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## **The Search for a Viable Foreign Economic Policy**

*Senator Frank Church\**

United States foreign policy is, to a great degree, influenced by the performance of the international economy. This fact was brought home with dramatic force in 1973, when Arab oil-producing countries suddenly quadrupled the price of oil. That abrupt increase in price, followed by the Arab oil embargo, nearly crippled the economies of the industrial nations of the west. The recent political upheaval in Iran and its affect on the world oil supply is only another poignant example of the extent to which the performance of the American economy, which obviously includes our national and multinational business enterprises, is intimately affected by external economic factors. It is becoming increasingly apparent that, in the global village, politics cannot be separated from economics and business.

Therefore, in discussing trade relations between the United States and other countries, it is necessary to address the political as well as the economic aspect of U.S. foreign trade policy. The debilitated state of U.S. foreign trade is due, not only to the weakened state of the world economy, but also to the inability of the major Western countries to cooperate in expanding their economies, thus mutually increasing imports. Added to this has been the inability of U.S. industry to take advantage of the devaluation of the dollar to out-sell foreign exports in domestic sales. After briefly canvassing the efforts of the international community to strengthen the world economy, placing the efforts made in a political milieu, one solution to the problem suggests itself. Global economic erosion has been caused in major part by the drastic reduction in the purchasing power of industrial nations highly dependent on oil. In 1977, President Carter launched an international initiative designed to reverse the declension in the world-wide economic growth rate. The Carter Administration sought to convince Germany and Ja-

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pan that the declining growth rate could only be reversed if they cooperated with the United States in stimulating their economies to a high level of economic activity. Higher economic growth rates were to be achieved through tax cuts and increased government spending. Faster growth in these countries would lead to a greater demand for imports from other, weaker economies. Hence, Germany, Japan, and the United States would act as three "locomotives" to pull the rest of the world out of the economic slump.

The success of the President's proposal depended on the willingness of Germany and Japan to move into current account deficit or, at the very least, to reduce their large surpluses. Such action would relieve some of the balance of payments pressure on the many weaker industrial countries.

Germany and Japan, however, did not receive the Administration's international economic strategy with much enthusiasm. At the Organization for Economic Cooperation and Development (OECD) ministerial meeting in the summer of 1976, both governments agreed to certain coordinated national growth targets for 1977. Although these targets were substantially below what the Administration had suggested, only the United States came close to meeting its target. Due to strong stimulative measures undertaken by the Carter Administration, the U.S. economy scored an impressive recovery in 1977 which continued into 1978. The Gross National Product rose by almost 11%,<sup>1</sup> and the unemployment rate fell from its postwar high of 9.1% in mid-1975, to about 6%.<sup>2</sup> In addition, excess capacity in the United States — the difference between actual production and available capacity in the manufacturing sector — dropped to 17%.<sup>3</sup> In 1978, the Gross National Product rose by 3.9%,<sup>4</sup> unemployment dipped slightly,<sup>5</sup> and capacity utilization continued to rise.<sup>6</sup>

While the United States increased its growth rate, Germany and Japan continued to pursue a policy of slow growth. In both countries, the unemployment rate actually rose. In 1977, the German economy expanded only 2.5%, and Japan's growth rate fell to less than half of its

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<sup>1</sup> BUREAU OF THE CENSUS, U. S. DEPARTMENT OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 441 (Table No. 710) (1978) [hereinafter cited as 1978 ABSTRACT].

<sup>2</sup> *Id.* at 398 (Table No. 643).

<sup>3</sup> 23 OECD ECONOMIC OUTLOOK 10 (Table No. 6) (1978). See 1978 ABSTRACT, *supra* note 1, at 807 (Table No. 1405).

<sup>4</sup> Wall St. J., Jan. 19, 1979, at 3, col. 1.

<sup>5</sup> 1978 ABSTRACT, *supra* note 1, at 398 (Table No. 643).

