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3 Trade Policy

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International Coordination of Trade Policy

3.1 Introduction and Overview

The post–World War II record of sovereign governments coordinating their international trade policies is really quite impressive. Yet it seems recently to have lost the luster that characterized its early life. Some recent initiatives have seemed to cartelize rather than liberalize. Others have failed to achieve coordination of any kind, dissolving in disarray. Fears cannot easily be calmed that the conventions and structures of postwar trade policy coordination are crumbling. Open hostility, military metaphors, and an air of frontier vigilantism are today quite common in trade policy discussions.

International trade policy coordination has clearly become more difficult. The postwar hegemonic environment has evolved into a more general strategic environment with several influential governments and blocs. New patterns of initiative and response have been slow to develop. New temptations have arisen for governments to abandon seemingly outdated conventions of cooperation, causing the system to retreat toward uncoordinated hostility. The growth of administered protection, aggressive reciprocity, and selectivity all illustrate this evolution.

International trade policy coordination is further complicated by economic developments. Some make a country's comparative advantage increasingly sensitive to sectoral predation by others, especially through subsidies and performance requirements aimed at multinational firms. Workers and others correspondingly bear the burdens of sharper adjustments and look to government to turn its trade policy narrowly inward in order to ease their load. Such "domestication" of trade policy is the antithesis of international coordination.

What changes might restore the liberalizing impetus of postwar trade policy coordination at its best? Several are considered in this paper. One is to extend the "Codes" approach to multilateral negotiations under the General Agreement on Tariffs and Trade (GATT). The Subsidies Code in particular seems ripe for refining, and ideas for development of a Safeguards Code are assessed. Standing GATT committees, with representative membership and regular meetings, are discussed, as are several ways that their independent leadership might be enhanced. A case is made that European and Japanese capacity to *initiate* coordinated liberalization is much greater and more promising than is generally acknowledged, as is that of even quite small countries in "minilateral" settings. Discreet preferential coordination is viewed as a way to rebuild trust and to write new rules and establish new precedents in administrative trade policy—rules and precedents that could eventually come to be accepted even by currently combative countries.

Many reflections in this paper are framed in categories from recent economic thinking about policy coordination in "strategic" environments—those with small numbers of self-consciously interdependent agents. I am hopeful that commentators on this paper will provide balancing admixtures of complementary perspective, institutional detail (e.g., beyond GATT), and operational feasibility. They will no doubt also provide important insights on other trade policy issues, not all of which concern coordination. Readers with limited interest in an introduction to strategic perspectives should find it easy to skim section 3.2 and read section 3.3 with more care.

At the cost of lengthening the discourse, I have tried to make it minimally "acronomyous." Thus I have resisted adopting IPC (eye-pick), ITPC (it-pick), and NITPC (nit-pick) as shorthand for international (trade) policy coordination or lack thereof. At the cost of exposing my ignorance, I have tried to draw a few insights from game theory, political science, history, and law. The nature of the topic seemed to compel it. I suspect I will be thanked for the first; I hope I can be forgiven for the second.

3.2 Postwar Trade Policy Coordination in Strategic Perspective

It seems quite natural to address a paper on economic coordination to international trade policy. It is a border policy that discriminates between foreign and domestic residents in goods and services transactions. Thus it always involves at least two countries and governments. There are many varieties of trade policy. Free trade is properly understood as the absence of any domestic/foreign discrimination (not the absence of government regulation), and national treatment as the absence of any added discrimination once border barriers have been "cleared." Most-favored-nation (MFN) treatment is the absence of discrimination among foreign residents of differing nationalities, and tariffs are discriminatory taxes.

Because trade policy always involves choices concerning international discrimination, it is fitting to ask about trade policy coordination, or its lack. Rules, aggression, unfair treatment, and similar terms all have natural usefulness in discussing trade policy.

At first blush, monetary and fiscal policies seem different from trade policy; they are really not. Monetary, fiscal, and trade policies all have discriminatory border effects that are quite similar. Monetary structure is a quintessential border policy, delineating regions of differing legal tender. Many taxes fall on residents of one country but not others. The ratio of government to private purchases can affect an economy's internal price ratio of domestic to foreign goods just like trade policy, because government purchases are usually concentrated on domestic goods. These similarities suggest that students of trade policy coordination and students of macroeconomic policy coordination have lessons to learn from each other.[1]

3.2.1 Retrospective Insights from a Simple Structure

The word "coordinate" is defined by Webster as "to bring into a common action, movement, or condition: regulate and combine in harmonious action: HARMONIZE." The key words in the definition suggest interdependence and mutuality. When applied to trade policy, the idea of coordination suggests both that each country's government fashions its policy conscious of its effect on other governments' trade policies and that the intended outcome is mutually advantageous to all.

