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Trade Policy Aspects of Industrial Policy in the U.S.

*Robert C. Cassidy, Jr.**

I am a trade lawyer from inside the Beltway and have the additional handicap of being a former government bureaucrat; therefore I have to approach this in a simple-minded way and ask myself, "What is industrial policy?" before discussing what the trade aspect to it might be. I do this because in the U.S., and I suspect in Canada as well, the term "industrial policy" is increasingly being used as a label, which may be either critical or complimentary, that is applied to many, unrelated government activities.

During the Reagan/Bush Era, the term was used to signal strong disapproval and once used, was intended to kill off any possibility that proposed action would ever be undertaken by the government. At the moment, it looks as though we may be moving into a period where any set of government measures that is labeled as being industrial policy will be considered to be a good thing without much more analysis. This business of labels is very important in government.

Many years ago when I was trade negotiator for the U.S. Government, I was in a small country in the Middle East working on a project which was of little interest to anybody outside of my office in Washington and the government of that country. We resolved the problem and, much to my surprise, my counterpart was so pleased with the result that he asked me to meet the king of the country. We got up and started walking across this very large square with a very hot sun beating down and I realized that my State Department handler had run off to the embassy to write a cable back home declaring victory which left me with no one to tell me how to address the king.

So there I was thinking about all the bad historical movies I had ever watched to find a form of address: "Your Grace." No, I did not think "Your Grace" was quite right. "Your Excellency." That was an ambassador. This guy is a king. "Your Highness?" That sounded good, but I was not too sure. I was getting increasingly worried about committing an enormous faux pas that would mar my otherwise brilliant performance in this negotiation. I found myself facing this guy, stuck out my hand, and said, "Hi, King, how are you?" The business of labels can often create difficulties.

I think the subject of this conference, "Industrial Policy", is an

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The following text was compiled from the transcript of the remarks made by Mr. Cassidy at the Conference.

area where labels used without any intellectual examination are beginning to cause substantial difficulties. Let me describe what I think the term "industrial policy" means in the current political debate in the United States.

Let us start with the easy part. Industrial policy is *not* every government action that affects the economy. If it were, "industrial policy" would be virtually everything the government does. The Department of Defense buys two million pairs of boots every year and the Department of Commerce imposes anti-dumping duties on liquid crystal displays for laptop computers. Neither of those actions, taken alone, is an industrial policy, because neither of them is reflective of an objective to promote economic development. The Department of Defense needed the boots so it bought them. Incidentally, it may have kept several boot factories running, but that was not the government's objective. Similarly, the Commerce Department closed the market to imported liquid crystal displays because the domestic industry instituted a dumping case. Neither one of these actions is the result of an industrial policy decision although they both affect the economy.

Industrial policy is not merely a reaction to what foreigners are doing. And here "foreigners" means Japanese. Reactive policies typically have absolutely nothing to do with what is going on in the economy of the United States. They usually are based on the argument that the Japanese do this and, therefore, we must do it in order to counter them.

What is industrial policy? In the most global sense it should be purposeful government action to a defined end. That definition raises a more difficult question: What is the end that is the object of the purposeful government action?

There are several levels here. At the macro-economic level, there is a consensus that a good effect of growth resulting from government policy would be growth with stable money supply, low inflation, whatever measures are necessary to encourage sufficient savings to cover investment, etc., and a reduction in deficits. We do all of those things. We have been attempting to adopt policies to achieve these goals for fifty years. While these policies may be considered to be industrial policy, they are not what we are talking about in the debate at the moment in the United States.

At the next level you have government policies to improve education, infrastructure, basic research and development, and proposals for apprenticeship programs. Things of this sort. This seems to me to be approaching industrial policy. It is within most people's parameters for what an industrial policy includes.

Then we have the thing which comes to most people's minds, I think, when we talk about industrial policy: Industry sector industrial policy. In other words, helping certain categories of economic actors to

do something. This includes joint research and development with the federal government or with federal government support; permitting joint activities that otherwise would be prohibited by antitrust laws; and foreign marketing support. For example, subsidized financing, through the export import bank or other means, and reductions in the costs of operating a business through tax benefits. Things of this sort are all in the category of industrial policy that is being considered at the moment.

But to what end? Is it to allow the owners of the enterprises to make more money? Is it to allow the enterprises to be bigger so their managers will feel more important? Is it to increase their market share? Is it to keep employed the workers they have now? Is it to employ more workers? Is to keep wage levels where they are? Is it to increase wage levels? Increase productivity? Beat the Japanese? What is the purpose of all of the policies? That is part of the problem. It is not clear what it is that we are supposed to be doing when we consider proposals for industrial policy. You have to approach it on that level before you can begin to expect the political process to have any coherent results. That I do not necessarily expect, but, nonetheless, if there is to be any hope we have to debate the objectives of "industrial policy."

