Buy American and Foreign Trade-Dependent Markets: An Analysis of Issues and Remedies

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Resumen

Miles de empleos en Estados Unidos se contratan por fuera cada mes; los defensores del proteccionismo argumentan que la pérdida de empleos nacionales son un resultado directo del traslado de procesos a otros países y de las importaciones. Por otra parte, el movimiento proteccionista Buy American y su respectiva influencia directa afectan a los comercializadores estadounidenses de industrias dependientes de las importaciones y las exportaciones debido a los potenciales conflictos entre los Estados Unidos y sus socios comerciales. Los mercados objetivo, locales y externos, se vuelven inalcanzables, mientras que empresas que son dependientes de importaciones experimentan dificultades para la importación de sus insumos. Este artículo se enfoca en los temas relacionados con Buy American que enfrentan los empresarios de Estados Unidos analizados desde la dimensión internacional, legal y ética. Igualmente, se analizan las acciones pasadas y actuales tomadas por las empresas de EE.UU. en esta materia, las ramificaciones de estas acciones, y las recomendaciones para las empresas afectadas por este movimiento.

Palabras clave: deslocalización, subcontratación, proteccionismo, Buy American.

Abstract

Thousands of American jobs are being outsourced each month, and protectionism advocates argue that domestic job losses are a direct result of off-shoring and importing. On the other hand, Buy American, a protectionist move, and its direct consequences, hurts U.S. marketers in industries dependent on imports and exports due to the potential conflict between the U.S. and its trading partners. Target markets become impossible to reach, both at home and abroad, while import-dependent firms experience difficulties importing their inputs. This paper focuses on issues of Buy American faced by U.S. businesses, the international, legal and ethical dimensions of these issues, past and current actions taken by U.S. businesses in this matter, ramifications of these actions, and recommendations for businesses affected by this movement.

Key words: off-shoring, outsourcing, protectionism, Buy American.

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Introduction

Not too long after the G20's London Summit held in April, 2009, more and more global marketers are paying attention to the negative consequences of governments' protectionist moves. While the last thirty years have been characterized by an era of globalization, a completely opposite intent —protectionism— is gaining momentum among countries all over the world. Globalization is about opening doors for international trade by removing barriers such as politics, tariffs, quotas, and several other restrictions on business, whereas, protectionism does just the opposite. Supporters of globalization argue that the more open trade is among countries, the more beneficial trade will be for any given country's economy (including job creation, GDP growth, household income levels, and overall national well-being). In contrast, advocates of protectionism argue that free trade is not fair trade, believing that domestic job losses are direct results of both offshoring and importing. In fact, the Federal Reserve Bank of New York claims about 40,000 American jobs per month are being outsourced (Shister, 2007). While protectionism has many different shades, a preferred method by developed countries, including the United States, is 'Buy Local' laws and movements.

The Buy American Act, a protectionist move, and its direct causes can hurt U.S. marketers in export/import-dependent industries due to negative effects of a conflict between the U.S. and its trading partners. Companies like Weyerhaeuser, Du Pont, Cargill, and Koch Industries —on the export side— and Dole, Wal-Mart, Target, Home Depot —on the import side— will encounter difficulties when their target markets become impossible to reach both at home and abroad due to the Buy American movement. Import-dependent firms will also experience trouble importing their foreign-made inputs. The purpose of this paper is to discuss problems U.S. businesses face due to the Buy American Act, focusing on the introduction of concepts related to protectionism and Buy American, the problems caused by Buy American, the international, legal and ethical dimensions of the issue, past and current actions taken on this matter, ramifications of these actions, and recommendations for U.S. businesses.

Protectionism and its means

Protectionism is a method that nations use to "protect" their domestic markets with the intent of helping local businesses. France is known for its steady protectionism, but in recent years, many other nations also have taken protectionist steps. Governments promote protectionism to reduce foreign competition faced by domestic industries. Protectionist instruments include tariffs, quotas, subsidies, and so called 'Buy Local' laws and movements (Appleyard, Cobb, & Field, 2007). To show how Buy American fits into this group of protectionist laws and regulations, these methods are discussed briefly.

