ROBERT T. ARTHUR*

U.S. Government Export Incentives for Small Business

The United States has been a debtor since 1985 due to annual merchandise trade deficits exceeding $145 billion.[1] Despite a significantly lower American dollar, a high level of imports is predicted to continue for two reasons: first, many items are no longer produced in the United States, and second, Americans have developed a taste for foreign goods.[2] While most of the attention is on the rapid rise in imports since 1981, the other side of the merchandise trade deficit, exports, is equally important. Between 1981 and 1985, American exports declined 9 percent from $233.6 billion to $213.1 billion, while imports increased 32 percent from $273.4 billion to $361.6 billion.[3] Lack of American export competitiveness is reflected in the fact that the U.S. share of world trade has declined from 15.4 percent in 1970 to 12.6 percent in 1984. Yet despite this decline, the relative importance of exports to the U.S. Gross National Product (GNP) rose from 4.2 percent to 12 percent over the same period of time.[4] Exports already account for one out of every nine manufacturing jobs in the United States and one out of every seven dollars of total U.S. goods produced.[5] The hidden economic potential of stimulating national export performance for the United States can be seen in our major trading partners where exports account for 25–50 percent of their GNP.[6] The U.S. Department

*J. D. Candidate, 1988, Southern Methodist University. Casenotes and Comments Editor, THE INTERNATIONAL LAWYER.

1. Burton, *The U.S. Trade Imbalance*, 6 AM. BUS. REV. 61, 61 (1988).
2. Wall Street Journal, Feb. 9, 1988, at 1, col. 4.
3. DEPARTMENT OF COMMERCE, THE EXPORT TRADING COMPANY GUIDEBOOK 1 (1987).
4. Smith, *State-Sponsored Shared Foreign Sales Corporations: An Incentive for Firms to Increase Exports*, 4 TEX. A & M BUS. F. 43, 44 (1987).
5. DEPARTMENT OF COMMERCE, *supra* note 3, at 5.
6. Smith, *supra* note 4, at 44.

of Commerce has determined that approximately every $32,000 in manufactured goods exported from the United States creates one new job.[7]

While general economic and management policies are beyond the scope of this comment,[8] there are identifiable areas in which to increase American export performance through specific export incentives and information programs. As the Senate Committee on Small Business noted:

> Export growth in the United States has been negligible since approximately 1974. Of the U.S. businesses that do export, it is believed that roughly eighty percent of the total export market is controlled by only 200 firms. The Department of Commerce estimates that small business currently accounts for no more than ten percent of total annual U.S. exports, but at least 20,000 small firms in this country have the potential to competitively and profitably market their products overseas. Clearly, one of the greatest opportunities for reversing the "no-growth" trend in our Nation's exporting lies with tapping that potential and increasing the number of small business exporters.[9]

A survey study conducted by the Export Promotion and Market Development Subcommittee (Export Subcommittee), which was established by the Senate Small Business Committee, received responses from over 1000 exporting and nonexporting small businesses and identified four perceived primary obstacles to small business exporting: (1) lack of information, (2) government (domestic and foreign) regulations, (3) the additional expenses incurred in exporting and international marketing, and (4) financing.[10]

The purpose of this comment is to survey current United States export incentives on the federal level and show how many of these incentives address the concerns enumerated by small businesses in the above study. In the process, this comment draws some conclusions as to what other legal reforms are needed to further stimulate American export performance.

I. Survey of United States Export Incentives

A. Information Sources

The most often cited barrier facing many existing and potential small business exporters is not a lack of competitiveness but simply a lack of information about foreign markets, laws, agents, and customers. Many potential exporters may also know little about federal programs designed

7. H.R. Rep. No. 629, 97th Cong., 2d Sess. 5, *reprinted in* 1982 U.S. Code Cong. & Admin. News 2467, 2470.

8. *See* Burton, *supra* note 1.

9. Senate Comm. on Small Business, Survey of Findings on Obstacles to Exporting Faced by Small Businesses, S. Rep. No. 249, 97th Cong., 2d Sess. 1 (1982) [hereinafter Senate Comm.].

10. *Id.* at 7.

to help American exporters. Before meeting with any government trade advisors, current and potential small business exporters should consider purchasing three books from the Government Printing Office.[11]

Many small businesses overlook the wide range of services and market data provided by the U.S. Department of Commerce to exporters. The primary organization within the Department dealing with U.S. exports is the International Trade Administration (ITA).[12] While the ITA has many divisions, the exporter need only contact one of the forty-eight district offices or twenty-four branch offices of the United States and Foreign Commercial Service (U.S.&FCS) located in commercial centers throughout the United States and Puerto Rico.[13] Each district office can give information about: foreign markets for U.S. goods and services and trade opportunities; services to locate and evaluate foreign buyers and sales representatives; financing aid to exporters; U.S. Export-Import Bank programs; tax advantages of exporting; international trade exhibitions; market and economic research data on foreign markets; U.S. export licensing requirements; and foreign nation import requirements. Each district office can also provide professional counseling by trade specialists to interested firms.[14] The U.S.&FCS conducts approximately 5,000 conferences, seminars, and workshops each year on export-related topics. The seminars are usually held in conjunction with state agencies, local chambers of commerce, World Trade Clubs, and District Export Councils.[15] The U.S.&FCS overseas posts also provide a range of services to help companies sell overseas.[16] One specific service is the Trade Opportunity Program (TOP) that can provide trade leads overseas. State officials have criticized this particular program as being on a fee basis, too expensive, and that many of the trade leads are out-of-date.[17]

