that specializes in the field of the manufacturer's product. We are limited in what we can do for the manufacturer, because the history and structure of the economy contemplates that we will be working for him during the developmental phase and, at a certain point, the manufacturer may contemplate taking over the export sales himself because, the way we are structured, there are few advantages for him to continue with the export management company, except the expertise they have provided.

Those troublesome export start-up expenses might be subsidized by the tax system. It would make the ETC system work very much better if subsidies could be available to the manufacturer who employed an EMC to help cover expenses such as new personal, travel, publicity and advertising, shows, etc. Perhaps tax incentives such as double expense deductions by manufacturer and ETC of export development expenses.

VI. A specific ETC problem is the obtaining of performance bonds, primarily for the Middle East. Such bonds are not readily available to ETCs. Middle Eastern governments will often not accept insurance company performance bonds, but banks are unwilling to provide them, except on a balance sheet basis, which is not available to many ETC's. Performance bonds are an export tool we need.

VII. There has also been a history of discrimination in Commerce and other governmental agencies against trading companies. We hold agencies with principals who have been actually advised by Commerce

not to do business with export trading companies.

VIII. Our Exporters Association tries to police its membership, we have a code of ethics, and we have basic requirements for membership, but we are entirely voluntarily staffed, with a very minimal budget, and so there are great limits on what we can to police our industry. Our trade association could benefit from specific programs to aid our industry; perhaps even a TEMPS program for such an association.

IX. DISC - I do understand this is the specific jurisdiction of this subcommittee. DISC is valuable to U.S. ETC's as the export incentive, and was very helpful in financing export accounts receivable at first. DISC is essential for ETC success.

The bank owned ETC's contemplated by this legislation are described as useful to small U.S. manufacturers in entering exports. We believe this is spurious. Bank ETC's might have superior export financing than the existing U.S. ETC's but they would have to be too large, too elegantly staffed to handle small exports. This is described as the main purpose of creating these bank owned ETC's. Given better bank credit the existing U.S. ETC's can obviously handle this smaller export business better. We have lower overheads, experienced people and existing networks of distributors.

We feel the new bank owned ETC's thus cannot perform the function for which they are to be created as well as we can. And we believe our industry is very threatened by bank owned ETC's.

In conclusion, we regard this bill as a serious effort to deal with an important problem and resource - ETC's and export financing. But it must build on existing ETC's; not create new ones, to make real sense. Our group is ready to cooperate with any export trade expansion efforts. We only hope we will not be destroyed in the process.

Mr. CHEW. It does have in it, Mr. Gibbons, the 8 or 10 suggestions of what incentives might help American export trading companies.

Mr. GIBBONS. Could you tick those off for me quickly?

Mr. CHEW. About 3 years ago, Congress financed the Hay study, the viability of American export trading companies. They recommended the first three things which I am going to suggest. One is that American trading companies, just like export trading companies all over the world, should be able to earn freight brokerage. About 20 years ago, Congress, in its wisdom, legislated that freight brokerage could be paid only to freight forwarders and not to manufacturers of trading companies. They were lumped in with manufacturers. That is the kind of incentive that makes Mitsubishi. Mitsubishi, or whatever you are trying to create here, pay \$10 and sell for \$9 and makes money on the freight and on the insurance and traffic and trucking and whatever, and that is what this original—we think that this American export trading company came out of some thinking that was done by our association 5 years ago, that vertical integration between the manufacturer, the farmer, the trucking company, the railroad, steamship company, pier company, port authority. That kind of integration which is essentially what the Japanese trading company has would make the United States more competitive in the service area of export trading. So, therefore, the freight brokerage is very important.

Second, American export trading companies should be permitted to earn insurance premiums on marine insurance, which we are not permitted to do. These are disincentives. Export trading companies should be allowed to form NVO, nonvessel operator-kind of steamship companies. These are things which Japanese trading companies can do.

There are Government programs like foreign commercial exhibits or shows which are set up by Commerce and the Department of Agriculture. Those shows are actually discriminatory against the American export trading company in favor of manufacturers. It is a long battle. It seems to us that the export trading company should have at least as favorable a situation in this kind of export development program as do the manufacturers.

I have two clauses in there about FCIA discrimination against, ETC's. Their policies are more damaging to export trading companies whose business is entirely export than to the manufacturer for whom export business is a partial.