Interdependence and mutuality are hardly revolutionary traits. They have permeated the past forty years of trade agreements among governments, most significantly under GATT. Interdependence and mutuality grew out of abhorrence of the consequences of world economic war followed by full-scale world war.[2]

Today there is a malaise that interdependence and mutuality are being abandoned world-wide, especially in the United States. Interdependent consciousness is on the defensive ("other countries be damned, we've got to *do something* about our trade deficit"), and mutuality is waning ("we've let ourselves passively be pushed around long enough; now it's time to teach those guys a lesson").

Are there good reasons for malaise? Is the future for trade policy coordination quite bleak? If so, is that so bad?

It is remarkable that the most familiar economic apparatus for analyzing trade policy is ill-suited for answering these questions because it applies to perfectly competitive environments with independent governments. Coordination questions arise only in "strategic environments." These insights were obscured in the early postwar period by the dominance of the United States in global trade. Yet even that period can be instructively described from strategic perspectives (see section 3.3.1).

Strategic environments are those in which the number of economic agents making interdependent decisions is relatively small. Each agent takes into account some counterresponse from rivals in calculating its best course of action. Actions include threats and promises, bluster and bluff, collaboration and commitment, all aimed at influencing the outcome of an endeavor toward one's own objectives. These are familiar features of games, war, and policy coordination. They have little place in the environment traditionally employed by economists to analyze trade policy.

In the perfectly competitive environment, each of many agents considers itself too small to influence market outcomes and, therefore, too small to be noticed. Each, therefore, makes choices assuming that all rivals' variables are given. Governments in the traditional framework are independent. They presume that their policies affect market equilibrium but do not account for the way that they may affect the behavior of other governments.[3] When agents take their rivals' actions to be immutable, strategic behavior plays no role, and coordination cannot even be characterized. Furthermore, there are only weak analytical defenses for trade policy of any sort except free trade.

Thus the analysis of policy coordination must begin in strategic environments.[4] The "prisoner's dilemma" model of table 3.1 is a primitive strategic environment from which to draw some simple first insights about historic trade policy coordination. One is that uncoordinated trade policy—policy that independently takes other countries' policy strategies as given—can lead to an outcome that, although rationally

Table 3.1 **Gains and Losses from Alternative Trade Policies in a "Prisoner's Dilemma" Model**

	"Their" Nation's Trade Policy	
"Our" Nation's Trade Policy	Cooperative Initiative (reciprocally liberalize)	Noncooperative Initiative (actively protect or promote)
Cooperative Initiative (reciprocally liberalize)	+ 1 for us + 1 for them	− 2 for us + 3 for them
Noncooperative Initiative (actively protect or promote)	+ 3 for us − 2 for them	− 1 for us − 1 for them

chosen, is unfortunate in the retrospective evaluation of each government. Each would prefer the cooperative outcome, but some form of coordination is necessary to attain and maintain it, specifically some communication and guarantee that each government will "play" the cooperative initiative and not "cheat." Without such a guarantee, uncoordinated national self-interest suggests that each government play noncooperatively. Each will be better off whether rival governments do the same ("we" would lose -1 instead of -2) or try to cooperate (we gain 3 instead of 1). Without coordination the grim outcome is trade war, well illustrated by the early 1930s.

The outcome of uncoordinated policy is less grim in a *succession* of encounters like that modeled in table 3.1. Experience and analysis show that a good uncoordinated trade policy strategy (called "tit for tat") is to play cooperatively unless cheated, then to retaliate (play noncooperatively), but only once until cheated again.[5] Nevertheless, it is obvious that a succession of coordinated cooperative outcomes would be even better for each country than "tit for tat," or certainly no worse. Thus coordination still looks desirable for the richer, dynamic version of this model.

The past forty years provide many illustrations of both the apparent desirability of coordination and what helps to attain it.

Coordination Compacts

GATT is a fine illustration of a compact in which governments coordinate by: (1) negotiating rules of cooperative play (e.g., "fair trade"), defining noncoordination (e.g., "nullification and impairment") and potential penalties for noncooperation (e.g., compensation, retaliation); and (2) exchanging pledges of cooperative behavior (by becoming signatories) and agreeing thereby to consult and ultimately to accept the stipulated penalties if they violate their pledge. Penalties for noncoop-

Table 3.2 "Gains" and "Losses" from Alternative Trade Policies with a Hostile Opponent for the *Same* Prisoner's Dilemma Model

	"Their" Nation's Trade Policy	
"Our" Nation's Trade Policy	Cooperative Initiative (reciprocally liberalize)	Noncooperative Initiative (actively protect or promote)
Cooperative Initiative (reciprocally liberalize)	+ 1 for us 0 for them	− 2 for us + 5 for them
Noncooperative Initiative (actively protect or promote)	+ 3 for us − 5 for them	− 1 for us 0 for them

eration are complemented by rewards for cooperation, often involving redistribution (side payments) of the collective gains. In GATT such redistribution is reflected in the principle of reciprocity introduced in its Preamble (in practice, the value of concessions offered and advantages received should be approximately equal) and also in the major exception to that principle (developing countries are freed from strict reciprocity in order to redistribute gains toward them—implicitly the side payment for their continued cooperation).