11. The first book, A BASIC GUIDE TO EXPORTING, has been called a "beginner's bible" to exporting. Golob, *Export Expertise*, 76 NATION'S BUS. 26, 29 (1988). This extremely comprehensive book contains information on business strategy and research, international transactions, federal export programs, and how to contact different government agencies. The second book, THE EXPORTER'S GUIDE TO FEDERAL RESOURCES FOR SMALL BUSINESS, explains the role of each federal agency and provides the names, addresses, and telephone numbers of agency officials to contact for export help. The third book, PARTNERS IN EXPORT TRADE, has a state-by-state directory with information on approximately 4,500 companies that either export or assist exporters in financing, export management or research.

12. DEPARTMENT OF COMMERCE, A BASIC GUIDE TO EXPORTING 5 (1986) [hereinafter BASIC GUIDE].

13. *Id.*

14. *Id.*

15. *Id.* at 6.

16. *Id.*

17. Kolari & Ringleb, *Promoting International Business Activity in Texas: Meeting the Financial Needs of Small- and Medium-Sized Businesses*, 4 TEX. A & M BUS. F. 20, 22 (1987).

The Small Business Administration (SBA) has an Office of International Trade, which can be contacted to obtain information on foreign markets and export procedures.[18] The SBA also has an export development specialist in each of the agency's regional offices. SBA services, available at no cost to eligible recipients, include export counseling, export training, financial assistance, and even legal assistance through an arrangement with the Federal Bar Association.[19] The SBA is also planning a series of export assistance seminars across the country in 1988 to guide small businesses through the export process.[20] Other federal programs available to assist exporters include the Foreign Agricultural Service of the U.S. Department of Agriculture and the Small Business Advisory Service of the Export-Import Bank.[21]

Finally, a number of state export efforts can be of service to small businesses. Almost all states now have some trade development services. These services vary widely from state to state and can include export education, marketing assistance, market development and financing, in-state trade centers, trade missions, trade shows, and foreign offices.[22] California alone now spends $10 million a year promoting its exports abroad.[23]

B. Financing Sources

A significant problem facing small business exporters is financing. A survey by *Nation's Business* identified difficulty in obtaining export financing and services from U.S. banks as a principal reason why small- and medium-sized American companies have not moved more aggressively into exporting.[24] The Export Subcommittee study identified five major complaints.[25] These complaints were: (1) difficulty in getting payments, (2) obtaining credit and/or banking inefficiencies, (3) the high cost of money, (4) too great a financial risk, and (5) lack of tax incentives.[26]

18. Office of International Trade, 1441 L Street, N.W., Washington, DC 20571, [(202) 635-7794].
19. Basic Guide, *supra* note 12, at 6.
20. Golob, *supra* note 11.
21. Basic Guide, *supra* note 12, at 8. The address of the Export-Import Bank is: 811 Vermont Ave. N.W., Washington, DC 20571. The small business assistance hotline is (800) 424-5201. For information on programs offered by government agencies not covered by this comment, such as the Foreign Agricultural Service and the Agency for International Development (AID), see Basic Guide, *supra* note 12, at 95-99 and Department of Commerce, Official Sources of Export Assistance for Small Businesses (1984).
22. Basic Guide, *supra* note 12, at 8, 100 app. V.
23. Golob, *supra* note 11, at 30.
24. *Banks that Can Aid Exporters*, 76 Nation's Bus. 27 (1988).
25. Senate Comm., *supra* note 9, at 14.
26. *Id.*

Most small businesses work with small- and mid-sized banks. These banks have a strong domestic business orientation and are very often not very knowledgeable about international business transactions, including letters of credit.[27] Small business exporters have numerous complaints against these banks involving unnecessary delays in processing letters of credit, not accepting foreign receivables as security for lines of credit (even when those accounts are covered by irrevocable letters of credit), and burdensome pledging requirements.[28] Regional banks have not been much better. An American Bankers Association commissioned study found the international department or function of regional banks to be "opportunistic and selective."[29] Even when dealing with large banks, small business exporters have complained of impersonal treatment, onerous application details, burdensome pledging requirements, and high minimum loan requirements.[30] Fortunately, the government has a number of programs in place to help small businesses.

