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Managed Trade and Quantitative Restrictions: Issues for Congress

Background

Congress plays a prominent role in shaping U.S. trade policy, due in part to trade policy's impact on the overall health of the U.S. economy and specific sectors, the success of U.S. businesses and workers, and Americans' standard of living. The Trump Administration and some Members of Congress contend that past trade negotiations and agreements have failed to address effectively foreign protectionist practices and enhance reciprocal market access for U.S. firms and workers. They cite as evidence the disruption of some U.S. industries, difficulties of U.S. firms in penetrating some foreign markets, and large U.S. merchandise trade deficits—even with countries with which the United States has a free trade agreement. They argue that the main goals of U.S. trade policy should be to achieve “fair” and “balanced” trade and to place more emphasis on measurable results (e.g., increased exports and market share abroad).

To some observers, the Trump Administration is pursuing a “managed trade” policy that seeks specific or numerical outcomes of trade by using the size of the U.S. economy as leverage. The concept drew attention in the 1980s and early 1990s in reaction to proposals and actions by Congress and the Reagan and Clinton Administrations to address the large U.S. trade deficit with Japan and the market-entry restrictions faced by U.S. firms there. Critics contend that the most recent manifestation of a managed trade approach by the United States is the potential quotas negotiated by the Trump Administration in the U.S.-Mexico-Canada Agreement on autos (through side letter agreements), as well as the quota arrangements that allowed South Korea, Brazil, and Argentina to avoid U.S. tariff increases on steel and aluminum imports stemming from the use of Section 232. Today, proponents of this approach argue, as they did three decades ago, that many trading partners are not fulfilling their trade obligations or that current trade rules do not address many barriers and distortive practices. Therefore, the most effective way to promote U.S. economic interests, they argue, is to pressure countries to agree to specific trade results. As the Administration pursues new trade agreements, the implications of this approach may interest the 116th Congress.

What is Managed Trade?

Generally, managed trade refers to government efforts to achieve measurable results by establishing—through quantitative restrictions (QRs) on trade and other numerical targeted approaches—specific market shares or targets for certain products. These are met through mutual agreement or under threat of trade action (e.g., increased tariffs). There are various types and degrees of government involvement in trade which might be termed managed trade, and governments often use different types of QRs to achieve their trade policy objectives (**Table 1**).

Table 1. Quantitative Restrictions on Trade

- Quantitative restrictions (QRs) on trade in goods are measures that limit the quantity of a product that may be imported or exported. They may be based on the number of units, weight, volume, and value. Major types of QRs include:
- **Prohibitions.** Bans on the importation or exportation of a product; such provisions may be absolute or conditional.
 - **Quotas.** Measures indicating the quantity that may be imported or exported; quotas can be global or bilateral.
 - **Licensing requirements.** Procedures that require an application or document (other than that required for customs purposes) as a prior condition for importation.
 - **Voluntary export restraints (VERs).** Actions taken by exporting countries involving a self-imposed QR of exports; VERs are taken unilaterally or under the terms of an agreement between two or more countries.

Source: P. Van den Bossche and W. Zdouc, *The Law and Policy of the World Trade Organization*, 3rd ed., 2014.

The Trump Administration has stated that, by negotiating quota arrangements on steel and aluminum with South Korea, Brazil, and Argentina, and potentially similar measures with other countries, the United States can ensure that trade with these countries is fair and balanced, and that U.S. imports are reduced to strengthen certain U.S. industries and boost employment. To some Members, however, this approach represents a move away from a market-driven, multilateral rules-based system to a unilateral managed approach driven by arbitrary numerical outcomes and targets—one that could lead to increasing trade restrictions, retaliation or replication by other countries, rising prices, lower global economic growth, and erosion of the international trading system.

Can Managed Trade be Economically Justified?

Few, if any, nations completely practice free trade. Some governments intervene more than others in markets by providing subsidies to domestic firms, restricting foreign imports, or promoting exports. U.S. trade policy over time has sought the elimination of these discriminatory or “unfair” practices through trade agreements and rules-setting. Advocates of managed trade policies have called for increased efforts to influence trade flows between the United States and certain trading partners, particularly China, in order to rectify market distortions and create a “level trading field” for U.S. firms. Such proposals reflect a belief that the current level and composition of trade between countries either provides unequal benefits to the partner or is not at an optimal level for the United States. Thus, QRs can help produce results which will both rectify distortions and provide net benefits to the U.S. economy.

