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The Other Deficit: A Review of International Trade in California and the U.S.

Senate Office of Research

THE OTHER DEFICIT:

A REVIEW OF INTERNATIONAL TRADE IN CALIFORNIA AND THE U.S.

Prepared by:
Senate Office of Research
Elisabeth Kersten, Director
November 1984

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Prepared by:

John Griffing
Senate Office of Research

November 1984

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CALIFORNIA LEGISLATURE

Senate

STATE CAPITOL
SACRAMENTO, CALIFORNIA
95814

November 1984

The Honorable Members of the California State Senate

Dear Members:

By virtually every measure available, California is the leading international trade state in the country. Likewise, trade is one of the most vital sectors of our state's economy accounting for 17 percent of our gross state product and over one million jobs. As the global center of commercial activity continues to shift from the Atlantic to the Pacific Basin, trade's importance to California -- the gateway to Pacific rim commerce -- will continue to grow over the coming decade.

In recognition of the role that international trade plays in our economy, the California Senate two years ago sponsored a major conference at U.C.L.A. Over 200 international business representatives and two dozen Members of the Legislature spent a day learning about trade's contributions to the California economy, discussing some of the difficult problems that were facing this sector, and developing initiatives designed to encourage the healthy growth of trade.

Despite the success of the conference and the passage of several of the recommendations that emerged from the group, the trade picture in the U.S. and California has continued to deteriorate. In 1983, the U.S. trade deficit reached a record $61 billion, and the latest projections for 1984 are for a deficit of $120 to $130 billion. California's deficit doubled in each of the past two years, reaching $8.6 billion in 1983. The state's agricultural sector was particularly hard hit as farm exports declined 21 percent in 1982 and another 8 percent in 1983.

To gain a better understanding of the extent and causes of our current trade problems, we asked the Senate Office of Research to examine the recent performance of the U.S. and California trade sectors and to review the major programs and legislative efforts that were being undertaken to deal with these problems. The results of that study are contained in the attached report, The Other Deficit: A Review of International Trade in California and the U.S.

The forecasts of continuing record trade deficits portend another session in which international trade measures will occupy a very visible berth on the Legislature's agenda. We hope that you will find the information in this report to be of use to you during the deliberations. If you have any questions about the report, please contact John Griffing in the Senate Office of Research at (916)445-1727.

David Roberti

SENATOR DAVID ROBERTI
President pro Tempore of
the Senate

Rose Ann Vuich

SENATOR ROSE ANN VUICH
Chair, Banking and
Commerce Committee

Elisabeth Kersten

ELISABETH KERSTEN
Director, Senate Office of Research

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INTRODUCTION

The growth of international trade in the postwar period has been both phenomenal and pervasive. Consider the following highlights:

- Thirty-five years ago, imports and exports totalled only 10% of our GNP. Today the figure is over twice that, down slightly from a 1980 peak of 25%.

- Over 6 million U.S. workers owe their jobs to exports. If we include port workers and others whose jobs depend upon imports, international trade may account for 10 million jobs in this country.

- In California, 25% of farm production is sold to foreign buyers, and the state's leading industries -- aerospace, computers, and semiconductors -- are almost synonymous with international markets.

The growth in trade not only affects us as workers and producers, but as consumers as well. Indeed, it would be hard to imagine what life would be like today without imports, from the clothes we wear to the cars we drive, from the beer we drink to the televisions we watch.

But today's news is not a testimonial of the postwar growth in international trade and the role that trade has played in raising the world's standard of living. On the contrary, record deficits, unfair trade barriers, increasing international competition, declining industries, and trade-related unemployment dominate the headlines.

The reasons that trade has become an area of problems rather than opportunities are not difficult to find. The recent worldwide recession, growing international debt burdens -- especially in Latin America, lingering adjustment problems related to the oil shocks of the 1970s, and -- for the U.S. at least -- a dollar that is by all accounts severely overvalued, have all contributed to the current turmoil.

Where will this lead us? Many analysts are concerned that growing trade tensions will be manifested in additional protectionist efforts, moves which will begin to undo nearly 40 years worth of progress toward the goal of free trade among all nations. Other observers are more sanguine, believing that the world's current trade problems are temporary and surmountable.

The answer to this question, despite its importance, is really beyond the scope of the report. The purpose of this paper is much more modest and basically twofold. First, it is to assess the current status of our international trade performance at both the national level and in California. The second purpose is to review the growing role that individual states are assuming with respect to trade activities, including state trade programs, and legislation. The emphasis, naturally enough, is on California's trade programs and legislation.

CHAPTER II:

THE U.S. TRADE PICTURE

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Although the current economic recovery is approaching the end of its second year, there is scant evidence that it has reached the international sector of the U.S. economy. Indeed, each passing month seems to bring the announcement of another new record U.S. trade deficit. In 1983, the U.S. merchandise trade deficit reached $61.1 billion, nearly twice the previous year's record (see Table 1). The cumulative deficit for the first seven months of 1984 has already eclipsed the 1983 mark, and most forecasters -- including Secretary of Commerce Malcolm Baldrige -- are projecting full-year deficits well over $100 billion for both 1984 and 1985.

Some commentators are quick to point out that a deficit in the U.S. merchandise trade account is typical and no particular cause for alarm. Indeed, one must go back to 1975 to find a positive balance. During most years the U.S. runs a surplus in services trade which more than offsets the merchandise deficit. For example, the U.S. ran a surplus on trade in services in 1983 of almost $54 billion. The primary sources of this surplus are earnings from U.S. investments abroad and earnings from services provided by U.S. banks, insurance companies, engineers, lawyers, and so forth.

Table 1

U.S. FOREIGN TRADE 1960-1983
(in billions of dollars)

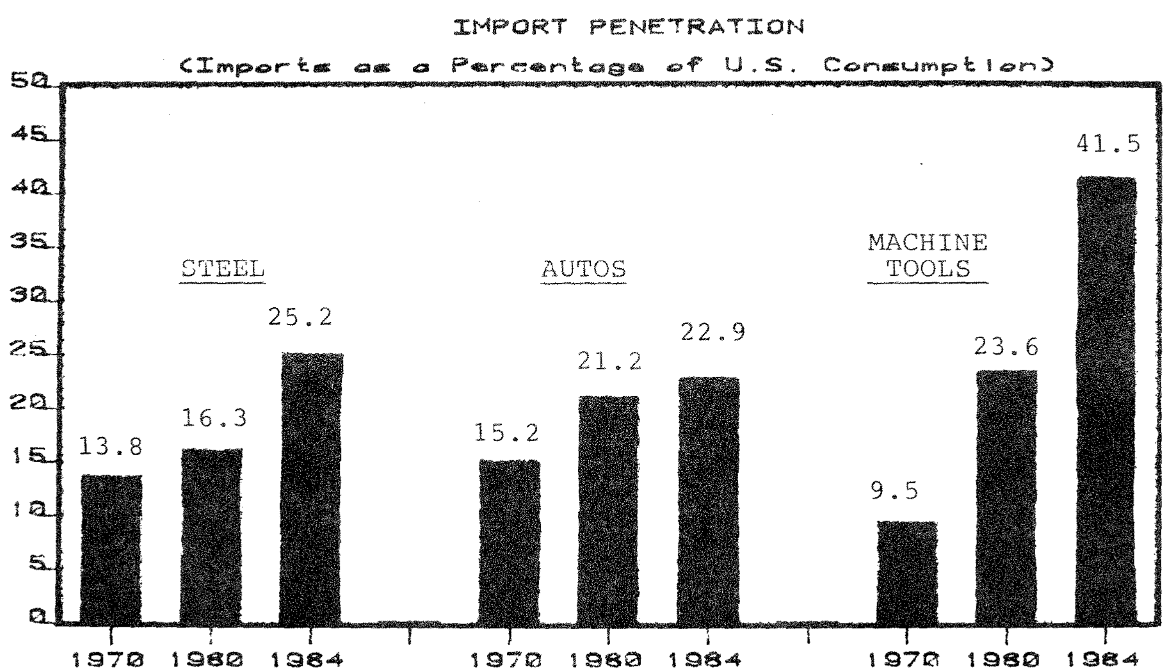
	EXPORTS		IMPORTS		BALANCE OF TRADE		
YEAR	MERCHANDISE	GOODS AND SERVICES	MERCHANDISE	GOODS AND SERVICES	MERCHANDISE TRADE	GOODS AND SERVICES	CURRENT ACCOUNT
1960	$ 19.7	$ 28.9	$ 14.8	$ 23.7	$ 4.9	$ 5.1	$ 2.8
1965	26.5	41.1	21.5	32.8	5.0	8.3	5.4
1970	42.5	65.7	39.9	60.1	2.6	5.6	2.3
1975	107.1	155.7	98.2	133.0	8.9	22.7	18.1
1976	114.7	171.6	124.2	162.4	- 9.5	9.2	4.2
1977	120.8	184.3	151.9	194.2	-31.1	- 9.9	-14.5
1978	142.1	220.0	176.0	230.3	-34.0	-10.3	-15.4
1979	184.5	286.8	212.0	282.1	-27.6	4.7	- 1.0
1980	224.3	342.5	249.8	333.5	-25.5	9.0	1.9
1981	237.1	375.7	265.1	362.6	-28.0	13.1	6.3
1982	211.2	349.4	247.1	350.6	-36.5	- 1.1	- 9.2
1983	200.3	332.2	261.3	365.1	-61.1	-32.9	-41.6

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, June, 1984, pp. 42-43.