Mr. GIBBONS. I think you are on page 8.

Mr. CHEW. The most important thing for export trading companies is improvement in their ability to finance their accounts receivable. American banks only need a few incentives, an export window at the Fed, a way of discounting overseas accounts receivable, of reselling. We were greatly damaged by the high interest rates. We have to compete around the world. We do business in countries around the world, and when the United States, for its own domestic reasons, increases interest rates to 18 percent, it puts us in a terrible competitive disadvantage.

I also have a clause in my statement suggesting if that the purpose of this legislation is to deal with the putting of small manufacturers in the export business; that tax incentives might be considered for manufacturers starting their export programs, using export trading companies, perhaps some of the expenses of the starting-up could be an expense of the manufacturer, as well as deductible to the trading company. This would encourage the use of export trading companies.

I have noted discrimination of Commerce programs against American export trading companies. I hold two contracts with manufacturers who were disincentived by Commerce to work with American export trading companies. Ours is an industry that has not only been overlooked by the Congress when they were fostering their export trading companies, but has also been given a difficult time by the administration.

DISC is the export incentive which is very important to us in the ETC industry. I agree with those comments concerning Treasury's prejudice against it and the testimony earlier by Mr. Levy that it was American exporters who benefit greatly from DISC. Small- and medium-sized trading companies and manufacturers should perhaps have, as Tom Rees suggested, somewhat larger exclusion, so we would have some competitive advantage under the DISC provisions.

Mr. GIBBONS. You say in your statement that DISC is essential for export trading company success. And, of course, we have had some people here saying they were not. I guess the Treasury said that.

Mr. CHEW. DISC is the only incentive you have in your piece of legislation. If export trading companies are going to be viable, they have to have some incentives of disincentives removed. We think DISC is a very important piece of legislation that deals right with the most serious problems with the American export community, which is the financing of accounts receivable. In our experience most major trading countries of the world have fewer limitations on their bank's ability to finance export accounts receivable.

Mr. VANIK. Mr. Frenzel?

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. Chew, we appreciate your testimony. You have indicated your disapproval of the banking provisions in this bill. Would the antitrust waiver sections be of help to your trading companies?

Mr. CHEW. It is very hard to say, Mr. Frenzel. There is no question that the perception of antitrust problems is a limiting factor. I have this problem constantly with my manufacturers. They say the Robinson-Patman Act prevents us from pricing the way you want us to overseas. We feel that the present legislation is

clear enough that the export transactions are not governed by Robinson-Patman, for example, but it is a very hard sell to our manufacturers. They all have been brought up scared. Whatever Congress may think, there is a lot of compliance with the antitrust and price-fixing matters, Mr. Frenzel. I think any language which encourages an understanding that much of the antitrust and price-fixing legislation does not run to international trade would be very useful.

Mr. FRENZEL. You don't think certification is likely to be of much help?

Mr. CHEW. Well, in our industry we have a very healthy fear of the Corrupt Practices Act, and we do not regard the certification procedure under that as anything except a cause of greater terror. We have to do business overseas and such legislation doesn't help. I am afraid I don't entirely understand the certification or the approval of the antitrust exemption under this bill, but my experience in all of these is like, as the Webb-Pomerene and the DISC, that the intent of Congress is always narrowed by strict interpretation until you have a classic case of going to the legal department or the law firm and saying, can I do this, and what is the poor lawyer going to say, yes, and then you get in trouble. You have yourself a real classic, impossible question when you go to your lawyer and say, will I be able to do this under this kind of legislation.

I think it is very important that it be made clear to the American industrial community, to the international trading community that the American price-fixing and antitrust legislation does not run in many cases to international trade. My business is trading; my business is exporting American processed products and services, and the orientation is toward that. Therefore, the price-fixing aspect is more important.

Mr. FRENZEL. Thank you very much.

Mr. VANIK. Thank you very much. We certainly appreciate your testimony.

The next witness is Mr. Richard A. Hoefs, director, International Tax Policy Division of Arthur Andersen & Co. Mr. Hoefs, your entire statement will be admitted into the record, as submitted. You may read from it or excerpt from it.

