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Toward a More Open Trade Policy

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Toward A More Open Trade Policy

by Murray L. Weidenbaum
with Michael C. Munger and Ronald J. Penoyer



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This booklet is one in a series designed to enhance the understanding of the private enterprise system and the key forces affecting it. The series provides a forum for considering vital current issues in public policy and for communicating these views to a wide audience in the business, government, and academic communities. Publications include papers and speeches, conference proceedings, and other research results of the Center for the Study of American Business.

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CENTER FOR THE STUDY OF AMERICAN BUSINESS

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Preface

The limited success of the November 1982 meetings of the General Agreement on Tariffs and Trade underscores the need for a new look at the troubled subject of international trade. This report represents just such a return to basics.

This study starts off with the proposition that has been neglected far too long—no party to the current world trade disputes has clean hands. Americans properly are outraged by the staggering array of barriers to our trade. But simultaneously, we seem to be oblivious to the many obstacles that we have placed on the exports of our trading partners.

Progress in achieving a healthier and more open trading system can come only from the mutual recognition of the policy shortcomings of all sides. On a constructive note, this study concludes with eight proposals for breaking the trade deadlock—with the United States taking the lead in a new approach to achieving freer world markets.

Introduction

The United States—and many of its trading partners—are drifting to protectionism. As a result, we stand to lose much of the benefit of the open world trading system which this country has so long and so energetically worked toward achieving. The tide must be turned before we repeat the sad, protectionist experiences of the 1930s.

Yet, at a time of high unemployment and slow economic growth, it is natural that American citizens become concerned over a rising tide of imports and over the tremendous array of obstacles erected by other nations to exports from the United States. These are very genuine concerns. They should not be treated lightly nor dismissed cavalierly. Rather, they should be carefully examined in the light of the total impact of international trade on the American economy.

This report presents such an analysis. It does indeed demonstrate that many other nations follow protectionist policies that limit their imports of goods and services from many countries, including the United States. This analysis also shows that many other nations also subsidize or otherwise unfairly help the industries and companies whose products at times achieve rising shares of our domestic market.

But this report does much more. For one thing, it reminds us of the vast array of protectionist measures that have been enacted in the United States to restrict imports from abroad. As will be pointed out in some detail, the basic reason for the popularity of protectionism is that it can be an effective means by which relatively small and well-organized groups can use the political process to their advantage at the expense of the mass of consumers who are not even aware of the burdens put on them in the form of higher prices. Thus, the burdens of protectionism can be viewed as a form of hidden tax on the consumer. This study also shows some of the many ways in which federal, state, and local governments discourage our own exports.

To put the matter bluntly, our hands—as a nation—are not clean when it comes to championing freer flows of world trade and investment. Moreover, if the United States, and its trading partners, both ignore their own barriers to trade and focus exclusively on the protectionist policies of others, we may see a substantial worsening of the current deterioration of trade relations.

Others have written on the specter of a “trade war” brought on by the return of the “beggar thy neighbor” policies of the 1930s, which unsuccessfully attempted to export unemployment from one nation to another.

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That characterization, at least at present, may be an exaggeration. However, some analysts have warned that the catalyst for the stock market crash of October 1929 was a congressional vote revealing the breakdown of the free trade coalition. In light of the large stake that the United States has in a healthy international trading and investment system, a posture of enlightened self-interest surely is warranted. Moreover, such a position also is appropriate in the case of other major industrialized nations, notably Japan.

Scratch an economist and you will find, at least in theory, a free trader. But, in the real world, we must be aware that free trade cannot be a one-way street. However much we oppose the very real and major barriers enacted by other nations that restrict our exports and world trade generally, we have to call attention to domestic protectionist measures—that is, barriers to trade imposed by the U.S.

Quite clearly, the American economy and the economies of other nations would not benefit from a race to erect higher and higher tariff and other restrictive barriers to trade. But reversing the process—reducing the many barriers to world trade—involves a parallel with the danger of unilateral disarmament. The United States cannot blithely follow a policy of free trade without simultaneously encouraging and expecting its trading partners to do likewise.

*The burdens of protectionism can be viewed as
a form of hidden tax on the consumer*

The body of this study contains five parts. The first section presents an analysis of the current pressures for increased protection from imports. The second section shows the wide variety of obstacles in foreign nations that reduce the flow of U.S. exports. The third part of this report treats the other side of the coin by showing the important array of U.S. obstacles that inhibit our own exports. Part four presents the case for free trade from the standpoint of historical experience and analyzes both the benefits of open world markets and the costs of protectionism. This study concludes by presenting a modern approach to trade policy that encompasses domestic changes and international actions that will benefit both the American economy and our trading partners overseas.

I. The Challenge of Protectionism

Each year, the United States imports and exports vast arrays of goods and services in the world marketplace. They range from automobiles, steel, industrial metals, textiles and agricultural products, to brooms, data processing equipment, clothespins, transport services, baseball bats and works of art.

To be sure, many, though certainly not all, of the goods traded internationally are important to the American economy and to the national security. Domestic producers in nearly all of the industries mentioned can feel the pressures of—and lodge protests against—lower priced competition from producers in other nations that sell goods in the United States. Potentially, any sector of the American economy can feel “hurt” by foreign competition—whether autos or clothespins are at stake—and call for “protection” from offending foreign competition. The rationale for such intervention by our government varies, ranging from “unfair” dumping below foreign market prices, to foreign barriers against our exports, to our own perceived national security requirements.

Protectionist sentiment has become one of the major challenges to the current policy emphasis on reducing governmental intervention in the economy and increasing reliance on the marketplace. A wide range of industries has been exerting pressure on the President, Congress, and government agencies to restrain the free flow of trade between the United States and the rest of the world. At times, the restrictionist impetus comes from the government itself, often as an adjunct to foreign policy. Let us first examine a few of the various, and often powerful, calls for trade restraint as background to an understanding of the protectionist pressures themselves and the proper response to them.

The Auto Industry: A Rocky Road

In recent years, some of the most powerful calls for restraint of international trade have come from the American automobile industry, which earlier had been a bastion of free trade. This sentiment is rooted in the fact that sales of imported autos—especially those made in Japan—have captured large shares of our domestic market. The data tell a dramatic story:

- In 1977, imported car sales constituted 18 percent of total U.S. domestic sales. By 1981, imports represented 27 percent of total U.S. auto sales, or 2.3 million cars. Last year, 80 percent of all imports—over 1.8 million autos—were made in Japan.
- Sales of domestically made cars stood at a 20-year low in 1981, totaling 6.2 million units, down 5.7 percent from 1980.
- Annual U.S. production of cars fell 32 percent between 1977 and 1981. 1981 was the fourth straight year of output decline.

- The four domestic auto manufacturers incurred losses totaling \$4.2 billion in 1980 and \$1.3 billion in 1981.
- In February, 1982, of the 1.5 million members of the United Auto Workers (UAW), 250,000 were reported to be on indefinite layoff and more than 51,000 on temporary layoff.
- 1,654 domestic car dealers—6.4 percent of the total—went out of business in 1980, three times the number of failures in 1975.¹

Whatever the causes of problems facing U.S. automakers, the result is that this industry, which includes two of the six largest industrial corporations in America, has called for federal assistance. At times the companies and the leading labor union (the United Auto Workers), together or separately, have supported and gained influential sponsors for proposed laws that would limit the import of cars, particularly those from Japan.

In 1981, considerable support developed for proposed legislation to establish firm quotas on imports of Japanese automobiles. In the face of that threat, Japan imposed a “voluntary” limit on its automobile exports to the United States for a period of two years. This unilateral “gentlemen’s agreement” was announced after a series of informal consultations between the United States and Japan. No similar restraints were sought on auto imports from other countries.

As a result of Japan’s voluntary restrictions and a weakening in the U.S. auto market, sales of Japanese cars in the U.S. in the first half of 1982 declined by 12.6 percent. In adjusting to the restraints, Japanese automakers raised auto prices and began to export higher-priced autos. In any event, pressure for further protection has continued because of the large share of the U.S. market that Japanese imports still represent. Evidence that the Japanese are fully aware of this can be found in the fact that Tokyo agreed in late 1982—several months earlier than necessary—to extend its “voluntary” restriction on imported autos for a third year. The agreement, setting a ceiling of 1.68 million imports a year, was not due for extension until March 31, 1983.²

One bill that has gained widespread support in Congress is the Fair Practices in Automotive Products Act (H.R. 5133 and S. 2300), which has more than 200 sponsors in the House of Representatives and 17 in the Senate. The bill would require automakers selling 500,000 or more cars annually in the U.S. to have 90 percent domestic (North American) parts and labor in their autos. Smaller requirements for domestic content would be imposed on producers selling fewer than 500,000 units a year, and those selling fewer than 100,000 cars (mainly European imports) would be exempt entirely. These restrictions would reach full force by 1986. The primary proponents of this bill are the UAW and automobile parts suppliers.

The domestic content bill is described as a “jobs bill” through which the investment dollars now flowing overseas will be spent domestically. Its title suggests that someone has been engaged in “unfair practices” in building and marketing cars. However, only six foreign manufacturers sold more than 100,000 autos in the U.S. during 1980 and 1981, and all six were Japanese. Implicitly, foreign producers of high-priced luxury cars—which sell in relatively small numbers—are not viewed as engaged in unfair practices. Thus, the bill seems clearly directed at automobile imports from the larger producers in Japan. The major reason given for assuming that those companies have been “unfair” are data showing that, between 1978 and 1981, domestic sales of U.S.-made cars decreased 33 percent, while sales of Japanese imports increased by 37 percent.

Based on a host of considerations regarding costs, plant size, and parts procurement, the domestic content bill would actually discourage investment in the U.S. by reducing foreign manufacturers’ capabilities to use worldwide sources for components. Consequently, reduced investment—coupled with the resulting lower sales of imported cars—would limit domestic competition and have corollary effects on productivity in the auto industry. The law would also reduce the international competitiveness of domestic U.S. automakers (i.e., in following a “world car”

*The “domestic content” bill for autos
would actually discourage rather than increase
investment in the U.S.*

strategy), since worldwide sourcing for parts permits efficient and cost-effective production. Bookkeeping required for compliance would be massive, since detailed reports on parts supplied would be needed. Profits for American automakers and parts suppliers would rise, but gains in this area would be offset by decreased competition in both domestic and international markets.

The U.S. Department of Commerce has estimated that, should the bill become law, auto prices in the United States would rise by 10 percent or more. A 1980 study by the Council of Economic Advisers reported that limiting imports to 10 percent of the U.S. market would raise car prices between 13 and 17 percent. Other studies by the Federal Trade Commission and the American International Automobile Dealers Association predict even greater price hikes, ranging between \$500 and \$3,000 more per car. Presumably, higher prices would further reduce the already weak demand for new motor vehicles.

The ratio of added consumer cost to jobs-generated has been estimated at four to one. The Reagan Administration has predicted that every new job generated in the auto industry would cost the U.S. economy \$100,000 a year.³

Steel Imports: Trigger Prices and "Dumping"

The concern of the American steel industry over steel imports, primarily from the European Economic Community (EEC) and Japan, predates that of Detroit over imported autos. Steel produced in other parts of the industrialized world has been sold in the U.S. in substantial quantities for more than two decades. For example, this country's net steel trade balance shifted from positive to negative as early as 1959, and imports have been on the rise since then. In 1981 steel imports comprised 16 percent of the U.S. market.⁴

This penetration of imports has, from time to time, prompted domestic steel producers to level charges that importers were "dumping," or selling steel at "less than fair value," defined as the price that the producer charges in its home market. U.S. law provides for anti-dumping duties to be levied on imports if the sale of dumped goods causes "material harm" to a domestic industry. Also, countervailing duties can be imposed to offset subsidies by foreign governments if subsidized imports cause harm. A major action to stem the flow of steel imports was taken in 1969, when Japan and the EEC were forced into a "voluntary restriction agreement" (VRA) for three years. This limitation of imports was aimed largely at European steelmakers that had made large inroads in the U.S. market. The current sentiment for protecting the steel industry, however, surfaced in 1977, when growing imports spurred domestic producers and labor unions to launch an intensive lobbying campaign in Washington. U.S. steelmakers also filed 19 separate antidumping suits. Thus, a strong political and legal offensive forced the Carter Administration to take a variety of specialized actions.

