

Aerospace Industries
Association
of America, Inc.

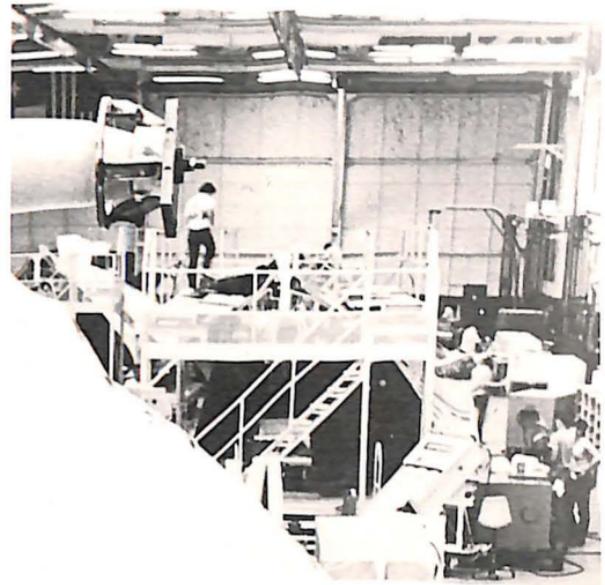
FOREWORD

The Reagan Administration has called for measured but strong response to the unfair trade practices which are contributing substantially to the massive U.S. trade deficit, including working bilaterally to open closed markets. The Aerospace Industries Association, representing the nation's aerospace manufacturers, supports this approach. U.S. trading partners should know that the United States expects fair treatment in the marketplace and will pursue its rights under U.S. law and the GATT. At the same time, the United States must stand by its long supported principles, continuing its support for the GATT and the multilateral negotiations process. The United States cannot combat unfair trade practices by establishing unfair trade practices of its own.

As the nation proceeds to tackle its critical trade problems, let us not overlook some positives: despite the trade imbalance, the United States has led the world to recovery from recession, and continues to generate more new jobs than any other nation. To-

day, U.S. unemployment is at its lowest level in years. Protectionism could upset the delicate balance of international economic interdependence, severely damage the world trading system, and harm our own long-term economic and political interests. In short, protectionism threatens the high standard of living that the United States has worked toward for decades.





**SOLVING THE
U.S. TRADE
PROBLEM:

PROTECTIONISM
OR
COMPETITIVENESS?**

For some time, America's trading position has been of serious concern among those responsible for U.S. economic policy, and among those U.S. industries whose livelihood is based in large measure on the sale of goods and services abroad. Now, as the U.S. trade deficit deepens dramatically, a state approaching public alarm has set in. This is reflected in the print and electronic media which daily publish and air stories about the toll that imports are taking on American industry and American jobs. It is reflected in Congress where 300 protectionist bills—from across-the-board import surcharges to industry-specific measures—have been proposed.

As Congress and the Administration deal with the trade deficit issue, it will be important to put the problem into proper perspective, to seek answers and not merely scapegoats in efforts to turn around a very serious, negative trend for America. We must understand fully the reasons for the massive trade deficit we are experiencing, and

accord each its proper share of responsibility.

It is clearly time for the United States to adopt a dynamic, aggressive program in order to remain a viable contender in the world marketplace. The approach, however, must center on a national commitment to increased productivity and competitiveness. In the international marketplace, continual adjustments are required of all industry sectors. The import-injured must be helped to adjust in ways that will make them more competitive, not less so. In the long run, protectionism may further weaken these industries by delaying their reaction to marketplace changes. In addition, while strengthening efforts to open markets, we must renew U.S. support of those principles of an open international trading system which, since the 1940's, have injected vitality into the world economic system, and significantly raised the standard of living for the trading nations.