1. *The Export-Import Bank*

The Export-Import Bank (Eximbank)[31] is a wholly owned government corporation, established in 1934 as an independent agency to facilitate and finance U.S. exports and has, since its inception, supported more than $160 billion in U.S. export sales.[32] Eximbank is directed by statute: (1) to offer financing to U.S. exporters that is competitive with the subsidized credit foreign governments offer their national exporters, (2) to give support only to transactions that have a reasonable assurance of repayment, (3) to supplement, but not compete with, private sources of export financing, and (4) to take into account the effect of Eximbank activities on small business, the domestic economy, and U.S. employment.[33]

All Eximbank programs have some general eligibility requirements. First, only U.S. origin goods and services are eligible.[34] Goods must have more than 50 percent U.S. content to qualify.[35] Foreign enterprises can also qualify for Eximbank help if they are exporting U.S. goods.[36] Fur-

27. *Id.* at 15.
28. *Id.*
29. *Banks that Can Aid Exporters*, NATION'S BUS., *supra* note 24.
30. Kolari & Ringleb, *supra* note 17.
31. 12 U.S.C. § 635 (1982).
32. 2 W. STRENG & J. SALACUSE, INTERNATIONAL BUSINESS PLANNING: LAW AND TAXATION § 10.01 (1987).
33. EXPORT-IMPORT BANK, FOR YOUR INFORMATION 1 (1984)
34. W. STRENG & J. SALACUSE, *supra* note 32, § 10.01[A][3][a].
35. *Id.*
36. *Id.* § 10.01[A][3][b].

thermore, the prospective exporter must see if the importing country is eligible for Eximbank support. The vast majority of non-Communist countries are eligible and even several communist countries have received Presidential approval for export credits.[37] Goods receiving Eximbank support must also be carried in ships of U.S. registry unless either the Maritime Administration waives the requirement because of the nonavailability of a U.S. registered ship for a particular voyage, or a reciprocal agreement with another nation excuses the requirement.[38] Finally, Eximbank will determine its premiums on the basis of a credit risk evaluation that looks at both the country credit risk and buyer credit risk.[39]

Eximbank provides exporters with help through four major means: (1) by providing repayment guarantees or export credit insurance so that exporters or their bankers will provide credit to foreign buyers, (2) foreign buyer credit programs through a combination of direct Eximbank credit and commercial bank guarantees, (3) direct, long-term financing for large projects and capital equipment sales, and (4) refinancing and discount programs to insure that commercial banks make capital available to American exporters.[40]

Export credit insurance is available through the Foreign Credit Insurance Association (FCIA) for short- and medium-term credit sales to foreign buyers. The FCIA is a group of U.S. property, casualty, and marine insurance companies that cooperate with the Eximbank to cover repayment risks.[41] Having such insurance allows American exporters to extend credit, or extend credit on more favorable terms, to foreign buyers, and thus be more competitive.[42] Credit insurance also encourages banks to extend credit to exporters on the basis of the insured accounts receivables.[43] Banks can also purchase credit insurance to cover their loans to U.S. exporters and about 200 banks have already purchased such "Master Policies" from the FCIA.[44]

While the FCIA has a wide variety of policies,[45] one in particular is designed to help small businesses new to international trade. The New-

37. *Id.* § 10.01[A][3][d].

38. *Id.* § 10.01[A][6]. The most prominent example of a reciprocal agreement is that with Brazil. *Id.*

39. *Id.* § 10.01[A][4].

40. W. STRENG & J. SALACUSE, *supra* note 32, § 5.06.

41. *Id.*

42. BASIC GUIDE, *supra* note 12, at 47.

43. *Id.*

44. *Id.*

45. For an up-to-date list and description of Eximbank programs, contact the Eximbank at the address listed in note 21 *supra*. *See also* W. STRENG & J. SALACUSE, *supra* note 32, § 10.01[B]. Service businesses should note that a Service Policy exists for the export of U.S. architectural, engineering, transportation, export promotion, and other services. *Id.* § 10.01[B][2] [viii] & app. 10V.

to-Export policy is offered with a maximum possible coverage (100 percent of the losses due to political risks[46] and 95 percent of the commercial losses[47]) that is not available to experienced exporters.[48] Only companies that have had export sales of less than $750,000 a year in the last two years and have not previously used Eximbank or FCIA programs can qualify for this specific policy.[49]

The Eximbank's Working Capital Guarantee Program is designed to encourage banks to lend American exporters needed working capital that would not be available without the Eximbank's assistance.[50] The Eximbank will guarantee up to 90 percent of a commercial bank's loan to the U.S. exporter.[51] The term of the loan will usually range from one to twelve months, but can be for a longer period.[52] The purpose of the loan must be for a specific export-related activity, such as inventory purchases for foreign markets, trade fair participation, and other promotional activities.[53]

The Eximbank also has a Small Business Credit Program that enables commercial banks receiving Eximbank support to extend medium-term *fixed-rate* loans at below market interest rates to finance the foreign sales of capital goods and quasi-capital goods and related services from U.S. small business exporters.[54] This program is useful since banks usually want a floating rate on medium-term loans and many foreign buyers are reluctant to accept a fluctuating interest rate risk in addition to the foreign exchange risk they bear on foreign currency loans.[55] These loans range from one to five years and require that the foreign buyer make a minimum 15 percent cash payment on the goods.[56]

Another Eximbank buyer credit program is the Cooperative Financing Facility (CFF). The CFF is a program to help qualifying foreign financial

46. Political risks include war, currency inconvertibility, cancellation/nonrenewal of a U.S. export license, imposition of export controls prior to shipment, and expropriation or nationalization of the buyer's business. D. EITEMAN & A. STONEHILL, MULTINATIONAL BUSINESS FINANCE 541 (3d ed. 1982).