The trigger price mechanism (TPM) for steel was put in place early in 1978. This device established "reference prices" for steel imports based on Japanese production costs. When imports fell below these prices, a dumping investigation would automatically be "triggered." The demise of this protectionist mechanism began in 1981, when imports rose substantially over those of 1980. In that year, EEC producers, for instance, increased their tonnage of steel sold in the U.S. by 63 percent and domestic producers began to register complaints about dumping and subsidies.

Robert Crandall of the Brookings Institution has found that the TPM raised imported steel prices in 1979 by 10 percent, and domestic steel prices by about 1 percent. The total effect was to raise steel prices in the United States by about 2.4 percent (because imports were 16 percent of the domestic market). It is ironic to note that a major customer of the U.S. steel industry is the hard-pressed automobile industry, which bears the higher costs that result from protection. Crandall has estimated the total cost to the American consumer of the TPM at about \$1 billion in 1979. He added, however, that the mechanism was probably the lesser of

two evils, since "trigger prices moderated the potentially inflationary effects that the full prosecution of dumping suits might have produced."⁴

The TPM was suspended in January, 1982, when seven major U.S. steelmakers filed a total of 132 cases of dumping with the U.S. International Trade Commission, aimed at firms in eleven European countries. In June 1982, the Commission proposed countervailing duties, ranging from 18 to 40 percent, on various EEC steel companies that were found to be subsidized by their governments. (In October 1982, the Commission ruled that the subsidized steel had injured our domestic steel industries. This action was a necessary step for the imposition of the duties.)

In an effort to halt the duties, European governments agreed in August of 1982 to quotas on 11 types of steel imports. This agreement was rejected, however, by U.S. steel producers, who refused to withdraw their countervailing duty petitions. Later, the Commerce Department also issued a preliminary antidumping ruling against various steel imports from the EEC.

*Quotas established by Western European
steel producers in response to U.S. pressures
are a type of cartel*

In October 1982, European governments agreed to quotas that would keep their steel imports to about 5 percent of the U.S. market and also added several types of steel to those governed by the previous quotas negotiated in August. That agreement was widely heralded in the United States, especially by the federal government and the steel industry. The companies then withdrew their original complaints, which were the basis for the countervailing duties.

On reflection, the results may not be so sanguine. The quotas which Western European producers are now establishing in response to U.S. pressures mean, in effect, that we have forced them to establish a type of cartel or market-sharing arrangement. Countervailing duties are a special form of tariff. They work through the price mechanism and deal with the problem of "unfair" (i.e., subsidized) competition. But quotas restrict "fair" and "unfair" competition alike. Thus, it would have been preferable for the U.S. government to have imposed countervailing duties to offset European steel subsidies rather than to absolutely reduce the flow of steel imports.

Moreover, the European Economic Community has indicated that its member nations would reduce their steel imports from countries such as Taiwan, Brazil and South Korea. This response to their agreement to limit Western European steel exports to the United States means that we can expect an increased volume of imports to the United States from non-European steel producers, none of whom are parties to the recent

market-sharing agreement. There are already rumblings about instituting steel-dumping charges against Japan and some of the developing countries. Thus, the United States may not be at the end of the road in terms of "protection" of our domestic steel markets.

*Extension of the Multifiber Arrangement
means that governments will continue to make
key decisions on the flow of textile products*

The Problem of American Textiles

Pressures against free trade in the textile industry in America have been strong for many years. In the mid-1950s the U.S. found it necessary to negotiate a five-year program to restrain Japanese exports of clothing. Other labor-intensive economies with large forces of low-wage, semi-skilled workers—including those of Taiwan, Hong Kong, and South Korea—continued to export so many textile goods to the United States in the 1960s and 1970s that further restraints were imposed. These included a Long-Term Arrangement (LTA) in 1962. This agreement was not entirely successful, since imports of cotton products, for example, increased from 5.2 percent of domestic consumption in 1961 to 14.3 percent in 1973.⁶

Economic factors in the domestic textile industry have an important bearing on recurrent demands for protection. In the face of moderately rising consumer purchases, domestic output of apparel and textile mill products has declined over the past decade or so. Apparel imports, in particular, have captured large shares of the domestic market and now comprise roughly one fourth of the total. In constant, inflation-adjusted dollars, the value of clothing imports to the U.S. increased from roughly \$1 billion in 1969 to well over \$3.5 billion in 1979, or 256 percent (in real terms). Not too surprisingly, the number of firms manufacturing apparel and textile mill products in the United States has steadily declined during the same period, falling by almost one third between 1969 and 1976. Small textile firms (those with less than \$100,000 in assets) have been hardest hit, decreasing in number by one half over the seven-year period.

U.S. trade in clothing and textile products is currently controlled by the Multifiber Arrangement (MFA) of 1973. Under extensions, the agreement will remain in effect through July, 1986, and now covers a wider variety of products than the previous LTA. The MFA allows most categories of apparel imports to grow at a minimum 6 percent annual rate, regardless of the growth rate of domestic purchases of clothing and textiles. However, the agreement also contains "flexibility provisions" that permit wide fluctuations in import volume. All in all, the recent extension of the MFA means that governments will continue to make key decisions as to the flows of textile products among the major producing and

consuming economies and, specifically, that textile imports into the United States will continue to be limited by government action.

Footwear Quotas and "Voluntary" Export Restraints

"Voluntary" export quotas, also known as Orderly Marketing Agreements (OMAs), had been imposed on footwear imports to the U.S. throughout the 1970s until 1981, when the Reagan Administration refused to extend them. In general, these import restraints have been severely criticized for two reasons. First, the cost to American consumers is high relative to any benefits to American producers and workers. Second, the "voluntary" nature of the quotas has meant that large quota profits have gone to foreign producers rather than to American consumers or taxpayers (as when the quota "rights" are distributed domestically in the U.S.). A recent study examining Korean footwear quotas in particular, however, has shown that several other factors exist that make the OMAs even less desirable than has traditionally been believed.

*Footwear quotas acted as a "regressive" tax
whereby low-income consumers
were more adversely affected than
high-income consumers*

Voluntary footwear quotas can impose significant economic damage on producers in the exporting country itself. In the case of Korea, firms that had less political power were discriminated against in the quota allocation process and were particularly hurt—although even the large firms that were favored in the process fared poorly under the voluntary arrangements. More important to the American consumer, however, is the fact that footwear quotas acted as a "regressive" tax whereby low-income individuals were more adversely affected than high-income consumers.

Since footwear is a necessity, the OMAs were considerably more regressive than an outright tariff on these goods for two reasons. First, the quotas increased the price of each pair of imported shoes from Korea, resulting in larger percentage increases for the low-priced footwear that is generally purchased by lower income groups. Second, the quotas induced an increase in the relative supply of higher-quality footwear (which is higher in price), thereby resulting in lower price increases for those shoes that are generally purchased by higher-income groups. In this sense, the voluntary restraints on footwear acted as a regressive "tax" on low-income consumers. In fact, data show that the implicit tax imposed by footwear quotas on the lowest income group (under \$7,000 annually) is about three times higher than that imposed on the highest income group (\$25,000 and higher).⁷

Thus, there is strong reason to believe that the effects seen in the case of "voluntary" quotas on Korean footwear—significant damage to foreign producers and an inequitable burden imposed on U.S. consumers—will also be seen in the voluntary restraints recently imposed on Japanese auto imports, discussed earlier.

Sugar Import Quotas: Price Sweeteners

Actions designed to protect the domestic sugar industry in the United States present significant obstacles to world trade for many reasons. Fundamentally, this industry is heavily subsidized by the Federal Government through its farm price support and loan programs.

A world glut of sugar in 1981 forced the world-market price down to roughly nine cents a pound, well below the level of 20 cents a pound in the U.S., which is determined largely through federal price supports. Should the domestic prices drop sharply, the U.S. Department of Agriculture would eventually be forced to take possession of unsold sugar posted as collateral for nonrecourse loans at the subsidized price. Under the support program, farmers could avoid repaying the loans by forfeit of the sugar. The USDA would have to store the surplus at an estimated cost of \$200 million a year. To avoid this result, President Reagan imposed quotas on imported sugar in May, 1982.⁸

The immediate result of those quotas is to raise sugar prices for major industrial users in the U.S. by about 4 cents a pound. It has been estimated that an increase of one cent adds more than \$224 million to the annual costs of the major industrial users. This cost, of course, is passed on to consumers—probably with the normal markup—when they purchase manufactured products containing sugar. By one estimate, the overall program of supports and quotas for sugar will cost American consumers \$3 billion a year.

The Soviet Gas Pipeline

Another recent impediment to free world trade was the economic sanctions unilaterally imposed by the United States on companies supplying materials to the Soviet Union for building the trans-Siberia natural gas pipeline to Western Europe. Since 1978, the U.S. has exercised some degree of control over exports to the USSR of equipment and technology for oil and gas exploration and production. In 1981, however, because of Soviet involvement in the imposition of martial law in Poland, these controls were broadened to include equipment and technology for the transmission and refinement of both natural gas and oil.

In June 1982, President Reagan expanded these sanctions to include equipment and technology of foreign origin that is exported by U.S.-owned or controlled firms, and products based on American technology that are sold through licensing or royalty agreements.⁹ After much complaint from our allies in Western Europe, President Reagan announced

the termination of the pipeline embargo in November 1982. The ban on licensing of equipment for exploration of oil and natural gas was adjusted to allow for licenses to be issued on a case-by-case basis. The November liberalization actions, taken after detailed discussion with our Western European allies, are designed to avoid future trade arrangements that might contribute to "the strategic advantage" of the USSR. In his announcement, the President indicated that "priority attention" would be given to trade in high-technology products and that no new contracts for the purchase of Soviet natural gas would be made by our trading partners, pending a study of alternative energy sources. Thus, direct or indirect controls over trade with the Soviet Union continue, albeit on a more multilateral basis.

From the viewpoint of foreign policy, such use of our economic power has many attractions over conventional responses in terms of military strength. Yet the economic repercussions are worthy of attention. Critics have pointed out that President Carter's partial embargo on grain exports to the USSR in 1979 was ineffective and cost American farmers a great deal, since other nations increased their grain sales to the Soviets. Also, the unilateral imposition of the pipeline embargo by the United States created serious tensions in this country's relationships with its NATO allies, and the possibility remains of other such uses of economic instruments in the future.

Unilateral imposition of the Soviet pipeline embargo by the U.S. created serious tensions in our relationships with NATO allies

The paperwork burden of the pipeline embargo was substantial. For example, the Department of Commerce asked 39 companies each to provide a general description of the technology specially designed for use in exploration, production, transmission, and refining which the company (or any subsidiary) has transferred during the past seven years to all locations outside the United States. The data requested include the date of each transfer and the name and address of the transferee. In addition, the companies were asked for a description of the products or technology which the company or any subsidiaries have supplied or plan to supply for the purpose of constructing the Siberian pipeline.¹⁰ Certainly, informational requests of this nature do little to encourage the future flow of technology across national boundaries.

Demands for "Reciprocity"

The five areas of trade just examined do not exhaust the pressures for erecting barriers to the free flow of trade. In a more general approach, further demands have been voiced by many industries for a new and spe-

cial type of "reciprocity"—erecting import barriers to the goods of foreign nations that close or restrict their markets to imports from the United States. Such actions, it is suggested, should be directed at nations that do not "reciprocate" in world trade as fully as does the U.S., particularly Japan, Western Europe, and Canada.¹¹

In the customary usage of the term, reciprocity has had a more positive connotation. It traditionally has been viewed as a matter of promoting "equivalent" trade opportunities in other countries, rather than as a device to force trade concessions on a *quid pro quo* basis or to obtain strict "equality" of markets worldwide. In this older sense, the term has normally been equated with "unconditional most-favored nation status" (MFN), under which the granting of privileges and the reduction of tariffs for one country must apply to all eligible countries.

The current sentiments for reciprocity are different, however, in that they involve both protectionism and retaliation against countries with less open trading policies. The new concept's main assumptions are that many nations have not offered trade and investment opportunities as freely as the U.S., and that existing means of trade enforcement are not strong enough to correct the imbalance. Under the newer approach, unilateral action and enforcement on the part of the U.S. would be stressed, rather than bilateral or multilateral agreements. Thus, the proposals for reciprocity legislation would mean closing American markets to those nations that do not grant U.S. firms equivalent access to their markets.