A broader and more appropriate measure of our international performance is the current account balance[1] which includes trade in merchandise and services plus inter-country transfers. As the final column in Table 1 demonstrates, however, record deficits are being reached in this measure as well. The 1983 current account deficit of $41.6 billion was not only a record, it was nearly equal to the total of the previous six current account deficits the U.S. has run since 1960.[2] Forecasters are also projecting 1984 and 1985 current account deficits of more than $100 billion.

Behind these figures are others which more directly illustrate the reasons that trade analysts are alarmed at the growing trade deficits. Foremost among them is the loss of jobs that such deficits entail. According to estimates by Data Resources, Inc., a leading economic forecasting service, the shift in trade has cost three million American jobs overall since 1980.[3] The employment losses have been particularly severe in several of the more traditional, blue collar industries such as steel, autos, and machine tools. As Chart 1 shows, imports have been gaining larger and larger shares of the U.S. market for these products with a resultant shift in jobs to other countries. But for the acceptance of voluntary auto import quotas by the Japanese, the import penetration figures for autos and unemployment rates among auto workers would be considerably worse.

Chart 1



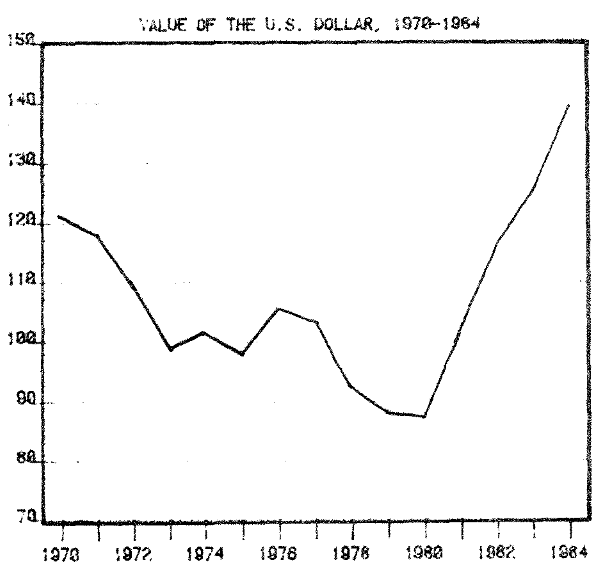
Source: New York Times, September 23, 1984

The trade deficits not only signify employment declines, they also represent a loss of income and hardship for U.S. firms and industries which are dependent upon exports or which must compete with the growing imports of foreign goods. While no separate figures exist to measure the hardship such as the rate of bankruptcies among export-related firms, we can gain some sense of the difficulty from the export figures in Table 1. Merchandise exports peaked at $237 billion in 1981 and have since fallen by nearly 16%. Goods and services exports are down nearly 12% from their 1981 high. The good news is that exports are not expected to decline further in 1984 although the benefits will come too late for many firms. The failure of these firms and the international trading expertise they represent is an economic loss that will prolong the trade deficits when, and if, U.S. export markets begin to recover.

Three major economic developments account for the bulk of the recent declines in the U.S. balance of trade. First and foremost is the loss of price competitiveness that has occurred as the value of the dollar has appreciated vis-a-vis other currencies. A second factor is differential growth rates; the recovery from the latest worldwide recession has been relatively stronger and has come earlier in the U.S. than in most other nations. A final reason is related to the international debt problems which have been particularly troublesome for Latin American countries.

The Rising Dollar

Chart 2



Source: Federal Reserve Bulletin[4]

The key factor explaining the growth in the U.S. trade deficit has been the rising value of the dollar. As shown in Chart 2, the dollar generally declined in value over the 1970s, ending the decade nearly 30% below its 1970 value. Beginning in 1980, however, the dollar reversed its downward drift and quickly shot to new heights, climbing nearly 60% in value in nominal terms. Even in real terms, that is after correcting for inflation, the dollar's rise has been almost as dramatic.[5] Just as the dollar has risen in value, foreign currencies have become less expensive. As a result, the cost of foreign-made goods has plummeted, and Americans have shifted their purchases in favor of more imports. Similarly, the cost of U.S. exports has risen sharply, thereby pricing U.S.-made goods out of many foreign markets. According to the President's Council of Economic Advisors, the resulting shifts in import and export sales account for $54 billion of the anticipated 1984 trade deficit.

What explains the dramatic climb in the value of the dollar since the late 1970s? Most analysts single out the high level of U.S. interest rates (in particular, real interest rates) versus those of the rest of the world. Foreign investors have been induced to place their funds in U.S. banks, securities, and other dollar-denominated assets in order to earn the higher available returns. The resulting strong demand for U.S. dollars has pushed its value to record highs. A second factor accounting for the rising dollar is a decline in the expected rate of inflation in the U.S. As the actual U.S. rate of inflation has fallen below that of other major currencies, investors have shifted back to the now more relatively stable U.S. dollar. Another related reason is the so-called "safe haven" argument. Proponents of this view contend that, as a result of increasing international economic and political turmoil, investors have moved greater volumes of funds into U.S. assets, which are perceived to be less risky.

Timing of Business Cycles

A second major cause of the worsening U.S. trade performance is due to a difference in timing between the business cycles of the U.S. and its major trading partners. The current economic recovery began earlier and has been notably stronger in the U.S. than in other industrial countries. In 1983, for example, real gross national product increased nearly 5% in the U.S., compared to 1% for Europe, 3.8% for Canada, and 2% for Japan. As a result, U.S. imports, which depend directly upon U.S. income, have been growing rapidly. On the other hand, our exports, which are a function of the economic health of our trading partners, have been declining. Estimates by the Council of Economic Advisors suggest that this difference in business cycles will account for $20 billion of the deteriorating U.S. trade balance in 1984.

International Debt Problems

The third major factor behind the record U.S. trade deficits is the high level of international debt and the attendant financing problems that have plagued many nations, particularly in Latin America. These countries have been forced to reduce their imports (and increase their exports) in order to earn the foreign exchange required to meet their external debt obligations. Since the United States is the primary source of imports into many of these nations, U.S. exports have borne the brunt of these adjustments. Exports of farm and construction machinery have been particularly hard-hit.

As Table 2 illustrates, the trade surplus the U.S. enjoyed with Latin America in 1981 disappeared and reemerged as a $16.3 billion deficit in 1983, a negative swing of $20 billion in just two years. Mexico accounted for $12.1 billion of that amount. Dramatic swings between 1981 and 1983 also took place in trade with Europe (minus $11.3 billion) and Canada (minus $8.3 billion). Interestingly enough, the trade deficit with Japan increased by only $3.8 billion. And, had it not been for a decline in oil imports and oil prices, the Nation's trade deficit would have been worse. The U.S. trade deficit with OPEC nations improved by $18.8 billion over the same period.

Table 2

U.S. TRADE BALANCES BY COUNTRY, 1980-83

(in millions of dollars)

COUNTRY	1980	1981	1982	1983
TOTAL	$-25,512	$-28,001	$-36,469	$-61,055
Canada	-1,277	-2,242	-9,323	-10,546
Western Europe	20,348	12,235	6,793	981
United Kingdom	2,970	-263	-2,352	-2,008
Germany	-243	-887	-2,689	-4,284
Japan	-10,411	-15,802	-16,991	-19,630
Latin America	1,319	3,705	-5,407	-16,286
Brazil	566	-691	-1,362	-2,403
Mexico	2,647	4,440	-3,820	-7,693
Venezuela	-740	-122	431	-2,237
OPEC Members (includes Venezuela and Ecuador)	-38,234	-28,837	-10,866	-10,036

SOURCE: Survey of Current Business, U.S. Department of Commerce, Bureau of Economic Analysis, June 1984.

CHAPTER III:

CALIFORNIA'S TRADE PERFORMANCE

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International trade is clearly one of the most important sectors of the California economy. Consider the following highlights:[8]

- International transactions account for around 17% of California's Gross State Product.
- On the average, 25% of California's farm production is exported to other nations, accounting for approximately 64,000 jobs in 1981.
- California leads the nation in the number of manufacturing jobs which are tied to exporting (526,500 jobs in 1981).
- 75,000 California jobs are due to international tourism (1981).
- International trade, including employment related to trade in services and to imports (e.g., port activities), accounts for one out of every ten jobs in California.

California's trade deficits have moved in tandem with overall U.S. trade deficits during the past few years. Following four years of steady improvement, California's trade balance plunged to a $-3.5 billion in 1982 and reached a staggering $-8.6 billion in 1983 (see Table 3). The only notable difference between California and the U.S. is that California's export shipments rose in nominal (i.e., actual dollar) terms in 1983, although they remain below their 1981 peak. The deficit doubled primarily because imports surged by 16.5% last year.