In brief, GATT is a compact that establishes communication and conventions to facilitate coordination. A tighter compact might also have established an institution that monitors and/or polices trade policy, with independent power to reward cooperation and penalize noncooperation. This GATT is *not,* except for very limited monitoring. It contrasts with the International Monetary Fund (IMF), which is a quasi-independent (yet representative) institution with greater ability to monitor (surveillance)[6] and limited powers to police (quota requirements, interest charges and payments, conditionality, limits on cumulative access). Had the International Trade Organization (ITO) not been aborted in 1950 (see Diebold 1952), the institutional support for trade policy coordination might be closer today to that for monetary coordination. (Whether this would necessarily be a "good" thing is another question entirely and will be addressed below.)

Common Objectives

Communication, conventions, compacts, and coordinating institutions come about only if there is enough mutual agreement among governments on objectives. Such agreement might be said to be a primordial condition for coordination devices to be attractive (see Cooper 1986, 1987) and was quite influential in the postwar design of GATT. Governments were nearly unanimous in their attraction to cooperative outcomes.[7]

This impetus for coordination can vanish, however, if mutuality of objectives is undermined, as may be happening today. The structure of table 3.1 provides a simple illustration. Suppose "their" government were to become determinedly hostile to "ours," even to the point of valuing our loss as much as their gain.[8] The implied objective for them would become the difference in their payoff and ours in table 3.1: $+3 - (-2)$, $-1 - (-1)$, $-2 - (+3)$, and $+1 - (+1)$, moving clockwise from the northeast quadrant. The new payoff matrix is given in table 3.2. Its innovation is that there is no longer any attraction for the hostile government to choose cooperative trade over trade war. Perceived gains are 0 in either case. Coordination may be infeasible because it takes two to make peace, but only one to break it.

The difference-in-objectives problem obviously grows worse if both governments are hostile toward each other.[9] Then goals are inconsistent, and neither government sees any attraction in coordinating. Trade wars like the 1930s are more enduring than under simple uncoordinated policy because they cannot be shaken by any mere provision of information, institutional reform, encouragement, or exhortation. What is needed before these devices can be used is stabilization of hostility (cease-fire), then reconciliation if possible—ideas that are reflected in the GATT principles of "standstill" and "rollback." Without genuine standstill and rollback, coordination for mutual gain is as impossible among hostile trade negotiators as it was between the Hatfields and McCoys![10]

One general lesson of postwar coordination is that it is very tough among agents with different objectives and may be impossible among agents with inconsistent objectives. A corollary is that momentum toward coordination can be maintained by limiting the scope for cooperative initiative to like-minded trading partners, thereby isolating hostile ones.[11] Correspondingly, an organization of sufficiently hostile governments can easily become paralyzed with an inadequate constituency for any attempt to reclaim or enhance coordination. The view that GATT has reached this point is evaluated below.

Common Structural Understanding

Agreement on objectives is, in turn, possible only if there is sufficient common understanding among governments on the payoffs to alternative trade policy initiatives and, therefore, on the structure of world trade that links policy to payoffs. Such common understanding might be said to be a "pre-primordial" condition for coordination devices to be attractive.

In this regard, it is sobering to consider how ill-developed is professional consensus on empirical models of global trade patterns and the effects of trade policy—ill-developed even in comparison to empirical models of global macroeconomics (e.g., the IMF's multilateral exchange rate model), which are widely acknowledged to have their own distinct problems. It is arresting to learn from macroeconomic research, such as Frankel (1986) and Frankel and Rockett (1986), that when models differ across participants, policy coordination *fails* to improve macroeconomic performance almost as often as it succeeds. Similarly arresting is Baldwin and Clarke's (1985) finding that *non*cooperative solutions to conflict over alternative Tokyo Round tariff-cutting formulae seemed superior for all protagonists to the compromise formula that actually emerged from coordinated negotiation.[12]

3.2.2 Deeper Dimensions of Postwar Trade Policy Coordination

Trade policy coordination is, of course, much more subtle and complex than suggested in the preceding account. There are at least four deeper dimensions: scope, virtue, instrument, and motive force.

Scope

Prospects for trade policy coordination and its outcome depend very much on its scope. Scope has three important variants. *Geographical* scope determines which governments are involved, whether coordination is multilateral, "minilateral," or bilateral—involving all trading partners, some, or only one.