Congress has been pressured from many quarters to enact this form of reciprocity. In early 1982, the Reciprocal Trade and Investment Act (S. 2094) was introduced in the Senate, sponsored by Sen. John Danforth (R-Mo.) and 11 others. It would require the government to measure the impact of foreign, nontariff trade barriers on the United States. The President would then be able to put in place American counteractions if the barriers of another country are not removed. This reciprocity bill was not reported out of a conference committee in the 97th Congress, although it was attached to a tariff bill (H.R. 4566) passed by the House of Representatives. Consideration of the measure was blocked in the Senate by Sen. Howard Metzenbaum (D-Oh.), one of the sponsors of the bill, and by Sen. Carl Levin (D-Mich.), who acted on behalf of the United Auto Workers and the AFL-CIO in attempting to attach to the legislation domestic content provisions for automobiles.

*Protectionist sentiment in the United States
seems to be stronger now
than it has been in decades*

The Current Outlook

Protectionist sentiment in the United States appears to be stronger now than it has been in decades. Furthermore, the threats to free trade seem to be rapidly multiplying, with a growing array of industrial sectors requesting special, protective measures from the government.

For example, in the Fall of 1982 a bill was pending in the House of Representatives that would suspend new foreign contracts for imports of uranium when imports exceeded 37.5 percent of total domestic demand over a two-year period. The proposed law is intended to forestall the large increase in market share that foreign producers of uranium are projected to obtain by 1990, and to bring relief to a domestic industry now facing slackened demand (especially from electric utilities).¹²

Improved relations with China have also brought about new pressures for protection from the effects of free trade with that country. In late 1982 the U.S. mushroom industry petitioned the Reagan Administration to impose an annual quota of 21 million pounds on canned mushrooms imported from mainland China. Nearly half of the import market in mushrooms was held by China in the first two quarters of 1982. U.S. producers of other goods, including makers of ceramic tableware, mechanics' shop towels, and undyed textile goods, have charged the Chinese with unfair pricing and unduly large market penetration. The U.S. textile industry has also become extremely concerned that China, currently the fourth-largest exporter of textiles to the U.S., may soon capture even larger market shares. In addition, other Chinese exports such as steel nails, manhole covers, refined gasoline, and certain tungsten products may soon undergo investigation.¹³

*The U.S. trade deficit with Japan
has been more than offset by
our trade surplus with Western Europe*

In a diverse world economy, virtually all sectors of American business are apt to find some appeal, at least in the short term, for protective measures. The following sections of this report will present an alternative view of protectionism and suggest why trade policy proposals need to be examined in the broader light of consumer and national welfare. The reader's appetite may be whetted by noting that, over the past decade, the highly publicized U.S. trade deficit with Japan has been more than offset by our trade surplus with Western Europe. Since 1979, the U.S. trade *surplus* with the two areas combined has totaled over \$7 billion, as shown in both Table 1 and in Figures 1A and 1B.

FIGURE 1A
U.S. Trade Balance with Western Europe and Japan, 1973-1982
(Imports minus Exports)

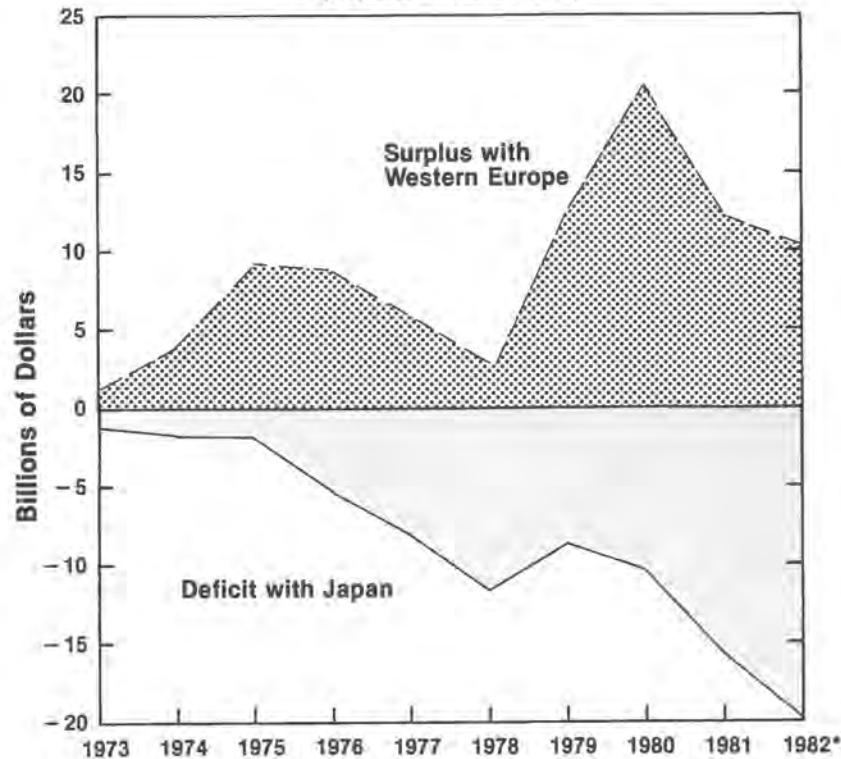
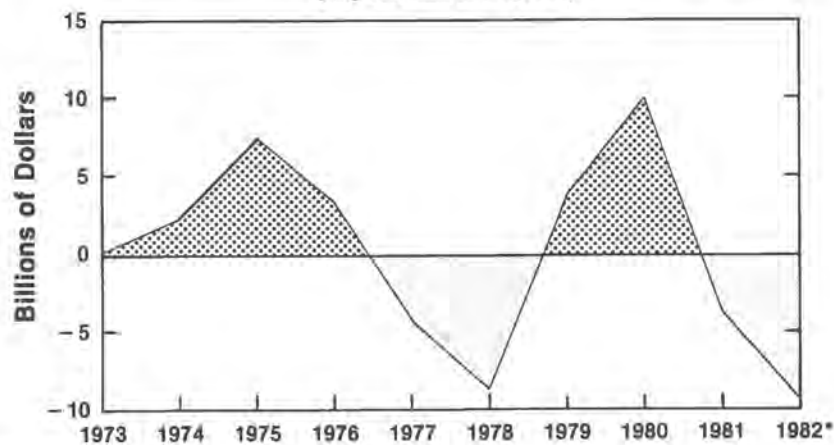


FIGURE 1B
Net U.S. Trade Balance with Western Europe and Japan, 1973-1982
(Imports minus Exports)



*Estimated annualized basis.

Source: U.S. Department of Commerce data on current account basis.

TABLE 1

Comparison of U.S. Trade with Japan and Western Europe
(billions of dollars)

Area	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982(I)*
Japan										
Exports	8.4	10.7	9.6	10.2	10.6	13.0	17.6	20.8	21.8	5.1
Imports	9.7	12.4	11.3	15.5	18.6	24.5	26.3	31.2	37.6	10.2
Deficits	-1.3	-1.7	-1.7	-5.3	-8.0	-11.6	-8.6	-10.4	-15.8	-5.0
Western Europe										
Exports	21.2	28.1	29.9	31.9	34.1	39.6	54.2	67.6	65.1	15.2
Imports	19.8	24.3	20.8	23.0	28.2	36.6	41.8	47.3	52.9	12.6
Surplus	+1.4	+3.9	+9.1	+8.9	+5.9	+2.9	+12.4	+20.3	+12.2	+2.6
Net surplus (+) or deficit (-)										
	+1	+2.2	+7.4	+3.5	-2.1	-8.7	+3.7	+9.9	-3.6	-2.4

*First quarter data only.

Source: U.S. Department of Commerce, *Survey of Current Business*, June 1982, p. 48. All figures are rounded.

Notes

1. See "Detroit's Last Hurrah?" *Research Reports*, American Institute for Economic Research, Vol. XLIX, No. 13 (March 29, 1982); "Domestic Content Laws: Will They Save the Auto Industry?" *Heritage Foundation Issue Bulletin* No. 87, August 24, 1982; and *International Letter*, No. 483, Federal Reserve Bank of Chicago (September 24, 1982), n.p.
2. Robert D. Hershey, Jr., "New Car Limit With Japanese," *The New York Times*, November 1, 1982, p. 26.
3. Other studies claim that the cost to the economy of re-employing an auto-worker under the "voluntary" export restrictions imposed by Japan in 1981 (discussed below), and currently in effect, ranges between \$245,000 and \$1,125,000. See *Domestic Content Laws: Rx for a Permanently Non-Competitive Industry*, American International Automobile Dealers Association, p. 9, cited in *Issue Bulletin*, p. 13.
4. Data for this section are compiled from Hans Van der Ven, "Steel Deadlock: A Primer," *Europe*, July-August, 1982, p. 24 et. ff.; Robert Crandall, "Steel Imports or Competition?" *Regulation*, July-August, 1980, p. 17 et. ff.; *International Letter*, Federal Reserve Bank of Chicago, Sept. 10, 1982; and Clyde H. Farnsworth, "Steel Curb: Prognosis for Trade," *The New York Times*, October 23, 1982, p. 18 et. ff.
5. Crandall, p. 23. See also Robert Crandall, *The U.S. Steel Industry in Recurrent Crisis* (Washington, D.C.: Brookings Institution, 1981).

6. See James T. Bennett and Thomas J. DiLorenzo, "Import Problems and Public Policies: The U.S. Textile Industry," *Heritage Foundation Backgrounder*, No. 192, June 22, 1982.
7. See Jooh N. Suh, "'Voluntary' Export Restraints and Their Effects on Exporters and Consumers: The Case of Footwear Quotas," Working Paper No. 71, Center for the Study of American Business, Washington University, St. Louis, October 1981.
8. See Seth S. King, "U.S. Plans Quotas on Sugar Imports," *The New York Times*, May 5, 1982, p. 1, and Daniel K. Inouye and Nicholas Kominus, "Is the Sugar Subsidy Too Sweet?" *The New York Times*, July 18, 1982, p. F2.
9. Lionel H. Olmer, "USSR Pipeline Sanctions," *National Journal*, September 25, 1982, p. 1655.
10. "U.S. Seeks Export Data From Pipeline Suppliers," *The New York Times*, October 1, 1982, pp. 39, 45.
11. Michael Doan, "A Global Trade War on the Way?" *U.S. News & World Report*, March 1, 1982, pp. 57-8, and "Statement of the Business Roundtable Task Force on International Trade and Investment on Reciprocity in Trade," March 19, 1982, pp. 9 et ff.
12. David Shribman, "Bill to Curb Uranium Imports Angers Two Key U.S. Allies," *The New York Times*, October 6, 1982, p. 1.
13. "A Plea to Hold the Mushrooms," *Business Week*, November 8, 1982, p. 40.

II. Foreign Obstacles to U.S. Exports

Foreign countries create a wide range of tariff and non-tariff barriers to U.S. products and services. Table 2 illustrates some of the impediments maintained by our major trading partners in Japan, Canada, and Western Europe.¹ By focusing on informal practices as well as formal tariff and quota barriers, we can get a good idea of the practical difficulties facing a U.S. firm trying to enter or expand its position in foreign markets.

Quotas on Imports

The first category of restraint is quotas, or restrictions on the quantity of foreign imports. For example, each of the six countries in Table 2 has quotas on foreign films and television programs. Other quotas apply to technical services, such as law practice and data processing personnel, as well as to products. Product quotas are both numerous and complicated, so we will use Japan as an example.

Japan currently maintains 27 separate product restrictions that have been illegal since 1963, according to the General Agreement on Tariffs and Trade (GATT), because they can no longer be justified on the basis of a trade balance deficit. At the time of this writing, talks are being conducted between Japan and the U.S. to attempt to liberalize or remove these restrictions, but at the present time Japan maintains quantitative import restrictions on: meat of bovine animals; milk and cream; processed cheese; meat of pigs; shore fish and cod roe; scallops, squid, shellfish, edible seaweeds; citrus fruits; pineapples; fruit juices; tomato juices, ketchup or sauce; starch and insulin; grape sugar; various types of flour, including wheat, rice and groats; beans, peas, peanuts; coal; and many leather products.