It should be stressed that the data in Table 3 measure merchandise trade through the state's three Customs Districts. There are no available figures for trade in services or military hardware, both of which are important to California. As a result, we do not know if California runs a surplus or a deficit on its overall trade.

A second caveat relates to the use of Customs District shipments as the basis for measuring California's trade. Coal from Utah that is shipped to Japan through the Port of Los Angeles is counted as a California export. Likewise, Japanese autos imported through Los Angeles and sold in Las Vegas are treated as a California import. As a result, the Customs data do not provide an accurate picture of the volume of exports originating in nor the volume of imports destined for California. While this is less of a problem in the overall trade figures, it becomes critical when examining trade between California and specific countries or trade in specific commodities.

Table 3

CALIFORNIA TRADE, 1960-1983
(in billions of dollars)

YEAR	EXPORTS	IMPORTS	BALANCE	TOTAL
1960	$ 1.4	$ 1.3	$ .1	$ 2.6
1965	1.5	1.9	- .4	3.4
1970	4.2	4.4	- .2	8.7
1975	10.3	11.7	-1.4	22.1
1976	11.5	15.3	-3.8	26.8
1977	12.2	19.1	-6.9	31.3
1978	14.9	21.5	-6.6	36.4
1979	20.3	24.9	-4.6	45.2
1980	26.8	29.4	-2.6	56.2
1981	30.0	31.7	-1.7	61.7
1982	29.1	32.6	-3.5	61.7
1983	29.4	37.9	-8.6	67.3

Source: Security Pacific National Bank -- International Trade Databank; U.S. Department of Commerce.

California's Place in International Markets

Not surprisingly, California ranks first among the 50 states in terms of international trade volume. Its position reflects the size of the state's economy (it is the 7th or 8th largest economy in the world);[9] its location as the gateway to the Pacific Basin, the most rapidly developing region of the world; and its economic mix. Numerous California industries and products, from almonds to walnuts and aircraft to telecommunications equipment, are heavily dependent upon healthy export markets for their success.

The state's leadership position is apparent in both manufactured goods and agricultural commodities (as it would probably also be in services if such data were available). California leads the nation in the export of manufactured products, accounting for 11.4% of the U.S. total. A recent study by the U.S. Department of Commerce shows that in 1981, the latest year for which such data are available, California's manufactured exports reached $18.8 billion, more than twice the level in 1977 and 61% higher than runner-up Texas (see Table 4).[10]

Table 4

MANUFACTURED EXPORTS BY STATE

(in billions of dollars)

RANK 1981	STATE	EXPORTS 1977	EXPORTS 1981	% CHANGE 1977-81	% PRODUCTION[1]	% EMPLOYMENT[2]
1.	California	$ 9.1	$18.8	106%	14.2%	14.5%
2.	Texas	5.4	11.7	117	12.5	12.7
3.	Illinois	6.3	10.4	64	13.4	12.9
4.	Ohio	6.0	10.4	72	14.8	14.7
5.	Michigan	6.9	10.3	48	14.7	14.6
6.	New York	5.8	10.2	74	12.7	11.4
7.	Washington	2.8	9.0	222	29.2	26.3
8.	Pennsylvania	4.7	8.1	72	13.4	13.2
9.	Massachusetts	2.3	5.1	121	15.4	14.2
10.	Indiana	2.9	5.0	70	13.7	13.3
	U.S. TOTAL	**$85.8**	**$164.3**	**91%**	**13.4%**	**12.8%**

[1] Export-related manufactures as percent of state manufacturing production.

[2] Export-related manufacturing employment as percent of manufacturing employment.

Source: U.S. Department of Commerce, Business America, February 6, 1984, p.12.

Although California leads the country in agricultural production, it is not the leading exporter of agricultural commodities. According to the U.S. Department of Agriculture, the leading agricultural exporting states in 1983 and the value of their farm exports (in billions of dollars) were:

1.	Illinois	$2.9
2.	Iowa	2.8
3.	California	2.5
4.	Kansas	1.8
5.	Minnesota	1.8
6.	Nebraska	1.8
7.	Texas	1.6
8.	Indiana	1.5

It should be noted that these figures are based on "production shares". The U.S. Department of Agriculture does not directly measure exports, but rather estimates each state's exports based on that state's share of U.S. production and the share of U.S.

production that is exported. This approach yields an estimate for California's agricultural exports that is 24% less than the $3.05 billion reported by the California Department of Food and Agriculture (CDFA). CDFA's more rigorous estimation procedure is based on port declarations and information provided by commodity groups, exporters, and the Canadian government. While CDFA's estimate is undoubtedly more accurate, we cannot conclude that California leads the states in agricultural exporting in the absence of applying similar estimation procedures to the other states.

Nonetheless, it is clear that California ranks among the top three exporting states. Moreover, California leads the nation in the number of commodities for which it is the leading export state. For example, California accounts for 100% of the U.S. exports of 11 commodities -- almonds, apricots, dates, figs, olives, pistachios, prunes, walnuts, garlic, cauliflower, and Ladino clover seed. In total, there are 28 crops for which California accounts for more than half of the nation's exports.

Table 5

CALIFORNIA AGRICULTURAL EXPORTS, 1982-1983

(in millions of dollars)

RANK 1983	AGRICULTURAL COMMODITY	VALUE OF EXPORTS 1982	VALUE OF EXPORTS 1983	PERCENT CHANGE 1981-82	PERCENT CHANGE 1982-83
1.	Cotton	$ 897.0	$ 859.0	- 9%	- 4%
2.	Almonds	236.3	243.2	-23	+ 3
3.	Oranges	194.2	241.7	- 5	+25
4.	Grapes	245.5	212.8	- 6	-13
5.	Rice	111.1	150.6	-65	+36
6.	Lemons	82.2	95.3	-11	+16
7.	Beef	91.0	75.5	+ 5	-17
8.	Wheat	218.5	72.9	-31	-67
9.	Prunes	71.4	66.8	0	- 6
10.	Peaches	59.9	53.2	-19	-11
11.	Walnuts	77.8	48.3	-12	-38
12.	Alfalfa	32.2	48.2	- 6	+50
13.	Dairy	38.0	46.4	- 2	+22
14.	Tomatoes	45.2	40.1	-11	-11
15.	Lettuce	39.4	37.2	+ 7	- 5
16.	Onions	29.8	28.8	-30	- 3
17.	Strawberries	21.2	28.7	+64	+26
18.	Celery	15.5	22.4	+ 8	+44
19.	Dry Beans	36.0	19.9	-21	-45
20.	Cottonseed	47.7	19.6	-12	-56
	All other	742.6	642.6	NA	-13
TOTAL		$3,332.4	$3,053.2	-21%	- 8%

SOURCE: California Department of Food and Agriculture Crop and Livestock Reporting Service.

Declining Farm Exports

Nowhere in the trade statistics do we see the impact of the appreciating dollar and the worldwide recession as clearly as we do in California's farm exports. The value of our exports dropped 21% in 1982, the first such recorded drop since the Crop and Livestock Reporting Service began collecting these figures in 1975. Farm exports declined another 8% in 1983 and little, if any, improvement is expected in 1984's numbers.

Table 5 lists California's top 20 agricultural export commodities and illustrates the deep and pervasive losses in export markets that have occurred in the last five years. Ten of the commodities suffered successive declines in export sales, while only two -- strawberries and celery -- showed increases for both years.

California's Leading Trade Partners and Products

Although California's farm exports are critical to the state's agricultural sector, manufactured commodities, particularly high technology products, dominate the state's top export categories. Table 6 lists the state's leading exports for 1983. Machinery and mechanical equipment head the list with $6.4 billion in exports. Automatic data processing equipment and office machinery comprise 25% of this category. Electrical machinery and equipment exports reached $5.3 billion, of which 60% was electronic tubes, photocells and transistors and 36% was related to semiconductors. Aircraft came in third with $2.3 billion in exports.

Table 6

CALIFORNIA'S PRINCIPAL EXPORTS - 1983

(in billions of dollars)

1.	Machinery and Mechanical Equipment	$ 6.4
2.	Electrical Machinery and Equipment	5.3
3.	Aircraft and Spacecraft	2.3
4.	Opticals, Scientific Instruments, and Photographic Equipment	2.2
5.	Petroleum and Natural Gas	1.3
6.	Other	11.9
	TOTAL	$29.4

SOURCE: International Trade Databank, Security Pacific Bank

Table 7

CALIFORNIA'S PRINCIPAL IMPORTS - 1983
(in billions of dollars)

1.	Electrical Machinery and Equipment	$ 9.2
2.	Motor Vehicles	5.6
3.	Machinery and Mechanical Equipment	5.4
4.	Apparel	2.0
5.	Petroleum and Natural Gas	1.8
6.	Opticals, Scientific Instruments, and Photographic Equipment	1.5
7.	Firearms, Sporting Goods and Toys	1.0
8.	Shoes, Hats, Gloves and Luggage	.9
9.	Other	10.5
	TOTAL	$37.9

SOURCE: International Trade Databank, Security Pacific Bank

On the import side, consumer goods dominate the leading import categories (see Table 7). Of the $37.9 billion of goods imported by California in 1983, motor vehicles, easily the most visible of foreign made products in California, accounted for $5.6 billion. However, electrical machinery and equipment led the list at $9.2 billion, with non-electrical machinery and equipment in third position. Other major consumer-oriented categories included apparel ($2.0 billion), firearms, sporting goods, and toys ($1.0 billion), and shoes, hats, gloves, and luggage ($900 million).

