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Trade Adjustment Assistance for Firms: Economic, Program, and Policy Issues

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Summary

Although free trade provides benefits to all trading partners, reducing barriers to trade forces firms and industries in all countries to adjust to stiffer global competition. For some, the adjustment process can be difficult and Congress, in recognizing this problem, has authorized programs to assist trade-impacted firms, industries, and workers. This report focuses on the trade adjustment assistance program for firms and industries, which provides technical assistance to help them develop strategies to remain competitive in the changing international economy. The TAA for firms program was reauthorized through fiscal year 2007 at an annual funding level of $16 million as part of the Trade Act of 2002 (P.L. 107-210).[1] This report will be updated periodically.

Economics of Trade Adjustment

Economists tend to agree that in defining the rules of exchange among countries, freer trade is preferable to protectionism. The theory of comparative advantage suggests that freer trade leads to mutual gains for countries because through exchange, they can specialize in producing those goods at which they are relatively more efficient, while trading for those at which they are relatively less so. Firm productivity increases through trade by reallocating resources to their more efficient use, while both firms and consumers gain by having a wider variety of goods to choose from at lower prices.

It is also true that as countries adopt freer trade policies, often through negotiated trade agreements, economies must adjust to increased competition, creating both "winners and losers." Some firms and industries will become more efficient and grow as they expand into overseas markets, whereas others will contract, merge, or perhaps even fail when faced with increased competition. While the adjustment process may be healthy from a macroeconomic perspective, much like market-driven adjustments that occur in

[1] See also CRS Report 94-478, *Trade Adjustment Assistance for Workers: A Fact Sheet*, by Paul J. Graney and CRS Report RS21182, *Trade Adjustment Assistance for Farmers*, by Geoffrey S. Becker.

the absence of trade (e.g. changing technology), it can be a rather harsh reality for many firms and their workers.

Critics of free trade agreements often highlight the adjustment costs of reducing trade barriers. To avoid business closures and layoffs, trade-impacted firms often seek to weaken, if not defeat, trade liberalizing legislation. This makes economic sense from the perspective of affected industries, firms, and workers, but economists argue that in the long run it can be more costly for the country as a whole. The costs of protection arise because competition is suppressed, reducing pressure on firms to innovate, operate more efficiently, and become lower cost producers.[2] The brunt of these costs falls to consumers, both individuals and businesses, who must pay higher prices.

One way to balance the gains of freer trade that are realized broadly throughout the economy, with the costs that tend to be more concentrated, is to address the needs of firms negatively affected. This can be done by legislating trade adjustment assistance (TAA). Supporters justify TAA policy on grounds that: 1) it helps those who are hurt by trade liberalization (the "losers"); 2) the economic costs are lower than protectionism and can be borne by society as a whole ("the winners") and; 3) given rigidities in the adjustment process, it helps redeploy economic resources more quickly, thereby reducing productivity losses and related public sector costs (e.g. unemployment compensation).

Firm and Industry Trade Adjustment Assistance

Congress first authorized TAA in Title III of the Trade Expansion Act of 1962 (P.L. 87-794), establishing a new firm and industry program under the Economic Development Administration (EDA) of the U.S. Department of Commerce. It provides *technical assistance* to help trade-impacted firms make strategic adjustments necessary to remain competitive in a global economy. Originally, firm TAA also included loans and loan guarantees, but Congress eliminated all direct financial assistance in 1986 because of federal budgetary cutbacks and concern over the program's high default rates and limited effectiveness. The TAA for firms program was reauthorized through fiscal year 2007 at an annual funding level of $16 million as part of the Trade Act of 2002 (P.L. 107-210).

To receive assistance a firm must first be certified as eligible by demonstrating: 1) a "significant" loss or threatened loss of employees; 2) a decrease in sales or production; and 3) that increased imports "contributed importantly" to both the layoffs and fall in sales or production. Once certified, the firm has two years to apply for assistance in developing and/or implementing its adjustment proposal. Approval depends on EDA's finding that the adjustment proposal: 1) is likely "to materially contribute" to the economic adjustment of the firm; 2) considers the interests of the firm's workers; and 3) demonstrates that the firm will use its own resources for adjustment.[3]

EDA can provide technical assistance to a firm for preparation of the petition for eligibility certification and to a certified eligible firm for developing the economic

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[2] For cost estimates of protection, see: Hufbauer, Gary Clyde and Kimberly Ann Elliot. *Measuring the Costs of Protection in the United States*. Washington, D.C., Institute for International Economics, 1994.