Tariffs are duties imposed on foreign goods being imported in order to raise these goods' prices. If a foreign exporter must pay a tariff on goods, this expense will be passed on to U.S. customers. Thus, the price paid by Americans will now be higher, encouraging customers to choose the now cheaper or more competitively-priced U.S. made product instead of the imported good.

Quotas are limits on the amount or number of goods that can be imported, which discourages many foreign businesses from exporting to the country imposing the quota. If profits are not substantial at the maximum number of goods sold based on the limitation, exporters will go elsewhere. While tariffs and quotas are favored by developing countries, wealthier nations, such as the U.S., prefer subsidies and 'Buy Local' laws when trying to limit imported goods. Subsidies are financial aids from the government of a nation to a firm or industry that is struggling to keep prices low enough to stay competitive. In the U.S., the auto and agricultural industries are examples of how the government is using subsidies as a tool of protectionism. For instance, the U.S. government has recently aided the American auto industry with $17.4 billion (Zakaria, 2009).

Last, and most importantly for the purpose of this paper, 'Buy Local' laws and movements present a very powerful tool for developed nations to influence international trade with the intent of helping local businesses. Using this method, the government is trying to encourage its consumers to buy locally-made products instead of imports. The degree of 'Buy Local' can vary from an actual law to heavy advertising campaigns by unions and agencies supported by troubled industries. In the United States, the Buy American Act (1933) has been reassured by the American Recovery and Reinvestment Act, which is worth $787 billion in government spending signed into law by President Obama in 2009 (Pulfer, 2009b). While the Buy American Act mainly deals with steel, iron, and manufacturing industries, as consumers buy into the idea of 'helping' the nation by purchasing U.S.-made goods, export/import-dependent businesses will face greater difficulties.

The Buy American Act: then and now

The original Buy American Act was written almost eighty years ago (Palmer, 2006). With the stock market crash of 1929, the U.S. was in the middle of the Great Depression by 1933 and desperately needed new jobs to reduce unemployment. Although President Hoover had a very strong opinion against the government intervening in economic or social problems, in 1933, pressured by the urging need of job generation, he signed the Buy American Act into law (Palmer, 2006). His vision was to encourage purchases of domestically-produced goods. Today, we know President Hoover was wrong. Europe's and South America's low-wage competition did not hurt American businesses. In fact, it pushed troubled American industries to improve their production processes or get out of business.

President Obama's recently enacted spending bill has created controversy and some nervous moments for the U.S. iron, steel, and manufacturing industries and many of the U.S.'s trading partners. The part that brought the most attention was the $787 billion American Recovery and Reinvestment Act that carried a

Buy American element in it. The Act states that funds originating from the stimulus package and being spent on iron, steel, and manufactured goods can only go to American suppliers (Pulfer, 2009b). Of course, there are several subsections of the bill indicating room for exceptions based on contradiction with public interest, unavailability of sufficient material in the U.S., and if an alternative supplier's price is more than 25% less than that of the American supplier's ('Buy American': What the Stimulus Bill Says, 2009).

In summary, the Buy American Act means that federal money should be used only in a way that supports local suppliers whenever possible, unless the product is unavailable or the U.S. price compared to foreign prices is unreasonably high. While the original purpose of the act was to create more American jobs due to increasing domestic production and spending, this act will actually hurt U.S. businesses. Rationale for this assertion is given below.

Why Buy American hurts U.S. Marketers

There are several major problems that U.S. businesses face due to the Buy American Act, resulting in negative consequences both at home and abroad. Export/import-dependent companies like Koch Industries Inc., Costco Wholesale, and Dow Chemical, will encounter considerable obstacles when their target markets become impossible to reach both at home and abroad due to this Act. Major problems caused by Buy American include decreased foreign demand for American goods due to a decline in foreign household incomes and trade wars, decreased domestic demand for domestic products, and a retaliation-induced inability to import inputs for U.S. production.