Given the leading categories of imports and exports, it is not surprising that Japan is easily California's top trading partner with nearly $22 billion in two-way trade (see Table 8). Although Canada is the leading trade partner for the U.S. as a whole, it is not among the top ten countries that trade with California, according to Census Bureau figures. As noted earlier, however, those figures are based on shipments through customs districts and are not always accurate. The extent of the inaccuracy is generally not known except in the case of Canada which gathers trade statistics on the basis of state of origin and destination. Official Canadian figures show that Canada was California's second leading trading partner with $5.5 billion in total trade (compared to $1.5 billion as shown by Census Bureau data).

Close on the heels of Canada are Taiwan and South Korea, followed by Hong Kong and Singapore. The dominance of the Asian nations in California's trade is perhaps more strikingly indicated by trade shares. Two-thirds of the total trade through California's custom districts is with Asian countries. If we include Australia and New Zealand, the total share increases to 72%. By comparison, Europe accounts for 14.3% of California trade, Canada 7.7%, and Latin America 5.5%.

Table 8

CALIFORNIA'S 10 LEADING TRADE PARTNERS - 1983

(in billions of dollars)

	COUNTRY	EXPORTS TO	IMPORTS FROM	TOTAL TRADE
1.	Japan	$6.9	$15.0	$21.9
2.	Canada	2.7	2.8	5.5
3.	Taiwan	1.6	3.9	5.5
4.	South Korea	2.7	2.6	5.3
5.	Hong Kong	1.3	1.9	3.2
6.	Singapore	2.0	1.2	3.2
7.	West Germany	1.0	1.6	2.6
8.	Australia	2.1	1.4	2.5
9.	Malaysia	1.2	1.1	2.3
10.	Mexico	1.1	1.1	2.2

Note: Ranking based on total trade.

SOURCES: International Trade Databank, Security Pacific National Bank, Canadian Consulate General

CHAPTER IV:

STATE TRADE PROGRAMS

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Overview

The federal government dominates public involvement in international commerce both because of its constitutional mandate and by virtue of the trade programs it has established. Nonetheless, individual states have begun to play a more active role in trade programs for a variety of reasons. One reason is apparent in the trade statistics -- the export community has suffered a substantial loss of business during the recent worldwide recession and has turned increasingly to government at all levels for some assistance.

Domestic firms which are not export-oriented have also lost business as the result of growing imports, and management and labor have pursued legislative relief often in the form of protectionist measures. At the federal level, "voluntary" quotas for Japanese autos have been established (and renewed), and the Reagan Administration has agreed to seek similar restrictions on steel imports. At the state level, "Buy America" statutes have been enacted in a number of states. "Domestic content" legislation, which would require that a certain percentage of a product be made in the U.S., has been pursued at both the state and federal levels.

State governments, individually as well as collectively, have taken a number of steps toward more active participation in international trade. The National Conference of State Legislatures and the National Governors' Association have both established active international trade task forces to represent state trade interests in Washington. The Western Governors' Association has sponsored several meetings of governors and trade officials from the western states to develop trade policy positions and to communicate their common interests to federal officials. The National Association of State Development Agencies (NASDA) has received federal funding to provide technical assistance to state trade programs. Traditional state trade programs -- focusing on information and technical and marketing assistance for exporters -- have been created or expanded, and new functions have been added.

The major new area of activity for the states has been in the area of export finance. Some fifteen states have now created export finance programs to provide technical and financial assistance to help small exporters overcome one of the major obstacles they face in trying to compete in the international marketplace. Chapter V. has additional information on state export finance programs.

One area in which state governments have been particularly active during the past few years is in establishing foreign offices to pursue state trade interests. According to the latest NASDA survey, between 1981 and 1984, the number of states with foreign offices increased from 20 to 28, while the total number of foreign offices increased from 40 to 55. The offices were distributed as follows:

Western Europe	28
Japan	17
Canada	4
Other Asian	2
Mexico	2
Brazil	1
Africa	1

Budgets for the offices ranged from $94,000 to $901,000 on an annual basis, and the average staff size was 2.4 employees. Over half of the employees were foreign nationals.

While trade promotion is an important function of these offices, the NASDA survey found that it is not the most significant. Only seven of 39 foreign offices responding to a survey question about their activities reported spending 50% or more of their efforts on export promotion. Attracting foreign investment to the home state constitutes the most important activity. Tourism promotion is also an important function.

Growing interest in trade programs has also shown up at the local level. In California, for example, in 1982 the City of Los Angeles established the Los Angeles International Trade Development Corporation (LAITDC) as a nonprofit entity designed to boost exports from L.A. based firms and thereby expand local job opportunities. The LAITDC attempts to pool talent from successful export firms in the region and to share that expertise with new-to-export firms.

A Short History of California's Trade Efforts

For the most part, California has historically left trade promotion to the private sector.[12] Unlike New York and other states in the East and Midwest which maintain sizable foreign trade offices with large budgets, California's efforts have been relatively modest. The current state trade agency, the California State World Trade Commission, operates with an annual budget of less than $450,000. This is approximately the same amount that was budgeted for the Office of International Trade, the Commission's predecessor, during the late 70s and early 80s.

The State of New York, by comparison, maintains an Office of International Commerce in New York City with a staff of 32 and an annual budget close to $2 million. Moreover, New York operates overseas offices in London, Tokyo, and Frankfurt, Germany. California currently has no foreign offices and operates out of a single domestic office in Sacramento.

It was not always this way. Former Governor Edmund G. Brown, Sr., made foreign trade promotion one of his priorities and helped fund sizable world trade offices in Los Angeles and San Francisco. Brown also envisioned several overseas offices to promote trade and investment in California in such cities as Tokyo, Mexico City, London, Rome, Paris, and Frankfurt. In fact, one such office was opened in Frankfurt, Germany, toward the end of Brown's second term.

During the Reagan era, most of the state's foreign trade activities were shifted back to the business and trade communities in the private sector. In his first term, Reagan's austere budget proposals led to a substantial reduction in commerce and trade promotion functions, including the closing of the trade offices in San Francisco, Los Angeles, and Frankfurt, Germany. Later, Reagan turned over most economic development and trade functions to Lt. Governor Ed Reinecke by Executive Order. Reinecke, in turn, formed and headed a Commission for Economic Development to help stimulate investment and trade. In his second term, however, Reagan established a small Division of International Trade within a reorganized Commerce Department.

Governor Edmund G. Brown, Jr., chose not to revive his father's ambitious concept of an aggressive state role in foreign trade promotion. His first budget included only two positions in the Department of Commerce for a Division of International Trade with a total budget of $174,000. Subsequently, Brown reduced the budget appropriation for the Department of Commerce to zero, and the Department and the Division of International Trade were closed.

Following the decision of Dow Chemical not to locate a huge new petrochemical plant in the San Francisco Bay Area and growing criticism of Brown's alleged "anti-business" attitude, the Legislature passed, and Governor Brown signed, Senate Bill 28 (Chapter 345, 1977). The bill -- the "Holmdahl-Lockyer-Rains Act" -- established the Department of Economic and Business Development and, within it, an Office of International Trade. The trade office was opened in 1978 and located in Los Angeles. During the final year of its five-year life, the Office of International Trade had a staff of seven (including a director appointed by the governor and a deputy director) and an annual budget of $465,000 (of which $350,000 supported the office directly and $115,000 covered administrative and executive expenses by the Department of Economic and Business Development). The principal duties of the office were:

1. Gathering, evaluating, interpreting and publishing data on California's foreign trade;

2. Serving as a link with federal and state agencies and with private organizations engaged in international trade to expand California's trade volume;

3. Serving as a clearinghouse to process inquiries from foreign governments and potential customers, and providing technical assistance to California producers and manufacturers in developing overseas markets.

The California State World Trade Commission

Convinced that a more effective means of promoting international trade and investment in California could be achieved via a joint state/private, nonprofit entity, Speaker Willie L. Brown, Jr., introduced legislation (AB 3757) in April 1982 to abolish the Office of International Trade and replace it with a newly created California State World Trade Commission. The bill passed both houses of the Legislature by overwhelming margins and was signed into law by then Governor Jerry Brown on September 29, 1982.