Now, let us assume, and I do, that the government in the United States is likely to become more interventionist in sectors. Is this a good thing or a bad thing? Well, you have heard two extremely articulate proponents from the two religious camps on this issue. And I commend you, Henry, for starting off that way because it is, in fact, an unavoidable fact. In this area we do have a confrontation between two sets of religious beliefs which have been ably set forth this morning. I think maybe at the end of the day we might have a straw poll to see which guy gets burned at the stake for being a heretic.

For the moment, my view is that I am absolutely, categorically agnostic on the religious debate. However, I do have a strong bias that, in general, allocation of scarce resources is done more efficiently by the marketplace than by governments. Government is slow. It has, generally speaking, less access to information than do private market players. And you have a strange contradiction. On the one hand, government policy changes constantly. All programs are adjusted to remove inequities all the time. Tax law in the United States never stays unchanged for more than about two months at any stretch, and that two months is the two months when the Congress is in recess. At the same time, while you have these changes at the margin, once a major policy measure is put into place and is successful, in the sense of allocating resources to a set of recipients, the policy creates a special interest group and it becomes extremely difficult to change the program or eliminate it.

For these reasons, the role of the government is awkward at best,

but that does not lead to the conclusion that there is no role at all. In some areas, markets just fail to function. If the government does not do it, it will not happen.

There are other areas where, as was noted this morning, our goal is not efficient allocation of resources, it is equity. It is some social result that we think is important and, therefore, we are willing to pay for it. But we must consider what we want government to do, and what it can do, and for what we want to pay. We do not have to reinvent the wheel to study this issue, and we do not have to go to Japan to study it either because we have, in North America, numerous examples of industrial policy in different areas which can be studied to see what works and what does not work.

We have the grandfather of all industrial policies in agriculture. I tend to agree that it has not worked all that well, although there are many farmers out there who would disagree with me. Forestry is a clear example of industrial policy. We have, in the United States, the programs conducted by DARPA, the Defense Department's Research and Procurement Agency, charged with developing new technologies and promoting the production of things that are useful to the military. DARPA increasingly has found its time and money in commercial activity; and sometimes with great success, I might add. That is industrial policy, although Mr. Reagan would be shocked to hear it said.

So in the United States, we have these examples. I am sure that you do in Canada as well. They are the things at which we should look to consider whether or not certain kinds of industrial policy work.

What does trade have to do with all of this? Well, the first thing you have to remember is that the oldest regulated industry in the world is international trade. I remember in the university museum at the University of Pennsylvania, which I recommend to anybody if you happen to be in Philadelphia, they have a spectacular collection of Sumarian and other tablets from the Mesopotamian area which are, I believe, the oldest known writings in the world. Are they kings' decrees? No, they are contracts to sell corn and a customs officer's request for the duties to be paid on that sale of corn. That was 5,000 years ago.

So we have an extremely old regulatory regime here that is common throughout the world. Indeed it led, not too surprisingly, to the oldest form of industrial policy, with an embargo on imports of foreign made goods and colonial networks where you could only import goods from the colonies or from the mother country, as the case may be, but not from anyplace else.

Although I am not sure I would characterize it as industrial policy, because it was not purposeful but imposed, proponents of using trade policy as an aspect of industrial policy often cite the period between about 1798 and 1813 in the United States when, because of a series of declared and undeclared wars, we were unable to import any-

thing from Europe. This was the period when the Industrial Revolution began to take root in the east coast of America. It has indeed been used as an example by later theorists in the nineteenth century of what is now known as the infant industry policy. You protect, for a short period, your domestic producers of widgets so they can get up and running to compete successfully with the foreigners and then, presumably, you drop your tariff barriers.

The presumption, of course, is that during the period of protection, the rents, the high profits that are running to the domestic producers, will be used by them to invest in new machinery, to innovate, and generally to become more competitive. That can happen. And sometimes it has happened. But history indicates that it often will not happen and that the increased profits will go to the owners or to the workers but, in any event, not back into the enterprise.

Today things are getting a lot more complicated. No economy can isolate itself from the world, certainly not the U.S. and Canada. Canadians know this perhaps better than any other people because they are like the mouse sleeping next to the elephant. Our domestic economic policies can have an effect on the rest of the world; anything that we do in the domestic economy will have some kind of repercussion on the outside world. But one thing is essential to understand; at least in my view, the focus of any industrial policy has got to be domestic, that is to say, have nothing to do with trade as such. Trade is an indicator. It shows you whether you are succeeding or whether you are failing, nothing more.