The United States' economic growth depends largely on foreign trade and foreign relations. In 1998, trade made up 2.5% of the \$8.7 trillion economy; in 2008, it accounted for 9.5% of the \$14.6 trillion U.S. GDP (Field 2009b). In 2008 alone, the U.S. exported over \$71 million worth of goods and services to China, \$260 million to Canada, and \$151 million to Mexico, while importing more than \$337 million from China, \$335 from Canada, and \$215 from Mexico (U.S. Census Bureau, 2009). These numbers show the U.S. economy's dependence on foreign trade. Furthermore, as a reaction to today's economic situation, many American businesses look for markets outside of the United States. For example, marketers of American luxury brands, such as Coach, have heavily invested in overseas markets. Coach not only opened and spent advertising dollars on dozens of new stores in China, but also in Hong Kong and Macau (Madden and Hall, 2008). Thus, it is critical for U.S. businesses to maintain excellent relations with foreign countries' target markets to keep overseas' demand alive and to grow their businesses.

One of the negative effects of Buy American to U.S. businesses is decreased foreign demand for American goods due to a decline in foreign household income and trade wars between the Unites States and its trading partners. First, if imports decline due to enough American consumers switching from buying imported products to purchasing domestically-produced goods, incomes of these foreign exporters will decline. Then, if the income of people from the nations whose exports to the U.S. fell declines, American exporters will incur losses due to less demand for their products. It is not a good situation for either U.S. or foreign firms. Not only will trade relations between the two countries suffer, but also the GDP of both nations will decline. Second, while Buy American's major rationale is to keep/create more jobs at home, the Peterson Institute of International Economics argues that Buy American would translate into only 1,000 jobs in the industry, and 9,000 in total, while the Obama administration-supported stimulus package will create over 220,000 in manufacturing (Pulfer, 2009a). So why is the support of buying American steel such a big issue? Well, many nations, including China, India, and Brazil, have expressed nervousness about this type of protectionism. These countries already think that the housing crisis that provoked global economic chaos began in the United States. President Obama, himself, recently said that he was worried about a possible trade war (Pulfer, 2009a). If a trade war was to form between the U.S. and its trading partners, American businesses would, indeed, face major difficulties associated with declining demands both at home and abroad.

The second major problem U.S. marketers face due to the negative effects of the Buy American Act is decreased domestic demand for domestic products. The United States' economic growth relies heavily on foreign trade as it is a dominant portion of the country's GDP. Buy American, being a protectionist effort to support domestic businesses while restricting trade, creates a disincentive for U.S. economic growth. If U.S. growth declines, the income level of domestic households will follow suit. This means, in fact, that American consumers will have less money to spend on both domestic and foreign goods. Therefore, no matter if American businesses target foreign markets or domestic shoppers, they will get hit hard due to weakened consumer spending. Moreover, this entire process will happen in the middle of a recession. Consumers are already cutting back on their purchases, making the Buy American effect much worse. American consumers have already cut their expenditures in 2009 by $200 billion, or 3.1%, from the year before (Mandel, 2009). While the Bureau of Economic Analysis has reported this number to be only $40 billion, or 1.4%, the Bureau has included outlays that are not in the control of American households, including Medicare expenses and increased money spent on education during the slump that persuaded people to go back to school. While Americans are spending less on American goods, domestic businesses face a significant problem.

The third problem U.S. marketers face is retaliation from other nations, making it difficult, if not impossible, for U.S. manufacturers to import inputs of production, to sell their goods, and to export them abroad. Consider how powerful retaliation is. Retaliation means that if a country's trading partner—the United States in this case—erects trade barriers, such as the Buy American Act, that country will respond by also raising barriers to trade. This two-sided economic conflict not only creates a trade war, it also alters the values of the involved countries' currencies (exchange rates). For instance, consider the case of steel imports from Canada (Pulfer, 2009b). If the U.S. creates restrictions on its imports of steel, more steel will be bought from American suppliers and less steel will be imported from Canada. Since less steel will be purchased from Canada, the demand for the Canadian dollar will decline, and the value of Canada's currency will depreciate. By the same token, there is now a lower supply of U.S. dollars (that was being supplied in order to buy Canadian dollars), which makes the U.S. dollar appreciate. As a result of the appreciated U.S. dollar and the depreciated Canadian dollar, other Canadian imports will be cheaper to U.S. customers, while American exports will be more expensive to Canadian consumers. This example illustrates how intended results of Buy American—or any other protectionist methods—will be offset by retaliation.