[3] P.L. 93-618, Sections 251 and 252, as amended.

adjustment proposal or implementing the proposal. In practice, this technical assistance is provided through one of the 12 Trade Adjustment Assistance Centers (TAACs), which operate as non-federal consultants. They provide technical assistance to firms from the initial certification process through implementation of the adjustment proposal.[4]

TAA appropriations through EDA since 1997 appear in **Table 1**. All have been used to support the TAACs. In some years, the TAAC's funding has been augmented by Department of Defense appropriations through the Defense Adjustment Assistance Program (DAAP). In addition, for fiscal years 1991-1994 (not shown), grants were made to specific industry representatives and research groups. These included the American Electronics Association (Europe and Japan offices); the Semiconductor Industry Association; the Motor Equipment Manufacturers Association; the Gear Research Institute; the American Foundrymen's Society; and the University of Texas. No funds go directly to firms.

Table 1. Firm Trade Adjustment Assistance: Appropriations, Fiscal Years 1997-2005
($ millions)

	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
EDA	8.5	9.5	9.5	10.5	10.5	10.5	10.0	11.9	12.0
DoD	1.6	1.5	1.5	0.5	0.2	0	0	0	0
Total	10.1	11.0	11.0	11.0	10.7	10.5	10.0	11.9	12.0

Data Source: U.S. Department of Commerce. Economic Development Administration (EDA) and *Budget of the United States, Fiscal Year 2006. Appendix.* p. 209.

The TAACs are staffed by professionals with broad business expertise who can help firms develop "recovery strategies" and also identify financial resources. They are, in effect, federally supported consultants specializing in business turnarounds. TAACs focus their efforts on certifying eligible firms and devising targeted adjustment strategies, which are usually implemented by private consultants on a contractual basis. EDA is statutorily restricted to cover no more than 75% of adjustment proposal costs, but beginning in fiscal year 1996, EDA reduced this to 50%, capped at $75,000 per firm.[5]

TAACs develop business recovery strategies specific to the needs of each firm, but competing with lower-priced imports typically involves making adjustments in one or more common areas. First, since firms must be experiencing falling sales to participate, TAACs often focus on marketing or sales strategies to identify new markets, new products, promotional initiatives, and export opportunities. Second, production inefficiencies are corrected to reduce firm costs and improve price competitiveness. Third, TAACs can develop debt restructuring strategies and frequently act as intermediaries in finding new sources of business financing through either government agencies (U.S. Small Business Administration) or private financial institutions.

[4] P.L. 93-618, Section 253, as amended and U.S. Department of Commerce. Economic Development Administration. *The Trade Adjustment Assistance Program*. May 1999.

[5] Ibid., and discussions with EDA staff.

Table 2 summarizes the disposition of TAA adjustment proposals, which shows that there has been a 100% adjustment proposal acceptance rate due, in part, to a preliminary review process that eliminates incomplete or ineligible applications. Most firms receiving assistance are small to medium-size manufacturing businesses. For the six-year period summarized in **table 2**, firms had an average $10.7 million in sales and 117 employees. The mean value of the trade adjustment assistance provided by the TAACs was $49,261 per firm.

Table 2. Disposition of Trade Adjustment Assistance Proposals, Fiscal Years 1999-2004

	1999	2000	2001	2002	2003	2004	Average
Received	141	147	113	148	161	165	146
Accepted	149	139	118	141	162	177	148
Rejected	0	0	0	0	0	0	0
Pending	1	9	4	10	7	0	5
Avg Firm Sales	$9.9	$10.8	$12.8	$11.7	$7.2	$11.6	$10.7
Avg Firm Employees	74	132	240	102	67	89	117
Govt Share (millions)	$7.1	$7.1	$5.3	$7.6	$8.1	$8.5	$7.3
Firm Share (millions)	$6.8	$6.5	$4.9	$7.1	$7.4	$8.1	$6.8
Total TAA (millions)	$13.9	$13.6	$10.2	$14.7	$15.5	$16.6	$14.1
Avg TAA Per Firm*	$47,651	$51,079	$44,915	$53,900	$50,000	$48,023	$49,261

* Calculated as government share of TAA Firm program divided by the number of accepted adjustment proposals.
Data Source: U.S. Department of Commerce. Economic Development Administration, *TAA for Firms Program: Adjustment Proposal Fact Sheet*.