The World Trade Commission represented a major departure from California's previous trade efforts in three respects. First, it elevated the trade function from that of a departmental office to a high-level commission involving three of the state's highest ranking elected officials. The Secretary of State is the chair, and the Governor and Lieutenant Governor are members. In addition, the President pro Tempore of the Senate and the Speaker of the Assembly each have two appointees to the 15-member Commission.

Second, the Commission was set up as a partnership of public and private trade interests. Twelve of the fifteen members are appointed from California's private international business community, including the four by the Legislature, three by the Governor, and five from the Advisory Council to the Commission. (The Advisory Council is made up of 20 to 40 members including 2 Senators, 2 Assemblymembers, and the directors of the departments of Food and Agriculture, Commerce, and Banking. The remaining members are appointed by the Commission and represent a broad cross-section of California industries and labor.) Appendix A includes a list of the current members of the World Trade Commission and the Advisory Council.

Finally, the Commission was established as a nonprofit corporation, rather than a state agency, in order to facilitate the gathering and use of private funds to promote trade with California.

Although AB 3757 went into effect January 1, 1983, the Commission got off to a slow start. By the Summer of 1983, after the requisite appointments to the Commission and the Advisory Council and the hiring of an executive director and staff, the Commission became operational. Its activities have also been limited by budget considerations. As a result of the state's fiscal difficulties, the Commission's first full-year budget was reduced from a proposed $465,000 (the amount that had been budgeted for the

Office of International Trade) to $417,000. In the 1984-85 fiscal year, the appropriation was increased by 6 percent to $443,000.

Given the limited budget and resources of the Commission, it has necessarily had to restrict its activities to a few areas. The principal focus has been on trade policy, while trade promotion has also received considerable attention. Third on the list of Commission priorities has been "networking", i.e., providing information and technical assistance to individual firms in conjunction with other international trade association and public trade agencies.

The Commission's emphasis on trade policy has stemmed from the recognition that the federal government dominates the international arena through treaty negotiations, legislation, programs (such as the International Trade Administration and the U.S. Export-Import Bank), and administrative/judicial proceedings (such as the International Trade Commission). The World Trade Commission has opted to use its limited resources to influence the federal administration and the Congress in behalf of the interests of California's international trade community. And, as the foreign trade deficit has mounted, the number of trade issues under consideration in Washington has mounted. Some of those which have received the attention of the Commission are the renewal of the Export Administration Act, the Generalized System of Preferences, the proposed Israel Free Trade Area, and domestic content legislation. A more complete list of the issues and a synopsis of recent Commission activities is included in Appendix B.

In the area of trade promotion, the Commission has also been quite active. In the Spring of 1984, the Commission co-sponsored a trade promotion, trade-investment mission to Japan with the California Department of Commerce (formerly the Department of Economic and Business Development). Forty-seven California companies and 30 Japanese agents of California products exhibited everything from nuts to computers at the "Greater California Exposition," which drew 30,000 Japanese visitors.

The trade-investment mission was actually comprised of two distinct but overlapping delegations, one for business and the other representing agriculture. The former included Senator Rose Ann Vuich, Gregory Mignano (Executive Director of the Commission), and Kirk West (Secretary of Business, Transportation and Housing). The business delegation was interested in discussing a number of economic issues and attracting Japanese overseas investment to California. Meetings were held with several Japanese banks, business organizations, and government agencies, including the Ministry of International Trade and Industry.

The agricultural delegation included Senator Vuich, Assemblyman Sam Farr, Clare Berryhill (Director, Department of Food and Agriculture), Gregory Mignano, and private representatives from California's major agricultural associations. The delegation discussed several California-Japan agricultural trade problems including market access, codling moth infestation of nectarines, and wine tariffs. The group met with U.S. Embassy officials, the Vice-Minister of Agriculture, the Executive Director of ZENCHU[13] -- the Agricultural Cooperative Association -- and others.

Building on the success of the Great California Exhibition, the Commission has undertaken a number of other trade promotion ventures this year. A California Pavilion was established at the Summer Olympics in conjunction with the Office of Tourism to promote trade and tourism in California. A trade mission visited South Korea in late September and participated in the Seoul International Trade Fair (SITRA '84) which drew nearly two million visitors. And a promotional packet and brochure were prepared to help the Commission advertise the state's goods, services, and investment opportunities.

CHAPTER V:

STATE AND FEDERAL TRADE LEGISLATION

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A. California Legislation

The growing importance of international commerce has been evident in the Legislature as well as the executive branch in California.* At the same time Speaker Brown was carrying legislation to establish the World Trade Commission, the President pro Tempore of the Senate, David Roberti, was putting together plans for a major trade conference. Held at UCLA in November 1982, the Senate Conference on International Trade brought together 200 international business leaders and 30 California legislators to discuss a wide range of trade issues and potential solutions.

Two other recent examples of the Legislature's increasing concern with trade issues are the formation of the Assembly Select Committee on International Trade, Investment, and Tourism, chaired by Assemblywoman Lucy Killea, and the appointment of a full-time staff economist in the Senate Office of Research to handle the Senate's growing workload in trade issues. The most telling evidence, however, is in the volume of trade-related legislation that has been introduced in recent years. The balance of this section provides a synopsis of the major trade issues and bills that came before the Legislature during the 1983-84 Session.

Export Finance

At the 1982 Senate Conference on International Trade, a great deal of discussion centered on the problems that exporters -- especially small- and medium-sized firms -- face in obtaining the financing necessary to move their products to foreign buyers. It was pointed out that other nations provide much more elaborate and extensive financing than the U.S., giving foreign-based exporters a substantial advantage over U.S. exporters. The U.S. Export-Import Bank (Eximbank), the major source of U.S. financial assistance to exporters, drew specific criticism for its failure to meet the needs of small- and medium-sized firms.

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*It should be noted that another arm of the executive branch -- the Lieutenant Governor's office has also become very involved in the trade arena. Lieutenant Governor Leo McCarthy has been one of the more active members of the World Trade Commission. In addition, the California State Economic Development Commission, which he chairs, has retained a staff consultant for trade and in March 1984 began publishing "The California Economic Development and Trade Update," a newsletter emphasizing trade issues important to California.

Three major developments related to export financing have occurred since the Senate trade conference. First, more than 25 states have passed, introduced or are studying legislation to establish state export finance programs. Secondly, in rechartering Eximbank in late 1983, Congress directed Eximbank to begin working with and through state export finance programs in order to improve its effectiveness with the small- and medium-sized export community. Finally, the International Trade Administration of the U.S. Department of Commerce began gathering and disseminating information and providing general assistance in the development of state export finance programs. This included the sponsoring of the only major study of export financing in the U.S. and the potential role of the states -- a six-volume, $100,000 study prepared by First Washington Associates of Washington, D.C.

In California, three bills -- SB 1196, AB 1625, and AB 2000 -- were introduced in the 1983-84 Session to establish a state export finance program. AB 2000 (W. Brown) was introduced as a spot bill but was never scheduled for hearing. The Speaker subsequently joined Assemblyman Sam Farr as one of the two principal Assembly coauthors of SB 1196. The second export finance bill, AB 1625 (Elder), which failed in committee, would have provided up to $1 billion in bond financing to California exporters. The third measure, SB 1196, was introduced by Senator Rose Ann Vuich with Senator Roberti as the principal coauthor. It passed the Assembly 58 to 19 and the Senate 28 to 2 (and subsequently passed the Senate 39 to 0 in a concurrence vote), and was signed into law by Governor Deukmejian on September 30, 1984. A summary of this major piece of legislation follows.

<u>SB 1196 (Vuich)</u> - Effective January 1, 1985, SB 1196 establishes an Export Finance Office within the California State World Trade Commission to work with the Export Import Bank of the United States and other public and private financial institutions and agencies with the goal of expanding exports of California goods and services.

The Office will operate under the general guidance of the California Export Finance Board, which will be comprised of seven members: two exporters (one to be appointed by the World Trade Commission, the other by the Speaker of the Assembly), two representatives of financial institutions (one to be appointed by the World Trade Commission, the other by the President pro Tempore of the Senate), the Director of Food and Agriculture, the Director of the Office of Small Business Development, and an agricultural representative to be appointed by the Governor.

The basic functions of the office are to provide:

(1) technical assistance and information to California exporters to help them locate and secure export financing from private

banks, Eximbank, SBA, and other organizations. Training for the staff will be provided in part by Eximbank.

(2) insurance and/or loan guarantees for exporters to help them qualify for export financing. Insurance will presumably be arranged through a blanket policy obtained by the state from a private insurer.

SB 1196 contained a one-time $10 million appropriation for the program: $250,000 for administrative costs of the program for the last half of the 1984-85 fiscal year, and the balance ($9.75 million) to serve as reserves for any insurance or loan guarantees extended by the Board. Any such insurance or guarantees will have to be secured by no less than a 25% reserve in the Export Finance Fund. In signing the bill, however, the Governor reduced the $9.75 million appropriation in the reserve fund to $2 million. He left the $250,000 appropriation for operating expenses intact.