**STATEMENT OF RICHARD A. HOEFS, DIRECTOR,
INTERNATIONAL TAX POLICY, ARTHUR ANDERSEN & CO.**

Mr. HOEFS. Thank you, Mr. Chairman. I commend the entire statement to the committee for reading, but I will skip over a good deal of it in the interest of time as well as the fact that it is duplicative of things heard earlier.

Let me point out, to begin with, I am here because of our expertise in the international business field. We have over 100 offices in all parts of the world, and clients of different sizes throughout the world that are involved in international trade. We do not see ourselves as becoming involved as an export trading company.

DISC at present has limited value to many small businesses. The principal reason is that it is too complicated. To illustrate a few years ago we put together a checklist of the things that a business

might need to be concerned with to be sure whether they were qualified as a DISC. That checklist ran 30 pages long.

I would like to get into some special comments on H.R. 7230. It seems to me, in looking at the bill, first one needs to focus on what its objectives are to be. If the objective of the bill is to build a sizable export activity of a trading-company type, considerable time, significant effort, and many risks are involved. Small business, therefore, will need help in getting into such an activity. Typically, that help could best be provided through larger export businesses getting involved in the field beyond the business that they are presently serving.

Without such help, it will be a long time before small business on its own can develop a substantial export activity. This is not to say that the bill would not help small business to get into the export area. It is a question of what the magnitude of the objective would be. In discussing this legislation with businesses, we find that antitrust is probably the paramount concern. I do not pretend to serve as an antitrust expert. Our firm is not involved in that area. We do see problems arising from it.

Based on prior utilization of Webb-Pomerene associations, businesses have doubt as to whether the existing legislation would be sufficient to eliminate the antitrust concerns that exist in the area. I think Mr. Chew's and Mr. Rees' comments earlier perhaps are indicative of that concern, which is a significant one. There is a mystique, a fear is probably a better term. And a great deal will have to be done to eliminate that fear when one considers the fact that we are asking business to move into a new area involving certain risks in a financial sense. Business certainly doesn't want to get involved in antitrust-type risks when it is also assuming business risks.

We believe that banks not only would be interested in export trade companies, but also they would be good additions to an effort of this type. They have many trading-company-type skills in their existing organizations. Such skills include experience in financing, foreign currency knowledge, knowledge of international business; they have a well-organized communication system and a knowledge of manufacturers and a reputation with those manufacturers in their region which they could utilize to develop the necessary business.

In looking to the question of getting existing export businesses involved in a broader way, such as getting a large company to expand its export activities, we find there is little interest on the part of large companies in doing this under the present legislation. That is not an illogical conclusion. Their export staffs are already fully occupied; learning new product lines would be troublesome to them; the closer the trading company product line relates to those of the manufacturers, the more difficulty they would anticipate with antitrust, and there are a number of other problems.

The net result of these circumstances, including those relating to existing manufacturers, is that if we are to attract meaningful involvement of both small and large businesses, incentives of some sort would seem to be required.

Mr. Chew mentioned the need for financing assistance, and other witnesses have done similarly. Tax incentives would seem to be of

greater use to larger companies, although they would be of use to small companies, also.

The present DISC incentives obviously are not sufficient motivation to reach the export level that this legislation would seek to achieve.

In the tax area, several types of incentives might be considered. Some of them have been mentioned this morning in one form or another. As you are aware, the present bill does expand on the activities of DISC to allow those activities to include certain services in particular. It is doubtful, however, if DISC qualification alone would be a sufficient incentive for trading company to build a substantial export effort. Existing DISC benefits could be expanded in several different ways, including allowing 100 percent of qualified DISC income to be deferred for small businesses. Another possibility would be elimination of the present DISC base period income limitation for small businesses.

Based on our review of the legislation, it would appear, merely to be certain that the trading companies properly qualified under DISC, it would be necessary to make certain changes in the definition of "qualified assets." Mr. Chew mentioned that the DISC legislation, as it presently exists, is aimed at the manufacturing DISC. As a result, the assets that must be owned in order to remain qualified as a DISC are very heavily oriented toward manufacturing. We believe that many new trading companies would have difficulty qualifying each year under the present asset definitions, and we find some specific technical flaws whereby qualification would be an impossibility unless such flaws are corrected. Therefore, we think some changes would be needed in H.R. 7230 for it to be successful under the present statutory wording.

