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Establishing American Trading Companies

*Franklin A. Cole**

On September 3, 1980, the United States Senate, by unanimous vote, passed landmark legislation designed to increase American exports of products and services by encouraging formation of U.S. export trading companies.¹ The Export Trading Company Act of 1980,² reintroduced and at this writing awaiting approval by a new Congress,³ is a significant first step in offering American companies, particularly those of small and medium size, the opportunity to enter markets on a par

* Chairman of the Board, Walter E. Heller International Corporation; B.S., University of Illinois, 1947; J.D., Northwestern University, 1950. The author acknowledges with gratitude the help over many years of Harvey S. Lederman, Vice President, Marketing and Public Relations of Walter E. Heller & Company; Charles A. Brizzolara, Vice President, Secretary and General Counsel of Walter E. Heller International Corporation; and Burton R. Abrahams, President of Walter E. Heller Overseas Corporation, in trying to impress upon Congress and regulators the need to provide the means to enable small and medium size firms to export, and the vast potential inherent in that activity.

¹ The Senate vote was 77-0. [1980] 323 INT'L TRADE RPT. U.S. EXPORT WKLY. (BNA) at C-1.

² S. 2718, 96th Cong., 2d Sess. (1980). "The purpose of this Act is to increase United States exports of products and services, particularly by small, medium-sized and minority concerns, by encouraging more efficient provision of export trade services to American producers and suppliers." 126 CONG. REC. S11,935 (daily ed. Sept. 3, 1980).

³ The Export Trading Company Act of 1981, S. 144, which is almost identical to S. 2718, was introduced on January 19, 1981, with the co-sponsorship of 49 U.S. senators. [1980] 342 INT'L TRADE RPT. U.S. EXPORT WKLY. (BNA) at C-5. Three separate bills have been introduced in the House: H.R. 1799, H.R. 1321, and H.R. 1648. [1980] 344 INT'L TRADE RPT. U.S. EXPORT WKLY. (BNA) at C-6.

with their international foreign competitors. The Act moderates restrictions that have blocked the growth of full-range export trade service companies that would help average-sized firms enter international markets. The effectiveness of the all-encompassing "one-stop" service organization is indicated by the success of the general trading companies of Japan. American export trading companies, organized to meet the needs of our own economy, could help to resolve the problems and business-related fears that have inhibited the average American manufacturer from international trade. While the Act is no panacea, it would promote the development of our export strength, and put us in a better position for the future. Its swift enactment should be supported.

After a brief review of the United States export balance, this article will explore the operation of the Japanese general trading companies, which have aroused interest in the American business community and have been proposed as a partial model for our own export trade.⁴ The provisions of the Export Trading Company Act of 1980 will then be examined to assess Congress' approach to the formation of export trading companies in the United States.

THE CURRENT STATUS OF AMERICA'S EXPORT TRADE

The American trade deficit in 1979 was \$24.7 billion.⁵ Although monthly figures in the first half of 1980 were favorable, and although the annual deficit may not have increased in 1980, this is still a sizable amount. Data from the U.S. Commerce Department shows that since 1978, we have begun to regain the share of free world exports we lost during the years 1970-77—that is, from our 1977 low of 12% we have come up to 12.5%.⁶ It is clear, however, that further improvement is needed. Growth in American exports has helped, among other things, to pay a tremendous oil bill, and has prevented a trade deficit that could have been twice as large.⁷ We need to strengthen our new trend

⁴ *Export Trading Companies and Trade Associations: Hearings on S. 864, S. 1499, S. 1633, and S. 1744 Before the Subcomm. on Int'l Finance of the Senate Comm. on Banking, Housing, & Urban Affairs, 96th Cong., 1st Sess. 55 (1979)* (statement of Frederick W. Huszagh, Executive Director, Dean Rusk Center, University of Georgia) [hereinafter cited as *S. 864 Hearings*]; see *Financial Institutions and Export Trading Companies: Hearings on S. 2718 Before the Senate Comm. on Banking, Housing & Urban Affairs, 96th Cong., 2d Sess. 21 (1980)* (statement of Sen. Stevenson) [hereinafter cited as *S. 2718 Hearings*].

⁵ N.Y. Times, Sept. 27, 1980, at 19, col. 1.

⁶ BUS. WEEK, Jan. 26, 1981, at 115. Even the improvement in the U.S. market share may be overstated, due to devaluation of the dollar during the 1970's, with the unit value of U.S. exports lessening as a result. *Id.* July 21, 1980, at 90.

⁷ Estimates for 1980 show that earnings of above \$27 billion in agricultural goods and \$26

of export growth. America's small and medium sized manufacturing firms represent an untapped source of business energy.

With the exception of giant corporations, and manufacturers in certain specialty lines, U.S. manufacturers on the whole are not export-minded. It is not difficult to understand why. For most of the nation's history, domestic demand has engaged average-sized firms to the exclusion of investigating foreign markets.⁸ After World War II, as international trade began to grow, it fit into the established marketing patterns of only the largest U.S. firms. Today a tiny fraction of American manufacturers have any regular export practice—8.3% of 300,000 firms, according to recent data from the International Trade Administration.⁹

Small and medium sized firms are deterred from entering the export business by more than habit and the historical pre-emption of the larger firms. The average firm has neither tremendous financial strength nor intimate knowledge of foreign business, and it fears the risks of credit and collection.¹⁰ International trade involves serious cost and inconvenience in handling red tape. One study found that 828 million documents, and 6.5 billion copies were used in U.S. international trade each year.¹¹ Locating and analyzing foreign markets,¹² and ar-

billion in manufactured goods will offset our fuel bill deficit of \$72 billion enough to leave a balance-of-trade deficit of only \$25 billion. N.Y. Times, Jan. 25, 1981, § 3, at 1, col. 1.

⁸ In 1970, the Research Department of Walter E. Heller Int'l Corp. performed a survey, "International Activities of 455 Commercial Banks with Deposits of from \$10 million to \$500 million" (April 15, 1970) [hereinafter cited as Heller Research Survey]. In answer to the question of why manufacturers, the customers of these banks, were not exporting the management consideration most frequently cited was "too busy with domestic sales" (91 mentions). The next most frequently cited reason was "lack of vision on the part of management" (61 mentions) (copy of this survey is on file at the offices of the Northwestern Journal of International Law & Business). A more recent study of 162 firms reported similar results: e.g., among firms of 11-20 years' experience, and firms of over 40 years' experience, "complacent and domestic-oriented firms" was given as the second-largest impediment to export (the largest was government regulations). Jones, *Clearing the Way for Exporters*, BUS. HORIZONS, Oct. 1980, at 26, 28.

⁹ Data from the International Trade Administration, U.S. Dep't of Commerce, 1980, as reviewed in the White House Commission on Small Business April 1980 Report to the President, show that only 8.3% of the nation's 300,000 manufacturers export regularly, and that only about 1,900 of these firms account for 84% of U.S. exports. The report goes on to say, "In [U.S. Department of] Commerce's view, at least 20,000 small companies that are not exporting now could easily sell their products overseas." *Id.* at 1.

¹⁰ Heller Research Survey, *supra* note 8, at 10; Jones, *supra* note 8, at 28, 30.

¹¹ International trade involves the use of

125 different types of documents; 1000 different forms are in regular and special use, with the average shipment involving 46 separate documents; 828 million documents and 6.5 billion copies are used annually in U.S. international trade; the average documentation cost per export shipment is \$375, and \$320 for imports; and documentation costs for all U.S. exports and imports totals almost . . . 7.5 per cent of the value of the shipments.