Unitary Method (Unitary Tax)

Although not a tax, the term "unitary tax" is commonly used to describe the method by which California and several other states determine what share of a multijurisdictional corporation's net income is subject to the state corporate income tax. As such, it is more appropriate to call it the unitary method. While technically not an international trade topic, the unitary method is the single most important international business issue facing the State of California. Numerous foreign consulates and foreign-based corporations have repeatedly urged the state to modify its current unitary methodology. Every attempt at discussing trade issues between California and foreign representatives begins and ends on the unitary question. As a result, it is impossible to separate the unitary issue from the more conventional international trade issues.

In California, legislation to repeal or modify the unitary method has been introduced every year for the past six years. To date, all the bills have failed either because of the potential revenue loss to the state or because of opposition to proposals which domestic-based multinational corporations felt were to be biased in favor of their foreign counterparts.

The 1983-84 Session of the California Legislature was no exception, although two changes were significant. First, the number of unitary bills increased dramatically. More than a dozen bills were introduced to modify or abolish the unitary tax. Second, the Governor announced his support for a new variation on the abolish-the-unitary-tax theme, which was subsequently embodied in SB 1437 by Senator Alfred E. Alquist, Chairman of the Senate Finance Committee. The Governor's proposal was based on one of the recommendations of President Reagan's Worldwide Unitary Taxation Working Group, of which the Governor was a member. Despite the interest in the Deukmejian-Alquist proposal, the bill failed in the Assembly as the result of opposition from domestic-based corporations which objected to the bill's treatment of dividends. A summary of the Alquist legislation and three other major unitary bills from the 1983-84 Session follows.

SB 1437 (Alquist) - This bill embodied the Governor's proposal to allow firms to elect between the present method of worldwide combined reporting and a comprehensive water's edge combined reporting with full taxation of foreign source dividends. It also included requirements for increased federal auditing to assist California in administering the Water's edge option. The projected revenue loss to the state was $270 million for the first full year it would have been in effect. The bill passed the Senate but failed to get a hearing in the Assembly Revenue and Taxation Committee. The provisions of the bill, with some modifications, were then amended into the conference committee report on another bill, SB 2083 (Lockyer), which was never adopted.

SB 1937 (Nielsen) - This bill was also based on the Governor's proposal, although it allowed for an exclusion for dividends paid by foreign subsidiaries of U.S. corporations to U.S. parent corporations. As a result, the bill would have entailed a substantially greater revenue loss to the state than SB 1437. According to estimates by the Franchise Tax Board, the state's revenue loss would run $400 to $600 million per year initially. Concern over the potential revenue loss caused the bill to fail passage in the Senate Revenue and Taxation Committee.

AB 2414 (Hughes) - This bill was substantially amended to reflect the "Illinois approach", providing a less comprehensive water's edge method than that proposed in SB 1437, with an exclusion of foreign source dividends. The annual revenue loss was estimated at $500 million. The bill failed in the Assembly Revenue and Taxation Committee.

AB 2415 (Hughes) - As introduced, this bill would have excluded foreign-based multinational corporations from California's unitary method, except for corporations involved in energy or the ownership of agricultural land, and would have cost the state $50 million per year initially. Similar bills by Assemblywoman Hughes passed the Assembly in 1980 and 1982 but failed in the Senate. During the last days of the 1983-84 Session. AB 2415 was substantially amended in the Assembly Ways and Means Committee to include the provisions of SB 1437 (Alquist), but this version died on the Assembly Floor.

Export Trade

Two bills and three resolutions specifically designed to enhance the export of California products were introduced in the 1983-84 session. All five measures passed the Legislature, although the Governor vetoed one of the bills, SB 1884. The measures were:

SB 1884 (Garamendi; Principal Senate Coauthor, Roberti; Principal Assembly Coauthor, Naylor) - This bill directed the California Energy Commission, in coordination with the World Trade Commission, to provide information and technical assistance to alternative energy firms, particularly small- and medium-sized firms, in order to facilitate their export efforts. $200,000 was appropriated from the Energy Resources Account, including $50,000 for the World Trade Commission, for the purposes of this act. The measure was vetoed by Governor Deukmejian.

AJR 146 (Killea; Principal Coauthor Senator Vuich) - This resolution memorialized the President, the U.S. Congress, the U.S. Department of Commerce, and the U.S. Treasury to initiate measures to locate additional regional export licensing offices, including one in California, in order to facilitate the rapid processing of export licensing applications. It passed (Resolution Chapter 139, Statutes of 1984).

ACR 48 (Johnston; Principal coauthor, Senator Vuich) - This measure requested the California State World Trade Commission to make the export of agricultural products one of its highest priorities and to undertake other specified tasks relating to California agriculture. It passed (Resolution Chapter 108, Statutes of 1983).

AB 3313 (Moore; Coauthor Senator Vuich) - This bill requires the California State World Trade Commission to conduct a study of the feasibility and the desirability of establishing one or more overseas trade offices and appropriates $30,000 for said study. The bill passed and was signed into law (Chapter 1569, Statutes of 1984).

AJR 150 (Bradley and Killea) - This measure urges the U.S. Bureau of the Census to conduct a pilot project to improve the reporting of trade statistics, using a 3-digit zip code reporting system with California cities as subjects. The measure passed (Resolution Chapter 183, Statutes of 1984).

Market Access

There has been increasing interest in the problem of unequal access for U.S. exports to foreign markets compared to the relatively free access that foreign-made goods have to the U.S. marketplace. The difficulties have been particularly acute for specific industries such as wine and high technology products, both of vital importance to California's economy. The following three measures to encourage greater market access passed the Legislature this session:

SJR 41 (Mello; Principal coauthors Senator Vuich and Assemblyman Willie Brown) - This measure memorialized the President and the Congress to enact legislation to (1) achieve foreign market access for U.S. wines substantially equivalent to the market access that foreign wines enjoy in the U.S. and (2) provide the President with the authority and remedies to deal with trade barriers relating to wine. The measure had 53 coauthors and passed both houses of the Legislature without a dissenting vote (Resolution Chapter 26, Statutes of 1984).

AJR 3 (Konnyu) - This resolution memorialized the President and Congress to provide strong, prompt and decisive leadership to encourage trade by all nations and asked the federal government to insist that California's exports be granted reasonable access to foreign markets (Resolution Chapter 130, Statutes of 1983).

AJR 33 (Baker) - This measure recognized California's contributions to and dependence on international trade; memorialized Congress and the California delegation to support enactment of legislation reflecting the objectives of the International Trade and Investment Act; memorialized the President to seek trade agreements according U.S. exporters foreign market commercial opportunities commensurate with those enjoyed by foreign exporters in U.S. markets; and memorialized Congress to authorize the President to negotiate such agreements (Resolution Chapter 90, Statutes of 1983).

Import Trade

California's long-suffering automotive and steel industries suffered a near fatal blow during the past recession as imports took larger and larger shares of these markets. Not surprisingly, five measures were introduced to boost domestic production and employment in these industries at the expense of imports. A sixth measure to encourage a rollback in garment imports was also introduced. Only one of the bills was signed into law, but because the sales tax increase was never triggered, it never became effective. The other five bills all failed passage in the Legislature. The six import-related measures were:

AB 351 (Young) - This bill would have exempted from California's sales tax the gross receipts from the sale of new vehicles manufactured or assembled and sold in California. It died in the Assembly Revenue and Taxation Committee without being heard.

AB 596 (M. Waters) - This bill would have prohibited any state agency from entering into a contract for the purchase of a motorcycle unless the motorcycle was assembled in the U.S. or 75% of its parts were manufactured in the U.S. or both. The bill died in the Assembly Governmental Organization Committee.

SB 1260 (Robbins and B. Greene) - This bill would have allowed a tax credit of 1% of purchase price to a taxpayer who purchased a new passenger automobile, certain new trucks, or a new motorcycle during a specified period of time in which the rate on the state sales and use taxes was increased, if the eligible motor vehicle was manufactured or assembled and sold in this state. Although the bill passed (Chapter 1323, Statutes of 1983), it never became effective, because the sales tax increase never took effect.

SB 1261 (Robbins) - This bill would have provided a 1/2 of 1% bid advantage to California automotive manufacturing businesses participating in the bidding on state contracts, and would have required the Commission for Economic Development to study the subject of tax incentives for automotive manufacturing businesses in the state. It was vetoed by the Governor.

AB 2157 (Vicencia) - This bill would have required the Employment Training Panel to monitor the employment effects of prefabricated steel imports and would have imposed a $100 per ton surcharge on contractors using prefabricated steel imported from foreign sources. It died on the inactive file at the author's request.

SJR 25 (Montoya and Roberti) - This measure supported the International Ladies Garment Workers Union's efforts to reduce garment imports. The measure died in Senate Rules Committee.

Miscellaneous Trade

A number of other miscellaneous trade bills were introduced but failed to pass the Legislature during the 1983-84 Session:

AJR 35 (Baker) - This measure would have memorialized the President and the Congress to enact legislation which would authorize the U.S. Department of Justice to examine in advance plans by high technology industries for cooperative research and development and to certify those which the U.S. Attorney General determines are not likely to violate federal antitrust laws. It died in the Assembly Judiciary Committee without a hearing.