WHY AIA IS CONCERNED

AIA is concerned because protectionism threatens both the aerospace industry and the national economy. Aerospace is an export-oriented industry. In 1984, exports averaged more than 20 percent of total aerospace sales and more than seven percent of all U.S. exports. Aerospace employed more than 1.2 million men and women in 1984, over 6 percent of total employment in U.S. manufacturing. We expect to add 47,000 employees in 1985. The Commerce Department estimates that at least 25,000 aerospace jobs are related to each billion dollars of export sales—roughly 30 percent of all aerospace employment.

In addition to this contribution to the U.S. work force, aerospace exports contributed to a positive trade balance of \$10.3 billion in 1984—a year in which the United States as a whole was experiencing an all-time record trade deficit of more than \$110 billion. Estimates are that the aerospace trade balance at year-end 1985 will be over \$13 billion, up from \$10.3 billion in 1984. In the first

five years of this decade, the United States suffered trade deficits totaling more than \$264 billion, which would have been worse except for an offsetting aerospace trade surplus approaching \$60 billion.

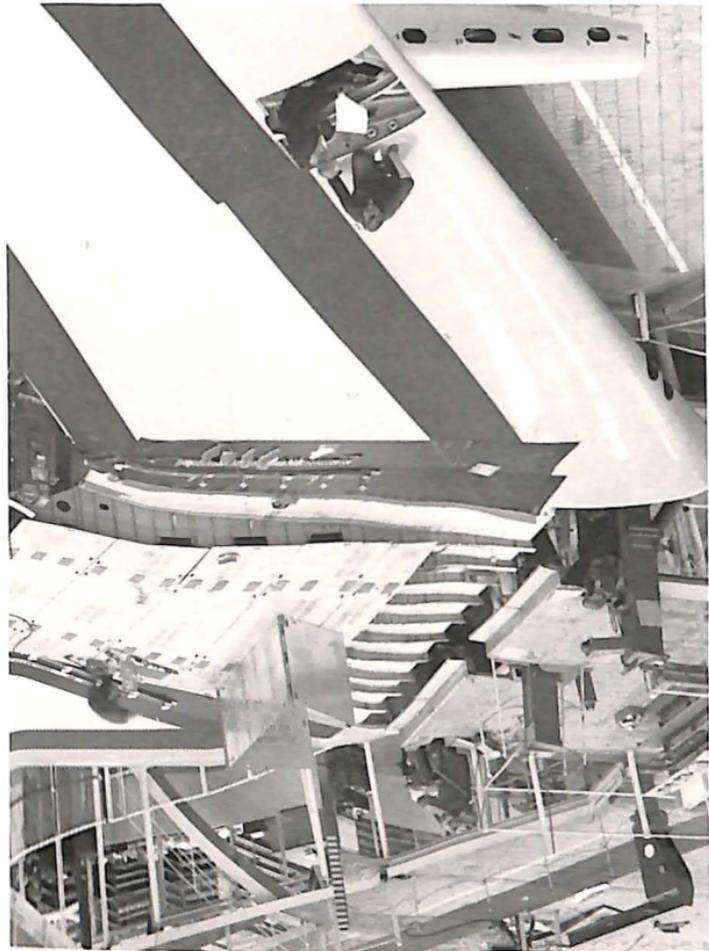
Aerospace exports benefit both the industry and the nation in several other ways. For example, exports help underwrite industry investment in R&D. This investment keeps the industry competitive in the world market. Since export sales substantially reduce unit costs, loss of exports would mean that U.S. airlines and their passengers, and U.S. taxpayers, ultimately pay more for civil and military aerospace products. Some U.S. producers could go out of business.

Aerospace exports also contribute to maintenance of critical facilities and a large, well-trained high technology labor force. Any reduction of these assets due to falling sales (either export or domestic) reduces U.S. capabilities in an emergency.

Aerospace is one of several key industries (others are electronics, telecommuni-

cations, biotechnology, computers and advanced materials) which play a pioneering technological role and stimulate development of technologies that generate jobs throughout the economy. Such industries play an important role in the export market where our nation has a comparative advantage in high technology. Protectionism could harm the development of these industries, depriving the United States of the important contribution they make to technological advancement and to the trade balance.