Tariffs on Imports

Table 2 also displays tariffs, including both formal customs charges and practices which have the same effect. For instance, Japan has explicit tariff quotas on corn and soybeans for industrial use, and implicit tariffs embodied in the practice of rebating "cargo taxes" and taxes on air fares to travellers who use the national air carrier. The same pattern is followed at times in other countries: Germany, along with the rest of the European Community, has variable levies on wheat, barley, oats, sorghum, rye and rice, along with explicit tariffs on data processing software and a variety of footwear.² But certain practices, such as discriminatory tax treatment of foreign firms, reserve asset requirements or reinsurance laws that do not apply to domestic firms, have very much the same effect as an explicit tariff. The U.K. maintains tariffs on data

TABLE 2 Foreign Barriers to U.S. Exports—Examples for Six Nations

Type of Restriction	Japan	Canada	West Germany	United Kingdom	France	Italy
QUOTAS	Foreign films Hiring of foreign personnel Licensing of foreign data processing firms 27 product categories	Foreign law firms Foreign films TV programs Foreign data processing personnel	Foreign banks Foreign films Foreign data processing personnel	Certain work permits Foreign law firms Foreign films	Foreign insurance companies Foreign law firms Foreign films Licensing of foreign data processing firms	Foreign films
SELECTIVE TARIFFS	Air cargo and air fares Tariff quota on some types of corn imports Soybeans		Insurance applications for operation and reinsurance Data processing software Most grains	Microfilming and certain publications Data communications hardware Forms of tax treatment for certain firms Most grains	Data communications hardware Air cargo and air fares Forms of tax treatment for certain firms Most grains	Automated reservation equipment Air cargo, air fares Air landing fees and import duties Taxation of foreign firms Most grains
BUY DOMESTIC RESTRICTIONS	Informal preferences for domestic telecommunications, freight firms Government insurance placed through domestic firms Steel subsidy of domestic production	Data processing services Consulting engineers Insurance on government projects must be bought domestically Telecommunications Preferences for domestic airlines	Limitations on foreign law firms, accountants, and bank personnel Informal domestic "monopoly" of insurance	Limitations on foreign accounting firms	Limitations on foreign insurance firms; government insurance placed with domestic firms	Prohibition of foreign TV commercials Limitations on foreign insurance firms

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TABLE 2 (Continued) Foreign Barriers to U.S. Exports—Examples for Six Nations

Type of Restriction	Japan	Canada	West Germany	United Kingdom	France	Italy
EXPORT/PATENT RESTRICTIONS	Lack of protection on copyrights, patents	No protection for foreign data processing services	No protection for foreign software and telecommunications		No protection for foreign data-processing software	Lack of protection for foreign software
DOMESTIC REGULATORY	Limitations on franchises of foreign firms Regulation of foreign insurance firms Restrictions on foreign law firms Nationalized grain markets	Limitations on foreign insurance firms	Limitations on foreign insurance firms	Limitations on foreign insurance firms	Limitations on foreign insurance firms	Limitations on franchises of foreign firms
BANKING & FINANCIAL SERVICES	Infrequent permission for foreign branches No foreign retail banking No foreign bank export rediscounting	Personnel restrictions Limited foreign equity participation	All bank information processing must be domestic	Equity restrictions on foreign banks, other restrictions including discriminatory reserve requirements	Limit on number of foreign directors	Currency control and exchange requirements Lengthy procedures for establishing foreign branches

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TABLE 2 (Continued) Foreign Barriers to U.S. Exports—Examples for Six Nations

Type of Restriction	Japan	Canada	West Germany	United Kingdom	France	Italy
TRANSPORTATION AND DISTRIBUTION SERVICES	Subsidized domestic air carrier Restrictions on containers imported by sea Distribution system biased against foreign products Informal entry barriers, difficult to negotiate	Preferences given to domestic air carriers; foreign carriers restricted or prohibited in using automated systems	Subsidized domestic air carrier Restrictions on foreign air carriers Maritime restrictions	Price ceilings on auto & truck leasing Subsidized domestic air carrier Preferential tax treatment for U.K. flag cargo vessels	Price ceilings on auto and truck leasing Subsidized domestic air carriers Subsidized domestic maritime insurance Restrictions on refrigerated containers Quotas on cargo on domestic flag vessels	Duty on imported automated reservation equipment Preferences given to domestic air carrier Foreign maritime carriers must bond cargo Restrictions on maritime containers
MISCELLANEOUS RESTRICTIONS	Subsidies to domestic construction firms bidding on foreign projects Subsidy of domestic data processing and tele-communications Subsidy for steel products	Restrictions on foreign-produced advertising, incl. tax disadvantages	Subsidies for domestic construction firms bidding on foreign projects Direct subsidy of domestic data processing and tele-communications Subsidy for steel producers	Subsidies for domestic construction firms bidding on foreign projects Subsidized motion picture industry Direct subsidies of domestic data processing and tele-communications	Tax and insurance benefits for domestic construction firms bidding on foreign projects Restrictions on earnings from foreign films Subsidized domestic film industry	Informal visa requirements on foreign professionals Subsidies for construction firms bidding on foreign projects Citizenship requirement before practicing law Subsidy of domestic film industry Credit and licensing restrictions on data processing

Source: See Footnote 1 at the end of this section.

communications hardware, as does France. France and Italy rebate cargo taxes and air fare taxes if the traveller uses the national air carrier, and Italy has tariffs on a variety of telecommunications hardware, including 25 percent on automated reservation equipment (interestingly, domestic Italian equipment does not meet the requirements of American air carriers).

Buy Domestic Restrictions

The third column in Table 2 illustrates, but by no means exhausts, some of the "Buy Domestic" requirements and practices of these six nations. Most of our international trading partners use their own airlines, place insurance for government projects only with domestic firms, and use only domestic computer capacity for data processing needs, whether by law or "understanding." There are also many product-specific requirements: Italy allows no foreign-produced television commercials, Germany (informally) allows no foreign insurance companies and no foreign banks, other than representative offices. Japan subsidizes steel production, which has the effect of raising the relative price of foreign-produced steel products, so that very little foreign steel is imported.

Other Regulatory Barriers to Imports

Laws in other countries regulating franchising, patents, and copyrights are often indifferently enforced, and the laws themselves differ widely, making international operation of a patented process or product line both very complicated and in danger of outright pirating. This is a growing problem in the protection of copyrights on telecommunications and data processing software—products that may be quite expensive for a U.S. firm to develop and very difficult to protect in another country. Most countries maintain regulatory restrictions on franchising of foreign firms, whether it be technical, professional services, banking, or consumer services such as restaurants or retail stores. The fact that regulations are vague, vary widely, and are often subject to interpretation by local bureaucracy makes entry by foreign firms both expensive and time-consuming.

In Italy, local objection to franchising a foreign firm can effectively block an application indefinitely, even if the objection comes only from potential competitors. Franchising, or almost any type of application, can be a very expensive proposition for U.S. companies operating in other countries. U.S. firms abroad often face a dilemma, torn between local bureaucratic practice which requires payment of "fees" at several points in the application process, and U.S. laws prohibiting bribery.

Barriers to Financial Services

The next general category, banking and financial services, is one of the most heavily restricted. Differential access to domestic rediscounting, discriminatory tax treatment and reserve requirements, outright prohibition of retail banking, and restrictions on foreign ownership, all make it difficult for U.S. banks to compete with local banks. Several countries have personnel quotas, and Germany requires that bank directors be German nationals, with at least three years' banking experience in Germany.

Transportation and Distribution Services

There are several types of restrictions on U.S. firms that offer transportation services in other countries. Among the explicit barriers are regulations on types of containers which may be imported (Japan, France, Italy), quotas for the minimum proportion of cargo that must be carried on domestic flag vessels, lengthy petition requirements for price increases in auto/truck leasing, and bonding requirements which apply only to foreign firms. More important, however, are informal restrictive practices. Most countries subsidize the domestic national air carrier, either directly or by differential access to ground handling facilities, terminal space, or automated reservation equipment. An interesting informal practice, most prevalent in Germany, Italy and Japan, is the fact that international travelers find it very difficult to make domestic connecting reservations on the national carrier unless the international portion of their flight is also booked on the national carrier; baggage handling is much slower for foreign carriers, and terminal facilities are often cramped or inconvenient.

Another aspect of foreign barriers is internal distribution systems. Japan's "kieretsu" distribution system gives preference to local products. No practical way exists to by-pass this highly traditional way of doing business. Informal vertical integration, in the form of long-term business "relationships" (perhaps several generations old), tend to effectively deny U.S. firms access to retail markets. For example, U.S. tobacco products are priced higher, given inferior marketing and display, and often ignored under the kieretsu system. The most difficult characteristic of this type of barrier is the fact that change is almost impossible to negotiate; as far as Japan's government is concerned, no trade barrier exists, and entry is free. This provides little comfort to the U.S. firm attempting to obtain competitive retail distribution. The problem also extends to the awarding of competitive bids. Technically, any company can submit a bid; in reality, the contract is given to the traditional domestic supplier. Nippon Telegraph and Telephone Public Corporation (NTT) recently submitted a request for bids, open to foreign countries, for a "modem" used in data communications. However, "rather than just outlining functional characteristics, U.S. executives claim, NTT specifies physical features right down to the location of ventilation holes—details almost identical to those of Nippon Electric Company's modem."³

In the face of increasing competition for international markets, informal barriers of this sort may become more widespread as other countries learn how effective they can be. For example, France recently announced a distribution policy that has effects similar to Japan's system. All imported video recorders must be cleared through customs at Poitiers, a city distant from the main transportation routes with a customs staff of only four and with no computerized facilities for handling the complicated paper work required for clearance.⁴

*All video recorders imported to France
must be cleared through customs at Poitiers,
a city distant from transportation routes,
having a customs staff of only four*

Miscellaneous Barriers to Trade

In the final section of Table 2 are a number of miscellaneous restrictions. Most are preferential tax treatment of domestic firms or outright subsidies for domestic production. For example, Italy and France provide direct financial support of a variety of domestic industries, while Canada restricts foreign-produced services such as advertising.

Weak Yen and Strong Dollar

An important factor affecting U.S. exports to other countries is the strength of the U.S. dollar vis-a-vis foreign currencies, especially the yen. This barrier is neither formal nor, perhaps, intentional. But if a foreign central bank allows its currency to depreciate against the currencies of its trading partners, imports into that country are more expensive and export prices fall. For example, between 1978 and the third quarter of 1982, the yen fell from 190.52 to the dollar to 276.30 to the dollar, raising the price of U.S. exports there and reducing the price of Japanese imports in the U.S. about 31 percent. It is difficult to tell if this is solely a response to market forces. As might be said, "while Japan may not be actively depressing the yen's value, it is doing much less than it could to strengthen the currency."⁵

Our discussion of foreign restrictions on U.S. products is intended to be only illustrative. Nonetheless, we have shown foreign barriers to be both pervasive and damaging. In the growing export of services, as well as the more traditional industrial and consumer products, foreign barriers sharply reduce the ability of American companies to compete for sales abroad.

Notes

1. The specific foreign barriers to trade listed come from a number of sources, the most important of which are: "Selected Impediments to Trade in Services, Domestic Analytical Report," from USTR computer group, provided by William E. Brock, U.S. Trade Representative; "List of Japanese Nontariff Barriers," provided by Lionel H. Olmer, U.S. Department of Commerce Under Secretary for International Trade. A more comprehensive listing can be found in the GATT inventory of non-tariff barriers, available for review in Washington, D.C. at the International Trade Administration or the office of the United States Trade Representative.
2. "Shoe Group Assails Trade Limits," *St. Louis Post-Dispatch*, October 20, 1982, p. 9A.
3. "Japan Opens a Door With a Built-In Barrier," *Business Week*, November 8, 1982, p. 41.
4. "France Signs \$4 Billion Credit to Bolster the Franc," *The New York Times*, October 28, 1982, p. 33Y.
5. "A Tough Choice on Yen Controls," *Business Week*, November 8, 1982, p. 99.

III. U.S. Obstacles to International Trade

As we have just seen, there are a great many diverse foreign obstacles to U.S. exports. In a general way, the American public is aware of the fact that many countries make it difficult for United States companies to export the goods and services that they produce. However, what is rarely appreciated is the fact that the United States itself does not maintain a posture of pure free trade. That is, our government imposes numerous obstacles on imports from other countries. Moreover, our government also restricts various types of exports from the United States.

Thus, any balanced and comprehensive treatment of international trade policy must take into account both shortcomings in foreign treatment of international trade, as well as shortcomings on the part of our own country. Four major types of trade obstacles inhibit imports into the United States:

1. "Buy American" statutes which give preference to domestic producers in procurement by federal, state, and local governments.
2. The Jones Act, which prohibits foreign ships from engaging in waterborne commerce between U.S. ports.
3. A variety of agricultural and other statutes which limit the import of specific products.
4. Selective high tariffs on specific items.