Historically, program evaluation has been limited, although there is considerable anecdotal evidence indicating that TAA has helped many firms survive that were seriously threatened by imports. The Urban Institute completed the most comprehensive evaluation of the program in 1998. It found the TAA program effective in helping "distressed manufacturing enterprises respond to foreign imports." Specifically, the study concluded that five years after certification, eligible firms that sought TAA had a higher survival rate (84%) than those eligible firms that did not ultimately pursue assistance (70%). This amounts to a termination (firm either merged or failed) rate for assisted firms of about half that of unassisted firms. Also, assisted firms on average added 4.2% more employees and had sales growth of 34% compared to a 5.3% loss of employees and 16% sales growth for eligible firms that had not received assistance.[6]

This study was careful to include a control group in making comparisons. By including data on those firms that entered the process and became eligible for assistance, but declined to pursue TAA, a comparison could be made between two similar groups of firms that took different paths. This is a useful distinction and lends credibility to the study's overall positive conclusions. Still, given the financial commitment needed to participate, it is likely that many eligible firms that did not pursue TAA may not have had the financial ability to do so. If so, it is likely the control group may include a larger proportion of the most financially distressed firms and even in this group, there was a 70% survival rate after five years. This would suggest that the firm TAA program may help at the margin, but without it, between 70% and 86% of firms would still adjust on their own. Nonetheless, the report does provide some indication that the TAACs may be helping trade-impacted businesses become more competitive.[7]

The Urban Institute report pointed to specific characteristics of the TAA program that were particularly effective including its unbiased diagnostic approach and competitive bidding process for consulting services, its success in targeting viable firms and ensuring they are financially and managerially committed to the adjustment strategy, and its customized, broad-based, and heavily subsidized assistance package. On the other hand, the firm TAA program was criticized for not reaching all trade-impacted firms, being limited and backlogged in responding to eligible firms by funding restrictions, and having a stringent and cumbersome certification process that needed simplifying. Also, TAACs were found to have inconsistent cost and fee structures and were encouraged to leverage other business assistance services.[8]

Economic and Policy Issues

By any measure, firm and industry trade adjustment assistance is a small federal program; it remains, nonetheless, controversial. Critics point to fundamental arguments opposing TAA that have been debated since before the program was initiated in 1962. First, given that competition resulting from trade liberalization is not considered "unfair trade," why should the federal government be involved? Second, why should federal assistance be necessary for adjustment to trade competition when there is no similar assistance for adjustment to domestic competitive pressures? Third, should not this adjustment simply be accepted as part of a dynamic market economy working to allocate resources more efficiently and in the country's long-term interests?

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[6] U.S. Department of Commerce. Economic Development Administration. *Effective Aid to Trade-Impacted Manufacturers: An Evaluation of the Trade Adjustment Assistance Program*. Prepared by the Urban Institute, Washington, D.C., November 1998. pp. i, 8-14. The study, in praising the firm TAA program, expresses a strong philosophical bias for assistance to trade-impacted firms, even to the point of considering increasing tariffs or other trade limiting remedies. See p. 57.

[7] The study also attempts to control for industry, regional, and national economic conditions that can be factors affecting firm recovery or failure. Ibid., pp. 13-17.

[8] For more details on cost-benefit analysis and program design improvements see Ibid., pp. iv-vi, 8-9, and 32-48.

Proponents of the program argue that TAA is only modestly funded and provides benefits to firms, owners, managers, and workers that are many times the value of the federal expenditures. Also, if changes in national trade policy have altered the rules under which businesses compete, does not the federal government have some responsibility for assisting firms that bear the costs of adjustment? Finally, a point in favor of firm TAA is that it focuses on adjustment, not long-term financial assistance. Firms must commit their own resources and have every incentive to make adjustment to ensure their very survival. They are not faced with the potential for dependency on long-term cash payments, which critics charge is a problem with some federal assistance programs.

In addition to purely economic reasoning, political considerations also surround the TAA debate. Historically, Congress has accepted, with some reservations, that freer trade is in the long-term interests of the United States. While those skeptical of trade liberalization may support TAA for the assistance it provides to affected workers and firms, proponents of freer trade may embrace TAA for its political expedience. To the extent that firm and industry TAA can address some of the concerns of adversely affected firms, it may support trade liberalization as a continuing foundation of U.S. trade policy and temper calls for relief through raising tariffs, quotas, and other restrictions to trade. Advocates of trade liberalization may find support for firm TAA as compelling from a cost-benefit perspective if it leads to broader acceptance of trade opening legislation.

The 109th Congress faces the possibility of multiple trade bills being introduced. The debate over approving trade implementing legislation for various free trade agreements, should it be introduced, will likely include the role of trade adjustment assistance. As one of many TAA programs, the firm assistance through the EDA will likely be part of this debate that in the past has focused on how to make trade liberalization work for all segments of the U.S. economy.