The U.S. aerospace industry has strong international market concerns. The industry's competition is vigorous and strengthening and is often supported by foreign government treasuries. Nonetheless, we do not see protection as an answer and urge that sound reasoning and an international as well as a national perspective guide U.S. policy makers.



AIA SUPPORTED POLICIES

Fiscal and Monetary Policies: A sound, aggressive approach to solving the U.S. trade problem should focus on competitiveness and fair trade. Fundamental to the competitiveness of U.S. industries is an economic environment as free as possible of unnecessary constraints and disadvantages. One important disadvantage is the strong dollar, a major cause of the current huge trade deficit. Some of the causes of the dollar's strength are beyond our control, for example, the strength of the U.S. economy in relation to the economies of our major trading partners. However, we can control other factors, such as those that support high interest rates. Current fiscal policies tend to increase the interest rate and have led, ultimately, to massive deficits. The continuing borrowing requirements of the government drive up the interest rates, making borrowing by domestic firms more costly; they also encourage the exchange of foreign currencies for dollars to take advantage of the high interest rates. Since the demand for dollars

has exceeded the supply because of these investment opportunities, we should create policies to alleviate this imbalance. Protectionist policies do the opposite—by restricting imports, they curtail the flow of dollars abroad without affecting the demand for dollars and are therefore likely to increase rather than decrease the value of the dollar. U.S. policy makers should concentrate on getting at the root of the problem: control of budget deficits will reduce the value of the dollar and have an immediate and positive impact on price competitiveness in world markets.

Continuing Multilateral Negotiations: Erecting barriers to foreign competition will not produce an improved trade balance, but will provoke retaliation—most likely aimed at the strongest U.S. exporting industries, such as aerospace. Despite a serious threat to its market share from foreign competitors, the U.S. aerospace industry continues to repudiate protectionism and to seek market discipline through multilateral trade

agreements. The current international policy framework for free and fair trade in the civil aircraft sector, the Agreement on Trade in Civil Aircraft, was a major step forward for trade liberalization. However, the industry would like to see major improvements in the agreement. The industry is also working to introduce multilateral discipline in export financing through the Organization for Economic Cooperation and Development. Despite the difficulties, the aerospace industry strongly supports the multilateral negotiations process. Such negotiations offer vastly greater potential than do import restrictions for improving the U.S. trade posture.

Effective Trade and R&D Policies: Building on sound fiscal and monetary measures, effective trade and R&D policies will provide the United States with the tools for an aggressive position in international markets. Such policies must be national objectives of the highest priority with a focus on stability and continuity.



National trade and R&D policies will require Government support of fundamental, high risk, long-term payoff research, and creation of a policy environment in which business can function effectively and competitively. The Government must:

- Root out disincentives and create research, investment and export incentives for industry;
- Promote free enterprise rules in the international marketplace; and
- Intercede where foreign competition is unfair or illegal.

The United States must remain committed to negotiation to achieve free and fair trade. At the same time, it must be willing to use those tools available to it, as a result of international agreements, when foreign government actions unfairly or illegally prevent U.S. industries from being competitive. The Reagan Administration is to be commended for its emphasis on negotiation—multilaterally and bilaterally—and a strong stance against unfair trade. Within the

framework of our international trading agreements there is much that the United States can do to strengthen its market position.

In its turn, Industry must:

- Review its international policies, practices and structures in order to give exports an even higher priority;
- Increase funding for research and development; and
- Increase capital investment to improve productivity, encourage innovation, enhance product quality and lower unit cost, in order to be more competitive here and abroad.

With competitiveness as our goal, industry and the government must work together to insure that America is on the cutting edge of technology in the 1990's. This will require a strong commitment to research and development and to innovation. Focusing on key technology developments, the United States must create products that are inferior to none in the world market.