47. Commercial losses include nonpayment due to insolvency, unjustified refusal to accept the goods, and protracted payment default. BASIC GUIDE, *supra* note 12, at 47. Exchange rate risks are different from currency inconvertibility risks and cannot be insured under FCIA policies, but currency market hedging is an alternative. D. EITEMAN & A. STONEHILL, *supra* note 46, at 541.

48. The insurance normally covers 100 percent of losses for political risks and 90 percent of commercial losses.

49. BASIC GUIDE, *supra* note 12, at 47.

50. EXPORT-IMPORT BANK, *supra* note 33, at 10.

51. *Id.*

52. BASIC GUIDE, *supra* note 12, at 47.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

institutions make credit available to their local small- and medium-sized businesses for the purchase of U.S. goods and related services. The Eximbank will lend one-half the needed funds at a low interest rate to the foreign bank. The foreign bank must bear all the commercial risks.[57]

While the Eximbank performs a very needed role and has accounted for over $160 billion in exports, it has received some criticism. The Eximbank estimates that its programs affect about 7 percent of American export sales annually.[58] At the same time, the Eximbank estimates that competing foreign institutions have assisted 39 percent of Japan's exports, 35 percent of the United Kingdom's, 33 percent of France's, and 11 percent of West Germany's.[59] The U.S. Eximbank's relatively poor performance is due to the uncompetitive nature of Eximbank's medium-term programs and the inability of the Eximbank to respond to substantive changes in its environment as quickly, freely, and quantitatively as other foreign agencies.[60] Due to these problems, at least one study rated the Eximbank's medium-term programs as one of the least competitive among the major trading nations.[61]

2. *Foreign Sales Corporations*

The Export Subcommittee survey of small business found that one of the financing incentives small business exporters desired was federal tax incentives.[62] Such tax incentives already exist, including special provisions for small business exporters. The Tax Reform Act of 1984 severely curtailed the benefits of Domestic International Sales Corporations (DISCs) and created Foreign Sales Corporations (FSCs) in order to comply with General Agreement on Trade and Tariffs (GATT) and still provide a tax incentive for American businesses to export.[63] The old DISC was held

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57. D. EITEMAN & A. STONEHILL, *supra* note 46, at 541.

58. 2 J. LEMLE, INTERNATIONAL FINANCE HANDBOOK § 7.2, at 18 (A. George & I. Giddy eds. 1983).

59. *Id.*

60. W. STRENG & J. SALACUSE, *supra* note 32, § 10.01[B][3][e].

61. *Id.*

62. SENATE COMM., *supra* note 9, at 14.

63. Block, Gilbert & Kuenster, *Transition From DISC to a Foreign Sales Corporation: Tax and Other Considerations*, 19 INT'L LAW. 343, 343 (1985). This article gives a clear and succinct explanation of the differences between the old DISC and the new FSC. The reason for the change was that the European Community and other GATT signatories complained strongly that the old DISC was an illegal trade subsidy under GATT. DISCs were given a tax deferral on 15–25 percent of export sales and there was no foreign management and economic activity requirement as with an FSC. Smith, *supra* note 4, at 45. The new FSC rules are found in I.R.C. §§ 921–927 (Supp. III 1985) and the DISC rules in *id.* §§ 991–997. *Id.* § 291(a)(4) has been amended and now only permits interest-charge DISCs. *Id.* § 995(b)(1)(E).

to be an illegal export subsidy by the GATT Panel.[64] To comply with GATT and still maintain tax incentives for American exporters, the United States developed FSCs with the understanding that the United States was not required to tax economic activities of its nationals that occur outside the United States, subject to certain arm's length pricing rules for related foreign buyers.[65]

Due to the complications of creating a tax entity that complies with GATT, a corporation desiring to qualify as an FSC must meet a number of formal requirements. The first requirement is that the FSC must be formed under the laws of a U.S. possession or a qualifying country.[66] Twenty-nine countries qualify under FSC rules by meeting certain "exchange of information" requirements.[67] This requirement is not really a problem as a number of U.S. possessions and qualifying foreign countries have passed "FSC incentive legislation" and as a result either impose no taxes or tax at a very low rate.[68] The second major requirement is that the FSC have no more than twenty-five shareholders.[69] Other general requirements are that: an FSC may not issue preferred stock;[70] an FSC must maintain an office in a qualifying jurisdiction and keep records at that office; an FSC must also maintain accounting records in the United States;[71] an FSC must have at least one director who is not a resident of the United States;[72] an FSC may not be a member of a controlled group of corporations that includes a DISC;[73] and the FSC must file an election for FSC status with the Internal Revenue Service within ninety days of the beginning of the FSC's taxable year.[74]

Companies willing to export American products through an FSC accrue substantial tax benefits. An FSC will receive tax exempt treatment for a portion of its foreign trade income (FTI). The FTI of an FSC is defined as "the gross income of [an] FSC attributable to foreign trading gross

64. Caplan, *Legislative Developments: The Abolishment of DISCs and the Creation of FSCs*, 15 DEN. J. INT'L L. & POL'Y 95, 98 (1986).