<sup>6</sup> *Id.* at 807 (Table No. 1405).

historic average of over 10%.<sup>7</sup> Excess capacity remained at 17% in Germany and 16% in Japan.<sup>8</sup> In 1978, Germany's growth performance did not exceed 4%.<sup>9</sup> Although Japan has pledged to make its "best efforts" to accelerate the nation's growth rate to 7%, its growth has hovered around 6% because of the deflationary effect of the appreciation of the yen.<sup>10</sup>

At the current Tokyo Round, representatives from Germany, Japan, Canada, the United States, and other Western industrialized nations appear to be moving toward agreement on a common economic policy.<sup>11</sup> While the United States has exerted heavy pressure on Germany and Japan to reduce their huge trade surpluses,<sup>12</sup> they have complained bitterly that the United States pursued for too long a policy of "benign neglect" with regard to the dollar and its prodigious appetite for imported oil.<sup>13</sup> The intensity of the mutual recriminations made it unlikely that any workable compromise could be reached in the foreseeable future.

Instead of placing the blame on its trading partners, the United States should abandon its diplomatic efforts aimed at forcing the German and Japanese governments to do what they are clearly unwilling or perhaps unable to do. For instance, the Germans are traditionally preoccupied with inflation. Their concern is not misplaced given their experience with hyper-inflation in the inter-war period. Both the German government and the public appear willing to accept a very modest rate of growth and a high level of unemployment in return for stable prices. Nonetheless, under the guidance of Chancellor Helmut Schmidt, Germany maintains one of the world's least inflationary economies and is presently the strongest economy in the West.<sup>14</sup>

Also, despite Japanese assurances to the contrary, it is equally unlikely that Japan will do much to eliminate its large trade surplus. The

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<sup>7</sup> Lewis, *In the West, a New Conservatism*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 45.

<sup>8</sup> 23 OECD ECONOMIC OUTLOOK, *supra* note 3.

<sup>9</sup> Geddes, *Germany's Long-Sought Upturn Takes Hold*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 46.

<sup>10</sup> Wall St. J., Jan. 4, 1978, at 1, col. 5.

<sup>11</sup> Lewis, *For Freer Trade, Still a Long Haul*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 9.

<sup>12</sup> Scott-Stokes, *Third World Industrializes, Challenging the West*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 13.

<sup>13</sup> Wall St. J., Nov. 14, 1978, at 1, col. 6.

<sup>14</sup> Crittenden, *A New World Disorder*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 38.

Japanese economy is uniquely export-oriented.<sup>15</sup> Due to Japan's reliance on foreign oil for 70% of its energy needs,<sup>16</sup> the Iranian crisis and the recent OPEC price increase have reinforced the Japanese emphasis on exports. Moreover, because of Japan's enormous 16% spare productive capacity,<sup>17</sup> a drastic reduction in Japan's exports would create havoc within her economy.

The intransigence of the Japanese government became clear in the Strauss Agreement of 1978, when the Japanese government made an effort to placate the United States through trade talks with the U.S. Special Trade Representative, Robert S. Strauss.<sup>18</sup> Japan's concessions under the Strauss Agreement, however, were little more than placating gestures. The projected 10% cutback in steel exports to the United States and the 40% cut in the sale of color television sets will mean, at most, a reduction of only \$700 million in Japanese exports.<sup>19</sup> Japan also pledged to hold auto sales in the United States to the prior year's level. However, 1977 was a banner year for Japanese auto sales in the United States, with a 36% increase over the previous year.<sup>20</sup>

Japanese import concessions under the Strauss Agreement were equally modest. Japan has promised to buy large quantities of enriched uranium, non-ferrous metals, and commercial aircraft from the United States, but these sales will mean only a one-time increase in U.S. exports.<sup>21</sup> Far more significant would be an agreement to reduce Japan's special tariff fees and quotas on imported food products. When a nation enjoys a Gross National Product of \$700 billion and imports a meager \$15 billion in manufactured goods,<sup>22</sup> there is considerable room for adjustment.

