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U.S. SENATE REPUBLICAN POLICY COMMITTEE

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Section 1604 of the Senate Stimulus Bill Should be Removed

Buy American Protectionist Measure Will Hinder Economic Recovery

Introduction/Overview

Section 1604 of the Senate stimulus bill is a classic protectionist measure, requiring that certain funds allocated in the bill be spent domestically. Although this may provide some appeal as a populist measure, protectionist measures, when analyzed as an economic proposition, have in the past actually hindered economic recovery in times of economic downturn, such as during the Great Depression, and will likely do the same today.

Provision Terms

Section 1604 of the bill requires that none of the funds provided in the bill may be used for the purchase of steel, iron, or manufactured items to be used in public infrastructure construction-related projects unless all the iron, steel, or manufactured goods were produced in the United States. This provision may be waived if the head of the federal entity involved in the project finds that:

1. applying the provision “would be inconsistent with the public interest”;
2. the iron, steel, or manufactured item is not produced in the United States in sufficient and reasonably available quantities and of satisfactory quality; or
3. requiring the inclusion of the iron, steel, or manufactured item produced in the United States would increase the costs of the project by more than 25 percent.

Analysis

Section 1604 promotes wasteful spending.

By its terms, section 1604 requires that funds be expended on domestic iron, steel, or manufactured items where the use of those domestic products does not increase the overall cost

of the project by more than 25 percent. It is not that difficult to imagine an infrastructure project where the domestic steel company's bid to support the project is \$1.2 billion and a foreign company's bid is \$1 billion. This bill would require that the funds of the project be directed to the company requiring \$200 million more to complete the project because it increases the overall cost of the project by "only" 20 percent. Moreover, it is not that hard to imagine that this may happen on ten projects, or even a hundred (which is simply two projects per state), and Section 1604 is soon requiring that taxpayers expend \$20 billion more for \$100 billion worth of projects. Even if the reference to Illinois Senator Everett Dirksen is apocryphal, pretty soon we are talking about real money.

Even though these protectionist measures harm laborers by causing job losses, they are requested as an electoral pay-off to organized labor.

After the November elections, labor unions soon began lodging their demands with the incoming administration. One of those demands was that "the new administration should explore mechanisms for ensuring that as much federally-funded work is performed in the United States as possible."¹ This demand is made even though it is likely the case that protectionist measures result in job loss. For example, one economic study assessed that approximately 200,000 job losses were attributable to the increase in steel tariffs in 2002, the industry seeking "protection" in the stimulus bill.² This job loss occurs because the private sector, apparently unlike the federal government, must live within its means. In this respect, when its costs increase in one area, such as material inputs, the private entity generally seeks to shed costs in another area, such as by cutting labor costs, for example, jobs. As a protectionist measure restricting trade just like tariffs, it is not unreasonable to assess that private industry will attempt to compensate for the cost increase precipitated by Section 1604 by cutting other costs, namely domestic jobs.

Section 1604 will hinder the very international trade required for economic recovery.

Economists have found that protectionist measures, such as the Smoot-Hawley Tariff, at least contributed to prolonging the Great Depression, by causing a collapse in international trade in the 1930s.³ For example, Amity Shlaes in *The Forgotten Man* found that protectionist measures begat retaliatory protectionist measures, depriving the United States of markets for its goods, thereby sending the United States deeper into its economic slump. "At a time when the country could have pulled itself out of a slump through trade, Washington was buttressing the walls preventing that trade."⁴

By analogy, Section 1604 is a barrier to trade similar to the Smoot-Hawley tariff. If the United States enacts protectionist measures like Section 1604, U.S. trading partners would

¹ AFL-CIO Recommendations for the Obama Administration p. 2, available at http://change.gov/page/-/open%20government/yourseatatthetable/20081211_AFL-CIO_Reg.pdf (original bold omitted).

² Dr. Joseph Francois and Laura M. Baughman, *The Unintended Consequences of U.S. Steel Import Tariffs: A Quantification of the Impact During 2002*, p. 12 (prepared for the Consuming Industries Trade Action Coalition) available at http://citac.info/remedy/2002_Job_Study.pdf.

³ Mario J. Crucini & James Khan, *Tariffs and the Great Depression Revisited*, p. 23, Federal Reserve Bank of New York Staff Reports, available at http://www.newyorkfed.org/research/staff_reports/sr172.pdf (September 2003, Staff Report No. 172) (concluding that tariffs were a "non-negligible" contributing factor in the Great Depression).

⁴ Amity Shlaes, *The Forgotten Man* p. 99 (2007).

almost assuredly retaliate by enacting similar barriers to trade, thereby causing a drop in U.S. exports. In this respect, if domestic economic gain comes to pass by requiring that only U.S. companies be used in domestic production, it would likely be offset by some amount of income lost by these same U.S. companies being foreclosed from competing for work abroad. This resulting trade war caused by Section 1604 would likely deepen and prolong the current economic downturn just as the collapse in international trade in the 1930s turned a recession into a depression.

Section 1604 breaks a promise to reject protectionism and promote growth.

Global economic growth will be critical to the recovery of the U.S. economy, and protectionist measures will hinder that global growth. It is for this reason that leaders of the Group of Twenty pledged to “reject[] protectionism,” and “refrain[] from raising new barriers to investment or to trade in goods and services” when they met in Washington on November 15, 2008 to address the economic downturn.⁵ As a protectionist measure and a new barrier to trade, Section 1604 of the stimulus bill turns its back on that very promise made just two months ago.

Serious concerns have also been raised that Buy American provisions would violate U.S. commitments and obligations as part of the World Trade Organization (WTO) rules pertaining to government procurement. This would set the opportunity for another country, on behalf of its domestic companies, to raise a claim that the provisions violate WTO rules. In fact, a number of foreign officials have already indicated that if enacted into law, the European Commission would pursue WTO challenges immediately. If successful, affected countries would be eligible to impose extensive retaliatory duties and tariffs on various U.S. products, thereby harming American exporters.

Conclusion

Given that protectionist measures hinder economic recovery, promote wasteful spending, and may actually result in job loss, the Buy American provisions of Section 1604 have no place in a bill designed to stimulate the economy and should be removed from the bill.

⁵ Statement from G-20 Summit on Financial Markets and the World Economy ¶ 13 (November 2008).