AB 808 (M. Waters) - This bill would have prohibited the investment of state funds in the stocks of any U.S.-based business doing business in or with South Africa. The measure died in the Assembly Finance and Insurance Committee.

AB 1694 (Katz, et al) - This bill would have required a business enterprise, which qualified as a committee for reporting purposes and made direct foreign investments or conducted a certain percentage of its business outside the U.S., to disclose additional specified information. The measure died in the Senate Elections and Reapportionment Committee.

ACR 115 (Moore) - This resolution would have directed the Legislative Analyst to undertake a study of long-term port development including the impact of regional port development on other ports and infrastructure and environmental and recreational consequences of port development. The measure died in the Assembly Utilities and Commerce Committee without being heard.

B. Federal Legislation

The focus of this report is on state trade programs and legislation. Nonetheless, since the federal government "sets the stage" for any involvement by the states in the international arena, the report would be incomplete without at least a cursory review of recent federal trade legislation.

The 98th Congress concluded in October after dealing with a wide range of trade-related issues and passing two major bills -- the Omnibus Trade Bill (H.R. 3398) and a budget deficit reduction bill, H.R. 4170, which replaced the major export incentive program (the Domestic International Sales Corporation or DISC) with a new one (the Foreign Sales Corporation or FSC). The former measure, H.R. 3398, consolidated several bills that were floating around the congress. However, a number of other important trade issues, such as the renewal of the Export Administration Act, the renewal of the Trade Adjustment Assistance program, and domestic content legislation, were not resolved and are expected to resurface in the 99th Congress. This summary is confined to the two measures which have been signed into law.

Omnibus Trade Bill (H.R. 3398)

Officially named the Trade and Tariff Act of 1984, H.R. 3398 consolidated several bills into one measure. Some of the principal features of the act are:

1. Generalized System of Preferences (GSP) Renewal

The GSP, which was scheduled to expire in January, 1985, is a system of tariff preferences granted by major industrial nations to imports from developing nations. The purpose of the program is to foster development of eligible "less developed countries" (LDCs).

H.R. 3398 extended the GSP for 8-1/2 years and incorporated several major changes in the program. To be eligible, recipient countries must honor U.S. intellectual property rights (e.g., copyrights) and provide certain worker protections. Footwear, handbags, luggage, work gloves, and leather flat goods and apparel have been added to the list of ineligible imports. Countries with per capita GNPs over $8,500 must be graduated out of the program. A two-year evaluation of the program will be conducted after which the President will be able to make changes in the GSP's product and country coverage.

2. U.S.-Israel Free Trade Area

At the request of the Administration, H.R. 3398 authorizes the President to negotiate tariff reductions and/or removal of tariffs and non-tariff trade barriers between Israel and the U.S. Any agreement will be subject to Congressional approval, although the bill provides for an expedited review of any deal worked out with Israel. The act also gives the President the authority to negotiate similar bilateral trade agreements with Canada and any other country seeking a free trade area with the U.S., again subject to Congressional approval.

3. California Wine Industry Relief

H.R. 3398 incorporated the so-called "Wine Equity Act," although the version adopted was considerably tamer than the original proposal. As adopted, the measure directs the President to negotiate with designated major trading countries in order to reduce trade barriers to U.S. (i.e., California) wine exports and to report to the congress. Originally, the bill would have required the President to impose trade barriers on the importation of wine from countries which discriminated against California wine exports.

In addition, H.R. 3398 redefined the domestic wine industry to include growers of wine grapes in order to allow those growers to file antidumping and countervailing duty petitions with the U.S. International Trade Commission. Earlier petitions filed by wine grape growers against European wine were denied because they were not considered to be part of the wine industry.

4. Reciprocity

The bill also incorporated the International Trade and Investment Act, giving the president more negotiating authority against foreign trade barriers involving trade in services and trade in high technology products. Services trade will not be covered by many of the same remedies that apply to unfair trade in goods. The act also authorized the President to negotiate lower tariffs on various high-tech products such as transistors, certain integrated circuits, etc. This last provision could be of special importance to California manufacturers.

Foreign Sales Corporations

Up until this year, the principal export incentive provided by the federal government was in the form of a tax break on foreign sales by so-called Domestic International Sales Corporations (DISCs). DISCs are essentially paper entities established by U.S. exporters to handle export sales of the parent corporation. U.S. law has allowed DISCs a tax break in the form of a long-term tax deferral on export profits earned by the DISCs.

For years, our trading partners complained that the DISC was an illegal tax subsidy and a violation of the General Agreement on Tariffs and Trade (GATT). Finally, in 1976, a panel of experts ruled that the DISC along with various tax subsidy export schemes used in several other countries were violations of the GATT. Subsequent negotiations to preserve the DISC scheme failed and the U.S. government agree to seek a DISC replacement that would conform to GATT requirements. These efforts culminated in the passage of the Foreign Sales Corporation Act of 1984 which was signed into law July 18, 1984.

A Foreign Sales Corporation (FSC) is a corporation that is set up in a foreign country on U.S. possession (excluding Puerto Rico) that has an eligible tax information sharing agreement with the U.S. Under the new law, a FSC is entitled to exempt from U.S. corporate taxation from 16% to 32% of the income earned from the lease or sale of export property. The FSC must conduct meetings of the board of directors and other management activities outside of the U.S. It must solicit, negotiate, or make the sales contracts offshore, and 50% of the total direct costs of sales promotion, transportation, processing, etc. must be incurred outside the U.S. Certain exceptions are provided for small FSCs.

The new legislation does allow the establishment of a DISC (or continuing an existing DISC) provided that certain conditions are met, primarily that a yearly interest charge based on the treasury bill rate is paid on the deferred taxes. The FSC Act also forgave the deferred tax liability accrued by DISCs prior to January 1, 1985. This provision was worth over $13 billion to the U.S. exporters which have operated DISCs since their 1971 inception.

CHAPTER VI:

TRADE OUTLOOK

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The consensus among economists is that the outlook for U.S. trade -- as measured by the trade balances -- is not very encouraging. Forecasts of merchandise trade deficits for 1984 and 1985 are typically in the $120 to $130 billion range, twice the 1983 level. Even the current account deficit is projected to reach $100 billion.

The principal factor behind the deteriorating trade balances will continue to be growing imports. Moreover, that side of our trade equation will be unlikely to benefit from the decline in oil imports that occurred in 1983. Last year non-oil imports rose by nearly 12%, but petroleum imports declined by 10%. As a result, total import growth was held below 6%. Stabilizing oil prices and the expected increases in the volume of oil imports that will result from an expanding economy in 1984 and 1985 are apt to push up the dollar value of oil imports. Total imports of all products will, as a consequence, increase substantially over 1983 levels.

Despite the bad news in imports, exports are expected to continue the recovery they began in late 1982. However, this growth will for several reasons be limited at best. The value of the dollar has not fallen, contrary to many forecasts, nor is it likely to drop precipitously anytime soon. Even if it did plunge in the near future, the trade balance would not show any improvement in 1984 and perhaps little, if any, in 1985. Secondly, the U.S. economy is expected to continue to outpace the rest of the world this year and maybe even in 1985. Finally, no quick recovery is expected in exports to the debt-plagued nations which are still under austerity measures and face continuing difficulty in obtaining trade financing.

By 1986, most economists expect to see the beginnings of a turnabout in our trade picture. Our trade problems will not be behind us, but the necessary conditions for a reversal in the U.S. trade deficits should be in place. Growth rates among our leading trade partners will have reached or surpassed U.S. growth rates, thereby boosting U.S. export sales. Countries plagued by heavy international debt loads will have hopefully made enough progress to increase their imports from the U.S., albeit in modest amounts. Last but not least, the value of the dollar should have dropped enough to retard the growth of imports and give a boost to U.S. export sales.

The key to the recovery of U.S. trade is clearly the value of the dollar. Unless and until the dollar begins to slide, our trade balances will remain at unacceptably high levels. During the past few weeks, the dollar has shown signs of, if not actually dropping, at least reaching a plateau. Declines in U.S. interest rates since August have been significant and are probably responsible for arresting the dollar's climb. If the U.S. interest drops are not just temporary and if interest rates in other major industrial nations continue to increase, vis-a-vis those in the U.S., the stage will have been set for a substantial decline in the value of the dollar.

This does not mean that a quick reversal of the dollar will be an unmitigated blessing. A declining dollar will increase the rate of inflation as imports become more expensive and as prices increase on competitive domestic products. Moreover, a drop in the value of the dollar will be accompanied by an outflow of capital which, in turn, will put upward pressures on U.S. interest rates and draw funds from the interest rate sensitive sectors of our economy such as housing and consumer durable goods. Last but not least, a drop in the dollar will put a dent in the overseas travel plans of those Americans who have been putting off their international travel plans. The recent surge of the dollar has made overseas travel a real bargain, and record numbers of U.S. travelers have been heading to Europe and other attractive foreign destinations.