Mutuality/hostility, as described above, is one criterion for determining the most promising geographical scope for coordination efforts. It also influences the choice of *substantive* scope and *sectoral* scope—what issues are to be covered, and for what sectors. Postwar trade policy coordination has emphasized trade in manufactured commodities, in part because trade in agriculture, services, corporate capital (e.g., investment, rights of establishment), and labor effort (e.g., immigration, guest workers) were inflammatory by comparison. Coordination was pursued on substance and in sectors where mutuality was feasible; substance and sectors where hostility reigned were isolated. By comparison to postwar trends, mutuality seems more feasible today for trade in some services, some corporate capital, and perhaps certain agricultural sectors. But international hostility seems to have grown in standardized labor-intensive manufactures such as textiles/apparel and basic metals.

Another criterion for determining the most promising scope for coordination is the "fluidity of side payments," how easy it is to exchange concessions on one issue with one trading partner for advantages on another issue with another trading partner. Recent trade policy coordination has employed two principles to enhance fluidity. One is across-the-board bargaining, with limited exceptions lists, which allows for concessions and advantages to be exchanged fluidly from sector to sector. An older principle is nondiscrimination (as defined by MFN, concessions must be offered to *all* trading partners, not just some), which allows for "inequities" in some bilateral tally of concessions and advantages to be offset fluidly by "windfalls" in some other.[13] It is obvious how important it is for fluid side payments to have common understanding among governments on payoffs and the underlying structure (model) of trade, as described above. Otherwise measures of concessions and advantages are wildly different among participants.

There is unavoidable tension between these criteria for scope. Caution to avoid hostile undermining of coordination encourages narrow scope; concern to lubricate the distribution of benefits from coordination encourages wide scope. Deep pockets capable of making lots of change sometime disintegrate from its weight.[14]

Virtue

Policy coordination by itself may have little value independent of its "virtue." The case for coordination is probably strongest where the case for policy intervention itself is strongest and weaker elsewhere. Thus, in public health (Cooper 1986), where externalities and international spillovers are clear and even quantifiable, the case for coordination is strong. In influencing the sectoral/industrial structure, however, where the case for government policy is less universally acknowledged, the case for coordination is weaker. This perspective may help to explain why the IMF found readier approval in the United States after World War II than did the ITO; there was readier approval at that time of an active role for government in macroeconomics than in microeconomics.

This lesson has been blurred in recent commentary on trade policy. There is an unwarranted tendency to believe that international policy coordination is by its very nature "good" and to neglect the possibility that uncoordinated unilateral policy may be "better." Virtue and coordination do not necessarily go hand in hand.[15] Language alone provides a way to appreciate this. Almost any outcome described as coordinated or cooperative could also be described as collusive. Almost any outcome described as uncoordinated (or chaotic!) could be described as competitive. Exactly the same formal structure supports types of coordination of very different timbre: coordination that signals harmonious forums full of respectful give-and-take in the mutual pursuit of noble goals; and collusion that sounds like closed, mean-spirited cartels which victims deride as vicious old-boy networks. It is all too easy to slip into the benign belief that the objective of government is the "public good," so that coordinated pursuit of that good is good in itself and to be desired. It is all too easy to forget public choice and other grounds for skepticism that government's objectives are prima facie good, on which coordinated pursuit of dubious objectives becomes doubly dubious.[16]

Postwar trade policy provides many illustrations. A traditional defense of MFN treatment is that it constrains the formation of predatory and other "bad" coalitions (coordinations) of trading partners; legitimate customs unions and free trade areas are, however, excused from MFN because these coalitions are on balance "good" (liberalizing). It is arguable that international policy coordination has been just as thorough and strong in the recent cartelization of global steel trade and the market-sharing negotiated under successive Multi-Fiber Arrangements as it was in the Toyko, Kennedy, and earlier rounds of GATT-sponsored trade negotiations. Voluntary export restraints are bilateral examples of deliberalizing coordination. Their ambiguous name has merit, though; they do involve a side payment (compensation) to the "offending" parties in order to maintain coordination—the implicit "quota rents" (Deardorff 1986). Although deliberalizing, they are nevertheless co-operative and thus not as hostile as a unilateral protective counter against an import surge.

Concerns about virtue would be mere fretting if the size of the gains or losses from coordination were small.[17] Some empirical research seems to suggest that these gains and losses are indeed small. Deardorff and Stern (1984) find that the economic welfare gains from the elimination of all post–Tokyo Round tariffs are infinitesimal. Whalley (1985, 180–84) finds that the gains from elimination of tariffs and all other deliberalizing post–Tokyo Round trade barriers are less than 0.5 percent of world income. Kreinin (1974, chap. 3) estimates the gains to the original six members of the European Economic Community (EEC) as around 1.5 percent of their 1970 national income, but MacBean and Snowden (1981, chap. 8) find the estimate diminished as the EEC expanded to nine members due to losses from the Common Agricultural Policy (itself arguably an example of deliberalizing coordination).