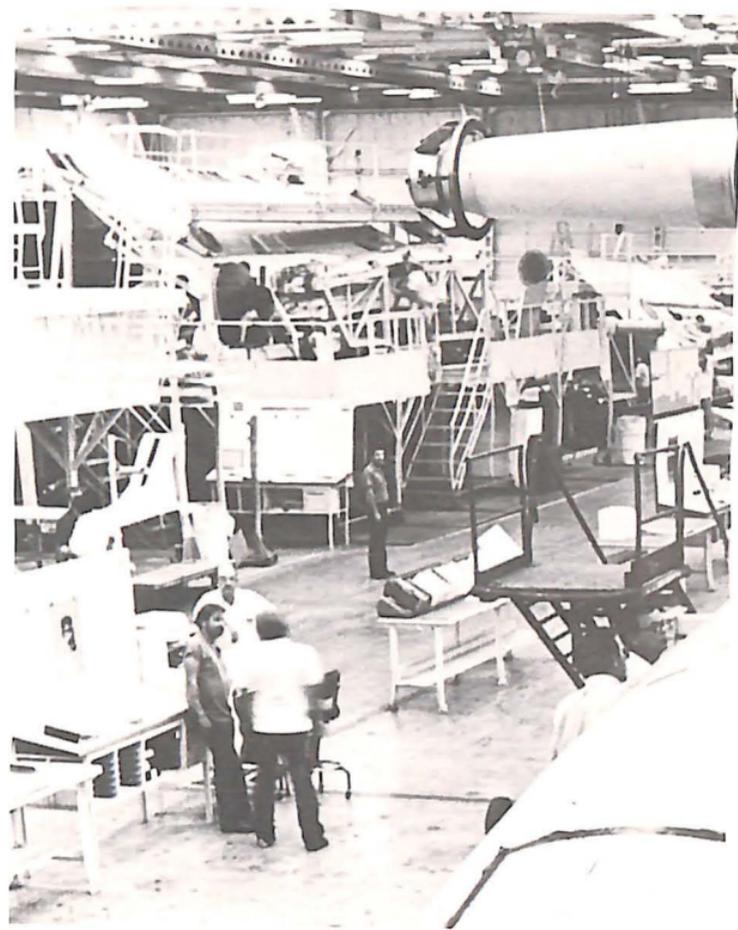
PROTECTIONISM—
AN
ECONOMIC
PERSPECTIVE

The United States can and should solve its trade problems through sound monetary and fiscal policies and a strong commitment to competitiveness. Protectionism, on the other hand, will inhibit innovation and creativity. It will prevent American business and industry from making the necessary commitments of both financial and human resources. It will make us less flexible, less able to make the continual market adjustments that are necessary. Americans need to understand that while protectionism has its benefits, it also has its costs.

Further, protectionism in our international business relations is opposite to the approach we have taken domestically. In recent years, the United States has sought to increase the efficiency of the economy through deregulation and tax reform. This has sometimes involved a restructuring of industries, with dislocations for both firms and workers. The removal of Civil Aeronautics Board regulation of airline rates and routes, for example, put strong downward

pressure on wages and other costs in the airline industry, but it allowed all airlines flexibility to respond to any combination of route and service level demanded by passengers. Some airlines were injured by these changes, but deregulation also encouraged new airlines and new types of services. Deregulation created change and uncertainty in aircraft manufacturing as well but the market, we decided, rather than the government, should make these economic choices. However, the momentum is shifting away from economic efficiency in U.S. trade policy when we move toward government intervention in the form of protection. Clearly, the worker forced out of a job or into a pay cut by imports is no worse off than one who lost his job because of some purely domestic factor. Is it economically justifiable to support and promote full and fair market principles domestically and not internationally?

The Benefits of Protection: In trading negotiations, a credible threat of protection is



useful. Trading partners need to be aware that the United States has the ability and the willingness to block access to its market in response to unfair trade practices.

