



## CRS Report for Congress

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

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### Summary

Economists generally agree that trade liberalization enhances the economic welfare of all trade partners, but in compelling firms and workers to face stiffer global competition, can also cause adjustment problems. Congress has responded by authorizing three programs to assist trade-impacted workers, firms, and farmers.<sup>1</sup> This report focuses on the trade adjustment assistance (TAA) program for firms, which provides technical assistance to trade-affected firms to help them develop strategies to remain competitive in the changing international economy. TAA program authorization lapsed on October 1, 2007 and was operating under a temporary extension through December 31, 2007. The House has passed a second three-month extension and a new five-year reauthorization bill. Neither bill has been passed in the Senate. This report will be updated periodically.

### The Economics of Trade Adjustment

Economists tend to agree that in defining the rules of exchange among countries, freer trade is preferable to protectionism. Insights from the theory of comparative advantage point to freer trade providing mutual gains for countries because exchange encourages specialization, where countries produce those goods at which they are relatively more efficient, while trading for those at which they are relatively less so. Evidence supports theory. Trade appears to “enable efficient producers within an industry, and efficient industries within an economy, to expand,” leading to a reallocation of resources that increases a country’s productivity, output, and income.<sup>2</sup> Consumers (both firms and households) also gain from a wider variety of goods at lower prices.

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<sup>1</sup> See also: CRS Report RS22718, *Trade Adjustment Assistance for Workers (TAA) and Alternative Trade Adjustment Assistance for Older Workers (ATAA)*, by John J. Topoleski.

<sup>2</sup> On how trade affects total factor productivity based on U.S. manufacturing firm and plant level data, see Bernard, Andrew B. and J. Bradford Jensen. Exporting and Productivity in the USA. *Oxford Review of Economic Policy*, vol. 20, no. 3. 2004. pp. 343-344, 350, 352, and 356.

It is also true that increased competition from trade liberalization creates both “winners and losers,” presenting adjustment problems for all countries. The more efficient firms and plants may grow as they expand into overseas markets, the less efficient may contract, merge, or perhaps even fail when faced with greater foreign competition. While the adjustment process may be healthy from a macroeconomic perspective, much like market-driven adjustments that occur in the absence of trade (e.g., changing technology), it can be a rather harsh transition for some firms and their workers.<sup>3</sup>

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. The brunt of these costs falls to consumers, both individuals and businesses, who must pay higher prices, but the national economy is also denied higher standards of living because of forgone productivity gains.

One way to balance the broad-based gains from freer trade with the more highly concentrated costs 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) including a new firm and industry assistance program, which is administered by the Economic Development Administration (EDA) of the U.S. Department of Commerce.<sup>4</sup> 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 FY2007 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 that (1) a “significant” number or portion of workers became or are threatened to become totally or partially separated; (2) sales, production, or both decreased absolutely; and (3)

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<sup>3</sup> Both the benefits and costs of trade derive from resources moving from less to more productive plants (intra-industry) and firms (inter-industry). Employment dislocation is the most noticeable cost, giving rise to congressional interest in TAA programs. *Ibid.*, pp. 345 and 356.

<sup>4</sup> The TAA for firms program was originally administered jointly by the Tariff Commission (predecessor to the USITC) and the Department of Commerce.

increased imports of competing articles “contributed importantly” to the decline in sales, production, and/or workforce. 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 reasonably calculated “to materially contribute” to the economic adjustment of the firm; (2) gives adequate consideration to the interests of the firm’s workers; and (3) demonstrates that the firm will use its own resources for economic development (adjustment).<sup>5</sup>

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 adjustment proposal or implementing the proposal. In practice, this technical assistance is provided through one of the 11 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.<sup>6</sup> TAA appropriations to EDA for fiscal years 1999-2008 appear in **Table 1**. All have been used to support the TAACs, no funds go directly to firms.

**Table 1. EDA Firm TAA Appropriations, FY1998-2006 (\$ millions)**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
TAA	9.5	10.5	10.5	10.5	10.0	11.9	11.0	12.8	12.8	14.1

**Data Source:** U.S. Department of Commerce. Economic Development Administration (EDA).

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, 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 (development and implementation), but beginning in FY1996, EDA reduced this portion to 50% for implementation costs in excess of \$30,000, capped at \$75,000 per firm.<sup>7</sup>

TAACs help develop business recovery strategies specific to the needs of each firm, which typically faces adjustments in many areas to compete with lower-priced imports. First, since firms must be experiencing falling sales or declining production 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.

<sup>5</sup> P.L. 93-618, Sections 251 and 252, as amended, and 13 CFR 315.7.

<sup>6</sup> P.L. 93-618, Section 253, as amended and U.S. Department of Commerce. Economic Development Administration. [<http://www.taacenters.org>].

<sup>7</sup> 13 CFR 315.6 (c)(2) and EDA.