Another possibility for a tax incentive would be to allow an export trading company to establish a foreign trading subsidiary to assist in carrying on export efforts. By changing the present subpart F income provisions to exempt from current U.S. tax the export income of such a subsidiary, the U.S. tax law would become comparable to that of governments of major trading competitors of U.S. business. We don't see why it isn't logical to have such a change under consideration, also.

Of considerable consequence to trading companies, be they small or large are the significant startup costs which will be incurred in the development of significant export activity. Current tax law would allow such costs as deductions; but if that law were adequate, obviously there would be motivation presently to establish trading companies. Therefore, treating those costs as deductions is not sufficient incentive to encourage effort into the export area. Alternative tax treatment for such costs seems appropriate to help finance such costs.

Senate bill 1663, the Stevenson bill, which was the original bill in this area, contained provisions allowing Government agencies to finance such costs. Those provisions have now been deleted. An alternative financing approach would be to allow qualified startup costs as a tax credit to the shareholders of the export trading company.

In order to be certain, however, that the Government does not bear all of the risk, such credits could be recapturable after a

specific period of time, such as 5 years. Thus, the ultimate risk would be on the shareholder, but the Government would provide interim financing needed to cover these startup costs.

Finally, I would comment on something Ambassador Askew covered this morning in considerable detail. In looking at present DISC or the expanded version of DISC, the restrictions on the General Agreement on Tariffs and Trade, the GATT Treaty, need to be kept in mind. There seems to be considerable uncertainty within the executive branch as to the exact status of DISC under the recent multilateral trade agreements. If I interpreted the Ambassador's views correctly, he seems willing to fight out that question, even on an expanded DISC basis.

This uncertainty, however, should be resolved because with such uncertainty existing, it will be difficult for any tax incentive provisions to be effective in the export trading company effort. Certainly agreement within the executive branch as to its status is essential in order for business people and potential investors who would go into this field to have some certainty as to how our own Government would look at status.

That covers my comments, Mr. Chairman. I would be happy to respond to any questions.

[The prepared statement follows:]

STATEMENT OF ARTHUR ANDERSEN & Co., RICHARD A. HOEFS, DIRECTOR,
INTERNATIONAL TAX POLICY

SUMMARY

- I. U.S. business' role in international trade has declined substantially and continues to do so--the competition is tough.
- II. Trading companies are important factors in international trade of several nations.
- III. Most small and medium sized businesses in U.S. have difficulty operating in export markets--risks are high and problems are many.
- IV. Other countries offer many incentives in export area. U.S. should consider possibility of adopting some of them.
- V. Specific comments on HR 7230.
 - A. Small/medium business cannot increase exports significantly by itself--larger businesses must be involved.
 - B. Anti-trust considerations are extremely important for all sized businesses.
 - C. Banks could be very helpful in trading company activities.
 - D. Incentives are needed particularly to help in financing start up costs.
 - E. Tax changes could be important incentives--DISC, Subpart F.

I am Richard Hoefs, Director of International Tax Policy of Arthur Andersen & Co., an international accounting firm.

My firm has more than 100 offices in 38 countries. Our clients include many businesses of all sizes and many nationalities. Many of them carry on business activities in world trade.

In 1979 my firm testified before the Subcommittee on International Finance of the Senate Banking Committee regarding Senator Stevenson's Bill 1663, the predecessor to current Bill S2718. A copy of that testimony is attached to this statement.* Many of the comments there are quite relevant to HR 7230 but, in the interest of time, I will not cover them.

BACKGROUND

Decline in Ability of U.S. Companies to Compete

Since the mid-1960s, an important trend has developed in the position of U.S. business in world markets. Foreign-based companies have been overtaking and replacing

* This material has been retained in the subcommittee files.

U.S. companies in their relative position as the major commercial forces in the world. Many factors have contributed to this--the economic recovery of Japan and the European countries from World War II, the varying effects of changing economic factors--such as government fiscal policies, inflation, depression and currency adjustments--and, of course, political factors.

This downward trend can be demonstrated by a review of annual sales of the 100 largest firms in the world. In 1965, 68 of the top 100 companies of the world were U.S. owned. By 1978, that number had fallen to 48. The only other major commercial nation to show a decline during this period was the United Kingdom; France and Japan showed astonishing gains in excess of 300 percent.