These calculations are misleadingly small estimates, however, of the gains from *maintaining* the status-quo level of coordination relative to trade war. They estimate instead the difference between the status quo and free trade. If the real status quo is far to the right along a continuum running from "trade war" to "free trade," then the measured gains to further "virtuous" coordination will be small, but the potential losses from failure of existing coordination or from extreme deliberalizing coordination might be huge. In the famous (infamous?) bicycle metaphor of trade policy coordination, there may be little additional momentum to squeeze into a bicycle cruising reasonably close to its maximum speed, but a great deal of momentum to lose if the bicycle were to fall down. Or, it's a long way down the slippery slope to the valley when you're close to the peak.

Whalley (1985), in fact, estimates both kinds of gains and losses. His very rough calculations of the losses from trade war relative to status-quo coordination appear in table 3.3. They are surprisingly large, especially for Europe and Japan; five to ten times larger than the gains to be achieved from further "virtuous" coordination.

For reasons described in section 3.3, *preserving* the virtue of current coordination is the modern trade policy challenge, not *perfecting* it. Table 3.3 suggests that this challenge does indeed have quantitative importance for the entire world.

Instrument

Another deeper dimension of trade policy coordination is the choice of instruments relied on to encourage it. Here the most important

Table 3.3 Percent of GNP Lost due to Multilateral Trade Wars[a]

	All Trading Areas Adopt	
	60% Tariff[b]	"First Step" Optimal Tariff[b,c]
United States	0.4	2.3
European Community	2.2	5.9
Japan	2.2	5.9
Rest of World	0.1	1.5

Source: Whalley (1985, 248).

[a]Average of compensating variations (CV) and equivalent variations (EV).

[b]Rates assessed to all imports in presence of existing nontariff barriers and factor taxes.

[c]Apparent optimal tariff against the aggregate of all other trading regions assuming no retaliation.

distinction is between rules and discretion. At one extreme the compacts of coordination may attempt to legislate meticulous rules that the institutions of coordination correspondingly adjudicate. At the other extreme, the compacts may simply specify regular meetings for communication that the institutions convene and inform. Policy coordination via the Bank for International Settlements and the June summit meetings have the latter spirit; GATT historically has the former.

Reliance on rules makes most sense when issues and policies can be reasonably defined and measured. Otherwise rules require immense resources to draft and monitor and can easily appear arbitrary and inequitable. Discretion, discussion, diplomacy, and entreaty are often more productive and cost-effective when issues and policies are hard to define and measure.[18] In this light one can interpret GATT's historic rules-centeredness as fitting the historic reliance of the world on objectively measurable tariffs and quotas. GATT tariff bindings are in fact an excellent example of a rule aimed at avoiding surreptitious cheating on the compacts of coordination. (Such rules are known as "credible precommitments" in the language of strategic policy coordination.) One can correspondingly defend the more consultative flavor of the Tokyo Round's codes for nontariff measures as fitting the world's relative shift toward administrative policy instruments (see table 3.7 and the surrounding discussion).

It is instructive along these lines to wonder if the Toyko Round code dealing with the most measurable nontariff measure, subsidies, has been generally regarded as the least successful code precisely because it could have gone further toward definition, measurement, and rules. The problems of common objectives and structural understanding, discussed above, are admittedly severe in coordinating rules on subsidies. Yet in the absence of coordination, unilateral attempts to define, measure, and countervail them seem inevitable (Shuman and Verrill 1984). The idea of a coordinated defining and "binding" of subsidies, much as tariffs are "bound" in the GATT, is considered below.

Motive Force

Impetus is another aspect of policy coordination not captured in simple accounts. Coordination can be imposed, agreed, or implicitly chosen, with varying implications along a continuum that joins them. Coordination is *imposed* when weaker, smaller, or less-skilled agents harmonize their policies with those of a strong, large, or skilled agent, which tailors its policy to elicit policy response among the followers that furthers its own goals. Coordination is *agreed* when enough consensus exists on objectives and structure among agents of comparable strength that they negotiate a compact. Coordination can be *implicitly chosen* even in the absence of a compact (or with an ineffective one) when agents recognize at least some gain from mutually cooperative outcomes and some penalty from cheating, as in the concept of implicit collusion among oligopolistic producers. In this light, early GATT coordination of trade policy might illustrate the imposing force of a hegemonic United States; Kennedy Round coordination might illustrate explicit agreement among equals; and current coordination might illustrate the kind of implicit impetus that is maintained solely by tenuous conjectures of gains "if we all keep cooperating" and penalties "if I defect." The stability of the coordination seems greatest when imposed and weakest when implicit. However, its "representativeness"—its reflection of the collective objectives of participants—may be greatest when it is agreed or negotiated among equals.