**Table 2** summarizes the disposition of TAA adjustment proposals, indicating a 100% adjustment proposal acceptance rate. This was due, in part, to a preliminary review process that eliminates incomplete or ineligible applications. Most assisted firms are small to medium-size manufacturing businesses. For the six-year period summarized in **Table 2**, firms had an average \$10.4 million in sales and 111 employees. The mean value of the trade adjustment assistance provided by the TAACs was \$48,407 per firm.

**Table 2. Disposition of Trade Adjustment Assistance Proposals, Fiscal Years 2001-2006**

	2001	2002	2003	2004	2005	2006	Average
Received	113	148	161	165	133	137	143
Accepted	118	141	162	177	132	137	145
Rejected	0	0	0	0	1	0	0
Pending	4	10	7	0	0	0	4
Avg Firm Sales (millions)	\$12.8	\$11.7	\$7.2	\$11.6	\$8.4	\$10.6	\$10.4
Avg Firm Employees	250	102	68	88	64	91	111
Govt Share (millions)	\$5.3	\$7.6	\$8.1	\$8.5	\$5.9	\$6.7	\$7.0
Firm Share (millions)	\$4.9	\$7.1	\$7.4	\$8.1	\$5.4	\$6.0	\$6.5
Total TAA (millions)	\$10.2	\$14.7	\$15.5	\$16.6	\$11.3	\$12.7	\$13.5
Avg TAA Per Firm*	\$44,915	\$53,900	\$50,000	\$48,023	\$44,697	\$48,905	\$48,407

**Data Source:** U.S. Department of Commerce. Economic Development Administration, *TAA for Firms Program: Adjustment Proposal Fact Sheet*. Received January 3, 2007.

\* Government share of TAA Firm program divided by the number of accepted adjustment proposals.

Historically, program evaluation has been limited. EDA has no formal evaluation process, although anecdotal evidence suggests that TAA has helped firms adjust to import competition. The Urban Institute conducted 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 amounted 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.<sup>8</sup>

<sup>8</sup> 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

(continued...)

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, but declined the assistance, 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.<sup>9</sup>

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.<sup>10</sup>

A Government Accountability Office (GAO) report points to similar problems in its own evaluation of the TAA for firms program. It highlights the inability of EDA to monitor and evaluate the performance of either firms assisted (after leaving the program) or the TAACs themselves. GAO also cites the small federal funding levels as reason for a backlog of unfunded projects and the small portion that federal assistance constitutes of the total firm adjustment project costs.<sup>11</sup>

## 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, if competition resulting from trade liberalization is not considered “unfair trade,” why should the federal government be involved? Second, why should federal assistance

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<sup>8</sup> (...continued)  
remedies. See p. 57.

<sup>9</sup> 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. The Government Accountability Office (GAO) was even more critical of this study, citing the “selection bias” issue, as well as failure to test for other explanatory variables. See U.S. GAO. *Trade Adjustment Assistance: Impact of Federal Assistance to Firms Is Unclear*. Report GAO-01-12. Washington, DC. December 2000. pp. 19-20.

<sup>10</sup> For more details on cost-benefit analysis and program design improvements, see Urban Institute, op. cit., pp. iv-vi, 8-9, and 32-48.

<sup>11</sup> GAO, op. cit., pp. 13 and 18.

be necessary for adjustment to trade competition when there is no similar assistance for adjustment to domestic competitive pressures? Third, should not this adjustment process simply be accepted as part of a dynamic market economy working to allocate resources more efficiently and in a way that is in the country's long-term interests?

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 the 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 increased tariffs, quotas, or other restrictions on 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 110<sup>th</sup> Congress**

TAA is part of the debate on how to make trade liberalization work better for all segments of the U.S. economy. Congress approved a three-month extension of all TAA programs through December 31, 2007 (P.L. 110-89). The House has also passed by voice vote another three-month extension, and by formal vote, a five-year reauthorization bill (H.R. 3920). The Senate has yet to act on a TAA bill.

Representative Rangel introduced the Trade and Globalization Act of 2007 (H.R. 3920). Following committee markup, the House passed the bill by a vote of 264 to 157. Major changes to the firm TAA program would include adding services firm eligibility, expanding the eligibility criteria, reauthorizing the program through FY2012 at \$50 million per year, and creating a small- and medium-sized manufacturing demonstration project. A new manufacturing redevelopment zone program would be added. The House defeated a Republican alternative by a vote of 196 to 226. It reflected an emphasis on cost and effectiveness issues, did not address services firms, and would have required more stringent performance measures and reporting requirements.

Senator Baucus introduced the Trade and Globalization Adjustment Assistance Act of 2007 (S. 1848) on July 23, 2007. It also would make services firms eligible to receive benefits and reauthorize the program through FY2012 at \$50 million. S. 1848 would also add a TAA program for rural and distressed communities.