One important reason for this shift in economic power among nations is the incentives provided by many governments to their businesses to give competitive advantages in world trade. We believe it's time for the U.S. Government to change the nature of its involvement and actively assist U.S. business with an objective of increasing U.S. international business and the export of U.S. products.

Importance of Trading Companies to Other Countries

Mr. Chairman, the "Export Promotion and Export Trading Company Act of 1980" could be very helpful. Of even more importance, it might start a positive trend.

Today in Japan, more than 50 percent of all exports are channeled through trading companies. Total business activities in exporting, importing and third country remarketing exceeds \$200 billion per year. Japanese trading companies are unique in the world. They buy, sell, barter, put together deals, form joint ventures, finance, warehouse and transport. In short, they provide virtually every commercial service needed to get goods produced by one party and sold to another party somewhere in the world.

In 1975, the Korean Government introduced a general trading company system. In four years the Korean general trading companies' business activity has grown remarkably. In 1975 total business amounted to US \$832 million, 16.4 percent of total Korean exports. Exports by trading companies in 1978 reached almost \$4 billion, an increase of almost 300 percent, and involved over 31 percent of total Korean exports.

As is evident from the experiences in Japan and Korea, in the right circumstances the trading company vehicle can stimulate export activity substantially.

Problems of Smaller U.S. Businesses

We believe there are many small and medium-sized U.S. companies which have not entered the export market to any significant degree. A small business cannot possibly know market conditions around the world. Each country represents unique marketing problems. Business faces uncertainty in risks caused by such things as wide currency fluctuations and costs in connection with collection problems. The bewildering array of complex export procedures generally overwhelms the small businessman.

American entrepreneurs can surmount all of these problems, but the typical small business cannot do it alone-- there is too much risk and too high an investment. A well organized trading company could help such businesses by knowing how to handle these risks and avoid possible mistakes, conditions which discourage the individual company from export markets.

Government Incentives of Other Countries

Every major commercial nation including Japan has developed many governmental aids to exports. (See statement on S1663 for detailed listing.) I will describe only two.

Most nations allow their companies to establish foreign subsidiaries in low tax countries to sell exports in world markets free of national income tax. Subpart F of our Internal Revenue Code imposes U.S. income tax on such practices.

Second, many countries, particularly those in Europe, make tax adjustments designed to impose local tax on imports and rebate local tax on exports. Our tax system contains no such features.

U.S. business does have the DISC as assistance. While DISC benefits are limited, they clearly aid some businesses, particularly larger ones. The DISC provisions, however, are highly complex, difficult to meet, and often of limited help in developing a new export business. As a result, they have minimal value to small and medium-sized business in our society.

Specific Comments Regarding H.R. 7230

To build a sizable export activity of a trading company type requires considerable time, significant effort and involves many risks. If an important objective of HR 7230 is to bring the U.S. balance of payments deficit

into balance within a few years, small businesses will not be able to accomplish this by themselves but will need the assistance of established exporters. As a general matter, neither small nor large businesses are likely to significantly change their business activities in the present economic situation without some meaningful incentives.

Earlier this year, in an effort to obtain a better understanding of the attitude of business toward the export trading company concept, we held a meeting with several potential trading company candidates to discuss their thoughts about the concept. Included in the meeting were representatives of two large U.S. international manufacturing companies, a major international bank and a large U.S. exporter.

The meeting disclosed a number of very interesting things. First, all the businesses are very concerned over possible antitrust implications for the export trading company unless significant legislative changes are made. Our firm is not knowledgeable on antitrust matters and therefore cannot comment regarding what is needed in that area. However, based on prior utilization of Webb-Pomerene Associations, they expressed doubts as to whether expansion of that concept will be sufficient to provide the antitrust protection which business seems to feel is needed.

As a result of our discussion, we believe many banks would be very interested in establishing trading companies if they were permitted to do so. Banks often have many useful trading company type skills in their existing organizations. Such skills include experience in financing, expertise on foreign currency matters, knowledge of international business, a well organized communication system, and a sound reputation with potential manufacturing business suppliers.

The manufacturing companies saw little appeal in the export trading company concept. Their present export staffs are already fully occupied and thus to become a trading company they would need to train and develop additional personnel. Learning new product lines would be troublesome to existing personnel. Presumably the closer the trading company product lines relate to those of the manufacturer, the more difficulty there would be with the antitrust area. Handling the products of other manufacturers would involve legal and personal relationships with such manufacturers which would result in additional business problems.