Among other things, this implies a potential opportunity in the future for atypical participants to initiate fruitful ideas for enhancing coordination. The United States may today be in a better position to respond to cooperating, coordinating ideas from abroad (e.g., from Israel, Canada, Japan, Mexico) than to initiate them itself. We turn in the next section to prospects such as this in the midst of changing environments for trade policy coordination.

3.3 Changing Environments and Prospects for Coordination of Trade Policy

The environment for trade policy coordination today is quite different than in the early post–World War II period when many enduring conventions of coordination were established under the GATT.

In the policy environment for coordination, the most significant changes have been the leveling out of influence among national governments relative to U.S. dominance in the early postwar period and the development of new administrative instruments of trade policy to replace the limitations that the GATT successfully coordinated for tariffs. In the economic environment for coordination, the most significant change has been the growth of large, mobile corporations that themselves practice coordination across borders. They are multinational in both operations and ownership. In the intellectual environment, these changes have been captured in the development of an analysis of trade policy coordination in strategic environments—those with small numbers of large rival firms and/or governments—that has challenged insights from the venerable competitive consensus.

These environmental changes interact with each other. Multinational corporations make it harder for any government to define and pursue its "own" national interest. Returns to the "capital endowment" that a country's residents own depend on revenue from far-flung foreign affiliates as well as revenue from home. Discriminatory border policies that increase revenue from one source at the expense of another have ambiguous effects on "our" multinational firms and their owners. Firms that are largely "ours" (majority-owned) may nevertheless pay significant fractions of their revenues to foreign shareholders. Strategic influence over the location and competitiveness of large, mobile multinationals is an understandably important objective of modern trade policy and leads to concerns about market access and administrative instruments such as performance requirements, tax incentives, and unitary tax systems. The sensitivity of firms to these policies aggravates the adjustment problems faced by owners of immobile factors of production—narrowly skilled workers, farmers, civil servants. Such groups are not internationally coordinated but may be large and coordinated internally (e.g., labor unions). Trade policies that protect and insure them, or that help them adjust to shifting sectoral prosperity, have a very different orientation than trade policies that expand markets abroad for exporting and multinational firms, insuring their right of establishment and fair competition. A country's own internal policy coordination can be undermined by a schizophrenia in which departments of commerce and ministries of industry promote "competitiveness"-enhancing trade policies while departments of agriculture and ministries of labor promote protectionist trade policies. International policy coordination is all the more difficult when large internal trade policy constituencies are uncoordinated or hostile.[19]

The following subsections describe these environmental changes in more detail and trace their implications for trade policy coordination.

3.3.1 Shifts in the Policy Environment

Policy environments have evolved (devolved?) since the 1950s and early 1960s. Strategic interaction among governments has come to reflect shifts in relative economic size and influence. New instruments, institutions, and principles of strategic policy interaction have emerged.

Relative National Strengths

For many reasons, dominant trade policy leadership fell to the United States early after World War II.[20] Its economy was least devastated by the war. Its military forces spearheaded resistance to Soviet expansion and played important roles in European and Japanese economic reconstruction. It vetoed the multilaterally planned ITO (Diebold 1952) in favor of a compact of its narrow commercial provisions, which became the GATT, more U.S.-patterned than the ITO would have been.

In strategic terms, this was a period of hegemonic interaction. Governments of relatively weak countries did not behave strategically. They tended to take U.S. trade policies as given and to adopt whatever trade policies seemed best for themselves without perceiving much scope for influencing the United States thereby. U.S. incentives were to act strategically, but in a unique way. The United States tended to choose trade initiatives mindful of collective foreign response, such as in its encouragement of European economic integration. But it could afford to be impassively obliging toward recalcitrance or provocation by single trading partners because the impacts were relatively small. This unusual combination of multilateral strategizing and bilateral impassiveness is similar to what one might expect from a large firm in an industry with a fringe of small perfect competitors. The large firm will be strategically calculating toward the aggregated collection of competitors but will appear unflappable toward isolated deviance.

Two things change if small agents in hegemonic environments grow significantly relative to the hegemon. They begin to act strategically toward the hegemon, seeking to press advantage and avoid its perceived "exploitation"; the hegemon no longer finds their provocations too minor to warrant response.

All this seems to have characterized the trade policy environment of the past forty years. First Europe and then Japan (and even several other countries) have grown relative to the United States in key indicators of economic influence. Patterns for two such indicators are illustrated in tables 3.4 and 3.5.[21] Such newly influential governments have begun to shape their trade policy strategically, attentive to U.S. response (e.g., Tokyo Round tariff-cutting initiatives by the EEC). And the U.S. government has become much more mindful of the domestic injury caused by "unfair" trade practices among its large trading partners and consequently has become much more active in legislating trade policy remedies. Figure 3.1 reveals the rise in unfair trade activity (bottom panel) relative to escape clause activity (top panel), which has actually fallen. Table 3.6 shows the recent acceleration of U.S. trade legislation, much of which is aimed at "redressing inequity."