There is a strong tendency, nonetheless, for politicians, for reasons that are easy to understand, to use trade policy measures only and claim that it is an industrial policy. I say it is easy to understand because it has absolutely no cost to the taxpayer. The costs it does have are hidden. They are very real costs, of course, but they are not apparent quickly in the way that most politicians care about.

Secondly, the people who are injured in the first instance are foreigners who do not vote. But trade policy cannot be a surrogate for industrial policy; it has to be a corollary to industrial policy.

Trade policy tools available in the U.S. are myriad. We have the traditional tariff and exceptions to tariff, such as the Generalized System of Preferences, the Caribbean-Basin initiative, free trade agreements with Canada and Israel and, presumably, soon to be with Mexico. These are very important, and although they tend to be seen as somewhat passe, tariffs are clearly the most pervasive trade regulatory measure available to any policy maker.

The U.S. has got the whole arsenal of unfair trade devices about which you are all familiar. These include dumping, countervailing duty, and Section 337. These are very hard to use as industrial policy tools because they are, by and large, initiated at the whim of private actors.

They are investigations, in a sense somewhat judicial in nature. They are very narrow in their focus, and they can have a very substantial effect in a small area, but that effect tends to last for a short period because of the marketplace adapting either through evasion or diversion or, alternatively, just moving investment of the productive facilities into the United States so you get behind the wall.

We also have the so-called fair trade rules such as the escape clause. They lend themselves to industrial policy because they are flexible. But they are virtually never used because of the requirement to pay compensation under GATT rules. Governments are loathe to do something which requires them, while pleasing one group of people, to irritate another group of people: they raise the duties on imports of yellow widgets but they have to lower the duties on imports of pink widgets to compensate for it.

We have national security trade policy tools. We can control imports in the name of national security, but it has not been used formerly since the Eisenhower Era. But, by and large, the government is loathe to go to use the device because national security is in the eye of the beholder and it becomes very hard to say no once you allow people to know you are going to take measures for national security reasons.

The more important aspect of national security trade policy tools is export control, which is an industrial policy of sorts. I think we are increasingly coming to recognize this as we grapple with the conversion of an export control regime that was directed at denying certain things to the Soviet Union and trying to reorient the export control regime to prevent the proliferation of nuclear and biological weapons.

The last, and perhaps the most important, trade policy instrument that is relevant to industrial policy is international agreements. There are formal agreements like the GATT and the U.S.-Canada Free Trade Agreement and all of the GATT codes with which you are familiar. There are informal arrangements, statements of principle coming out of the Organization of Economic Cooperation and Development ("OECD") and G-7 pronouncements on what the value of the dollar ought to be on any given day of the week. We have the so-called Gray Zone agreements where people agree to restrict their exports or keep their prices at a certain level. This system of agreement is likely to be used, I think, as a corollary to any industrial policy, because it has a number of appealing features: it is flexible, it avoids confrontation, and so on.

But the new initiatives for agreements that we see in the Uruguay Round, using that as an example, show the problems with this approach. First, if you try to negotiate with the world, you either will never reach any agreement at all or you will negotiate an agreement which is the lowest common denominator and, therefore, virtually meaningless. Second, if you do get an agreement that has good norma-

tive rules, you then have to make sure that your dispute resolution works effectively. That raises the issue of how the other parties implement it in their national law, and in countries where the rule of law is not as ingrained as it is in the United States and Canada. The fact that a government may enact a statute that says everything you want it to say does not necessarily mean that is what is going to happen.

So we insist that the dispute resolution procedures must be strong, they must be tough, they must be automatic, they must be like a court. But what if you lose? Then you have the Congress saying "What the hell is this? Yeah, we want strong procedures but that's for the foreigners, not for us." I can go on, but nonetheless this is the kind of thing that one has to confront in thinking about using trade policy instruments.

Are these trade tools adequate to be the corollary to industrial policy? Absolutely. We do not need any new laws. We probably have too many trade laws already. The difficulty that we confront in many cases is that our trade laws are beyond the control of the policy makers. Policy makers have a great deal of difficulty in stopping anti-dumping cases once they start. They have a great deal of difficulty in stopping countervailing duty cases once they start. The problem presented to industrial policy makers as they consider the external effects of any industrial policy they may devise is not that they do not have the right tools, they have an enormous set of tools, but it is how to use what is available to them. There they are going to have to use some imagination and, dare I say, clever lawyering.

In conclusion, my major point is that trade policy cannot be, and never will be, an alternative to, or substitute for, an industrial policy, whatever its objectives may be. Trade policy may be consistent with an industrial policy and promote it, but it is very much a corollary and it cannot take the place of an industrial policy.