In order to attract meaningful involvement of both small and large business, incentives of some sort would seem to be required. Tax incentives would seem to be of greater

use to larger companies which have less difficulty meeting financing needs. Both financing and tax incentives would be important in obtaining the active participation of small businesses. Whatever incentives are provided should be meaningfully greater than those presently available.

In the tax area, several types of incentives might be considered. The business activities of an export trading company under the bill include many activities which qualify under existing DISC provisions. HR 7230 seems to expand the allowable activities of DISC to allow all export trading companies to be qualified as DISCs. But it is doubtful if DISC qualification alone would be a sufficient incentive. Existing DISC benefits could be expanded in several different ways including allowing 100 percent of qualified DISC income to be deferred. Elimination of the present DISC base period income limitation might be considered for smaller businesses.

The export trading company should be allowed to establish a foreign trading subsidiary to assist in carrying on the export effort. By changing the present Subpart F income provisions to exempt from current U.S. tax the export income of such a subsidiary, U.S. tax law would become comparable to that of governments of major trading competitors of U.S. business.

Of considerable consequence to potential trading companies are the substantial start-up costs which will be incurred in the development of significant export activity. Current tax law allows such costs as deductions but it is doubtful if this is a sufficient tax benefit to motivate business to get into an expanded export effort. Therefore, an alternative tax treatment for such costs seems appropriate to help finance such costs. S1663 contained provisions allowing government agencies to finance the costs. A preferable financing approach would be to allow qualified start-up costs as a tax credit to the shareholders of the export trading company. In order to be certain the government does not bear all of the risk involved, such credits could be recapturable after a specific period of time such as five years. Thus the ultimate risk for the business would be on the shareholder, but the government would provide the initial financing needed.

In considering any tax and financing incentives, the restrictions under the General Agreement on Tariffs and Trade need to be kept in mind. There seems to be considerable uncertainty within the executive branch as to the exact status of DISC under the recent multilateral trade agreements. Because of this uncertainty, it is difficult for us to determine whether the existing DISC provisions could be effectively utilized either in their present form or on a

modified basis as part of the export trading company activity. With such uncertainty existing, it will be difficult for any tax incentive provisions to be effective in the export trading company concept; agreement within the executive branch as to its status is essential.

Mr. VANIK. Thank you very much.

Mr. Gibbons?

Mr. GIBBONS. No, sir, I have no questions at this late hour, but I think you have an excellent statement, and I intend to study it further.

Mr. HOEFS. We will be happy to respond privately if you have some questions.

Mr. VANIK. Mr. Frenzel?

Mr. FRENZEL. I, too, want to thank the witness. I would like to ask him whether he thinks the bill, as it now appears before us, will be helpful to the creation of trading companies and whether it will result in any increased exports.

Mr. HOEFS. In an absolute sense, the answer to that has to be yes. I am skeptical as to how large the volume of increased exports would be under this bill. If we are aiming at our balance-of-payments deficit as the target that talks in terms of billions of dollars of additional exports; and I don't see this bill as being that important.

Mr. FRENZEL. No, we have a very large export program in which trading companies are taking part now, and we would like to make it a little larger. I think when we started on this bill we were trying to remove some disincentives which were not hampering the foreign trading companies. I think we have slipped over now onto the incentive side, which is the thrust of your thoughts. However, it seems to me if we offer incentives to trading companies, we certainly cannot fail to offer them to manufacturers as well, maybe selling directly.

Mr. HOEFS. I would agree with that.

Mr. FRENZEL. So maybe we are really talking about another bill here as we are discussing the incentives, as you are, which I think is worthwhile and would be very helpful, but obviously they embrace a far wider sphere than the bill.

Mr. HOEFS. I don't mean to sound negative on the bill. My comments are presented in terms of being helpful to motivate additional exports. Clearly, the bill is a positive step, and I would commend the efforts that have gone on. Frankly, when it started, I was skeptical much of anything could be accomplished. The fact we are here today and this is the fourth or fifth congressional body that has considered it, is indicative of the fact that a lot has been accomplished. I commend the people who have been working on it, because it has been a very positive thing.