Study by the Nat'l Comm. on Int'l Trade Documentation, *cited in* Mullen, *Export Promotion: Legal and Structural Limitations on a Broad United States Commitment*, 7 LAW & POL'Y INT'L

ranking effective foreign sales representation,¹³ present two further discouraging problems. In the face of these obstacles, it is not surprising to find the mass of small and medium sized firms appearing to export by chance, if at all.¹⁴

The federal government might be supposed to have mitigated these problems with an effective policy of export incentives. But it has not. The chief tax incentive in this field is the Domestic International Sales Corporation (DISC) program,¹⁵ which has been severely criticized.¹⁶ At best, the U.S. tax incentive program has been described as "not being designed to aid the expansion of exports . . . intended to be neutral; that is, to neither help nor hinder exporting."¹⁷ The main federal export credit vehicle is the Export-Import Bank, which was designed to help expand exports,¹⁸ but its effectiveness is also uncertain. The Treasury remains optimistic about the merits of Eximbank trade support,¹⁹ but at the very least, heavy extension of government credit tends to distort private investment decisions, cannot provide important business leadership, and is not likely to solve the average firm's problems of lack of know-how and lack of capacity to handle red tape.

GENERAL TRADING COMPANIES—THE JAPANESE MODEL

There is a model of trade growth whose successes appear strikingly to match some of our needs. That model is a form of enterprise within the economy of Japan, the *sogo shosha* or "general trading company." Japan, one of the most populous countries in the world and terribly poor in natural resources,²⁰ had to become a trading expert in order to

Bus. 57, 74-75 (1975). Mullen is not persuaded of the accuracy of these statistics, but notes that they are cited repeatedly throughout the Government and the exporting community.

¹² S. 2718 Hearings, *supra* note 4, at 82-83 (statement of Douglas R. Stucky).

¹³ Heller Research Survey, *supra* note 8, at 10; Jones, *supra* note 8, at 28, 30.

¹⁴ *Id.*

¹⁵ S. 864 Hearings, *supra* note 4, at 296 (report by George D. Holliday).

¹⁶ E.g. S. 864 Hearings, *supra* note 4, at 257 (statement of Harvey Kapnick, Chairman, Arthur Andersen & Co.). "[W]e prepared a 30-page list for our people to use in determining whether a particular company has problems qualifying as a DISC or not. Obviously, a small- or medium-size company can't begin to deal with that complexity." *Id.*

¹⁷ H.L. WEISBERG & C. RAUCH, A COMPARATIVE STUDY OF EXPORT INCENTIVES IN THE UNITED STATES, FRANCE, THE UNITED KINGDOM, GERMANY AND JAPAN 48 (1970) (published by International Division, Chamber of Commerce of the United States).

¹⁸ S. 864 Hearings, *supra* note 4, at 298 (report by George D. Holliday).

¹⁹ S. 864 Hearings, *supra* note 4, at 34-35 (statement of C. Fred Bergsten).

²⁰ In 1977, Japan imported 99.7% of her petroleum, 76.6% of her coal, 73.0% of her natural gas, 98.8% of her iron ore, 92.8% of her copper, 100% of her lumber, 100% of her wool and cotton, 96.0% of her wheat, 97.0% of her soybeans. JAPAN EXTERNAL TRADE ORGANIZATION (JETRO), THE ROLE OF TRADING COMPANIES IN INTERNATIONAL COMMERCE 21 (1980).

survive at all. To get vital raw materials, Japan had to import; to pay for imports, Japan had to export. Where in America the work of trade is done largely by manufacturers, in Japan it is carried on largely through import-export firms classified as trading companies. In fiscal 1979, trading companies accounted for 54.5% of Japan's imports and 48.2% of her exports.²¹ There are some 8,000 trading companies in Japan, many specializing in particular industries or products, such as food products, textiles, or machinery; nine of them are large enough, and general enough to be called "sogo shosha."²²

Existing U.S. export management companies are generally quite small and lack the resources to provide a range of export services to small and medium sized manufacturing firms.²³ In contrast, the sogo shosha are large international trade service experts and do a remarkably wide range of work. Not themselves manufacturers, they facilitate the trade of thousands of products—from missiles to instant noodles. As trade intermediaries, the sogo shosha provide financial services, business information, and auxiliary international trade services such as documentation, insurance, warehousing, and transportation, which they have learned to do efficiently and at a low cost.²⁴ Some of their customers are large, but many are average-sized firms who could not easily afford to provide these services for themselves.²⁵

The core business of the sogo is trade, principally in foodstuffs, textiles, metals and machinery, and chemicals.²⁶ Once concerned pri-

²¹ Wall St. J., Dec. 17, 1980, at 48, col. 1.

²² JETRO, *supra* note 20, at 6-8. In order of sales volume, the nine sogo shosha are Mitsubishi, Mitsui, C. Itoh & Co., Marubeni, Sumitomo, Missho-Iwai, Toyo Menka Kaisha (Tomen), Kanematsu-Gosho, and Michimen. In 1977, a tenth firm, Ataka, merged with C. Itoh, pushing the latter into third place ahead of its long-time rival, Marubeni.

Unfortunately, there are still few useful studies in English on the sogo shosha. I shall refer mainly to YOUNG, *THE SOGO SHOSHA: JAPAN'S MULTINATIONAL TRADING COMPANIES* (1979). Marubeni has published MARTIN, *THE UNIQUE WORLD OF THE SOGO SHOSHA* (1978). See generally, ROBERTS & MITSUI: *THREE CENTURIES OF JAPANESE BUSINESS* (1973); *ASIA'S NEW GIANT: HOW THE JAPANESE ECONOMY WORKS* (Patrick & Roskovsky, eds. 1976); *BUSINESS IN JAPAN* (Norbury & Bowmas, eds., 1974); NAKANE, *JAPANESE SOCIETY* (1970) (short, insightful ethnographic study); YANAGA, *BIG BUSINESS IN JAPANESE POLITICS* (1968) (political science).

²³ Barovick, *Expanding the Role of Export Trading Companies*, BUS. AMERICA, April 21, 1980, at 11.

²⁴ YOUNG, *supra* note 22, at 57-68.

²⁵ *Id.* at 138-42.

²⁶ In fiscal year 1975, the sogo shosha carried 47% of Japan's exports of machinery (56% of her export foreign trade), 82% of her metal exports (21%), 61% of her textile exports (6.8%), 65% of her chemical exports (6.4%), 100% of foodstuff exports (1.4%); 54% of her imports of mineral fuel and metal raw materials (52% of her import foreign trade), 81% of her foodstuff imports (16%), 42% of her machinery imports (7.2%), 74% of her textile exports (4.4%), and 18% of her chemical product imports (3.7%). YOUNG, *supra* note 22, at 7.

marily with sales into the Japanese domestic market,²⁷ as the sogo shosha matured they began to develop more sophisticated trading practices: two-way trade, for example, buying iron ore from a foreign mining company and selling Japanese mining and transportation equipment in return; barter trade, exchanges of goods for goods without currency; "switch" trade, in which imports from one foreign country are paid for in the goods or currency of another;²⁸ and offshore or third-country trade, in which neither the supplier nor the market is in Japan. One sogo shosha was asked for polyester fibers by a Brazilian textile maker. The sogo shosha went to a large American chemical company, which was willing to supply the fibers but was short of an essential raw material, ethylene glycol. A French firm was willing to supply the ethylene glycol, but only if it could get benzene. The sogo shosha procured benzene from firms in the U.S. and Holland, the French firm produced the ethylene glycol, and the American textile maker was finally able to provide the polyester fibers for the textile manufacturer in Brazil. This transaction, illustrating the trading practices of the sogo shosha and their match-making skill with producers and suppliers, involved five trading company offices in four countries. It was concluded in one week.²⁹

As the sogo shosha's international trading activity grew more extensive and more sophisticated, they developed global communications networks, which have become their hallmark. In 1978, each of the six largest sogo shosha had from 100 to 130 overseas offices, with the smallest of the nine, Nichimen, maintaining "only" 86.³⁰ Nissho-Iwai, for example, the sixth in rank by sales, in the U.S. alone has offices in New York, Detroit, Chicago, St. Louis, Atlanta, Los Angeles, San Francisco, Portland, Seattle, and Anchorage, a more extensive U.S.