Sharp disagreement over a common economic policy has become a major source of political dissension among the Western nations and Japan. Since 1977, the international community has witnessed a long series of summits, OECD ministerials, International Monetary Fund meetings, and bilateral consultations devoted to the solution of economic problems. Each met with the same result: world leaders entered speaking optimistically of "interdependence" and "cooperation," but

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<sup>15</sup> Misawa, *Tokyo as an International Capital Market—Its Economic and Legal Aspects*, 8 VAND. J. TRANSNAT'L L. 1, 3 (1974).

<sup>16</sup> Phone Statement by the Japanese Embassy to the offices of Senator Frank Church in Washington, D.C. (March 1978).

<sup>17</sup> 23 OECD ECONOMIC OUTLOOK, *supra* note 3.

<sup>18</sup> Special Trade Representative's Office, Statement Release (March 1978).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> Strauss-Ushiba Communique (1978).

<sup>22</sup> Morgan Guaranty Trust Co. (newsletter), April 1978, at 5.

emerged grim-faced and empty-handed. Even the current Tokyo Round displays the countries' calls for greater trade.<sup>23</sup> Yet, despite these efforts, national economic growth targets have not been met, and trade imbalances have not improved.

Diplomatic relations among the main protagonists, Germany, Japan, and the United States, have taken on distinctly strained overtones. To be sure, the weakened dollar has placed the United States in a weakened position despite President Carter's economic rescue efforts. Mutual recriminations and finger-pointing have become such widespread practices that it is difficult to predict which is likely to become more tense—a U.S. arms summit with the Russians or the next economic summit with our major trading partners and closest allies.

The July 1978 Economic Summit in Bonn apparently followed the same pattern. Once again, the heads of state who met in Bonn agreed on a comprehensive strategy covering growth, employment, inflation, and international monetary policy. Yet, when one examines the commitments stemming from the Summit, one finds, for the most part, goals couched in broad generalities. The hoped-for break-through in the Multilateral Trade Negotiations, a major objective of the Bonn summit, failed to materialize. Participating nations were unable to reach an agreement on vital areas under negotiation, such as market access for agricultural products and the reduction of non-tariff trade barriers. Possibly, these goals will be finally realized in 1979.

The recent New Year's Summit in Guadelupe of President Carter, Chancellor Schmidt, Prime Minister Callaghan, and President Giscard d'Estaing resulted in more promises of economic cooperation among the Western nations.<sup>24</sup> The substantive results remain to be seen.

Indeed, Americans have found it difficult, both in the private and the public sector, to form a unified and effective economic program designed to deal with America's two greatest enemies: inflation and devaluation of the dollar. The \$32 billion trade deficit of the United States<sup>25</sup> and, in particular, its voracious appetite for foreign oil, have created a crisis of confidence in the American dollar. The year 1978 marked a period in which the value of the dollar plummeted. In the last two years, the value of the dollar dropped 34% against the Japanese yen and 22% against the Deutsche mark.<sup>26</sup> On the inflation front, the

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<sup>23</sup> Lewis, *supra* note 11.

<sup>24</sup> NEWSWEEK, Jan. 15, 1979, at 37.

<sup>25</sup> 1978 ABSTRACT, *supra* note 1, at 858 (Fig. no. 31.2).

<sup>26</sup> Hershey, *The Dollar's Tough Road Back*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 38.

United States has performed poorly in comparison to its trading partners; 1978 was marked by double-digit inflation.<sup>27</sup> Germany and Japan, however, appear to have their inflation rates well in hand, with rates of about 3% and 4% respectively.<sup>28</sup>

The depreciation in the value of the U.S. dollar could have led to a reduction in the U.S. trade deficit. United States industries are primarily responsible, for they have not chosen to take advantage of the depreciation.