At present, U.S. trade policies provide specific responses to certain types of 'unfair trade practices,' and in addition, Section 301 of the Trade Act provides a broad remedy for practices not specifically mentioned. This remedy was designed to be *discretionary*, allowing the President flexibility in integrating trade policy, foreign policy, and national security concerns. The President can thus weigh the importance of various issues in making a decision. The same policy that permitted the President to emphasize political and military over economic concerns when the United States enjoyed a healthy balance of trade, now allows him the flexibility to emphasize trade issues in the current environment of high trade deficits, and if necessary, to use the threat of protection as a means of securing access to closed markets. In short, current trade policies do

provide leverage in U.S. negotiations for fair trade.

Protection does shelter U.S. industries from international competition, slowing down the dislocation of workers and firms in a specific industry, but these benefits are political rather than economic when viewed from a national perspective. The protection that slows down dislocation often has other influences which affect the market in ways that are not anticipated. The 'voluntary' export restraints on Japanese cars, for example, led the Japanese to produce more expensive and luxurious models, a market which had been highly profitable for U.S. automakers. A result of high sugar prices due to protection is that the U.S. soft drink industry, among others, has turned to corn sweeteners as a sugar substitute. Protection can only change the form and speed in which international market forces affect an industry; it cannot prevent changes from occurring.

Until now, domestic political power has

not directly influenced U.S. trade policy. While some industry groups have succeeded in securing protectionist legislation, the United States has been a leader in opening the world trading system. U.S. economic policies would be poorly served by a policy-making structure which rewards industries with protection based on their domestic political clout.

The Costs of Protection: Fair trade among countries brings significant net economic benefits through the principle of comparative advantage. In the case of consumer goods, the principle can be demonstrated in the way trade among the states makes the U.S. as a whole wealthier. If Maine were to prevent the entry of Florida oranges, some Maine residents would prosper by growing greenhouse oranges; however, the major effect would be a drop in the availability of oranges in Maine. At the same time, Florida would be profoundly affected due to lower levels of orange production. A similar effect has occurred in the international market-



place where the protected U.S. market price of sugar is approximately three times the world price. Consumers are the clear losers, paying higher prices for a wide range of foods and beverages.

Protection negates the principle of comparative advantage for industries—even before the threat of retaliation is factored in. The low international price of copper has forced some U.S. domestic mines out of business, leading to dislocation of firms and workers in copper producing areas. However, protection leading to higher copper prices would have had other deleterious effects. Firms using copper in other articles such as pipes, wiring, electrical components, etc., would pay more for copper, and their goods would be priced higher. Protection for copper producers would negate any comparative advantage that manufacturing firms using copper might have and could be a factor in the competitiveness of those firms, vying for business with firms who paid less for copper, in the international marketplace. Domestic companies would even be