In addition, there is a perception that the economic systems of some U.S. trading partners are fundamentally different from that of the United States. Rather than try to harmonize

their trade laws and business practices with those of the United States, some advocates argue that the United States should negotiate agreements that specify results that are roughly consistent with what might be expected under open market conditions. Finally, others also contend that past trade negotiations—which focused on reducing barriers rather than on results—have not yielded the benefits that were promised or expected. They argue that some countries are neither doing enough to stimulate their economies nor removing barriers directly under their control to reduce imbalances in their economic ties with the United States. Therefore, under this view, using QRs and other policy tools gives the United States leverage to force these countries to change their distortive economic policies, which will ultimately lead to “freer” and “fairer” trade.

“[T]he Trump Administration will work aggressively to address trade imbalances, promote fair and reciprocal trade relationships, enforce U.S. rights under existing trade agreements, and work with like-minded countries to defend our common prosperity and security against economic aggression.”

Office of the U.S. Trade Representative, February 28, 2018.

Some policymakers have also long perceived growing bilateral U.S. trade deficits as an indication that U.S. trade with other nations is uneven or unfair. They believe that policies that restrict U.S. imports and boost U.S. exports can help decrease the size of the U.S. trade deficit. However, most economists disagree with this assessment, noting instead that the overall U.S. trade deficit is primarily the result of macroeconomic forces—namely the low level of U.S. savings relative to total investment. While managing bilateral trade flows may affect bilateral trade imbalances, they have little impact on the overall U.S. trade balance. Bilateral imbalances may also reflect the impact of global supply chains, and such data excludes services trade.

Many economists question the ability of the state, rather than market forces, to provide the most efficient allocation of scarce resources, even when attempting to respond to trade-distorting measures by trading partners. They warn that while QRs and similarly trade-distorting policies could raise production in some sectors (e.g., steel), they may decrease it in others (e.g., autos), leading to net economic losses. In addition, they point to lessons from the limited experience that the United States had managing trade relations with Japan in the 1980s. Auto VERs, for example, curtailed imports of Japanese cars, but they also may have helped push car prices upward, which ultimately benefitted the Japanese auto industry. Also, the major U.S. automakers still faced strong Japanese competition, since Japanese manufacturers moved some of their production to the United States. Policymakers typically weigh the unintended effects against the main objective of controlling trade flows.

The WTO and QRs

While World Trade Organization (WTO) agreements do not explicitly include specific references to managed trade, they include language that limits the ability of members to pursue such an approach to trade policy. For example, the 1994 General Agreement on Tariffs and Trade (GATT) sets out a general prohibition on QRs (*de jure* and *de facto*) on exports and imports—a core U.S. objective during the Uruguay Round. The *Agreement on Safeguards* prohibits

VERs, stating that “Member[s] shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side,” and requiring that any such existing measure be phased out or brought into compliance with the agreement. Also, the *Agreement on Agriculture* and the *Agreement on Textiles and Clothing* (ATC) contain specific rules regarding the elimination of QRs. With agriculture, QRs had to be converted into tariff equivalents or tariff rate quotas—which in the strict sense of the term are neither quotas nor QRs. In terms of textiles, the ATC provided a ten-year “integration process,” terminating all QRs by the end of 2004.

While QRs are, as a rule, prohibited, there are exceptions to this prohibition and rules on their administration. For instance, if and when in place, QRs are to be administered in a non-discriminatory manner, and the distribution of trade still allowed is to be as close as possible to what trade would have been in their absence. In addition, the rules for import-licensing procedures are to be neutral in application and administered in a fair and equitable manner.

A basic principle of the rules-based multilateral trading system underpinned by the WTO has been that “tariffs are the preferred and acceptable form of protection.” The reasons for this preference are both economic and practical. Unlike QRs, tariffs are more transparent (and verifiable) and their impact on imported products is immediately clear. Also, QRs impose absolute limits on imports, while tariffs do not. It is also considered easier to negotiate the gradual reduction of tariffs than it is to negotiate the elimination of QRs. Finally, while the price increase resulting from tariffs goes to the government as revenue, the price increase resulting from QRs generally benefits foreign producers.

Issues for Congress

Whether a managed trade approach will dominate future U.S. trade negotiations remains to be seen. Some Members of Congress may welcome the Trump Administration’s attempts to prod additional U.S. trading partners into negotiating or accepting QRs. Others, however, may see it as an undesirable shift in U.S. trade policy. While increased government intervention on trade flows may not provide long-term net gains to the U.S. economy—as most economists contend, some Members may view the nature of U.S. trade concerns with some partners as so unique that managed trade outcomes, particularly through the use of QRs, can be justified in the short-term to level the playing field. However, U.S. trading partners may see U.S. actions as “beggar-they-neighbor” policies that seek to enhance U.S. economic interests over those of other trading partners. In addition, other countries may seek to adopt managed trade policies of their own, increasing protectionism that could undermine U.S. and global economic growth and the rules-based global trading system.

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