Mr. FRENZEL. Whoever is in charge of it I am sure would accept the commendation and would also agree with you that we are talking about a tiny little corner of the whole trade or export problem. The previous witness said that he was disturbed by a

description of the bill as urgent, and I consider it much less urgent than some other problems, like 911. Nevertheless, this is what is before us, and it is part of the problem, and I hope we move it forward. I thank you for your testimony.

Mr. VANIK. Mr. Hoefs, in your testimony you didn't say anything about whether or not there is a need to extend the DISC privilege to the banks. Do you have any comments you want to make on that? You probably heard some of my reaction.

Mr. HOEFS. Yes, I did a little earlier, and, as you made them, I was thinking about it. I guess I would have to say I am sure some of the banks are looking forward to that possibility, but having talked to some bankers, I think their reaction is more aimed at the business opportunity involved than it is the tax benefit that could occur. I would be a little doubtful, frankly, whether the banks could get substantial benefit from the DISC provisions because of the limitations that are placed on their involvement, but it was an original question when I heard you raise it this morning, Mr. Chairman.

Mr. VANIK. Thank you very much, Mr. Hoefs. We certainly appreciate your testimony.

This concludes the subcommittee's hearings on the export trading companies legislation.

[Whereupon, at 12:32 p.m., the hearing was adjourned.]

[The following was submitted for the record:]

STATEMENT OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF
INDUSTRIAL ORGANIZATIONS

The AFL-CIO supports exports that promote U.S. jobs and help to create a healthy industrial base. We oppose H.R. 7230, because we do not believe this bill will accomplish those objectives. Ending antitrust regulations for huge banks, ending the appropriate historic separation between banking and commerce, and giving additional tax breaks to unidentified beneficiaries are not solutions to U.S. trade problems. We urge the Committee to re-examine the costs and the potential adverse impacts of this legislation, so that improved export mechanisms can be included in a realistic and comprehensive bill.

H.R. 7230 ends the prohibition in U.S. banking laws that maintains the separation of banking and commerce. The lender and exporter can become one under this legislation—a damaging change in U.S. law.

As the small business spokesmen have pointed out, the small businesses that could export need credit, not further takeovers of export business by huge banks. Many fear that corporate power and size, not exports, will be expanded and even small banks are wary of the changes.

At a time when banks and commercial enterprises in the United States are claiming capital shortages, a measure that will result in a further competition for funds and diminution of capital for productive investments is unwarranted.

Thus by allowing banks to control Export Trading Companies and providing them with still another tax benefit, risky ventures are encouraged and the reach of the banks is extended to exports.

This bill, therefore, adds to the nation's financial risk. H.R. 7230 encourages financial institutions not only to be part of the commerce the banks are responsible for financing, but also restructure their operations for an even greater tax advantage. This is too great a burden to place on the U.S. monetary structure.

H.R. 7230 also extends antitrust exemptions of the Webb Pomerene Act to associations formed for the purposes of exporting services and to export trading companies. Exempting the nation's largest banks and an unidentified number of existing international lawyers, accountants and other so-called "service" firms will add to the competitive problems of many business.

The statute is so loosely drawn that it appears to provide a wide-open antitrust exemption for companies and banks which call themselves "services" or "Export Trading Companies."

Such concerns about H.R. 7230 have been outlined to the Committee by many witnesses. Assistant Secretary of Commerce Abraham Katz properly disagreed with

the "removal of the requirement that antitrust immunity will help promote exports and with providing automatic certification for existing Webb Pomerene associations." We share the U.S. Trade Negotiator Reuben Askew's concern that our "efforts to promote exports abroad, and thus make this nation more competitive in world trade, do not lead to anti-competitive developments within the United States."

Our concerns about the bill were heightened by the Emergency Committee for American Trade's request for a specific authority to allow export trading companies to import—to make contracts for "buy-back" or "barter trade." Thus some of the multinational proponents of "competition" who are supporting this bill actively seek arrangements that will make sure that imports come into the United States—imports developed by the sale of U.S. technology. The AFL-CIO has repeatedly criticized such "buy-back" arrangements. They cost jobs and provide multinationals special protected markets behind the closed barriers of other nation's. The result is an adverse impact on the jobs, production and technological future of the United States. To this effect, we would like the Subcommittee to consider the statement of Charles Levy, Vice President of ECAT: "Export trading company legislation, or its accompanying legislative history, should clarify the extent to which an export trading company has the authority to engage in the business of importing goods and services into the United States. For example, a growing volume of international trade now involves barter arrangements and third country trade. Without clear legislative authority, a U.S. export trading company could find itself at a distinct disadvantage in participating in barter and third country transactions."