²⁷ *Id.* at 86-89; MARTIN, *supra* note 22, at 4-10.

²⁸ See, e.g., importing precision machinery from West Germany with Indonesian currency as the currency of settlement so as to reduce the Indonesia-Japan trade deficit. YOUNG, *supra* note 22, at 11. "Two-way" trade, barter, and "switch" trade are sometimes collectively called countertrade. In countertrade agreements the seller of industrial products or technology often agrees to purchase goods produced by his equipment or technology (a "buy-back"), or agrees to purchase other goods produced by the buyer ("counter-purchase") representing in value a significant portion of the amount due for the industrial products or technology. See Weigand, *Apricots for Ammonia: Barter, Clearing, Switching, and Compensation in International Business*, 22 CAL. MGMT. REV. 33 (Fall 79); Walt, *Countertrade Gains Popularity as International Trade Tool*, BUS. AMERICA, July 14, 1980, at 12-16.

²⁹ YOUNG, *supra* note 22, at 11. In fiscal year 1976, the combined offshore trade of the sogo shosha was \$15.4 billion. See *id.* at 197-202; JETRO, *supra* note 20, at 23-25; BUSINESS IN JAPAN, *supra* note 22, at 177.

³⁰ U.S.-Japan Trade Council, Report No. 31, Japan's Sogo Shosha, at 12 (Sept. 28, 1979).

network than operated by many middle-sized American firms.³¹ During fiscal 1976, the top six sogo shosha spent ¥57.5 billion (about \$192 million) on communications expenses.³² The enormous amount of business intelligence that they collect is disseminated, usually free of charge, to their customers.³³ Such a service is greatly appreciated by the customers, and secures for the sogo shosha a continuing working relationship which also yields further business insights.

Though they are not bankers, the sogo shosha have also developed financial business.³⁴ They supply credit, loans, and loan guarantees to their customers, serving as risk-absorbing intermediaries between their trade customers and the commercial banks. Sogo shosha take long-term notes and deferred payments from customers for sales of commodities, and issue short-term bills or make advance payments to suppliers for purchasers. The six largest sogo shosha carried 34% of the total commercial credit extended by Japan's major corporations (452 firms) for the entire fiscal year ending March 31, 1974.³⁵ Sogo shosha make short-term loans for operating expenses, and long-term loans for purchasing equipment, plant construction and even real estate. They borrow heavily from the large commercial banks and lend small sums (though some loans are substantial) to thousands of small and medium sized producers.³⁶ They are in an excellent position to do this. The huge flow of business information available to the sogo shosha, plus the intimate knowledge of their customers acquired by working on a day-to-day basis to perform documentation, insurance, transport, and coordination and management services, enable the sogo shosha to make detailed and realistic assessments of the risks of lending and giving credit.³⁷ From the customer's point of view, finance is another service available from the sogo shosha with which they already deal and are on

³¹ YOUNG, *supra* note 22, at 74-75.

³² By late 1973, Mitsui was employing three computers in Tokyo, London, and New York to control a system of telex lines, telegraph, and privately leased data channels, in which the private channels alone carried some 20,000 messages a day to 44 offices in Japan and 112 offices overseas. YOUNG, *supra* note 22, at 77-79. (Mitsui had 130 overseas offices in 1978). On *one day* in 1977, the Tokyo office of Mitsubishi: received 144 international telephone calls and made 72; received 30,000 domestic telephone calls, 30,000 intercom calls, and made 35,000; received 4,260 copies of subscription newspapers; received 15,600 pieces of mail (10,000 from overseas) and sent out 19,000 (10,000 overseas); received 17,000 telexes, and sent 22,000. Mitsubishi operates 450,000 kilometers of telex lines, the equivalent of 11 times around the globe. U.S.-Japan Trade Council Report, *supra* note 30, at 8.

³³ YOUNG, *supra* note 22, at 67.

³⁴ *Id.* at 58-60; MARTIN, *supra* note 22, at 21-23.

³⁵ YOUNG, *supra* note 22, at 56-68.

³⁶ *Id.* at 62.

³⁷ *Id.* at 140-42.

good terms. From the banker's point of view, the size and diversity of the *sogo shosha* make them good loan customers; and, with the *sogo shosha* as knowledgeable intermediaries to smaller businesses, the banks' risk is much reduced.³⁸

Building on a base of closely-tailored import and export trade, the *sogo shosha* have become advisors, organizers, and catalysts in Japan's economic development, participating in Japan's growing business of exporting industrial plants,³⁹ in overseas natural-resource development projects, and in the creation of huge receiving-fabricating-distributing complexes or "combinats." By the summer of 1972, the *sogo shosha* along with five steel wholesalers had built over 200 steel centers in Japan. These centers stocked steel-mill inventories, provided shearing, sawing, and grinding to specifications, made deliveries, and offered the usual information and finance services.⁴⁰ The success of the steel centers led to more and larger ventures in other products, including food-stuffs.⁴¹

³⁸ *But see* Hoshii, *Japan's Banking and Investment Systems*, in *BUSINESS IN JAPAN*, *supra* note 22, at 49, 71-72; ADAMS & HOSHII, *A FINANCIAL HISTORY OF THE NEW JAPAN* 434-37 (1972). Dr. Hoshii complains that *sogo shosha* may be forced to suffer losses on liquidating collateral such as warehouse receipts and bills of lading, and that their very attention to smaller firms, and intimate involvement with clients, inhibit the traders from cutting off credit as a bank would when risk grows too high. This concern was sounded in Japan particularly in the early 1970s after the so-called "Nixon shocks" affecting dollar-yen exchange. *See* The "Trading Companies" columns for the early 1970s in *Nihon Keizai Shimbun* (Japan Economic Journal), *INDUSTRIAL REVIEW OF JAPAN* (published annually).

³⁹ For example, the \$7.3 million sale by Sumitomo of a Du Pont magnetic-powder factory to the U.S.S.R. in 1975. *Wall St. J.*, Dec. 17, 1980, at 48, col. 1. In 1976 the value of Japanese plant exports was \$6.5 billion. MARTIN, *supra* note 22, at 25-27; *see* YOUNG, *supra* note 22, at 203-04.

⁴⁰ YOUNG, *supra* note 22, at 136-38; JETRO, *supra* note 20, at 15.

⁴¹ JETRO, *supra* note 20, at 21-23. Marubeni has a six-acre lumber center near Tokyo, housing twenty lumber wholesalers and a sawmill. MARTIN, *supra* note 22, at 17. On a much larger scale is the 23-hectare Konan food combinat (about 57 acres) organized by Mitsui at Kobe harbor, with facilities for berthing cargoes of up to 60,000 tons, and with conveyors, pipelines, silos, refrigeration, first- and second-stage processing, and wholesale and retail distribution all on the site. Konan Pier, and the Konan Utility Co. (in which all the processors have equity participation), are Mitsui subsidiaries. Professor Young considers the development of combinats tantamount to organization of a new industry. YOUNG, *supra* note 22, at 110-12.

In natural-resources development, Mitsubishi is the chief organizer of one of the world's largest natural gas projects off the shore of Brunei on the island of Borneo, with 45% participation by Mitsubishi, 45% by Royal Dutch Shell, and 10% by the Brunei government. Mitsubishi did the feasibility and technical studies, carried out the negotiations, built a liquefaction plant, and constructed unloading bases in Japan. Seven tankers, each with a capacity for 32,000 tons of liquid natural gas and chartered by Mitsubishi at a rate of five million tons a year, transport the gas 4,500 kilometers from Borneo to Japan. YOUNG, *supra* note 22, at 159.