In addition, two major types of domestic U.S. policy actions reduce the ability of American firms to compete both at home and abroad:

1. A variety of domestic regulatory activities, which impose burdens on domestic production not borne by foreign producers.
2. Export controls, which restrict certain types of exports on national security or foreign policy grounds or for domestic political reasons.

Any balanced treatment of international trade must take into account both shortcomings in foreign treatment of trade, as well as shortcomings on our own part

"Buy American" and Merchant Marine Statutes

"Buy American" provisions have been enacted by many governmental units.¹ The Federal Buy American Act of 1933 requires federal agencies purchasing commodities for use within the United States to pay up to a 6 percent differential for domestically produced goods. As much as a 50 percent differential is paid for military goods produced at home. In addition, the Surface Transportation Assistance Act of 1978 requires that, for purchases over \$500,000, American materials and products be used,

unless the Secretary of Transportation makes some statutory exceptions. Also, American flag vessels must be used to transport at least 50 percent of the gross tonnage of all commodities financed with U.S. foreign aid funds (see Table 3).

The Buy American laws of the states are varied. New York requires state agencies to buy American steel. New Jersey requires that all state cars must be domestically produced. Arizona applies preference to other states with "Buy State" laws, if the product is not available in Arizona. In addition, numerous states and municipal authorities require use of American materials in privately owned as well and publicly-owned utilities.

The Merchant Marine Act of 1936 (the "Jones Act") requires that all ocean-going shipments from one point in the United States to another be transported in U.S. flag vessels. This law, of course, effectively bars all competition in U.S. domestic marine transport. Moreover, the perverse effects of such cabotage laws are greater than might be expected. For example, at times, Canadian lumber transported in Japanese flag vessels could undersell domestic timber from Oregon in the lucrative Southern California markets. In such cases, both the American merchant marine and the American timber industry suffer damage. Foreigners then become the unintended beneficiaries of these attempts to subsidize the American merchant marine.

Import Restrictions on Agricultural and Other Goods

Numerous federal statutes restrict the import of specific products. For example, section 22 of the Agricultural Adjustment Act of 1935 permits the President to regulate the imports of agricultural products if such imports materially interfere with price support programs operated by the U.S. Department of Agriculture. Section 22 quotas are currently employed to limit imports of dairy products, peanuts, cotton, and cotton products.

*Restrictions on sugar imports cost
American consumers over \$1.5 billion a year*

As described in Section I, in order to maintain the domestic sugar price at the level mandated by the Agricultural and Food Act of 1981, sugar import fees are levied and quotas are being imposed. In 1980, the staff of the Federal Trade Commission estimated that the restrictions on sugar imports were costing American consumers over \$1.5 billion a year.² Under the Meat Import Act of 1979, the President has authority to impose beef import quotas if imports of beef reach a certain trigger level. In practice, the U.S. generally has encouraged foreign exporters to restrain their sales voluntarily to avoid the imposition of formal quotas.

TABLE 3
Buy-American Practices Imposed by the States

State	Practice
<i>Alabama</i>	Requires use of U.S. materials "if available at reasonable prices" in cases of public works financed by state funds.
<i>California</i>	Requires use of materials of U.S. origin (subject to court challenge).
<i>Georgia</i>	Requires state agencies to buy American products if price and quality are equal.
<i>Hawaii</i>	Establishes a scale of preferences for domestic products.
<i>Idaho</i>	Requires state bids to carry a clause restricting use of foreign materials.
<i>Indiana</i>	Restricts use of foreign steel and aluminum.
<i>Kentucky</i>	Discourages state agencies from requesting foreign-made products.
<i>Maine</i>	Reserves the right to reject bids involving foreign products when in direct competition with American products.
<i>Massachusetts</i>	Grants preference, "other considerations being equal," to in-state products first and then to other American products.
<i>New Jersey</i>	Requires U.S. domestic materials to be used unless their cost is "unreasonable."
<i>New York</i>	Restricts use of foreign products through general specifications for bids.
<i>North Carolina</i>	Follows a policy of purchasing domestic products "wherever we deem we are not penalizing ourselves as to competition, availability, service and ultimate cost."
<i>North Dakota</i>	Requires certain bids to carry the phrase "bid domestically produced material only."
<i>Oklahoma</i>	Requires purchases of domestic goods and equipment unless a foreign product is of "equal quality" and also "substantially cheaper" or is of "substantially superior quality" and is sold at a "comparable price to domestic products."
<i>Pennsylvania</i>	Prevents use in state projects of foreign steel and aluminum products made in countries that "discriminate" against American products.
<i>South Dakota</i>	Writes state specifications for American-made products; if foreign-made is bid, award is made on condition of acceptance by the state agency.
<i>Wyoming</i>	Generally discourages use of foreign goods.

Source: Norman S. Fieleke, "The Buy-American Policy of the United States Government," *New England Economic Review*, July-August 1969.

Section 8e of the Agricultural Marketing Agreement Act of 1937 specifies that if certain grade, size, quality or maturity standards are employed in a marketing order for a commodity (restricting domestic supplies), then the same or comparable requirements apply to imports of that commodity. These nontariff barriers apply to 16 crops:

Tomatoes	Green Peppers	Walnuts
Avocados	Irish Potatoes	Dates
Mangoes	Cucumbers	Raisins
Limes	Oranges	Prunes
Grapefruit	Onions	Filberts
Egg Plant		

In addition, several so-called Orderly Marketing Agreements (OMAs) were negotiated in the 1970s whereby other countries agreed to restrict their exports to the United States. The practical effect, of course, is similar to that of a quota imposed on our imports. Such OMAs have covered non-rubber footwear and color TVs. The current voluntary restraint program governing the export by Japan of cars to the United States is a close cousin.

As pointed out earlier, a more elaborate set of import restraints exists in the textile area. In that case, the United States has entered into a series of interrelated bilateral agreements with the major textile exporters and importers to restrict the import of textiles to and from various nations. The FTC staff study estimated the cost of these restrictions to the American consumer at nearly \$6.0 billion a year.³

In addition, the long-standing escape clause of the Trade Act of 1974 and its predecessor statutes provides for temporary "relief" from low U.S. tariffs in the case of industries that show serious injury, or threat of that condition, from imports.⁴

*The cost of textile restrictions to the
American consumer total nearly \$6.0 billion annually*

Selective High Tariffs

Despite low average duties (3.1 percent), some individual U.S. tariffs are quite high. Tariffs on textiles average 20 percent. Duties on fruit juices are over 27 percent, and the rate on ceramic products is over 14 percent. Table 4 shows the major high tariff items. In 1980, these specific tariffs represented, in the aggregate, 11.9 percent of the value of the imports in the categories shown.

Miscellaneous Barriers to U.S. Exports

The United States conducts a great variety of domestic regulatory activities which inevitably affect the relative prices of competing U.S. and foreign goods and services. In some cases, foreign producers are not

TABLE 4
Major U.S. High-Tariff Items, 1980
(Value in Millions of U.S. Dollars)

Product	Value	Duty	Average Tariff
<i>Agricultural Products</i>			
Dairy Products	\$ 314.2	\$ 29.8	9.5%
Vegetables	659.9	74.5	11.3
Beverages	2,255.4	153.3	6.8
Fruit Juices	(143.6)	(39.7)	(27.6)
Tobacco	486.6	59.5	12.2
<i>Manufactured Products</i>			
Wood Veneers	612.5	56.9	9.3
Textiles	8,152.1	1,792.8	22.0
Apparel	(5,499.8)	(1,468.9)	(26.7)
Benzoid Chemicals	1,444.1	197.0	13.0
Synthetic Resins	159.8	16.4	10.3
Ceramic Products	968.7	140.1	14.5
Glass Products	603.6	66.1	10.9
Specified Products	17,240.0	1,319.8	7.7
Footwear	(3,975.4)	(493.7)	(12.4)
Jewelry	(820.9)	(82.9)	(10.1)
Matches	(120.3)	(13.5)	(11.2)
<i>Miscellaneous Products</i>	<u>298.4</u>	<u>37.8</u>	<u>12.7</u>
TOTAL	\$33,196.3	\$3,944.0	11.9

Source: Statistical Services Division, U.S. International Trade Commission.

subject to similar burdens. In many other instances, the social objectives of other nations are achieved at lower cost. For example, a recent comparison of U.S. environmental regulatory policy with that of the United Kingdom concluded that our government's approach has been relatively insensitive to the objectives and unresponsive to the objections of private enterprise, and that our regulatory regime is "more coercive than in any other industrial democracy."⁵

The details of the burdens imposed by domestic regulation on American producers have been fully documented elsewhere.⁶ In addition, there are important special burdens that the Federal Government has imposed on companies involved in foreign trade.

For example, the Foreign Corrupt Practices Act of 1977 requires strict record-keeping standards to monitor the anti-bribery sections of the stat-

utes. Violators of the Act face severe penalties. A company may be fined up to \$1 million, while its officers who directly participate in violations or have reason to know of them face up to five years in prison and \$10,000 in fines. Frankly, it is difficult to raise any discussion of the Foreign Corrupt Practices Act without being criticized for being callous on ethical matters. However, this statute has been cited for establishing a regulatory regime that displays the same cavalier attitude toward the burdens it imposes as do many other well-intentioned regulations. Thus, the key questions is not "Are you in favor of bribes?" but rather, "How can the law be carried out most effectively and with minimum adverse side effects?"

The Federal Government imposes many special burdens on companies involved in foreign trade

A former chairman of the Securities and Exchange Commission, the agency administering the Act, has stated, "the anxieties created by the Foreign Corrupt Practices Act—among men and women of utmost good faith—have been, in my experience, without equal."⁷ A study of U.S. export competitiveness by the Center for Strategic and International Studies at Georgetown University concluded that the language of the Foreign Corrupt Practices Act is so sweeping and ambiguous that American firms turn down foreign business when they merely suspect that they could be charged with bribery. Thus, business people are forced into marketing approaches that are "unnaturally conservative."⁸

One of the major criticisms of the Act is that it has cost American firms export opportunities without reducing the level of foreign corruption. By precluding American firms from taking part in questionable transactions, which may be perfectly legal and acceptable practices in many other nations, the Act reduces the ability of U.S. firms to compete overseas. The General Accounting Office has found in a survey of 250 American companies that 30 percent of the respondents that engaged in foreign business had lost business as a result of the Foreign Corrupt Practices Act. The GAO has recommended that Congress amend the Act to clarify several important provisions.⁹

U.S. anti-boycott laws and regulations are designed to limit the extent to which foreign boycotts can affect U.S. domestic commerce or trade with nations other than the boycotting nations. Several specific statutes were enacted in response to the boycott of Israel by the Arab league, such as the Anti-Boycott Amendments to the Export Administration Act of 1977 and the Ribicoff Amendment to the Tax Reform Act of 1976. As a result of the anti-boycott rules, a number of U.S. companies, particularly those located in Arab countries, claim that they have lost sales. Also, some business executives have complained that the recordkeeping

and reporting requirements of the multiple anti-boycott provisions raise the cost of production.

In addition to these highly publicized activities, several environmental programs impose requirements with regard to exports. For example, the regulations under the Federal Insecticide, Fungicide, and Rodenticide Act require exporters to notify countries for which products are destined that a hazardous product is being exported 30 days in advance of the export—even if the product is not viewed as hazardous under the laws of the importing country. The importing nation must notify the exporter that the notice was received. No other country has such a restriction.

At times, domestic regulation (in the United States and elsewhere) has been used to restrict imports. For example, a major U.S. barrier to imports is the array of state and local building codes. Government authorities typically enact the codes that are drawn up by private building associations. This procedure opens the way for imposing discriminatory standards favorable to the local industry. Ceramic tile provides a good example. After Japanese imports captured much of the U.S. market for floor tile in the 1960s, many building codes were revised to screen out imported wall tile by requiring a thickness of one-fourth inch. That rule disallowed the import of tile produced in Japan and Europe, which had a standard 5/32 inch thickness.¹⁰

The Export Administration Act mandates trade controls over many products—including certain domestic crude oil and petroleum products, unprocessed red cedar, and horses exported by sea

Export Controls

Despite the general desire of public policymakers to promote exports, many U.S. statutes prevent or restrict the export of specific commodities. The Trans-Alaskan Pipeline Authorization Act of 1973 prohibits the export of oil from North Slope fields. Public Law 94-373, a rider to the Appropriation Act for the Interior Department and related agencies, bans timber exports from federal lands west of the 100th meridian.