Another possible reaction to Buy American is embargo, which is the prohibition of merchandise going from one country to another. The U.S. is currently claiming to have an embargo with Cuba, for instance, even though oil has been imported from the island nation uninterruptedly.

Since American manufacturers not only offshore parts of the production process but also import many inputs of their production, embargo would be an extremely hard hit for these products' marketers. It might become impossible for the U.S. to import inputs of production. The U.S., for example, is importing a large amount of textiles from China and Mexico because it is much cheaper to produce abroad than it is domestically. If China decides to pose an embargo with the United States, many businesses in the furnishing, clothing, and carpeting industries will face a serious problem (Field, 2009a).

International dimensions

There are several international elements of the Buy American Act and its negative consequences. The Act is affecting global market players including Canada, Mexico, member nations of the European Union, China, India, and Brazil. The latter three nations are getting very close to translating Buy America into "blame America" (Pulfer, 2009a). These countries are suffering from the economic downturn and are desperate to end it. They understand that the crisis started in the United States and do not appreciate the fact that the U.S. is creating protectionist barriers to global trade.

For Canadian marketers, the issue is quite complicated. Even though only federal money is restricted by Buy American (local and state projects are not under these restraints), the bill also specifies that even if only one U.S. dollar from these federal funds is spent on a job, the project must meet all terms of Buy American provisions (Pulfer, 2008b). In other words, Canadian firms will have much less chance to win U.S. projects as U.S. suppliers will enjoy priority.

Another indicator of the braking U.S. foreign trade is the downward trend of surface transportation. Approximately 88% (by value) of transportation among the U.S., Canada, and Mexico moves on land (Agency Group 06, 2008), and a decline in surface transportation trade is a good indicator of declining international trade. According to the Bureau of Transportation Statistics (BTS), this measure in January 2009 was 27.2 % lower than that of January 2008 (Agency Group 06, 2008).

Finally, Buy American is affecting relations with European nations. At the recent G20 meeting, European Union member nations clearly expressed their requests to drop Buy American provisions http://www.timesonline.co.uk/tol/news/world/europe/article5655115.ece As a matter of fact, the European Union has already responded to similar U.S. protectionist moves in the past. According to an official list published in March of 2008, many U.S. items were subject to further 15% customs duties as part of the Byrd Amendment retaliation (Mandelson, 2008). A complete list is given in Appendix 1.

Legal dimensions

There are two major legal elements that Buy American-affected businesses need to examine more closely. Regulations of both the North American Free Trade Agreement (NAFTA) and the World Trade Organization (WTO) might conflict with Buy American provisions in the recent American Recovery and Reinvestment Act. Under NAFTA regulations, discrimination against foreign bidders and suppliers is illegal, but only in projects involving federal money (Pulfer, 2009b). Thus, Canadian and Mexican businesses remain with only a few options when it comes to bidding for U.S. projects, they can either make a complaint to the U.S. federal government or have their government complain on their behalf. Either way, both countries' businesses will lose on the long run.

The second legal dimension of Buy American is a potential conflict with WTO regulations. The WTO's original purpose is to free up trade among nations. While advocates of Buy American claim that Buy American is not meant to be protectionist (Field, 2009b), provisions of the bill will be barriers for many importers and exporters, both in the U.S. and abroad. Again, this is a problem because trade in goods and services are essential for U.S. growth.