Table 3.4 Ratio: National Real GDP per Capita[a] to the Equivalent for the Aggregate of the Ten Countries in the Table

Year	Brazil	Mexico	Korea	India	Japan	U.S.	Germany	France	U.K.	Italy
1953	0.416	0.691	0.309	0.220	0.619	2.963	1.464	1.473	1.751	0.961
1963	0.479	0.787	0.307	0.195	1.017	2.633	1.944	1.714	1.698	1.269
1973	0.570	0.825	0.454	0.156	1.703	2.543	2.059	1.969	1.630	1.343
1977	0.657	0.857	0.574	0.163	1.711	2.511	1.996	2.030	1.579	1.454
1983	0.595	0.955	0.956	0.158	2.009	2.560	1.835	1.867	2.010	1.583
1984	0.535	0.855	0.989	0.155	2.074	2.744	1.756	1.706	1.840	1.560

Sources: Real GDP per capita: 1953, 1963, 1973, 1977 from Kravis, Heston, and Summers (1982, 330–36); 1983, 1984 from World Bank (1985, 1986) with data spliced to Kravis, Heston, and Summers data in the following manner:

table entry = $y^* \cdot k/p$,

where y^* = GNP per capita in 1983 or 1984 dollars (World Bank 1985, 1986);

k = Ratio of Kravis, Heston, Summers figure for 1975 real GDP per capita to World Bank figure for 1975 GNP per capita

p = 1983 or 1984 deflator for U.S. GNP assuming 1975 = 1.00, from IMF, *International Financial Statistics Yearbook,* 1986, pp. 690–91.

Population: 1953[b], 1963, 1973 from U.S. Bureau of the Census (1980); 1977, 1983, 1984 from World Bank (1979, 1985, 1986).

[a]In 1975 dollar prices.

[b]Average 1950–1955.

Table 3.5 **Percent Share of Exports in Aggregate Exports of the Ten Countries in the Table**

Year	Brazil	Mexico	Korea	India	Japan	U.S.	Germany	France	U.K.	Italy
1953	4.1	1.6	0.1	2.9	3.4	41.8	11.7	10.6	19.9	4.0
1963	1.9	1.3	0.1	2.2	7.5	32.0	20.0	11.2	16.8	6.9
1973	2.2	0.8	1.1	1.0	13.2	25.4	24.1	13.1	11.1	7.9
1977	2.3	0.9	1.9	1.2	15.5	23.2	22.6	12.5	11.2	8.7
1983	2.6	2.5	2.9	1.1	17.5	23.4	19.8	11.1	10.7	8.5
1984	3.0	2.7	3.2	1.0	18.6	23.8	18.8	10.7	10.3	8.0

Source: IMF, *International Financial Statistics Yearbook,* 1981 and 1985 issues.

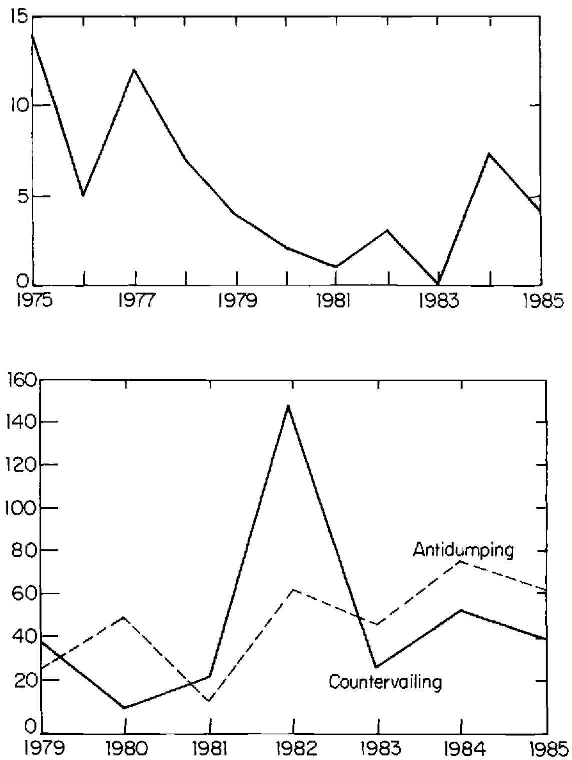

Fig. 3.1 Trends in U.S. import relief (Section 201) and unfair trade remedies. *Top panel:* Escape clause investigations, 1975–85. *Bottom panel:* Countervailing duty and antidumping investigations, 1979–85. *Source:* Destler (1986, 124, based on appendix B).