The Export Administration Act of 1979 provides for controls on exports of goods and technology which would make a significant contribution to the military potential of any other nation or nations and which would prove detrimental to the national security of the United States. The Act was used to deny an export license for the sale of a Sperry-Univac computer to the Soviet News Agency TASS. The French quickly permitted Honeywell-Bull to sell TASS a computer.

As mentioned previously, the Export Administration Act mandates permanent controls over a variety of products, including certain domestically produced crude oil, certain refined petroleum products, certain

unprocessed red cedar, and horses exported by sea. In 1980 the Act was employed to embargo grain exports to the Soviet Union for national security reasons. It was invoked again in 1982 to carry out the ban against U.S. firms (and their overseas subsidiaries and licensees) participating in the construction of the natural gas pipeline between the USSR and Western Europe.

One academic study of U.S. export controls in the 1970s concluded that, while the great majority of applications for approval under the Export Administration Act are promptly reviewed, the more sensitive requests "get tied up in a bureaucratic morass."¹¹ Although a 1974 amendment to the Act placed a 90-day limit on license reviews, the average time required for reviews that went to the operating congressional committee in 1975 was 224 days. The author of the study concluded that "there is considerable evidence to conclude that the licensing system has indeed been a powerful disincentive to exports."¹² The General Accounting Office has also studied the area of export licenses for commercial items and found that the government "carefully examines less than 1 out of 20 export applications it processes, resulting in a licensing system which bears more resemblance to a paper exercise than a control mechanism."¹³

*Export controls call into question
the reliability of the U.S. as a
supplier of products to other countries*

Export controls do more than limit U.S. international trade for the time they are imposed. These restrictions call into question the reliability of the United States as a supplier of products to other countries, which are likely to develop alternative sources. A clear example is soybeans. The main effect of the U.S. controls over soybean exports in 1974 was to induce Japan to turn to other producing countries, particularly Brazil. Japan invested huge amounts to develop alternatives to U.S. production, thus effectively and permanently reducing our share of the world soybean market.¹⁴

Notes

1. See Murray L. Weidenbaum, *Business, Government and the Public*, second edition (Englewood Cliffs, N.J.: Prentice-Hall, 1981), pp. 251-255.
2. Morris E. Morkre and David G. Tarr, *Effects of Restrictions on United States Imports: Five Case Studies and Theory*, Staff Report of the Bureau of Economics to the Federal Trade Commission, Washington, D.C., Government Printing Office, 1980, p. 197.
3. *Ibid.*
4. Stanley Nehmer, "The Trade Act of 1974 as a Vehicle for Adjustment," in U.S. Congress, Joint Economic Committee, *The International Economy: U.S. Role in a World Market*, p. 291.
5. David Vogel, *Coercion Versus Consultation: A Comparison of Environmental Protection Policy in the United States and Great Britain*, a paper prepared for the American Political Science Assn. Annual Convention, Sept. 1982, p. 1.
6. See Murray L. Weidenbaum, *Business, Government, and the Public*, second edition, (Englewood Cliffs, N.J.: Prentice-Hall, 1981), and *The Future of Business Regulation* (New York: Amacom, 1980).
7. Cited in *Proposed Revisions of the Foreign Corrupt Practices Act* (Washington, D.C.: American Enterprise Institute, 1981), p. 10.
8. *Ibid.*
9. Comptroller General of the U.S., *Impact of the Foreign Corrupt Practices Act on U.S. Business*, AFMD-81-34 (Washington, D.C.: U.S. General Accounting Office, March 4, 1981).
10. William R. Cline, "Long-Term Change in Foreign Trade Policy of the United States," in U.S. Congress, Joint Economic Committee, *The International Economy: U.S. Role in a World Market*, p. 214.
11. Gary K. Bertsch, "U.S. Export Controls: The 1970s and Beyond," *Journal of World Trade Law*, January/February 1981, pp. 67-82.
12. *Ibid.*
13. Charles A. Bowsher, Comptroller General, "The Government's Role in International Trade: GAO's Contribution," *GAO Review*, Summer 1982, p. 30.
14. *Statement by the Honorable C. Fred Bergsten, Assistant Secretary of the Treasury for International Affairs Before the Committee on Banking, Housing and Urban Affairs*, March 6, 1979, p. 3.

IV. The Case for Freer Trade

Given the widespread use of protectionist devices to inhibit the flow of trade among nations, it may be useful to examine the key conceptual and historical justification for maintaining and achieving an open trading system. The case for freer trade is rooted in a basic economic law: the principle of comparative advantage, which holds that total economic welfare will be enhanced if each nation specializes in the production of items that it can produce, in relative terms, most efficiently. This, of course, is an important case of Adam Smith's more general point concerning the advantages of the specialization of labor.¹

Historical Experience

The arguments in favor of freer trade are supported by a great deal of historical evidence. Through most of the twentieth century, the United States has played a strong leadership role in developing the world trading system. During the 1930s, however, the United States and many other countries followed "beggar-thy-neighbor" trade policies which contributed to the worldwide depression. The Smoot-Hawley protectionist tariff epitomized this approach in the United States. The results for many companies were extremely negative. For example, firms that had relied on substantial foreign business were limited to the domestic market, which for some was inadequate for survival.

During the 1930s, the U.S. and many other countries followed trade policies that contributed to the worldwide depression

After World War II, this country embarked on a program of reciprocal trade agreements. Initially arranged bilaterally, they evolved into the further improved multilateral trading system of the postwar years. This approach broke down many of the historical barriers to world trade. An especially fine example occurred in the 1960s: the acceleration in world trade and economic growth in that decade followed a sharp and mutual reduction in tariff barriers which contributed to lower prices for consumers. We continue today to reap benefits from the policies initiated in the those years.²

We can turn to our own economic history for earlier examples of the benefits of an open economy. This country began as a trading nation. If the concept of "Gross National Product" had existed in the 18th and 19th centuries, people would have pointed to the United States as one of the more open economies in the world, as measured by the share of GNP involved in foreign trade—although tariff debates were common throughout the 19th century. In its early years, the United States was among the

more trade-oriented economies in the world. We were major suppliers of a wide variety of agricultural exports and raw materials, and of such delicacies as rum. In addition, our service exports, such as shipping, were an important economic activity. We were a major importer of manufactured goods and a major recipient of foreign capital. These factors continued to play a critical role in the development of the American economy during the 19th century.

Around the turn of the century the dynamics of the American economy shifted. Exports and imports became smaller shares of GNP and remained rather stable. U.S. investment abroad increased, gradually transforming us from an international debtor into a world creditor. Increasingly, we became a self-sufficient economy. Only in the last 20 years has the international sector once again begun to increase its relative importance in our economy.

Despite the concern about a U.S. merchandise trade deficit, the U.S. runs a steady surplus when we consider goods and services

Foreign trade is now an important element in U.S. business and employment. In 1980, exports and imports of goods and services each represented over 12 percent of our Gross National Product (see Table 5). Twenty years ago, exports were less than 6 percent of GNP; imports, less than 5 percent. Much of this shift has occurred in the past decade, when imports and exports as a share of GNP have doubled and a positive export balance has been maintained. Despite all the concern about a U.S. merchandise trade deficit, it is clear from Table 1 (in the first section of

TABLE 5
Trade in the U.S. Economy, 1960-1980*
(Dollars in billions)

	1960		1970		1980	
	Amount	Percent	Amount	Percent	Amount	Percent
Exports of goods and services	\$28.9	5.7%	\$65.7	6.6%	\$339.8	12.9%
Imports of goods and services	23.4	4.6	59.0	5.9	316.5	12.1
Net exports	\$ 5.5	1.1%	\$ 6.7	0.6%	\$ 23.3	0.8%

* Data are on a national income accounts basis. All figures are rounded.
Source: Department of Commerce

the study) that this country runs a steady surplus when we consider both goods *and* services. In an economy that increasingly has been shifting toward a service orientation, any analysis of international economic activity that ignores the important service sector surely is inadequate. Figures 2A and 2B illustrate this point dramatically, and Figure 2C shows how the import of services has contributed to a net trade surplus for most of the last decade.

It is interesting to note two often overlooked facts: (1) In real terms, the rate of growth in U.S. imports of goods and services was stronger in the 1960s than in the 1970s (8.0 percent versus 5.0 percent), and (2) U.S. export growth, by contrast, was stronger in the 1970s than in the 1960s (8.6 percent versus 6.3 percent; see Table 6). While the reasons have not

TABLE 6

Real Growth of U.S. Trade and GNP, 1960-1980
(Average Annual Percentage Increases)

	1960-1970	1970-1980
Exports of goods and services	6.3%	8.6%
Imports of goods and services	8.0	5.0
GNP	4.0	3.2

Source: Department of Commerce

FIGURE 2A
U.S. Trade Balance in Goods, 1973-1982
(Goods Imports minus Exports)

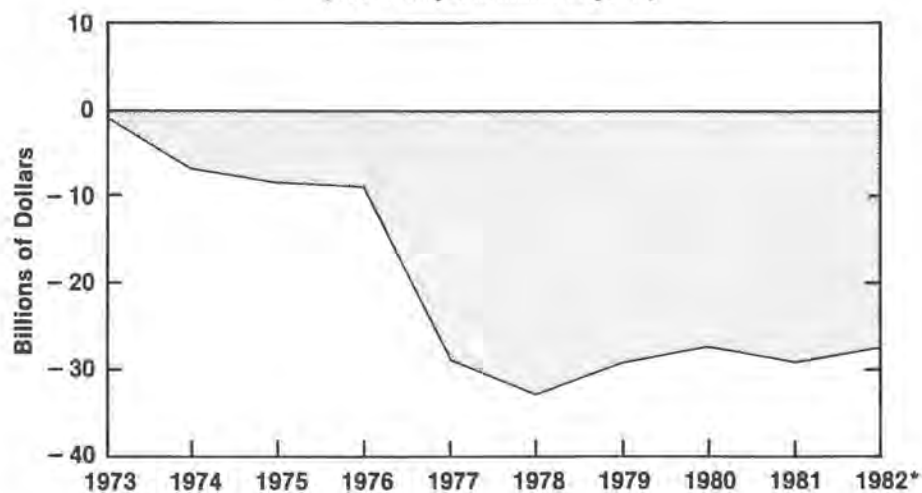


FIGURE 2B
U.S. Trade Balance in Services, 1973-1982
(Service Imports minus Exports)

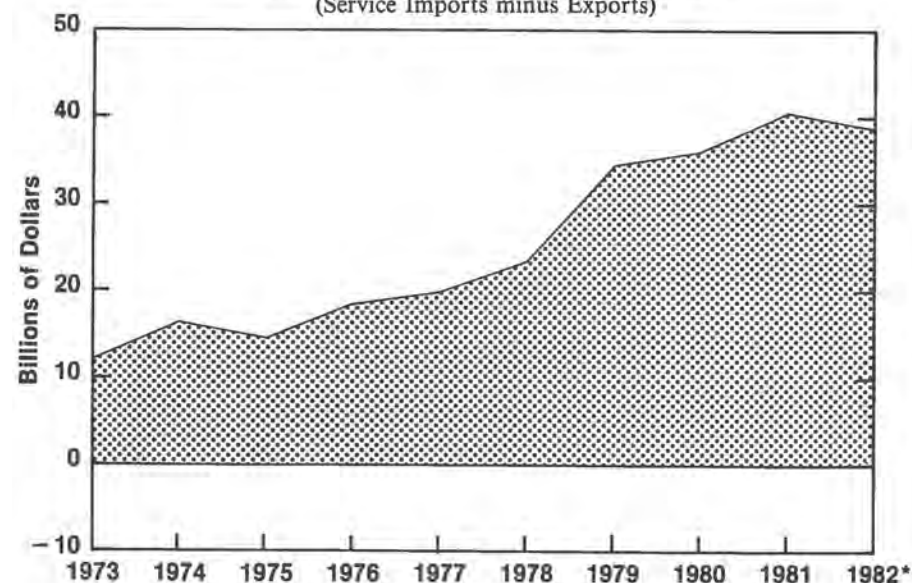
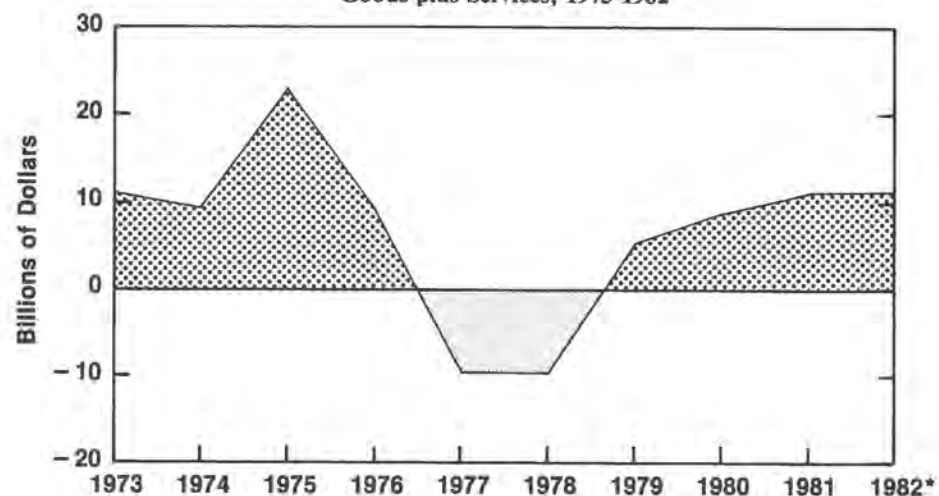


FIGURE 2C
U.S. Trade Balance on Current Account, Goods plus Services, 1973-1982



*Estimated annualized basis.