It should be recalled that Mitsubishi, the largest *sogo shosha*, had a total sales volume of \$55 billion in fiscal 1979, *Wall St. J.*, Dec. 17, 1980, at 48, col. 1, some five times the sales of the smallest *sogo shosha*, and ten times the sales of the largest non-Japanese trading company, Kooperativa Förbundet of Sweden. YOUNG, *supra* note 22, at 17-18, 25-26. Young finds that the

For the most part, the *sogo shosha* of today do not predate World War II.⁴² In the late 1940's, some of the traders that until then had been fairly specialized began to increase their trading volume and the scope of their business. In this, they were helped by several of the principal banks, who were able to offer capital and leadership at a time when both were in short supply.⁴³ A new configuration began to form in the Japanese business community: "enterprise groups" (*keiretsu*), associations of firms whose members tended to cooperate with each other and to compete with firms outside, but without the subordination to vertical control that had characterized the pre-war conglomerates.⁴⁴ The banks were often the financial nuclei of these looser, more fluid groups, and the trading companies, as they took on the purchase, sale, and sometimes the distribution of products manufactured by other group members, broadened in range both geographically and in product variety, maturing into true general traders—*sogo shosha*.⁴⁵ In the last few years, group members have continued to rely upon each other in business relations, but not exclusively. During fiscal 1973, firms in the six largest groups transacted an average of ten to thirty percent of their total purchases and sales with the *sogo shosha* in their group.⁴⁶

huge capital requirements and high risks of natural resources development have so far put most of such projects on a basis more like Marubeni's Dampier Salt venture, an 11,800-hectare salt field in Western Australia developed in 1969-71, with 21% participation by Marubeni, and 11% by Nissho-Iwai, at a cost of about \$25 million. See also MARTIN, *supra* note 22, at 72-76. In this pattern, where rival trading companies join as joint venture partners, with non-Japanese concerns also involved, the *sogo shosha* can jockey for market power with each other and also keep an eye on the operational methods of their rivals. YOUNG, *supra* note 22, at 155-57. The long-term planning of projects such as Dampier Salt, or the Brunei natural gas development (which took six years), is another strength of the *sogo shosha*. U.S.-Japan Trade Council Report, *supra* note 30, at 6.

⁴² Although trading companies in the broad sense were formed as early as the Meiji era in the second half of the nineteenth century, only Mitsui and Mitsubishi had developed a general enough trading business before World War II to be comparable to the *sogo shosha* of today. See, e.g., YOUNG, *supra* note 22, at 31-37.

⁴³ See, e.g., YOUNG, *supra* note 22, at 35-36; ROBERTS, *supra* note 22, at 394-95.

⁴⁴ YANAGA, *supra* note 22, at 32-40; Lockwood, *Japan's "New Capitalism,"* in THE STATE AND ECONOMIC ENTERPRISE IN JAPAN 447, 495-98 (Lockwood ed. 1965); YOUNG, *supra* note 22, at 36-38, 48-51. Roberts is more cynical of the similarity between the *keiretsu* and the prewar order, ROBERTS, *supra* note 22, at 408-28, but Prof. Yanaga, who wrote the preface to the Roberts book believes that "the present setup is very different from the setup before the war in spirit, structure, and operation." YANAGA, *supra* note 22, at 39.

⁴⁵ BUSINESS IN JAPAN, *supra* note 22, at 160-64; MARTIN, *supra* note 22, at 33-36; YOUNG, *supra* note 22, at 37, 48, 83-144.

⁴⁶ Sales of the sixty-five firms in the Mitsubishi, Mitsui, and Sumitomo groups to their *sogo shosha* amounted to approximately 20% of the *sogo shosha's* purchases. About 5-6% of the three *sogo shosha's* sales was purchased by their group firms. (The other firms were more dependent upon the *sogo shosha* than *vice versa*.) Sales and purchases transacted with their *sogo shosha* made up about 30% of the sixty-five firms' total sales and purchases. For the remaining six *sogo*

Financial arrangements have followed a similar pattern, with the firms looking to group financial institutions for about twenty percent of the borrowing needs of "their" *sogo shosha*.⁴⁷

The *sogo shosha* have clearly been a main force in Japan's extraordinary export success. Their development of overseas markets, and their management of trade functions, have enabled Japanese manufacturers to put more capital into improving plants and products. Their extension of information, administrative services, and knowledgeable credit have helped small and medium sized firms in particular to participate effectively in international trade, to the great benefit of Japan. As a method of organizing commercial enterprise, the general trading company—large, diversified, flexible, mastering a great flow of information and expert at arranging international transactions, backed by the resources of major banks and able to stand as an intermediary where they cannot—has a number of virtues from the point of view of American international trade.

CURRENT BARRIERS TO THE FORMATION OF U.S. EXPORT TRADING COMPANIES

It seems fair to say that the *sogo shosha* model could not be followed identically in the United States, for a number of reasons, some having to do with the normal practices of American manufacturers,⁴⁸ and some having to do with the degree to which the *sogo shosha*'s

shosha, and the 122 firms in the groups to which they belong, the relationship is rather weaker, accounting for some 10% of the total sales and purchases of the manufacturers in these groups. The latter six groups are those in whose assembly leading banks were most instrumental. These figures are averages compiled by the Japan Fair Trade Commission, and do not state transaction percentages between specific group firms and group *sogo shosha*. YOUNG, *supra* note 22, at 44-45.

⁴⁷ YOUNG, *supra* note 22, at 42-44. For example, Mitsubishi took 14.8% of its loans from the Mitsubishi Bank, an additional 10.5% from other Mitsubishi group institutions, and 9.5% from its "second main bank," the Bank of Tokyo; while C. Itoh satisfied more of its borrowing needs from the Sumitomo Bank (12.9%) than from all the financial institutions in the Dai-Ichi Kangyo Bank group (12.1%) to which C. Itoh is considered to belong. *Id.* at 34, 37, 39-41. See P.B. STONE, JAPAN SURGES AHEAD 59, 164 (1969).

⁴⁸ *Sogo shosha* are not active in products that call for after-sales service, such as automobiles, cameras, and consumer electronics. In these lines the manufacturers do much more trading, as is done in the U.S. YOUNG, *supra* note 22, at 100; U.S.-Japan Trade Council, *supra* note 30, at 1. Further, *sogo shosha* are so highly leveraged that, in the words of even the optimistic Professor Young, "[w]estern financiers without previous experience with the *sogo shosha* all shudder in disbelief when they read the trading concerns' financial statements." *Sogo shosha* borrow 97% of their total capital and operate at nearly a 1:1 assets-liabilities ratio. YOUNG, *supra* note 22, at 72-74. As a banker I cannot object to Professor Young's characterization. He maintains, however, that the *sogo shosha* have been operating this way since the early 1950's, *id.*, and his data for fiscal 1976 show an average profit on equity for the nine firms of 24% and an average annual dividend of 12%.

strength may rest on socially and culturally founded Japanese business habits that might not be viable here.⁴⁹ In addition, legal barriers, principally in the form of U.S. banking laws and regulations, have precluded the formation of effective export trading companies in the United States.⁵⁰

U.S. banking laws and regulations issued over the last sixty years have established and implemented a general policy of separating banking from commerce within the United States.⁵¹ Certain of these provisions have restricted the ability of banking organizations from participating in export trading companies.⁵² For example, Edge Act corporations are prohibited from investing in any corporation "engaged in the general business of buying or selling goods, wares, mer-

⁴⁹ Any fair study of "company style" (*shafu*), institutionalized business entertainment (*Hito no kokoro wa yoru wakaruru*—"You get through to a man's soul at night"), the interplay of revealed position (*tatema*) and true intention (*honno*), the relationships between persons who stand as elders (*oyabun*, literally "parents" and also meaning mentors/teachers/superiors) and those who defer to them (*kobun*, literally "children" and also meaning protégés/pupils/juniors), and so on, is beyond the scope of this short article, if not beyond the grasp of this author. However, those who appear to understand Japan insist that these matters are of modern and crucial importance in Japan today. See BUSINESS IN JAPAN, *supra* note 22, at 268-87, 46-48, 88-110; YANAGA, *supra* note 22, at 1-29; see generally, NAKANE, *supra* note 22. One must acknowledge that manner may be an indispensable foundation of method.