65. *Id.*

66. Generally, an FSC must be organized under the laws of a qualifying jurisdiction outside United States customs territory. Qualifying jurisdictions include all United States possessions, except Puerto Rico, and all foreign countries that have an exchange of information agreement or a tax treaty with an equivalent information provision. I.R.C. §§ 222(a)(1)(A), 927(d)(3) & (5) (Supp. III 1985).

67. W. DIAMOND, FOREIGN SALES CORPORATION xiv (1987).

68. I.R.C. § 922(a)(1)(B) (Supp III 1985); *see* W. DIAMOND, *supra* note 67, at xv–xvii; Sharp, Steele & Jacobson, *Foreign Sales Corporations: Export Analysis and Planning*, 63 TAX MAG. 163, 163 (1985).

69. I.R.C. § 922(a)(1)(B) (Supp. III 1985).

70. *Id.*; Block, Gilbert & Kuenster, *supra* note 63, at 344.

71. I.R.C. § 922(a)(1) (Supp. III 1985); Treas. Reg. § 1.922–1 Q&A 12 (1987).

72. I.R.C. § 922(a)(1)(E) (Supp. III 1985).

73. *Id.* § 922(a)(1)(F).

74. *Id.* §§ 922(a)(2), 927(f)(1).

receipts."[75] Foreign trade gross receipts (FTGRs) include the sales, exchange, or lease of "export property," related and subsidiary services, engineering or architectural services for foreign construction projects, and the performance of foreign managerial services for an unrelated FSC or DISC.[76] "Export property" is simply all property of U.S. origin that is sold for direct use or consumption abroad and not more than 50 percent of the fair market value of which is used in articles that are then imported into the United States.[77] For FTGRs to qualify for favorable tax treatment under the FTI provisions, they must meet two basic tests. The foreign management test requires that all formal board and shareholder meetings be held outside the United States and that the FSC's principal bank account also be maintained outside the United States.[78] The foreign economic processing test requires that the FSC participate "in the solicitation (other than advertising), negotiation or the making of the contract relating to such transaction" outside the United States,[79] and that at least 50 percent of five specific exporting costs (advertising, order and invoice processing, shipment or ordered goods from the FSC, and assumption of credit risks) must be borne by the FSC.[80] These two tests were necessary additions to insure that the FSCs met GATT requirements that only exporting activities outside a country's territorial limit may receive advantageous tax treatment.[81]

Significant tax benefits result from having an FSC. The amount of FTI that is exempt from United States taxation is determined on the basis of two factors: (1) whether the U.S. seller and the FSC are related, and (2) which transfer pricing rule is used. The interplay of these factors and the different arm's length and administrative transfer pricing rules can lead to some fairly complicated analysis.[82] Tax experts have determined that for corporate FSC shareholders, these tax exemptions combined with a

75. *Id.* § 923(b).

76. *Id.* §§ 924, 927.

77. *Id.* § 927(a). Section 402 of the Tariff Act of 1930, 19 U.S.C. § 1401 (1982), sets forth the standard to be used in determining "fair market value."

78. I.R.C. § 924(c)(1) & (2) (Supp. III 1985); P. Vishny, Guide to International Commercial Law § 8.38D (1986).

79. I.R.C. § 924(d)(1)(A) (Supp. III 1985); P. Vishny, *supra* note 78, § 8.38E.

80. I.R.C. § 924(d)(1)(B) (Supp. III 1985). An exception to the 50 percent rule exists where the FSC may bear 85 percent of the cost of just two of the five required export activities. *Id.* § 924(d)(2).

81. Caplan, *supra* note 64, at 99–102.

82. The amount of FTI that is exempt from United States taxation when an FSC deals with a related party (the nominal situation) is determined on the basis of which of two transfer pricing rules (the administrative "safe harbor" pricing rules under I.R.C. § 925(a) (Supp. III 1985) or the well known arm's length rule under *id.*, § 994(a)(1)) are used. A short, clear explanation of these rules can be found in the Basic Guide, *supra* note 12, at 56. For more detail analysis, see W. Diamond, *supra* note 67.

100 percent FSC exempt income dividend exclusion for distribution out of exempt FTI,[83] would normally translate into about a 15 percent reduction in taxable income from exports and a 5.1 percent decrease in the tax rate from 34 percent (the maximum corporate rate) to 28.9 percent.[84] The FSC's nonexempt FTI is immediately subject to taxation by the United States.[85]

Small businesses have the option of creating a "small FSC."[86] The small FSC's major advantage is that it does not need to meet the foreign management and economic process tests of regular FSCs to receive the same favorable tax treatment.[87] The required economic process activities must still be performed by the small FSC, but they need not be performed outside the United States.[88] The small FSC must still meet all the formal tax election requirements and the transfer pricing rules.[89] The small FSC is limited to only $5 million of FTGR that can be used in determining its exempt FTI.[90] If a small FSC's FTGR exceeds $5 million, it may select only the most profitable sales for favorable tax treatment.[91]