Ethical dimensions

Ethical questions of Buy American for U.S. businesses include the so called "true blue" predicament and the "real origin" dilemma (Pulfer, 2009a). "True blue" is an expression used among suppliers for a project or commodity for which every single input was purchased from U.S. suppliers. However, what would stop, and more importantly, how can it be proved, that a supplier is claiming "true blue" status while buying foreign made inputs in order to compete with other suppliers? What is more, since NAFTA and Buy American have restrictions only on federal money, it is really up to local and state officials to decide who they do business with as long as they spend their own money. Should they follow suit with federal actions or use procurement?

Another ethical question arises when a decision has to be made about the origin of a product. Given today's complex supply chains, the origin of a good's nationality can be extremely difficult to determine. At what point can a product be called American, when parts are imported from China, assembled in Mexico, and packaged in the U.S.? These difficult questions can create major conflicts between business partners and governments.

Previous actions and ramifications

Since it seems that U.S. businesses have very few ways of dealing with problems of Buy American, another country's experience can provide a case study. Costa Rica had a very similar policy to "Buy American" between 1960 and 1982 (Daniels Radebaugh and Sullivan, 2009). This era reflected a so-called Import Substitution policy, which basically was a call for local/domestic production of goods and services that were previously imported. While foreign competition was reduced by heavy taxation of imports, it was necessary to subsidize local industries to keep prices low. The money for subsidies came from higher taxes imposed on the successful players of the Costa Rican economy. Hoped-for results from the import substitution policy were increased exports and the diversification of the economy. While diversification did thrive in the home economy, the cost was high: historically successful companies were discouraged by higher taxation and new industries only thrived through government subsidization. Moreover, innovation was stifled due to lack of competition. In the end, Costa Rica opened its markets to international trade and foreign investment by offering incentives to attract foreign companies like Intel, Procter & Gamble, and Baxter.

Recommendation and ramifications

Companies like Du Pont, Cargill, Dole, and Wal-Mart, have only a few options available to overcome the negative consequences of Buy American. Since many feel that this matter is overwhelming, one option that export/import-dependent industries could choose is to simply switch industries and/or methods of doing business. This, of course, is not so simple. In fact, there is a reason why companies do business in a particular industry. Transforming an entire business not only requires considerable time and resources, it also calls for a completely new strategy. Another course of action would be to develop an extensive advertising campaign focusing on transforming consumers' perception of products as being American. Businesses from several industries could ban together to develop this campaign.

However, the ethical dilemma remains for many industries: is the product really American? Another solution is to fight against protectionism. While this solution sounds complicated and unoriginal at first, it has the ability to address the root of the problem. A legal and efficient way of doing this is lobbying the U.S. government and convincing foreign governments to request the U.S. to stay away from protectionism.

While all the alternatives above are difficult and expensive to implement, an organized lobbying effort indicates a very powerful instrument in the long-run. Lobbying has a bittersweet image because its lawful purpose is to persuade legislative proposals, to influence regulatory decisions, and to negotiate government contracts (Miller and Jones, 1998). The proposed recommendation for affected businesses is a wide-ranging, international lobbying effort that would put enough pressure on U.S. legislators to change or completely avoid protectionist laws and regulations. This effort would have a great chance of being successful as there are already signs indicating political concerns about Buy American. For instance, President Obama, being under foreign governments' pressure, has been expressing his worry about Buy American and said he does not want to engage in a possible trade war, nor is he planning to become the leader of one (Ellis, K. et al). And the President is not the only one projecting these sentiments, influential business leaders, such as Kevin Burke, president and CEO of the American Apparel and Footwear Association, signaled a similar point of view. Mr. Burke agreed that this is the worst possible time to implement protectionist policies that can incite trade wars (Ellis, K. et al 2009).

In sum, export/import-reliant countries, industries and companies should come together to fight Buy American. While the worst case scenario would be an unsuccessful lobbying effort of the U.S. government, but if successful, consumers, businesses, and governments alike will benefit from freer cross-border trade. Favorable foreign relations and trade is one of the most essential elements of a thriving U.S. economy.

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