Source: U.S. Department of Commerce data on current account basis.

been fully explored, it seems likely that our export growth performance reflected three key factors:

- Our increased trade with developing countries, whose GNP growth slowed less in the 1970s than that of the developed countries.
- Our specialization in production and trade of high-technology products, of agricultural commodities, and of services.
- The evolving ramifications of the trade liberalization of the post-war period.

In passing, we should note that there is a close, but not generally appreciated, connection between imports and exports. A strong trade position requires both a high volume of imports and a high volume of exports. In fact, the only way, in the long run, to increase a country's exports is to increase its imports. U.S. exporters need to find foreign buyers with the dollars necessary to buy their goods and services. In general, these dollars are obtained when Americans import and pay for foreign goods and services.

In the short run, it is true that we can and do lend foreigners the dollars with which to buy our exports. When such loans are made at market rates of interest, trade is properly advanced. But when government-subsidized credit is provided, such funds are denied to other, more productive uses in the domestic economy.

Thus, imports put dollars in the hands of foreigners—which can then be used to buy our exports. It follows that restrictions in imports will result in fewer dollars in the hands of those in other countries who might wish to buy our wheat, aircraft, chemicals or machinery—unless we wish to make up the difference by loans or transfer payments to foreigners.³

In some cases, the connection between imports and exports is even more direct. Import restraints can reduce employment and profits in our more productive export industries, in many cases in the same region of the country. For example, in the non-rubber footwear industry, U.S. exports of hides to foreign shoe producers suffered as a result of our restraints on the import of foreign shoes.

*Open trade lowers inflationary pressures
by increasing the supply of goods and services
competing for the consumer's dollar*

The Benefits of Free Trade

At this point it may be useful to attempt to generalize from historical experience. The benefits of freer trade are numerous:

- Open trade contributes to lowering inflationary pressures by increasing the supply of goods and services competing for the consumer's dollar. Thus, the question of free trade is basically a consumer issue, and an extremely important one.

- Open trade minimizes the role of government in influencing private-sector decisions, thus allowing individuals and business firms to respond to the needs and pressures of the international marketplace. Viewed in this light, freer trade is key to promoting economic freedom and the private enterprise system.
- Open trade improves the efficiency with which our own resources are allocated and thereby yields more growth, higher levels of employment, and an improved living standard here at home.

*Open trade yields more growth,
higher levels of employment, and an
improved standard of living here at home*

Aside from the direct and measurable aspects, trade stimulates competition, stirs creative energies, rewards individual initiative, and increases national productivity. Among nations, it speeds the exchange of new ideas and technology. In the long run, international trade means the creation of new jobs and the reduction of inflation. In sum, it contributes to a healthier economy—one with more job opportunities and a wider variety of goods and services.

The Costs of Protectionism

In this time of great interest in benefit/cost analysis, we may properly inquire as to what are the costs of free trade as well as the benefits. The obvious costs are borne by the workers who become unemployed as a result of imports—assuming that imports are the cause. What is less apparent, however, is that any form of trade restraint to help a specific industry really is an internal transfer of income and wealth to that industry from U.S. consumers (in the form of higher prices for domestically produced goods and services) and from American workers and owners of our export industries, who bear the brunt of retaliatory trade restrictions in the form of lower wages and lower profits.

*The question of free trade is basically
a consumer issue*

Moreover, many of the benefits of protectionist measures, even to the group advocating them, can turn out to be very temporary. For example, quotas on shoe imports resulted in an upgrading in the quality of imports. Thus, American producers found themselves threatened in that part of the market in which, prior to the protectionist action, they firmly dominated. The same process is visible in the current case of "voluntary" restraints of Japanese auto imports.

One of the great difficulties in public policy discussions involving protectionist measures is that the beneficiaries are usually few in number,

but each has a large individual stake in the outcome. Moreover, they have little concern about the likelihood of retaliation by foreign governments on other American industries. Thus, the incentive for vigorous and concentrated political activity is strong.

In addition, pleas for protectionism reflect the ability of relatively small but influential groups to convince legislatures to adopt policies that benefit them, albeit at the expense of citizens at large. The balance of power is extremely uneven, given the limited knowledge that consumers currently have about these matters. Those who benefit from exports and from the greater supply of goods and services are generally not even aware of the process by which they benefit. Although the benefits of open trade may far exceed the costs, those benefits—such as lower prices to consumers—are widely diffused among 50 states and 225 million residents. Any single consumer's stake in the outcome is quite small. The individual consumer almost surely is not aware of why the price of a given item is going down—or not rising. Consequently, resistance at the grass roots level to protectionist measures so often is considerably less than pressures for their adoption.

*A great difficulty in protectionist measures
is that the beneficiaries are few in number,
but each has a large stake in the outcome*

Scholarly studies typically show that the total benefits of freer trade—savings to consumers, gains from moving resources out of inefficient sectors, stimulus to investment, and increased economies of scale—far exceed the costs. One study concluded that the benefits of tariff reductions are approximately 80 times as large as the costs of labor adjustments (the latter measured in terms of the unemployment resulting from increased imports). High ratios of economic benefits of trade liberalization to labor adjustment costs have also been estimated for other nations, ranging from 49 to 1 in Japan to 96 to 1 in the European Economic Community.⁴ These ratios of costs of protection to benefits, it should be noted, are much higher than the specific numbers cited in the earlier section on the auto industry. However, both the aggregate and specific comparisons show that the benefits of protectionist measures are far less than the total costs imposed on society.

Clearly, if an economy is to reap the benefits of free international trade, it also must incur the costs. These costs may be seen as the various resource-adjustment costs and income-redistribution problems associated with specialization and trade. Trade changes relative prices and, thus, forces reallocations of resources. Over time, a nation engaged in trade experiences further changes in relative costs, technology, and tastes—all of which, in turn, alter the composition of its exports, imports, and

domestic production. The adjustments do not occur instantaneously, and after the transition, the benefits are not distributed evenly throughout the economy. Nevertheless, typically the consumer savings from freer trade more than justify the adjustment programs instituted for those who are initially hurt by the change.⁵

The question is frequently asked, "Other nations do not have a policy of freer trade, so why should we?" But rather than talking in absolutes, the more appropriate question to ask is, "Are the trade policies of other nations more open today than they would be without the continued pressure of agreed international 'rules of the game'—rules often developed under the persistent and patient influence of the U.S. Government?" The answer is a resounding "yes." Trade policy, here and elsewhere, is far more open today as a result of our efforts and of our example of a relatively open domestic market.

Is the U.S. better off with this incremental improvement than without it? Again, the response is positive. The goods we import are cheaper than domestic substitutes. Our 225 million consumers have more choice. The markets for our exports are less restricted than they might otherwise be. And these points are abstracted from the income-generating effects of increased trade. Yet it is also true that if trade were still more open, society as a whole would be still better off. On the other hand, increasing our own trade restrictions—whether for retaliatory reasons or otherwise—runs the risk of setting us on a path leading back toward the policies of the 1930s.

*The international counterpart of our domestic
support for a market-oriented, private enterprise
economy must be a policy of strong opposition
to trade-distorting interventions
by all governments*

That does not mean that we must advocate a passive policy toward other nations' trade barriers or export subsidies. The international counterpart of our domestic support for a market-oriented, private enterprise economy must be a policy of strong opposition to trade-distorting interventions by all governments, our own as well as all others. The credibility of this country's commitment to open and freer trade is not enhanced by companies sending their lawyers to Washington on Monday to seek the removal of import barriers overseas, and then turning around on Wednesday to send the same attorneys back to Washington to advocate import restrictions on the products of their foreign competitors.

The benefits and opportunities of an open trading system are hard to overestimate. For example, despite the many real obstacles, quite a few

American companies have experienced significant success in penetrating Japanese markets. It is reported that Coca-Cola is the largest-selling soft drink in Japan, Schick is number one in the razor market and Nestle commands 70 percent of the instant coffee market.⁶

Notes

1. See, for example, William J. Baumol and Alan S. Blinder, *Economics: Principles and Policy* (New York: Harcourt Brace Jovanovich, 1979), Ch. 36.
2. See Robert R. Russel, *A History of the American Economic System* (New York: Appleton-Century-Crofts, 1964), Chs. 25 and 38.
3. For a detailed economic analysis of trade effects, see, for example, Herbert G. Grubel, *International Economics* (Homewood, Il.: Richard D. Irwin, Inc., 1977).
4. William R. Cline, "Long-Term Change in Foreign Trade Policy of the United States," in U.S. Congress, Joint Economic Committee, *The International Economy: U.S. Role in A World Market* (Washington, D.C.: Government Printing Office, 1980), p. 206.
5. Gerald H. Anderson and Owen F. Humpage, "A Basic Analysis of the New Protectionism," *Federal Reserve Bank of Cleveland Economic Review*, Winter 1981-82, p. 3. See also Ingo Walter and Kent A. Jones, "The Battle Over Protectionism: How Industry Adjusts to Competitive Shocks," *Journal of Business Strategy*, 1982, pp. 37-46.
6. William R. Cline, *Reciprocity: A New Approach to World Trade Policy?* (Washington, D.C.: Institute for International Economics, 1982).

V. A Modern Approach to Trade Policy

If any single finding has emerged from the preceding analysis of domestic and foreign obstacles to trade among nations, it is that no nation has clean hands in this regard. Surely, many foreign nations have erected a multitude of barriers against the importation of goods and services. Some of these nations, not too surprisingly, run large trade surpluses with the United States and other countries. But, also, some of these nations that have a wide variety of obstacles to our exports nevertheless experience substantial trade deficits with us and with other nations. Specifically, the public is well aware of the large amounts of Japanese goods that are imported into the United States and the excess of our imports from that country over our exports. But how many of our citizens are also aware of the large trade surpluses that we run with Western Europe, often of the same order of magnitude as our deficits with Japan?

If anything is clear in this murky area, it is that the protectionist approach does not guarantee a nation of a positive balance in its trade account, even if that is deemed desirable. Surely, the American experience demonstrates that, when this nation erected high tariff walls, such action was not followed by times of domestic prosperity. Conversely, eras characterized by lowering trade walls usually ushered in periods of economic growth. Advocates of protectionist measures also tend to ignore the fact that such measures lead to foreign retaliation.

There is a noticeable "demonstration" or copycat effect that can work constructively or negatively. As the largest trading nation in the world, our actions inevitably set both the tone and the standards for many other countries. When we erect trade walls, other nations tend to match us—and the present environment of relatively troubled international trade provides a congenit example. The worldwide response to U.S. actions is avowedly slower on the way down, but that may be inevitable, given the greater dependence on foreign trade on the part of most other developed nations.