FSCs and small FSCs are excellent vehicles for stimulating small business export growth. One of the major problems facing small business exporters besides financing, however, is the additional expense and risks involved in trying to sell overseas.[92] As noted above, an FSC can have up to twenty-five shareholders, each shareholder being a separate business. This requirement is beneficial to small business as several small companies may pool together and establish a "shared" FSC. In this way small companies can spread the generally low operating costs of an FSC, share risk, pool exporting expertise, and derive certain economies of scale.[93] The shared FSC has worked out well for small exporters. The basic shared FSC would have each exporter own a separate class of stock, have each shareholder conduct its business separately so that the FSC and its other shareholders do not gain access to proprietary information, and have each shareholder pay a commission on its exports to the FSC to cover costs (about $3000–$4000 per year per shareholder operating costs).[94] To date, small exporters have reported about a seven-to-one

83. I.R.C. §§ 923(a)(2), 291(a)(4)(A) (Supp. III 1988).
84. Smith, *supra* note 4, at 46; Block, Gilbert & Kuenster, *supra* note 63, at 347–48.
85. I.R.C. § 921(d) (Supp. III 1985).
86. *Id.* § 922(b).
87. *Id.* § 924(b)(2)(A).
88. Temp. Treas. Reg. § 1.921-2 Q & A 12 (1987).
89. Caplan, *supra* note 64, at 105.
90. I.R.C. § 924(b)(2)(B)(i) (Supp. III 1985).
91. *Id.*
92. SENATE COMM., *supra* note 9, at 12.
93. Smith, *supra* note 4, at 46.
94. *Id.*

payoff in money spent on operating a shared FSC versus the money saved on taxes.[95] State authorities, trade associations, banks, shipping companies, and other groups of businesses are actively promoting shared-FSCs.[96]

II. Other Barriers Facing Small Business

Two primary problems to small business exporting identified by the Export Subcommittee survey study are government (domestic and foreign) regulations and the additional expenses incurred in exporting.[97] Government regulations was the second most often cited obstacle in the study of exporting by small businesses. The primary concerns of small business in this area are: (1) too much paperwork—foreign and domestic, (2) the complexity and restrictive nature of foreign laws, and (3) the complexity of the Export Administration Act and slow response time to inquiries by businesses concerning export controls and regulations by the Department of Commerce.[98] The expenses incurred in exporting was the third most often cited barrier in the study. The primary concerns are: (1) foreign duties and value added taxes, (2) transportation/shipping costs, and (3) promotion/marketing expenses.[99] Fortunately, a legal mechanism is available to help small business deal with expense and complexity of exporting and government regulations.

A. Export Trading Companies

The purpose of the Export Trading Company Act of 1982[100] is "to encourage exports by facilitating the formation and operation of export trading companies, export trade associations, and the expansion of export trade services generally."[101] The Export Trade Act helps American businesses through five specific means: (1) by granting export trading companies (ETCs) a great deal of flexibility to act as trade facilitators or trade developers; (2) permitting investments in these ETCs by banking institutions; (3) directing the Eximbank to develop programs to insure that commercial banks make capital available to American exporters; (4) clarifying antitrust laws as they apply to export trading generally; and (5) granting limited antitrust protection to certain approved activities.[102]

95. W. Diamond, *supra* note 67, at xx.
96. *Id.*
97. Senate Comm., *supra* note 9, at 7.
98. *Id.*
99. *Id.*
100. 12 U.S.C. § 1841, 15 U.S.C. §§ 1, 4001–03, 4011–21 (1982) [hereinafter ETCA].
101. H.R. Rep. No. 924, 97th Cong., 2d Sess. 3, *reprinted in* 1982 U.S. Code Cong. & Admin. News 2501.
102. Griffin & Modell, *The Export Trading Company Act*, 30 Prac. Law. 73, 74 (1984).

An ETC can be formed by a person or an organization doing business under U.S. laws and operates principally either to export American goods or services or to assist such exports by providing one or more export trade services.[103] The range of "export trade services" that can qualify a company as an ETC is very broad. The Export Trade Act's definition of export trade services includes: (1) consultation; (2) marketing; (3) international market research; (4) advertising; (5) insurance; (6) product research and design; (7) legal assistance; (8) transportation, including trade documentation and freight forwarding; (9) warehousing; (10) foreign exchange; and (11) financing.[104] The ETC can thus serve as a "one-stop" intermediary for facilitating exports or specialize in the provision of a particular service.[105] ETCs have or can develop the expertise to deal with the complexities of international trade and government regulations that cause small businesses so much concern. Besides expertise, ETCs can also help small businesses achieve some economies of scale relating to export activities. The ETC may also function as trade developer for American products in foreign markets. ETCs acting as trade developers can also specialize by commodity, by export region, or by focusing on a particular foreign market to develop for American goods.[106]

The ETC Act also amends the Bank Holding Company Act of 1956[107] to allow bank holding companies to invest up to 5 percent of their consolidated capital and surplus in one or more ETCs and own up to 100 percent of an ETC.[108] The bank holding company may also lend the ETC money, but only at rates charged other firms of equal credit worthiness.[109] Congress believes that banks can be valuable partners because of their experience in international transactions and their access to substantial financial resources.[110] Unfortunately, bank ETCs are subject to a number of burdensome Federal Reserve Board restrictions that are in addition to some special restrictions within the ETC Act itself.[111] As a consequence, only twenty-nine bank ETCs are operational at present.[112]

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103. ETCA § 103(a)(4), 15 U.S.C. § 4002(4) (1982); Griffin & Modell, *supra* note 102, at 74.