⁵⁰ Many businessmen have seen another legal barrier to the formation of export trading companies (ETCs) in American antitrust laws. ETCs need to deal with and represent a large number of manufacturers. Generally, the products traded will at most be complementary, but on occasion products may be in competition for the same foreign order. The applicability of our antitrust laws to this situation is unclear. Title II of the Export Trading Company Act of 1980 proposes to clarify the antitrust requirements applicable to export trade associations by revising certain language in the Webb Pomerene Act of 1918 and by providing a certification procedure, administered by the Department of Commerce, enabling ETCs and other such associations to receive antitrust clearance for specified export trade activities. See S. REP. NO. 735, 96th Cong., 2d Sess. 13-17 (1980).

⁵¹ Though federal regulation of banking reaches back to the National Currency Act of 1863, ch. 58, 12 Stat. 665 (1863) and beyond, federal regulation over both state and federally chartered banking institutions properly commenced in 1913 with the formation of the Federal Reserve Board under the Federal Reserve Act, ch. 6, 38 (part 1) Stat. 251 (1913). American banking regulations should not be taken to be a consistent whole. "In [the regulation of banking by the federal government], through accidents of history in conjunction with understandable human failings, a situation exists that has never been paralleled, as far as I can ascertain, in terms of complexity, confusion, irrationality and difficulty of administration." Robertson, *Federal Regulation of Banking: A Plea for Unification*, 31 LAW & CONTEMP. PROB. 673, 673 (1966); see WHITE, BANKING LAW (1976); Chase, *The Structure of Federal Regulation of Depository Institutions*, in HOUSE COMM. ON BANKING, CURRENCY & HOUSING, 94TH CONG., 2D SESS., FINANCIAL INSTITUTIONS AND THE NATION'S ECONOMY (FINE), COMPENDIUM OF PAPERS PREPARED FOR THE FINE STUDY 145 (Comm. Print 1976).

⁵² Senator Stevenson notes there are some 16 different limits on the degree to which banks and bank holding companies can participate in trading companies. *Export Trading Companies: Hearings and Markup on H.R. 7230 Before the Subcomm. on Int'l Econ. Policy and Trade of the House Comm. on Foreign Affairs*, 96th Cong., 2d Sess. 5 (1980).

chandise or commodities in the United States.”⁵³ The Glass-Steagall Act generally prohibits a national or state member bank from acquiring for its own account “any shares of stock of any corporation.”⁵⁴ The Bank Holding Company Act of 1956 generally prohibits a bank holding company from engaging in non-banking activities or from owning or controlling shares of any company that is not a bank.⁵⁵

The Bank Holding Company Act does make numerous exceptions to the prohibition of “nonbanking activities.” The most important exception allows bank holding companies to start or acquire non-banking activities which are “so closely related to banking as to be a proper incident thereto” and which produce “public benefits.”⁵⁶ It is within this limited exemption that banks and bank holding companies have served the economy outside of the traditional sphere of commercial banking.⁵⁷ While the Federal Reserve Board has found a certain range of activities to be “closely related” to banking and thus open to investment by banking organizations,⁵⁸ it is clear that banks and bank holding companies cannot engage in the purchase and sale of inventories or in the operation of a warehouse, docking or transportation facilities, except as a result of the acquisition and operation of such a business on a temporary basis through foreclosure of a debt previously contracted,⁵⁹ or as a less than five percent equity owner of such business.⁶⁰

⁵³ 12 U.S.C. § 615(a) (1976 & Supp. III 1979). Edge Act subsidiaries can engage directly in such international banking operations as accepting deposits from foreign parties, issuing or confirming letters of credit, extending loans, creating bankers' acceptances, purchasing and selling securities, and engaging in foreign exchange trading. Edge Act subsidiaries can also make equity investments *abroad*, and engage in international investment banking. 12 U.S.C. § 615(c) (1976).

⁵⁴ 12 U.S.C. § 24 (1976). Bank failures and liquidations of the early 1930's, blamed chiefly on the agricultural depression and alleged abuses of authority by bank managements in stock market speculation, led to the formation of the Federal Deposit Insurance Corporation (FDIC) under the Glass-Steagall Act.

⁵⁵ 12 U.S.C. § 1843(a) (1976 & Supp. III 1979).

⁵⁶ 12 U.S.C. § 1843(c)(8) (1976 & Supp. III 1979) directs the Board in determining whether a particular activity proposed by a bank is incidental to banking to consider the benefits to the public of the proposal, such as greater care, increased competition, or gains in efficiency. These benefits are to be balanced against possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

⁵⁷ By traditional commercial banking the author means the operation of a place where credits are opened by deposit or collection, subject to payment or remittance upon draft, check or order, and where money is advanced or lent, or promissory notes received for discount or sale.

⁵⁸ 12 C.F.R. § 225.4(a) (1978). Generally, these activities encompass credit extension and related activities, financial management services, data processing services related to banking and finance, and specialized courier services. Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 787, 797 (1979).

⁵⁹ 12 U.S.C. § 1843(c)(2) (1976 & Supp. III 1979); divestiture of interests acquired through a debt previously contracted is regulated under 12 C.F.R. § 225.101 (1978).

⁶⁰ 12 U.S.C. § 1843(c)(6) (1976 & Supp. III 1979).

The underlying purpose of the special regulation of banking organizations is to insure their soundness, so that public depositors may be protected against the risk of bank failure. Banking organizations have been kept separate from other lines of business primarily to help regulators issue guidelines to banks as financial intermediaries.⁶¹ However, while administrative ease and efficiency in regulatory oversight are important objectives, the separation of business and commerce is not sacrosanct.⁶² Other means of guaranteeing the soundness of financial institutions exist, such as controls on a banking organization's financial exposure in an affiliated company, controls on insider misconduct, and deposit insurance.⁶³ Regulatory authorities should select the least restrictive form of regulation that still satisfies the underlying purpose for their oversight and control. Maintenance of a barrier between banking and commerce for the mere sake of tradition appears to be neither consistent with the underlying purpose of regulatory oversight, nor appropriate to the international economic challenges in our non-traditional times.

U.S. banking organizations should be allowed to participate in the formation and operation of American trading companies. Banking organizations can offer both the substantial financial resources and the support facilities and services which appear essential if export trading companies are to be rapidly formed on a scale sufficient to affect overall U.S. export levels.

Banking organizations are the principal U.S. institutions with the capital and lending capacity needed to help organize and operate American trading companies. The penetration of foreign markets carries high overhead costs and requires long-term capital commitments.⁶⁴ To bid competitively and move goods quickly, trading companies must also have access to ready short-term capital reserves.⁶⁵ While some export financing could be made available through the Export-Import

⁶¹ Clark, *supra* note 58, at 791.

⁶² *Id.* at 815.

⁶³ See generally, Clark, *The Soundness of Financial Intermediaries*, 86 YALE L.J. 1 (1976).

⁶⁴ For example, a single small-size trading company office in a major foreign market location requires from three to five persons and would cost on a yearly basis, including expenses, \$300,000 to \$400,000. Any serious export management company requires an office in at least three to five of the major market areas. *Export Trading Company Act of 1980: Hearings on S. 2379 and S. 864 Before the Subcomm. on Int'l Finance of the Senate Comm. on Banking, Housing, and Urban Affairs*, 96th Cong., 2d Sess. 168 (1980) (statement of Jerry L. Hester, President, International Trade Operations, Inc.) [hereinafter cited as *ETCA Hearings*].