For example, the rapid depreciation of the dollar during the first half of 1978, particularly against the currencies of Detroit's two most serious competitors in the small car market, Germany and Japan, offered American auto makers an unexpected opportunity to recapture the small car markets lost to imports. Rather than seizing this opportunity, U.S. automakers utilized this depreciation as an excuse for raising their own prices on compact cars. As a result, they squandered the opportunity to recapture their lost dominance of the American market and contributed further to the inflationary spiral. In 1978, Ford, General Motors, and Chrysler announced significant price increases for their sub-compacts, while only American Motors was willing to lower prices in that category.<sup>29</sup> In effect, any price advantage the auto industry could have gained from the dollar's depreciation was lost by a combination of greed and lack of foresight. Piecemeal increases instituted by the major auto manufacturers during 1978 are already continuing into 1979.<sup>30</sup> In December, GM and Ford announced increases averaging 0.5% on 1979 models.<sup>31</sup> In 1978 alone, GM announced six separate price increases.<sup>32</sup> If this pattern of behavior is followed by other U.S. manufacturers, the depreciation of the dollar may not help solve the U.S. trade problems.

Further, most nations believe that the United States could contribute to a healthier economic climate by controlling its rate of energy consumption and by reducing the amount of oil it imports. The current threat of gas rationing indicates vividly that the United States is truly a profligate in its energy habits. Far more than in any other society, the American style of living is built around the automobile. It is not merely because Americans enjoy driving cars; they simply have no al-

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<sup>27</sup> Farnsworth, *In the U.S., an Accomodation to Inflation*, N.Y. Times, Feb. 4, 1979, § 12 (International Economic Survey), at 46.

<sup>28</sup> Hershey, *supra* note 26, at 42.

<sup>29</sup> Wall St. J., Dec. 15, 1978, at 3, col. 1.

<sup>30</sup> *Id.*

<sup>31</sup> Wall St. J., Dec. 6 at 1, col. 2; *id.* Dec. 13, at 2, col. 2.

<sup>32</sup> *Id.*

ternative. Patterns of work and play, the structure of American cities, and the rural lifestyle are all based upon universal access to the automobile.

In addition to the task of reducing oil imports, the United States must face an even more difficult problem: during the past decade, American industry lost much of its competitive position in foreign markets. What the United States needs, I believe, is a recapitalization of private industry. Since 1969, productivity in this country has actually declined.<sup>33</sup> American industries have simply not put back into production enough of what they have taken out. In comparison to the performance of other industrial countries, U.S. reinvestment has been dismal. While Japan plows back an average of 35% of its Gross National Product into capital expenditures, and Germany 26%, the United States spends an average of only 18% on reinvestment.<sup>34</sup> Even industries which have shown modest productivity gains have not kept pace with their foreign competitors. The steel industry is a case in point.

While the Germans and the Japanese have adopted the most efficient and technologically advanced means of production, many U.S. steel plants have been allowed to decline into obsolescence. From 1964 to 1975, productivity in the U.S. steel industry increased only 17.5%, while the Common Market countries raised their productivity by 89.5%, and Japan increased hers by 166%.<sup>35</sup> As a consequence of its outmoded plants, the U.S. steel industry cannot compete either at home or abroad.

Unlike other U.S. industries, American agriculture has made significant gains in productivity. It is no coincidence, then, that agriculture is also the most successful U.S. export industry.<sup>36</sup> Following the example set by the agricultural industry, increased productivity of American industries could spur economic growth and reduce the U.S. trade deficit without fueling inflation.

To stimulate reinvestment, better incentives must be provided for the investment of risk capital in the United States. It is not enough to wait for activity among private investors; the federal government must take action. For the past 36 years, risk capital has suffered from overly burdensome taxation. Excessive personal income taxes, exacerbated by an inflation which raises taxpayers into higher income brackets, have

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<sup>33</sup> Caterpillar Tractor Corp., National Policy for U.S. Exports (Oct. 1978) (speech by Lee Morgan).