104. 15 U.S.C. § 4002(3) (1982).

105. Griffin & Modell, *supra* note 102, at 74.

106. *Id.*

107. 12 U.S.C. §§ 1841–1850 (1982).

108. ETCA § 203(3) (amending 12 U.S.C. § 1843(c) (1982)); Griffin & Modell, *supra* note 102, at 75. Title II of the ETCA covers the banking provision and may also be cited as the "Bank Export Services Act." ETCA § 201, 12 U.S.C. § 1841 note (1982).

109. ETCA § 203(3), 12 U.S.C. § 1843(c)(3)(B)(iii) (1982).

110. Griffin & Modell, *supra* note 102, at 75.

111. The Federal Reserve Board's regulations can be found in 12 C.F.R. §§ 211.31-.34 (1986). For a full discussion of how the Federal Reserve Board's regulations have hindered the development of bank-owned ETCs, see Lacy, *The Effect of the Export Trading Company Act of 1982 on U.S. Export Trade*, 23 STANFORD J. INT'L L. 177, 194–200 (1987).

112. Lacy, *supra* note 111, at 182.

One of the advantages of ETCs are that they can be formed by several small businesses and serve as the exporting department for these companies. The primary concern with various cooperative efforts in business is U.S. antitrust laws. Fortunately, the ETC Act addresses the antitrust concerns of the business community as well. The ETC Act has clarified antitrust law concerning foreign activities by stating that a potential antitrust violation will occur only when allegedly illegal activity has a "direct, substantial and reasonably foreseeable" anticompetitive effect in the United States.[113] *Eurim-Pharm GmbH* v. *Pfizer, Inc.* [114] is an example of a federal district court dismissing an antitrust action on the basis that it did not have subject matter jursidiction because of the ETC Act's amendment of the Sherman Act. The ETC Act also provides ETCs or anyone, including individuals, interested in exporting with additional protection from antitrust actions through certificates of review. Certificate holders have a number of protections against antitrust actions for any conduct *specified in* the certificate of review. These protections include: (1) the Attorney General of the United States can file an action only if the conduct of the certificate holder threatens clear and irreparable harm to the United States; (2) civil suits may not claim treble damages, only injunctive relief and actual damages for failure to comply with the four conditions on the certificate; (3) the ETC Act creates a presumption that conduct within the scope of the certificate is legal; and (4) an unsuccessful plaintiff will be required to compensate the defendant for the costs of defending the lawsuit.[115] In an important case of first impression, the Third Circuit Court of Appeals reversed a lower court decision and granted a summary judgment motion by the federal government that an antitrust action against a certificate holder be dismissed.[116] In a unanimous decision, the court held that the presumption that the certified activity is legal should be upheld if a review of the Commerce Department's administrative record shows that its decision to issue the certificate was "carefully reasoned" and "supported in the record."[117] The ETC Act basically requires the issuance of a certificate of review unless there is a substantial likelihood that the applicant's export activities will have a domestic anticompetitive effect.[118]

113. ETCA § 402 (amending § 7 of the Sherman Act, 15 U.S.C. § 6a (1982)).

114. 593 F. Supp. 1102 (S.D.N.Y. 1984).

115. ETCA § 306, 15 U.S.C. §§ 15, 26, 4016 (1982); Griffin & Modell, *supra* note 102, at 76.

116. Horizons Int'l, Inc. v. Baldridge, 624 F. Supp. 1560 (E.D. Pa. 1986), *rev'd*, 811 F.2d 154 (3d Cir. 1987).

117. 811 F.2d at 169.

118. Lacy, *supra* note 111, at 179. For the four specific conditions that must be met, see 15 U.S.C. § 4013 (1982).

B. THE RELATIONSHIP OF ETCs AND FSCs

The ETC Act tries to encourage exporting by small- and medium-sized businesses by allowing them to work together through ETCs that can ship or market their goods abroad. The ETC Act would allow these businesses to form such joint ventures without risking any significant antitrust liability. These joint ventures would allow small businesses to derive the traditional benefits of economies of scale, pooled expertise, and shared risk.[119] The key relationship between ETCs, which can take a variety of forms, and FSCs, which must meet certain very specific requirements, is that an ETC may set up as an FSC or have an FSC as a foreign subsidiary.[120] This provision allows the small business joint venture to receive the legal benefits of ETC membership as well as the tax benefits of the FSC.[121]

III. Customs Benefits to Exporters

A. FREE TRADE ZONES

Free trade zones (FTZs)[122] have existed since 1934, but have seen truly explosive growth since 1970.[123] The number of FTZs has increased from eight general purpose FTZs in 1970 to ninety-one general purpose FTZs and thirty special subzones in 1983. The value of the industrial operations in FTZs has increased from $743 million in 1978 to over $3.9 billion in 1982.[124] Any major port of entry in the United States can be designated an FTZ.[125] A manufacturer can also seek permission to designate a factory that is reasonably close to the FTZ as a subzone, rather than have to build a new factory in an existing general purpose zone.[126] These subzones now account for over half of all zone economic activity and over 90 percent of all zone manufacturing.[127]