⁶⁵ *Export Trading Company Legislation: Hearings on H.R. 7310, H.R. 7364, H.R. 7436, and H.R. 7463 Before the Int'l Trade Subcomm. of the House Comm. on Banking, Finance and Urban Affairs Comm.*, 96th Cong., 2d Sess. 168 (1980) (statement of Abraham Katz, Assistant Secretary for International Economic Policy, Department of Commerce).

Bank, the bulk of new export financing must come from private commercial banks.⁶⁶

Since the finance component of an export sale is sometimes the most important, export trading companies must be knowledgeable in international export financing.⁶⁷ U.S. banking organizations already have considerable expertise in the broad range of international export financing options. Their participation in American trading companies could promote the trading companies' sophistication in structuring competitive financing options.

U.S. banking organizations also already have an extensive domestic retail banking network which reaches a large number of the small and medium sized companies that manufacture exportable products.⁶⁸ This network could supply that important introductory link between trading companies and potential American exporters which the Japanese were only able to provide through reliance on loosely structured "enterprise groups."

Many U.S. banking organizations have already developed an overseas network of branch banks, affiliates, and foreign correspondent banks. These firms, linked by global communication networks much like those successfully employed by the Japanese trading companies, now acquire detailed knowledge of local economic conditions, government policies, foreign exchange regulations, and business practices.⁶⁹ American banks could thus provide a tremendous reservoir of information, talent and experience that would take new trading companies years to develop on their own.⁷⁰

⁶⁶ *ETCA Hearings*, *supra* note 64, at 169 (statement of Jerry L. Hester). Adequate capital reserves are needed, for example, by trading companies bringing together several participants on a turnkey project export to secure needed project bid guarantee credits from banks. *Id.* (In a "turnkey" export of, say, an industrial plant, the undertaking is to deliver the plant in operating condition so that the buyer need only walk up to the front door and turn the key.)

⁶⁷ This fact is recognized, for example, in provisions of the Export Trading Company Act of 1980 which authorize and direct the Export-Import Bank to establish a guarantee program for commercial loans to U.S. exporters secured by export accounts receivable or inventories of exportable goods, but only to the extent that the Board of Directors determines that the private credit market is not providing adequate financing. § 107. The Act also authorizes an additional \$20 million per year in fiscal years 1981 through 1985 to the Economic Development Administration and the Small Business Administration to help export trading companies meet start-up costs through loans, guarantees and operating grants. § 106. By comparison, private bank investments and loans to export trading companies are expected to total \$1 billion within five years after enactment of the Act. S. REP. NO. 735, 96th Cong., 2d Sess. 11 (1980).

⁶⁸ See *ETCA Hearings*, *supra* note 64, at 121 (statement of James B. Sommers, President, Bankers' Association for Foreign Trade).

⁶⁹ *Id.* at 120. In 1979, 139 U.S. banks had 779 foreign branches. Korth, *The Evolving Role of U.S. Banks in International Finance*, THE BANKERS MAGAZINE, Jul.-Aug. 1980, at 68, 69.

⁷⁰ See *ETCA Hearings*, *supra* note 64, at 121 (statement of James B. Sommers, President,

Finally, U.S. banking organizations could encourage and help American exporters develop a longer-term view of their presence in the international marketplace,⁷¹ providing the leadership which mere passive government assistance cannot.

The participation of U.S. banking organizations could thus significantly accelerate the development, and enhance the viability of American trading companies. The challenge in allowing such participation will be to balance the traditional concerns that underlie U.S. banking laws against the capacities that American trading companies must possess in order to achieve a strengthening of the export trade of this country. This is the challenge to which the Export Trading Company Act of 1980 attempts to respond.

BANK PARTICIPATION IN EXPORT TRADING COMPANIES

The Export Trading Company Act of 1980 does not authorize banking organizations⁷² to undertake the activities of an export trading company directly. The Act does, however, permit banking organizations to invest up to \$10 million in one or more separately incorporated export trading companies without prior federal regulatory approval, if the investment does not cause an export trading company to become a subsidiary of the investing banking organization.⁷³ Investments that exceed the \$10 million limit or that confer control of an export trading company upon the investing banking organization⁷⁴ require prior ap-

Bankers' Association for Foreign Trade). With fewer restrictions abroad than in the U.S. on conducting commercial banking operations, the overseas branches of many U.S. banks have developed special expertise in fields such as merchant banking. See Asher, *Merchant Banking Is Alive and Very Well in London*, *BANKING*, July 1978, at 44.

⁷¹ See *ETCA Hearings*, *supra* note 64, at 150 (statement of Erland Heginbotham, Assistant Secretary of State for East Asian and Pacific Affairs).

⁷² The term includes state and national banks, federal savings banks, Edge Act and Agreement corporations, bank holding companies, and "bankers' banks." § 105(a)(1). "Bankers' banks" are banks whose stock is owned exclusively by other banks and which are engaged exclusively in providing banking services for other banks and their officers, directors or employees. § 105(a)(5). Through "bankers' banks" a number of smaller banks can join to form an export trading company.

⁷³ § 105(b)(1)(A).

⁷⁴ § 105(b)(1)(B). In addition to investments which cause an export trading company (ETC) to become a subsidiary of the investing banking organization, prior regulatory approval is required for investments causing more than 50% of the voting stock of an ETC to be owned or controlled by banking organizations. *Id.* The terms "control" and "subsidiary" have the same meaning as assigned to those terms in the Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841-50 (1976 & Supp. III 1979). § 105(a)(12). Section 2 of the 1956 Act defines "control" as ownership of 25% or more of the voting shares, control of a majority of the directors, or exercise of a controlling influence. 12 U.S.C. § 1841(a)(2) (1976 & Supp. III 1979).

proval of the appropriate federal banking agency.⁷⁵

A banking organization's aggregate investment in export trading companies is limited by the Act to five percent of the banking organization's consolidated surplus and capital.⁷⁶ The Act also prohibits any banking organization from directly or indirectly investing and lending more than ten percent of its capital surplus in or to an export trading company.⁷⁷ These limits on a banking organization's financial exposure, either as an investor in or creditor of any export trading company, apply regardless of whether the export trading company is controlled by the investing or lending banking organization.

In addition to mechanical statutory limits on a banking organization's investment in an export trading company, the Act empowers the appropriate federal banking regulatory agency to order termination of an investment in an export trading company whenever "it has reasonable cause to believe that the ownership or control of any investment in an export trading company constitutes a serious risk to the financial safety, soundness or stability of the banking organization and is inconsistent with sound banking principles, with the purposes of the Export Trading Company Act or with the Financial Institutions Supervisory Act of 1966."⁷⁸ Thus, while the Act relaxes prohibitions that had kept

⁷⁵ In reviewing proposals for investment in ETCs in excess of the discretionary limits, the appropriate federal banking agency must take into consideration the financial and managerial resources, competitive situation, and future prospects of the banking organization and ETC concerned as well as the benefits of the proposal to U.S. business, industrial, and agricultural concerns (with special emphasis on small, medium-size and minority concerns), and to U.S. competitiveness in world markets. § 105(d)(1). A banking organization wishing either to make additional investments in ETCs, or to undertake through a subsidiary ETC a line of activity not previously approved, must give the appropriate federal banking agency 90 days prior written notice, within which period the agency must act. § 105(b)(2). Applications by banking organizations to make a \$10 million investment or any controlling investment in an ETC must be acted upon by the appropriate federal banking agency within 120 days. § 105(b)(3).