<sup>34</sup> *Id.*

<sup>35</sup> COUNCIL ON WAGE AND PRICE STABILITY, REPORT TO THE PRESIDENT ON PRICES AND COSTS IN THE UNITED STATES STEEL INDUSTRY 45 (Table III-2) (Oct. 1977).

<sup>36</sup> 1978 ABSTRACT, *supra* note 1, at 417 (Table No. 678).



squeezed large numbers of middle and upper-income earners out of the investment market. In addition, the capital gains tax has made investment risks increasingly less attractive to those people who can still afford them. The combination of the two has driven money out of productive investment and into tax shelters such as tax-free bonds. High tax rates are not merely curtailing investments; they may be reducing the flow of revenues to the Treasury. In 1968, when the capital gains tax rate was only 25%, the tax drew in \$7.2 billion in revenues.<sup>37</sup> In 1977, at rates that reached as high as 50%, the tax produced only \$8 billion in revenue.<sup>38</sup> Moreover, the capital gains revenue, as a percent of total taxes, dropped from 9.3% in 1968 to 4.5% in 1975.<sup>39</sup>

Financial experts have largely attributed the post-war economic boom in Germany to the Adenauer Government's decision to ignore the advice of American State Department economists.<sup>40</sup> Against such advice, the Government proceeded to make drastic cuts in taxes. As a result, the freed capital fueled new economic activity which provided more revenue to the public treasuries. In the United States, the Kennedy tax cuts of 1964 produced a surge of non-inflationary growth.<sup>41</sup> Unfortunately, the growth passed unnoticed, for it was quickly dissipated by the onset of the Vietnam War.

The tax cut remedy has worked in the past; I believe the United States should try it again. With interest rates on the rise, the United States presently faces an economic crisis. This country must decide whether to support a free enterprise system or abandon it. If the U.S. government continues to squeeze the private sector with excessive taxes and high interest rates, people will abandon the capital markets and the choice will have been made.

I strongly support the new tax laws, effective January 1, 1979, which, among other things, reversed the 36-year trend of higher capital gains taxes.<sup>42</sup> The maximum rate on corporate capital gains has been reduced to 28%.<sup>43</sup> The result in the long run will be salutary for both the economy and the Treasury. A clear decision to cut taxes eliminates much of the uncertainty that has discouraged the business community from reinvesting its profits. I recommend that the maximum rate of taxation on individual income, whether earned or unearned, should be

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<sup>37</sup> 124 CONG. REC. E2172 (daily ed. April 26, 1978) (remarks of Rep. Kemp).

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* E2377 (daily ed. May 4, 1978) (remarks of Rep. Kemp).

<sup>41</sup> *Id.*

<sup>42</sup> Wall St. J., Nov. 9, 1978, at 8, col. 1.

<sup>43</sup> *Id.*

reduced to 48%. Within a short period of time, the loss of revenue to the Government should be more than replenished through the increased economic activity stimulated by the cut.

The new tax cuts do not help the middle-income taxpayer. The tax savings on capital gains will be offset by (1) the planned Social Security tax increases and (2) the boost people receive into higher tax brackets because of inflation. Admittedly, corporations have received additional tax relief, including an increase on the investment credit. I believe, however, that no American citizen should have to pay a higher rate of income tax than does General Motors. Therefore, tax reforms for individuals must continue.

Rather than relying on diplomacy to convince Germany and Japan to adopt a common economic policy—a futile endeavor, it is time for the United States to focus on the fundamental shortcomings of its own economy. Let the United States declare an economic detente with Europe and Japan. Let them proceed with the policies they regard as best, while the United States undertakes to bolster its own competitive position in the world marketplace. In the end, this may bring us closer together—both politically and economically—far sooner than any “locomotive” they are unwilling to board.