We urge this Committee to make sure that the multinationals do not once again get a measure that will in fact encourage imports under the guise of legislation to promote exports.

The most objectionable part of the bill is the back-door tax cut for multinational banks, firms and almost any other type of business that are involved in "services"—a term virtually without limitation in the bill.

The bill would widen the DISC tax gimmick. As in the basic DISC legislation, there can be no assurance that exports of such services would result from the tax break. In many cases, the measure would simply provide a "free ride" for multinational banks, insurance companies, lawyers, and warehouse operators who would get an added tax break for continuing to do what they are currently doing. In addition as noted by Deputy Assistant Secretary Halperin substantial revenue losses would result: "However, H.R. 7230 would expand the category of service income entitled to DISC benefits. The extension of DISC benefits to 'services produced in the United States' and to 'export trade services' could create a substantial revenue loss, which the present budgetary restrictions simply would not permit."

His statement also makes it clear that there is no assurance that for the tax loss there would be more exports. "Many of our large international service firms (for example, law and accounting firms) would create export trading companies simply to qualify for DISC benefits provided by H.R. 7230. The result would be a substantial revenue loss without demonstrable growth in U.S. exports."

The substantial loss in the name of export promotion widens a tax loophole that has consistently shown that its cost has far outweighed any benefits. The estimates of tax liability reductions are \$300 million to \$700 million a year on top of the \$1.4 billion current cost of DISC. But this we suspect a conservative estimate. The list of "services" and "export-related services" industries suggests that the cost may be far greater since "services" can include a wide open range of activities from training to legal work to warehousing: "Services produced in the United States" are defined (sec. 103(a)(3)) as including, but not limited to, amusement, architectural, automatic data processing, business, communications consulting, engineering, financial, insurance, legal, management, repair, training, and transportation services, not less than 50 percent of the fair market value (as determined under regulations issued by the Secretary) of which is provided by United States citizens or is otherwise attributable to the United States." "Export trade services are defined (sec. 103(a)(4)) as including, but "not limited to, international market research, advertising, marketing, insurance, legal assistance, transportation, including trade documentation and freight forwarding, communication and processing of foreign orders to and for exporters and foreign purchasers, warehousing, foreign exchange, and financing, when provided in order to facilitate the export of goods produced in the United States or services produced in the United States."

H.R. 7230 also would qualify export trading companies as subchapter S corporations, by exempting them from normal existing subchapter S requirements. Under current law, subchapter S corporations or "tax option corporations" are generally limited to 15 individual shareholders. They are specifically prohibited from having corporate shareholders and cannot have more than 80 percent of their gross receipts from sources outside the United States. The bill would eliminate both those require-

ments. Additional tax incentives to promote foreign income and investment are, in our view, contrary to efforts needed to reindustrialize and revitalize America.

The AFL-CIO believes that expanding exports are important to the nation's health and many industries, including those that provide services, need and deserve the help of the U.S. Government in an increasingly complicated international trading world. However, tax gimmicks like DISC or exemptions from specific safeguards in U.S. tax law will not accomplish that objective. Rather, they will add complications and divert funds from programs that could produce desirable and demonstrable results.

We, therefore, urge this Committee to reject H.R. 7230.

WASHINGTON, D.C., July 22, 1980.

JOHN M. MARTIN, Jr.,
Chief Counsel, Committee on Ways and Means,
U.S. House of Representatives.

DEAR MR. MARTIN: In accordance with the July 14, 1980, press release of the House Ways and Means Committee Subcommittee on Trade requesting written comments on export trading company legislation, we wish to submit the enclosed memorandum for your consideration.

Respectfully submitted.

PAUL H. DELANEY, Jr.

Enclosure. [NOTE: Contents of memorandum available in Subcommittee's legislative file or refer to hearings before the Subcommittee on International Trade of the Committee on Finance, United States Senate, 96th Congress, First Session, on S. 1376, July 11, 1979, pp. 636 thru 689.]

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