⁷⁶ § 105(b)(1). The limit for Edge Act and Agreement corporations not engaged in banking is 25%. *Id.* The 25% limit is smaller than currently provided for non-banking Edge investments overseas under the Federal Reserve's Regulation K. 12 C.F.R. § 211.5 (1980). The 5% limit is the same as currently applied to national bank investments in small business investment companies, 12 C.F.R. § 225.111 (1980), and in community development corporations. 12 C.F.R. § 7.7480 (1980). In contrast, national banks can invest in excess of 5% in safe deposit corporations, 12 U.S.C. § 24 (1980), premise companies, 12 U.S.C. § 371(d) (1976 & Supp. III 1979), bank service corporations, 12 U.S.C. § 1862(a) (1976), Edge Act and Agreement corporations, 12 U.S.C. § 618 (1976 & Supp. III 1979), and agricultural credit corporations, 12 U.S.C. § 24 (1976). There is no limit on the amount a national bank can invest in Federal National Mortgage Association (FNMA) or Government National Mortgage Association (GNMA) corporations authorized under Title IX of the Housing and Urban Development Act of 1968, in the Student Loan Marketing Association, or in non-banking companies permissible under the Bank Holding Company Act. 12 U.S.C. § 24 (1976).

⁷⁷ § 105(c)(2).

⁷⁸ § 105(d)(4). This broad regulatory authority to require divestiture of any ETC investment

banks from involvement in export trading companies, the participation that will now be permitted remains strictly controlled by statute and by regulatory oversight.

On the Senate floor, with the support of certain federal banking authorities,⁷⁹ Senator Proxmire proposed an additional restriction limiting the participation of banking organizations in export trading companies to a 20% non-controlling interest.⁸⁰ Had this been approved, it would not only have significantly tipped the balance against the formation of export trading companies, but would also have undermined the prudential limitations in the Act designed to guarantee the soundness of banking organizations. A controlling interest in an export trading company does not necessarily threaten the soundness of a bank more than a non-controlling interest. The bank's real financial exposure is determined by the total amount of assets it has at risk in the separately incorporated export trading company, either as equity investment or in the form of loans, and this is already strictly controlled by the 5% and 10% capital surplus tests.⁸¹ The public policy of ensuring bank soundness is already satisfied; controls over the affiliated export trading company's corporate governance structure do no more to limit the banking organization's capital at risk. Indeed, limitations on a banking organization's ability to obtain control of an export trading company in which the former's capital is at stake can actually increase the risk to the banking organization. Relegated to a minority and non-controlling equity position, the banking organization would not be able to preclude those export trading company activities which the bank might consider unsound and which might lead to the export trading company's collapse. Such an unfortunate scenario was recently played out in the

parallels powers over other bank holding company investments which were given to the Federal Reserve under the Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978) (codified in scattered sections of 5, 12, 15, 28, 31, and 42 U.S.C.).

⁷⁹ See *S. 2718 Hearings, supra* note 4, at 8 (statement of Irvine Sprague, Chairman, Federal Deposit Insurance Corporation), 61 (statement of Henry C. Wallich, Member, Board of Governors, Federal Reserve System); S. REP. NO. 735, 96th Cong., 2d Sess., 34 (1980) (Letter from Paul A. Volcker, Chairman, Board of Governors, Federal Reserve System).

⁸⁰ Senator Proxmire's amendment was proposed Aug. 26, 1980, and defeated by voice vote, [1980] 322 INT'L TRADE RPT. U.S. EXPORT WKLY. (BNA) at C-1 (Sept. 2, 1980); 323 *id.* at C-1.

⁸¹ It has been suggested that a banking organization's liability may extend beyond its capital at risk if it has been providing management to an ETC or was engaged in significant intercompany transactions and if creditors of a failing ETC are able to "pierce the corporate veil." *S. 2718 Hearings, supra* note 4, at 11 (statement of Irvine Sprague, Chairman, Federal Deposit Insurance Corporation). This is a purely speculative danger. Clark, *supra* note 58, at 834.

financial collapse of the Real Estate Investment Trust industry.⁸² Unwilling to be placed in such a position again, banking organizations might forego investing in or lending to export trading companies,⁸³ depriving the export trading companies of needed know-how and financial resources.

While majority control of non-banking affiliates by banking organizations is clearly called for to ensure the formation and success of export trading companies, it has been suggested that such control might give rise to possible conflicts of interest and to transactions between banks and export trading companies which are unfairly biased in favor of one of the parties. It has been feared, for example, that ownership of export trading companies by banking organizations would skew the latter's "arm's-length" credit judgments, and lead banks to grant loans to export trading companies when the loans—or the trading companies—were unsound.⁸⁴ Even if ownership did not lead to impaired judgment in granting of credit, some suggest that banking organizations will feel compelled to rescue failing export trading companies which have come to be identified with the banking organization and whose financial condition is reflected on the banking organization's consolidated balance sheets.⁸⁵

These concerns are without solid foundation, and even if potentially justifiable, are adequately safeguarded against by provisions of the Act. The Act does not suspend the numerous banking regulations and fiduciary laws which are applicable to a banking organization's top management. While there is the potential for insider misconduct in any transaction between corporate affiliates, these stringent laws and regulations already inhibit managerial overlaps and harmful self-dealing.⁸⁶ It is unlikely that rational bank officers, whose compensation is tied to the wisdom of their investments, would suddenly so compromise

⁸² See Taylor, *The Financial Collapse of the REIT Industry: An Analysis and Proposed Regulatory Framework*, 9 TEX. TECH. L. REV. 451 (1978).

⁸³ In a similar context, in recommending that the Small Business Investment Companies Act be amended to remove a provision which prohibited a bank from acquiring 50% or more of the voting stock of an SBIC, the Senate Banking, Housing and Urban Affairs Committee noted: "Allowing banks to control or wholly own a license would serve to encourage financial institutions which are interested in the sound development of the SBIC program [to invest] and would increase the amount of capital available for small business investment." S. REP. NO. 420, 94th Cong., 2d Sess. 8-9 (1976).

⁸⁴ See, e.g., *S. 2718 Hearings*, *supra* note 4, at 60 (statement of Henry C. Wallich, Member, Board of Governors, Federal Reserve System).

⁸⁵ *Id.* at 61.

⁸⁶ In addition, the Act specifically empowers the appropriate federal banking agency, in approving applications for investments in export trading companies exceeding \$10 million or conferring control on the investing banking organization, to impose such conditions as it may deem

their professional judgment that they would endanger the soundness of their banking organizations with excessively risky loans. Still further assurance is provided by provisions of the Act which prohibit the total of a banking organization's historical cost of direct and indirect investment in all loans to export trading companies from exceeding ten percent of the banking organization's capital and surplus,⁸⁷ and explicitly prohibit either extending credit to any export trading company in which the banking organization holds any interest, or to customers of such a company, on terms more favorable than those afforded other similar borrowers in similar circumstances, or extending credit that involves more than normal risks of repayment.⁸⁸ Thus, the Act limits the amount of resources a bank may commit to the rescue of a failing export trading company, and furthermore, it prevents the sort of identification of a bank with the trading company, that would lead to a rescue attempt.⁸⁹ The Act, then, protects the soundness of the bank without preventing its affiliation with an export trading company.

Another concern regarding the granting of credit by banking organizations is that bank affiliation with export trading companies will lead to favoritism and anticompetitive tie-ins in which third parties would be extended unsound, undue, or simply unfair credit from banking organizations in return for the purchase of commodities or services from bank-affiliated export trading companies.⁹⁰ These fears appear to be greatly exaggerated. With significant competition for credit and customers in an efficient capital market, and with little evidence of substantial reciprocal dealing problems in the past, there is little to suggest that our ordinary antitrust laws and policies could not adequately deal with any such problems that might arise.⁹¹

Some Shortcomings in the Act

It must be noted, that in addition to regulating a banking organi-

necessary to prevent possible conflicts of interest, or banking practices that would be unsafe or unsound. § 105(d)(2).

⁸⁷ § 105(c)(2).

⁸⁸ § 105(c)(4).

⁸⁹ § 105(c)(1) prohibits an ETC from using a name which is similar in any way to the name of the investing banking organization. For a discussion of the consequences of the public confusing the name and identity of a risky affiliate with that of the intermediary itself, see Schotland, *Bank Holding Companies and Public Policy Today*, in HOUSE COMM. ON BANKING, CURRENCY AND HOUSING, 94TH CONG., 2D SESS., FINANCIAL INSTITUTIONS AND THE NATION'S ECONOMY (FINE), COMPENDIUM OF PAPERS PREPARED FOR THE FINE STUDY 233, 270-77 (Comm. Print, 1976).