On reflection, this sequence of events should be expected: when the forces of competition are strengthened and broadened, the prospects for productivity growth are enhanced and our domestic industries tend to experience improved competitiveness in world markets. Conversely, when companies get in the habit of looking to the government for help, their own entrepreneurial and risk-taking characteristics are attenuated. In any event, extended periods of recession and slow growth have tended to exacerbate protectionist pressures, while such pressures are generally reduced during periods of rapid growth and rising employment.

Domestic Reforms in Trade Policy

1. *Fundamental to any effective trade policy is establishing and carrying out a domestic economic policy that increases the incentives to invest and produce, to raise productivity, and to reduce costs—and so helps raise domestic incomes and lower inflation.* These policies strengthen the ability of American firms to respond to constant changes in domestic and international markets. All this suggests that an enlightened and effective approach to international trade policy should begin with general economic policies that encourage competition and provide greater incentives to the key factors that generate sustained economic growth and reduced inflation. Examples of those incentives range from lowering tax burdens that discourage saving and work effort to curtailing regulatory requirements that inhibit research and development, investment, and production to reducing the deficit financing that competes with private investment for available savings.

2. *In addition to those general economic measures, we need simultaneously to cut back the many confusing and unnecessarily burdensome laws and regulations that inhibit our exports as well as our imports.* As has been amply demonstrated, the United States maintains an extensive array of regulatory requirements on domestic production. Few of these burdens can be shown to generate more benefits than costs to the society. In many instances, the burdens are far greater than is the case in other industrialized nations. Furthermore, the United States directly restricts the export of a great variety of items, usually for foreign policy or national security reasons. These restrictions have ranged from weapons and nuclear power plants to goods that are deemed “strategic,” to grain, timber, and petroleum and items to be used in the natural gas pipeline between the USSR and Western Europe. It should be noted that important indirect costs result from using the embargo mechanism to pursue noneconomic objectives. The repeated instances discourage American companies from pursuing an export-oriented market strategy and cause foreign markets to turn to more secure sources of supply.

We need to cut back the many, burdensome laws and regulations that inhibit our imports and exports

The International Orientation in Trade Policy

3. *We need to fundamentally revise our attitude toward multinational corporations and acknowledge their positive role in a healthy world economy.*

Companies that are multinational in their operations tend to adapt to change more readily and are less likely to plead for protection than other

companies. Many specific aspects of public policy toward American overseas business need to be reconsidered. One candidate for review is the detailed regulations of the Foreign Corrupt Practices Act which often inadvertently and unnecessarily limit the ability of United States companies to compete in overseas markets. Outright bribery is not to be condoned. But “special commissions” are standard business practice in many parts of the world and reflect local customs rather than American initiative. Also, the anti-boycott law may reduce American business potential in some Arab states. Because many of these obstacles to our exports reflect important social objectives, the solution in this area may, in part, entail convincing other nations to adopt similar approaches. Nevertheless, there is a compelling case for reviewing existing regulations to determine which of them can be modified to a more cost/effective stance.

We must acknowledge the positive role played by multinational corporations in a healthy world economy

4. *As a nation we need to understand that, from the viewpoint of economic performance, protectionist measures are counterproductive.* They reduce competition. By encouraging resources to move into or stay in less efficient industries, they result in lower growth in productivity in the overall economy. That, in turn, adversely affects our competitiveness in world markets and—almost predictably—generates further pressure for additional protectionist measures. The result is lower domestic employment, which, in turn, often generates additional pressures for government interference. That is an example of a more general principle: government intervention begets more government intervention.

In a healthy and dynamic economy we must expect that some industries and regions will grow more rapidly than others and that some sectors will experience more difficulty. We must rely primarily on market forces, and not on government bailouts, to make the appropriate adjustments.

In certain situations the adjustments to import pressures are not easy. For example, as a result of changes in resource endowments or the spread of technology, know-how, and entrepreneurial activity abroad, it may become apparent that the United States no longer has an economic basis for producing various labor-intensive products that require little skill or capital. In these circumstances, our domestic industry must either find a way of upgrading its own capabilities or shift resources to other activities. And in these situations, primary reliance again should be placed on market forces to facilitate those adjustments in the affected industries.

5. *The emphasis in trade adjustment policies should be just that: adjustment, not preservation of an uncompetitive industrial structure. A*

healthy, dynamic economy is a flexible economy, where business executives, consumers, and workers have a continuing opportunity to invest their capital, tailor their budgets, and find employment in response to market forces unaffected by artificial government barriers or props. Thus, while there may be a role for government assistance to individual workers who have lost employment because of import dislocations, this assistance should be temporary—and oriented toward facilitating their search for new employment in other industries and, conceivably, in other locations. The general rule in trade adjustment situations should be to help individuals, not industries per se.

Free Trade as a Two-Way Street

How, then, should the United States respond to the vast array of protectionist measures put in place by its friends and allies around the world? Of course, we cannot ignore them. As a practical matter, free trade must be a two-way street. But we cannot harp at foreign barriers while we blithely ignore our own. As this report has demonstrated, the United States maintains a great many restrictions on imports—precisely the kinds of actions that we berate others for taking.

6. In responding to foreign obstacles to our trade, the serious question is how to develop policies aimed at increasing freer flows of trade and investment with our trading partners without harming the present international trading system or starting a spiral of protectionist actions.

*We cannot harp at foreign trade barriers
while we blithely ignore our own*

Our objective should be a policy that lowers—not raises—barriers, and opens—not closes—markets. The current interest in “reciprocity” should not mean a focus on equivalent access on a sector-by-sector or product-by-product basis. By all means, it should not be a guise for protectionist actions. Most important, the need for reciprocity should not be determined by whether or not the U.S. has a trade deficit with a particular country. The primary and preferable method for responding to the pressures for “reciprocity” should be by dealing with the serious concerns that give rise to those pressures, such as surges of imports. That positive response should be in the form of seeking liberalization of foreign markets rather than by raising equivalently restrictive barriers in our own.

A most salutary action on the part of the United States was the November 13, 1982, announcement of the termination of the ban on American firms (and their subsidiaries and licensees) participating in the construction of the natural gas pipeline between the USSR and Western Europe. A constructive follow-on action would be the elimination of one or more of our subsidy programs for agricultural commodities—such as sugar and dairy products—to be made contingent on Western Europe

beginning to reduce the vast array of subsidies and supports to its agricultural sectors. Certainly, the American consumer and taxpayer would benefit from those actions, as would their counterparts overseas.

To this end, the United States government should continue its efforts to improve the existing rules of the game for trade in goods—particularly under the General Agreement on Tariffs and Trade and the codes developed in the Multilateral Trade Negotiations. It is not too soon to start the long process of developing new sets of international rules relating to the rapidly expanding trade in services.

The battle for open markets must be waged at many levels and in various arenas. If the foregoing analysis has relevance for American consumers, it surely has even greater relevance for Japanese consumers. And, of course, it is the Japanese public that bears the ultimate burden of the vast array of trade restrictions, both formal and informal, that is maintained by that nation. Viewed from a broad, historical perspective, Japan, of all the major developed nations, is the one which most recently has made the transition from a developing country to a mature, industrialized economy. However, the Japanese have only begun to change their policies and customs to reflect that fundamental shift. The “infant industry” approach has not yet been abandoned. Yet, looking at the decade of

*The battle for open markets has even greater
relevance for Japanese consumers*

the 1980s, it is clear that Japan now has a key stake in the health of the world trading system. Japan has benefitted greatly from the openness of the world economy. Without that liberal environment, it is doubtful that its export-led growth would have occurred. Surely, steps to open that nation’s markets more widely to foreign trade and investment seem long overdue.

7. The sooner that Japan succeeds in adjusting its trade posture to current economic realities worldwide, the sooner will its trade relations with open advanced economies move to a sustainable basis. As the “Wisemen’s Report” (the Report of the Japan-United States Economic Relations Group, January 1981) so clearly stated, Japan “needs to develop and articulate a new, more active international role. Japan should strive to substantially improve access to its market.” The Wisemen—a very distinguished group of former business and government leaders of Japan and the United States—specifically urged Japan to strive “to substantially improve access to its market” and to join the United States in providing international leadership in setting an example and in strengthening the institutions and practices supporting freer flows of trade, capital, and technology.

Towards a Freer World Economy

In the current economic environment, in which pressures for protectionism run strong, improving the "rules of the game" for free trade is not especially easy. The demands for restricting a wide variety of imports to the U.S. are myriad and often carry strong influence in government. In this regard, then, the central question may be, how can the tide effectively be turned? Or, more precisely, how do we maintain and improve our free markets and the benefits that flow from them?

8. *In its fundamental form, the answer to rising protectionist pressures lies in efforts that combine vigorous education with strong persuasion.* To that end, much of this report has been devoted to setting forth the range of adverse economic effects—both domestic and international—resulting from tightening or closing off world access to our domestic markets. In particular, the key feature of protectionism that cannot be stressed too strongly is its pronounced effects on American consumers—people who buy goods and services every day but who are not aware, in large part, of the negative results which restricted world trade has on their pocketbooks and standard of living. Protection is, in effect, a hidden tax on the consumer, and often an extremely regressive one.

The key feature of protectionism is its pronounced effect on American consumers

Additionally, it is important to point out that American industries will, ironically, suffer rather than benefit from protection from imports, either in the short or long run. By reducing domestic competition and raising the prices of goods—all in the name of protecting American industries and jobs—consumption and output are consequently reduced, inflation is ignited, jobs and incomes are lost, and the economy as a whole suffers damage. Seen in this light, protectionism cannot be viewed as the remedy to an illness; rather, it is, itself, an illness.

On the one hand, businesses and American workers alike must be pressed on this point. If the vitality of free markets and the interests of private enterprise are to be well served, then the "quick fix" of trade barriers must be avoided, since the damage they cause—though often subtle in their workings—far outweighs the benefits that accrue to specific, protected industries. Moreover, the "snowball" effect of protectionism can be very strong, because once the precedent is established in one industry, others will seek the same sorts of protection from government.

On the other hand, policymakers in government must recognize that they face an important task not only in seeking to reduce the barriers imposed by foreign governments on American exports, but also in reforming or removing many of our *own* obstacles to the export of U.S. goods. If American firms are to compete effectively in world markets, the wide range of domestic laws and regulations hindering trade must be

revised. The signing into law in October of the Export Trading Company Act of 1982, which will encourage joint export ventures by giving firms some protections against antitrust actions, is certainly a step in the right direction. More must be done, however, at all levels of government and in the private sector itself to promote the sale of U.S. goods overseas by removing our own barriers to trade.

If American firms are to compete effectively in world markets, the wide range of domestic laws and regulations hindering trade must be revised

In the final analysis, government officials, American business, workers, and consumers will benefit from understanding—and putting into practice—a few basic principles regarding the crucial area of U.S. participation in world trade. These principles are central to the free market on which our economy is based:

- American firms and the millions of people who depend on them for their livelihoods must recognize that open trade presents far more possibilities for them than does closing U.S. markets. In simple terms, open markets create more business opportunities; restricted markets do not.
- Trade barriers such as import restrictions and forced "reciprocity" should not be used as a political rationalization for dealing with industrial problems that are essentially of domestic origin.
- Important multilateral agreements on trade should be maintained and vigorously pursued. At the same time, foreign governments should be made aware, at every turn, of the domestic pressures in the U.S. for restricting markets. Moreover, the wide variety of non-tariff trade barriers that are so prevalent in the world today should be exposed to the glare of publicity.
- While the full spectrum of businesses in the United States should clearly enunciate its views on world trade, American firms must also look at both sides of the coin. As the world's largest importer and exporter, the U.S. runs trade deficits with Japan, while it simultaneously maintains large trade surpluses with Western Europe and other world regions. Put another way, we should not ignore our own competitive advantages by concentrating solely on those of other nations.
- Moreover, in an economy which avowedly has become more service-oriented, we need to overcome our historic preoccupation with commodity trade. Rather, we need to focus on the total flows of commerce between the United States and other nations, including services as well as goods, and investments as well as current account transactions. After all, it is from the totality of our economic dealings with other economies that we gain the totality of benefits from a more open exchange of things—and ideas.

With these principles in mind, if the United States—which is the major trading nation in the world—takes the initiative, we could change the entire tenor of economic and foreign trade policy relationships with the world, particularly with Western Europe and Japan. Rather than continuing down a road of increasing trade tensions and worsening overall relationships, such an enlightened change in our policies and actions would provide a fine opportunity for embarking on a period of more open trade and investment and creating an improved environment for achieving this nation's general foreign policy objectives.