The rapid growth of FTZs is due to the significant advantages they offer to both importers and exporters. There are a number of distinct advantages to American manufacturers who both use foreign raw materials or components and then export the finished product through FTZs. The

119. Smith, *supra* note 4, at 48.
120. *Id.*
121. *Id.*
122. FTZ Act of 1934, 19 U.S.C. § 81a-81u (1982).
123. deKieffer & Thompson, *Political and Policy Dimensions of Foreign Trade Zones: Expansion of the Beginning of the End?* 18V AND. J. TRANSNAT'L L. 481, 496–97 (1985).
124. *Id.*
125. 19 U.S.C. § 81b(b) (1982); Tannenbaum, *An Overview of Import-Export Cost Saving Techniques*, 33 PRAC. LAW. 25, 26 (1987).
126. Foreign Trade Zone Board Order No. 29, 17 Fed. Reg. 5316 (1952).
127. deKieffer & Thompson, *supra* note 123, at 492–93.

primary advantage is that the manufacturer can avoid customs duties as the FTZ is considered to be outside the jurisdiction of the U.S. Customs Service.[128] No duties are paid on goods imported into an FTZ, processed, and then exported to a foreign market. There are also a number of tax advantages for exporters to be located in an FTZ. Manufacturers can use FTZs to avoid United States excise taxes. This tax need never be paid if the goods are exported from the FTZ to a foreign market.[129] Also, the Trade and Tariff Act of 1984 exempted FTZs from state and local *ad valorem* taxation on goods that enter a zone and are destined for exportation.[130]

B. Drawbacks

Those that cannot avail themselves of an FTZ have the option of a drawback. A drawback is a refund of up to 99 percent of the customs duties previously paid on imports when those goods are exported from the United States.[131] The drawback is available either to the importer who reexported the goods or to the supplier who imported the goods and sold them to an American manufacturer who then exported them (changed or unchanged).[132] The drawback is allowed on imported merchandise if the merchandise is exported within three years of the date of entry, or five years if the merchandise has been processed in some manner and has changed form.[133]

IV. Conclusion

Many of the obstacles to exporting that small American exporters refer to revolve around their lack of knowledge of exporting, foreign markets and laws, and the additional operating, shipping, and marketing expenses they would incur in trying to penetrate these markets. Export trading companies and "shared" foreign sales corporations were designed to give both legal and tax incentives for small businesses to export and engage in self-help by pooling their own foreign marketing expertise and sharing their risks and expenses. Furthermore, the Eximbank has programs in place to help ensure that commercial banks extend credit to exporters.

128. *Id.* at 495. Apart from its special customs status and certain tax advantages, an FTZ operation is still subject to Federal, state, and local laws. Finkel, *Role of U.S. Foreign Trade Zones in Exporting and Importing*, in Legal Aspects of Exporting: An Introduction ch. XI, at 5 (Small Business Administration ed. 1984).
129. deKieffer & Thompson, *supra* note 123, at 495.
130. *Id.* at 496–97.
131. 19 U.S.C. § 1303 (1982).
132. Tannenbaum, *supra* note 125, at 25.
133. *Id.* at 27–28.

The Eximbank's buyer credit programs should also help make foreign market penetration easier. Some of small businesses' other financing concerns have also received direct responses from government programs. One of the foremost concerns of small businesses when dealing with foreign customers is simply getting paid. The FCIA's credit insurance policies dramatically reduce both commercial and political risks for American exporters.

Numerous regional seminar programs by the Department of Commerce and the SBA address many of the problems identified in this comment. Unfortunately these programs are for the most part not reaching their target: small businesses. As one Commerce Department official states: "The Commerce Department is not filled with marketing experts who know how to promote its programs."[134] Even greater efforts to reach small business are required. More cooperation with state and regional agencies and better program promotion are two options. Greater cooperation between federal agencies is needed to avoid confusion and unnecessary duplication of efforts.[135] Increased cooperation between state and federal agencies also is important since states now spend as much on international business development as the federal government. Greater federal-state cooperation could certainly benefit federal efforts to reach small business.

Problems with three specific federal programs—the Eximbank's medium-term financing programs, the Eximbank's lack of active promotion of ETC financing,[136] and bank ETCs—need attention. In addition, the Department of Commerce's certificate of review process for antitrust protection to American exporters should be simplified and further refined as not to disclose confidential business information and marketing plans. Finally, small business itself should make a greater effort to learn about potentially very profitable foreign markets, especially in light of the recently dropping United States dollar against more major foreign currencies.

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134. *Commerce Gets Mixed Reviews*, 76 NATION'S BUS. 31 (1988).

135. Busbee, *Rationale for a Coherent National Export Program*, in WORLD TRADE AND TRADE FINANCE (J. Norton ed. 1985).

136. Lacy, *supra* note 111, at 190.