⁹⁰ See, e.g., *S. 2718 Hearings*, *supra* note 4, at 2 (statement of Senator Proxmire).

⁹¹ Clark, *supra* note 58, at 827-28.

zation's relationship as an investor in or creditor of an export trading company, the Export Trading Company Act places restrictions on the operations of the non-banking export trading company itself, independent of its relations with any banking organization. For example, the Act empowers the appropriate federal banking agencies to set standards by which any export trading company in which a banking organization has an ownership interest may take title to goods.⁹² In particular, the agencies can establish inventory-to-capital ratios for those circumstances in which the export trading company may bear a market risk on inventory held.⁹³ Also, an export trading company in which a banking organization has an ownership interest cannot take positions in commodities or commodities contracts in securities, or in foreign exchange, other than as may be necessary in the course of its business operations.⁹⁴ Finally, the Act defines an export trading company as a company organized and operated "principally" to export U.S. goods and services and to facilitate their exportation by unaffiliated persons.⁹⁵ However, the word "principally" is ambiguous and could be read to restrict activities integral to the operation of a successful export trading company, but which are not specifically related to exporting.

By regulating the operational activities of a banking organization's non-banking affiliates, the Act departs from its previously principled grounds. As discussed above, the public policy of guaranteeing the soundness of banking organizations is already served by limitations on bank financial exposure in export trading companies.⁹⁶ The justification for limiting the business discretion of non-financial business corporations is neither as clear nor as persuasive as in the case of regulating financial institutions which are directly entrusted with the public's capital, and which are themselves limited in their dealings with the corporations whose discretion appears to be the cause of concern.

The extra control sought over export trading companies is understandable enough in itself. For example, the limitation on an export trading company's ability to take positions in commodities would pre-

⁹² § 105(d)(2). The appropriate federal banking agency may not impose standards for the taking of title which "unnecessarily disadvantage, restrict or limit export trading companies in competing in world markets." § 105(d)(3).

⁹³ § 105(d)(2).

⁹⁴ § 105(c)(3).

⁹⁵ § 103(a)(5). An export trading company is defined as a company doing business under the laws of the U.S. or any state and which is exclusively engaged in activities related to international trade. § 105(a)(13). This definition does not permit export trading companies to engage in agricultural production, manufacturing, or in underwriting, selling or distributing securities. *Id.*

⁹⁶ See text accompanying notes 79-83 *supra*.

vent traders from engaging in purely speculative activities of which most of their investors would disapprove. However, it is in the province and discretion of the investors to ensure that adequate internal controls in an export trading company block activities that the investors may consider imprudently speculative. The failure of a non-financial business corporation is of principal concern to its shareholders. To the degree that its shareholders may be financial corporations, they are already under regulation. While the financial health of all American businesses is of concern to federal authorities, the federal mandate over banking organizations is properly exercised—as in the remainder of the Act—by limiting bank exposure in non-banking activities and by providing guidelines for the transactions between banking organizations and their affiliates.

The potential for restricting trading company activities under the terms of the Act “principally” to the exportation of U.S. goods⁹⁷ and the provision of export trade services⁹⁸ is worrisome. As discussed above, successful export trading companies are often involved in two- and three-way trade, and they both import and export goods in barter transactions.⁹⁹ These complex forms of trade have become increasingly important, and to restrict importing operations would cost the trading companies flexibility (including the capacity to arrange transactions so as to relieve currency deficits), would possibly close markets, and would certainly retard the export trading companies’ absorption of the commercial experience needed to become competitive in the international marketplace.

Many of the advantages that trading companies would offer U.S. manufacturers in export transactions, including simplification of documentary and financial problems, are equally desirable on the import side. Indeed, experience shows that these advantages can be most fully exploited by traders who engage in both export and import. Trading companies that can confidently engage in export and import would more rapidly acquire the specialized knowledge and skills of international commerce and would be able to achieve better and more profita-

⁹⁷ U.S. goods are defined as tangible property manufactured, produced, grown or extracted in the U.S., in which the cost of imported raw materials and components shall not exceed 50% of the sales price. § 103(a)(2). Fifty percent was chosen because it is the existing standard in the Internal Revenue Code for eligible “export receipts” of Domestic International Sales Corporations (DISCs). S. REP. No. 735, 96th Cong., 2d Sess., 6 (1980).

⁹⁸ The term “export trade services” encompasses a wide variety of activities including consulting, international market research, advertising, marketing, insurance, product research and design, legal assistance, transportation, trade documentation, communication and processing of foreign orders, warehousing, foreign exchange, and financing. § 103(a)(4).

⁹⁹ See notes 28-29 and accompanying text *supra*.

ble use of their assets and their distribution networks. While the legislative history of the Act clearly recognizes that the business of export trading companies "may include some domestic trade, some import trade and some third-party international trade wholly outside U.S. commerce," the meaning of "principally" is clarified nowhere in the Act, nor are standards for the application of the term provided.¹⁰⁰

CONCLUSION

Recognition has been growing that the United States needs to export more and export better. Though our balance-of-trade troubles are not over, our export performance in the last year has improved.¹⁰¹ Now is the time to buttress this trend, to build it into a turn-around, and to regain our role as Yankee trader.¹⁰²

One way to improve our exports is along the Japanese model of general trading companies. The attractiveness of this model for us is that it would re-allocate burdens and make use of untapped resources with good economic sense. When traders master the skills of exporting, an entire spectrum of manufacturers can benefit from a trade expertise that they can afford to pay for but could not afford to develop for themselves. When the special expense of exporting and the requirement of international know-how do not rest afresh on every firm that would have its products go abroad, manufacturers can be free to make more effective use of their capital and traders can reduce costs through efficiency and economies of scale. Whatever elements of this model might not be suitable to transport here, the general trading company is logical and successful and worthy of our study.

The Export Trading Company Act of 1980 attempts to meet the issue of our export needs. It would allow banks to support trading companies while still calling for compliance with the regulatory guidelines that protect the interest of the public. Banking organizations are

¹⁰⁰ S. REP. NO. 735, 96th Cong., 2d Sess., 6 (1980). The Senate Committee on Banking, Housing and Urban Affairs, in its report on S. 2718 stated that under § 103(5) a "presumption is established that on the average at least one-half of the company's total business . . . will be directly related to U.S. exports which must contain at least 50 per cent value attributable to the U.S." *Id.* Another standard, suggested by witnesses in the hearings for the Act, would measure the percentage of gross or net earnings of an export trading company generated directly in export trade. *See, e.g., S. 2718 Hearings, supra* note 4, at 103 (statement of Robert L. McCormick).

¹⁰¹ There are many reasons besides the balance of trade to strengthen our export performance. The President's Export Council has suggested fourteen, including reinforcing the dollar, providing industry with new incentives to innovation and productivity, preventing self-defeating protectionist measures, and, not least, opening new jobs. *BUS. AMERICA*, Dec. 1, 1980, at 9. But the importance of a trade balance should not be discounted.

¹⁰² *BUS. WEEK*, June 30, 1980 (special issue), at 134.

the best point of departure for this new form of enterprise. They already have the global reach and the financial strength that trading companies will need. The Act, for the most part, takes intelligent steps that would encourage trading companies to take root and grow. When the Act falls short, it is in certain provisions that unnecessarily interfere with business judgment in pursuit of public policy objectives that have already been secured. These provisions, though few, digress from the main design of the Act.

The supporters of this bill should be commended for their appreciation of international trade. The establishment of American trading companies, with their capacity for skill, economy, and the effective inclusion of average-sized businesses, should invigorate our exports to the benefit of ourselves and our trading partners throughout the world.