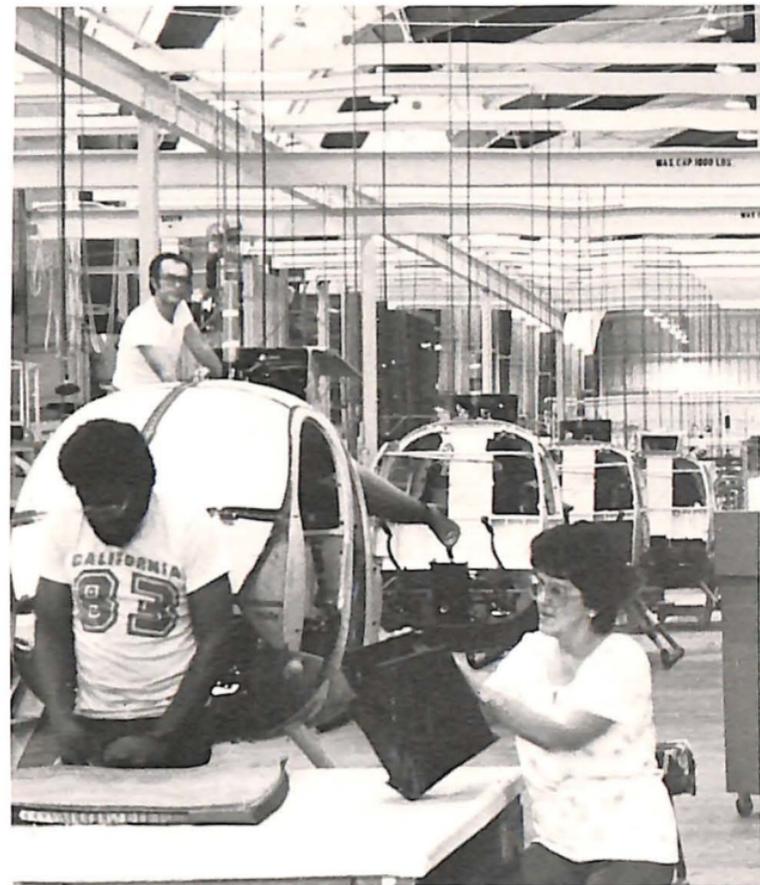
at a disadvantage in the U.S. market unless protection was extended to all imports containing copper. Rather than solving any of our economic problems, protectionism creates a whole host of new problems.

Protectionism also impedes the continual process of adjustment that takes place in an economy. The location of many high technology companies around Boston was due in part to the depressed nature of the region after the departure of the textile and other traditional industries. High technology companies were drawn to the area because of the large labor pool. The existence of skilled and unskilled labor is a requirement for industrial growth, so the loss of jobs in one industry or region is part of a cycle that occurs continuously on both a local and a national scale. Rapidly growing sectors are hampered by protection if it prevents or discourages retraining and movement of workers into those growth industries.

Since the costs of protection greatly exceed the benefits, what are the alternatives? Alternatives might include retraining and/or

relocation programs which would entail lower costs to the nation, and could increase the flexibility of the labor force. These programs can be costly, and have their limitations, but they do provide a bargain in comparison with protection.

Retaliatory measures can be expected as a response to U.S. protection. We have only to look at the disastrous consequences of the Smoot Hawley tariffs, which were imposed after the stock market crash of 1929. Responding to high unemployment and political unrest, and in an effort to 'export' U.S. joblessness, Congress enacted the high Smoot Hawley tariffs in 1930. This protectionist legislation set off a series of retaliatory measures by other nations; prevented foreign nations from making payments on outstanding loans, since exports to the United States were their primary means of earning foreign exchange; and caused a contraction of world trade that seriously affected the income and employment levels of all nations. National economies have become increasingly interdependent since that



time, and the effects of U.S. protectionist measures today would be even more immediate. The United States plays an important role in the international marketplace as both a buyer and seller of goods. If the United States restricts imports significantly, repercussions would be felt in most countries around the world. At best, the market for U.S. exports would be diminished, but it is also possible that the stability of the international economy would be jeopardized.

The United States was a leader in the trade liberalization period in the 1950's and 60's, when giant leaps in income and standards of living were among the benefits of increased world trade. The ability of the United States to set the tone of world trade in the 80's and 90's should cause us to look beyond the short term political consequences of our actions. The image of the United States as a leader of the free world will be enhanced by enactment of policies that effectively deal with the real causes of the trade deficit, rather than politically expedient policies that deal only with symptoms.

The support being generated for protectionist legislation is raising expectations that new laws will provide answers to U.S. economic problems. Americans are expecting more jobs, increased competitiveness, a leveling of the value of the dollar, and a lower trade deficit. These expectations will inevitably lead to frustration. Some of the protectionist legislation is at least as tough on Americans as it is on recalcitrant trading partners. Protectionism should be used only as leverage to obtain free markets around the world since protection involves sacrifices—not benefits—to the country that employs it. And protectionism is clearly inconsistent with our long-term national goal of being competitive in the world market for decades to come.

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