No matter which way the dollar turns, the U.S. trade picture will continue to be dominated by record setting deficits in 1984, 1985, and possibly in 1986. As a result, those industries which are dependent upon exports or which must compete with imports will continue to suffer. Unemployment in those sectors will remain high and financial difficulties and possibly bankruptcies will beset many producers. California farmers may be particularly vulnerable after substantial, successive declines in exports. Their capital reserves have no doubt been drawn down to dangerously low levels by the problems of the last two to three years.

As the trade deficits persist, so too will the pressures in Washington, D.C. and in state capitols for various forms of assistance. Import relief, reciprocity, trade adjustment assistance and other demands will again be on the table. As a result, the individual states -- including California -- will continue to play an increasingly active role in international trade.

FOOTNOTES

FOOTNOTES

1. The current account contains three distinct types of transactions: merchandise trade, services, and transfers. Transfers include foreign aid and private remittances as well as payments to foreigners of interest on their holdings of U.S. government debt. Excluded is inter-country borrowing. Thus, if the U.S. runs a current account deficit, it must borrow from abroad to make up the difference. The current account, therefore, measures the net amount the U.S. as a whole is lending to (surplus) or borrowing from (deficit) other nations.

2. The sum of the six U.S. current deficits for 1971-72, 1977-1979, and 1982 was $47.4 billion.

3. "The Too-Mighty Dollar Takes a Toll of Manufacturing Jobs," New York Times, September 23, 1984, p. E3.

4. Index of the trade-weighted average exchange values of the U.S. dollar against the currencies of Germany, Japan, France, United Kingdom, Canada, Italy, Netherlands, Belgium, Sweden, and Switzerland. (March, 1973 = 100). The July, 1984 index was used for 1984. Federal Reserve Bulletin, Federal Reserve Bank, various issues.

5. Adjusting for differential inflation rates yields the "real" change in the exchange rate. From 1979 to 1983, the dollar increased 42.2% in nominal terms and 41% in "real" terms. Source: Federal Reserve Bulletin, July 1984.

6. The Annual Report of the Council of Economic Advisors, 1984, p. 47.

7. Ibid., p. 49.

8. Sources for the estimates are respectively: Security Pacific Bank, California Department of Food and Agriculture, U.S. Department of Commerce, California Office of Tourism, California Council for International Trade.

9. Since California is not a separate nation, its GNP (or Gross State Product) must be estimated. According to estimates by the Bank of America, California's economy ranked as the world's 7th largest in 1982. Security Pacific Bank estimates for 1983 placed California in 8th position.

10. U.S. Department of Commerce, Business America, February 6, 1984, pp. 10-12.

11. The Council of State Governments, "The States' Presence Abroad: The Development of Foreign Trade Offices," Lexington, KY, September 1984 (based on a 1984 survey by the National Association of State Development Agencies).

12. This section draws heavily from the following paper: "California's International Trade," Lou Angelo, Senate Office of Research, October 1982.

13. Additional information on the mission can be found in "Report of the California-Japan Trade Mission," May 7, 1984, available from the California State World Trade Commission.

APPENDIX A

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APPENDIX B

CALIFORNIA STATE
WORLD TRADE COMMISSION

November 1, 1984

TO: John Griffing GM
Senate Office of Research

FROM: Gregory Mignano
Executive Director

SUBJECT: World Trade Commission Activities

The following is a synopsis of major policies and programs on which Commission staff has been working. Fuller reports on each item are available upon request.

I. TRADE POLICY

A. Export Finance -- Following enactment of SB 1196, the Commission staff is planning implementation of a state export finance program, meeting with representatives of Eximbank and other government agencies to ensure effective use of resources. The measure, written by State Senator Rose Ann Vuich, creates within the Commission an Export Finance Office to assist small and medium-size California exporters. Guiding the office, a seven-member board will be authorized to furnish exporters with insurance, co-insurance, and loan guarantees. The program will receive a $250,000 initial administrative budget for FY 1984-85, backed by $2 million to support insurance and guarantees.

Vuich introduced the bill last year after Congress had directed the U.S. Export-Import Bank to cooperate with state export finance agencies in providing greater assistance to small and medium-size businesses wishing to sell overseas.

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B. <u>Export Controls</u> -- Last-minute efforts to renew the 1979 Export Administration Act, which expired last year, failed when House and Senate conferees were unable to agree on a provision that would have limited U.S. - South Africa trade. The disagreement followed collapse of conference negotiations over a proposal that would have given the Defense Department statutory authority to review licensing of high-technology shipments to friendly nations.

Working to influence development of U.S. export control policy, staff continues frequent contact with the California congressional delegation and other key members of Congress. In addition, Commission members have begun to assemble a California coalition to recommend a new set of technology transfer laws that would unshackle the state's fast-growing high-tech exporters.

Commissioners McCarthy and Liebman recently told a Commerce Department hearing that revised amendments to regulations governing the distribution license procedure are less draconian than those issued in January. Nevertheless, both Commissioners agreed that the new amendments continue to pose problems for high-tech exporters -- problems which the distribution license was created to alleviate.

C. <u>International Competition in the Grape Industry</u> -- In January, 1984, the WTC passed a resolution supporting the Wine Equity Act and a pending countervailing duties/antidumping action filed by the American Grape Growers' Alliance for Fair Trade. Following WTC staff recommendation, federal lawmakers adopted a more GATT-compatible approach to address inequities in the wine trade. Further changes in the bill also give processed commodities producers standing before the International Trade Commission.

D. <u>1985 Farm Legislation</u> -- 1985 offers prospects for new omnibus trade farm legislation. Commission members emphasized the need for representation of California specialty crops growers and directed staff to accelerate efforts to influence next year's farm legislation. To this end, staff has begun consultation with industry representatives, developing priorities for California's specialty, high-value, and value-added crops.

E. <u>Generalized System of Preferences</u> -- Congress reauthorized for 8 1/2 years the GSP program, which allows many products from developing countries to enter the United States duty-free. WTC staff was instrumental in compromise language that will save the California specialty crops industry hundreds of thousands of dollars annually. Meeting with United States Trade Representative William Brock and several members of Congress, staff argued successfully for language that prohibits consideration of GSP applications denied in the previous three years.

F. <u>Unitary Tax</u> -- Unitary tax reform proposals failed to clear the Legislature during its closing days this year, but efforts to modify the controversial method will resume when lawmakers convene again in January. The Commission, at its September meeting, adopted a position supporting reform. One proposal, supported by the Governor, would allow multinationals a choice between the unitary method and a waters-edge approach. However, domestic multinationals object to that proposal, as it reaches to foreign dividends and is claimed to put domestic multinationals at a competitive disadvantage vis-a-vis foreign multinationals.

II. TRADE PROMOTION

A. Seoul International Trade Fair -- Staff recently returned from Korea, where over 100 sales leads were collected from visitors to our California exhibit, which emphasized the state's high technology products. California's reputation in Korea -- the state's third largest export market -- generated sales opportunities for other products and services as well.

At the same time, a small California delegation met with Korean government and business officials. Delegation members urged these officials to accelerate Korea's import liberalization drive. California business and government leaders also stressed the special relationship between Korea and California, with its large Korean population.

B. "Made in USA Fair" -- The Commission is working to promote the "Made in U.S.A. Fair" to be held next year in Japan. Over 5,000 Japanese buyers are expected to attend the March 11-14 high-technology sales exhibition in the coastal city of Nagoya, an industrial center of eight million residents. Some 300 U.S. firms will participate, according to the Japan External Trade Organization (JETRO), sponsor of the event. JETRO will arrange meetings between U.S. sellers and Japanese buyers, and provide exhibitors with booth and basic booth facilities free of charge. The Commission staff is working out of JETRO offices in Los Angeles and San Francisco to recruit a large California contingent.

C. Overseas Offices -- AB 3313, recently approved by the Governor, funds the Commission to study the "feasibility and desirability" of establishing one or more California offices overseas. The bill, written by Assembly Member Gwen Moore, provides an appropriation not to exceed $30,000 for the study. Staff will shortly solicit proposals.

D. Agricultural Trade Seminars -- During the last year, the Commission has hosted a series of four agricultural trade development seminars in cooperation with the California Department of Food and Agriculture, the California Farm Bureau Federation, and the University of California Cooperative Extension. Owing to the success of these seminars, the Commission has agreed to co-sponsor additional programs in San Diego and Monterey. Intended to improve the profit-making potential of California exporters and shippers, the seminars explore policies, sources of assistance, and market strategies and information. Previous seminars have each drawn roughly 100 participants.

E. Promotional Material -- A colorful packet of information advertising California's goods, services, and investment opportunities recently joined the Commission's assemblage of promotional material. A 12-page booklet describing the people and products of California also features a set of 14 fact sheets summarizing an array of the state's key industries - from agriculture to aerospace. The material was prepared under Commission staff supervision by Coming Attractions Communication Service of San Francisco.