Table 3.6 **Number of Trade Bills Introduced in Various U.S. Congresses (percentage change over previous Congress)**

Congress (years)	Destler (1986) Count[a]	Ahearn (1986) Count[b]
96th (1979–80)	62 —	1089 —
97th (1981–82)	56 (−10%)	1150 (−6%)
98th (1983–84)	57 (+2%)	1401 (+22%)
99th (1985–86)	93[c] (+60%)	1758[d] (+25%)

Sources: Destler (1986, 75–76), Ahearn (1986).

[a]Counts bills whose primary purpose was to restrict trade or benefit U.S. producers.

[b]Counts bills employing twenty trade-related terms, some to expand trade, some to protect, with various shades based on personal evaluation.

[c]Growth rate between January-September of 1985 and January-September of 1983 applied to number of bills introduced to 98th Congress: (49/30) × 57.

[d]1985 figure times 2.

Instead of being analogous to an industry with one large firm facing a fringe of small competitors, the trade policy environment today is closer to a genuine oligopoly with a small number of large "coequals."

This has many implications:

1. It suggests that trade policy coordination cannot feasibly be imposed but must be either explicitly negotiated ("agreed" in the language of section 3.2.2) or implicitly adhered to. The United States can no longer dictate the timing, agenda, or formulae for multilateral trade liberalization, as illustrated by comparing the outcomes of GATT ministerial meetings in November 1982 and September 1986 to those prior to the Kennedy Round in 1963 (Baldwin 1986a, 5–12).

2. It suggests that *any* of the coequal governments can initiate trade policy coordination, not just the historic "leader."[22] In fact, if the historic leader is nursing a sense of injustice and grievance over lost ("stolen") influence, with sporadic withdrawal and "lashing out" as in interpersonal conflict, then it might enhance the chance of success for coordinating initiative to be reversed. The United States may, today in particular, be better able to respond cooperatively to cooperative initiatives abroad than to defend taking cooperative initiative itself.[23] The posture implied for governments in Europe and Japan is more aggressively inviting than usual; that implied for the U.S. government is more "seductively responsive" than usual.[24]

3. It suggests that if trade policy leadership is not adequately forthcoming from newly coequal governments, there may be reason to invest "independent agents" with specified leadership functions. Such functions might include monitoring, reporting, and initiating meetings (and perhaps even complaints). Suggestions range from radical to mild. Some favor restructuring the GATT institutionally to resemble the IMF (Camps and Diebold 1983, 59–67).[25] Others suggest merely the creation of an Independent Trade Policy Committee ("serviced by the GATT Secretariat"; GATT Wisemen's Report 1985, 42) or a permanent negotiating committee (Aho and Aronson 1985, 48). The aim of all such suggestions is to facilitate leadership impetus and provision of accurate information, both crucial to maintaining policy coordination and avoiding devolution into disarray and possibly trade war.

4. It suggests the advent of discriminatory trade policy coalitions. A coalition is coordination of limited scope among a subset of trading partners over (perhaps) a subset of issues. It is a natural occurrence in strategic interaction among coequals and is by its nature discriminatory (*not* MFN). A hegemonic environment by its nature provides no motive for coalitions either for the large agent or for the many small ones. These insights seem little appreciated in recent discussions. Today's trade policy environment is *structurally* conducive to coalitions and hostile to MFN, whereas the postwar hegemonic environment was

the opposite. The difficult question is whether conservation efforts aimed at preserving the life of this endangered animal (MFN) are still worthwhile, or whether inevitable extinction should be hastened in an effort to breed species more at home in today's jungle!

5. It suggests that if implicit trade policy coordination is followed, (see section 3.2.2) then periods of cooperation may be punctuated by periods of "punishment" for perceived policy violation with, of course, counterretaliation and symptoms of trade war.[26] Difficult technical questions involve how the probability and duration of such periods vary with asymmetries in the size of the agents involved or with the size of the parties or coalitions being "punished,"[27] and what sort of dispute-settlement mechanisms most predictably restore the peace of implicit coordination.

New Instruments, Institutions, and Principles

Administered intervention. Every coordination compact is at risk because of the constant temptation for each rival to try surreptitiously to avoid the constraints on behavior, that is, to "cheat" secretly on one's partner-rivals.

This instability can be seen in the growth of "administered intervention" aimed surreptitiously at undoing the effects of GATT-coordinated reductions in tariff bindings. Administered intervention is flexible, discretionary decision-making toward opaque nontax instruments of import protection and export promotion. It includes voluntary export restraints, orderly marketing agreements, standards, licensing, and internal distribution barriers to imports, as well as performance requirements, tax forgiveness, credit guarantees, and implicit subsidies of many types for exports.

Whalley (1985) provides a striking way to illustrate the significance of administered intervention. In estimating the welfare effects of complete removal of both tariffs and nontariff barriers to imports, he finds the latter to account for more than half of the estimated effects. His calculations are summarized in table 3.7.[28] According to them, administered intervention affects the exports and imports of Japan the most and the United States the least.

One implication of the greater use of administered intervention is intricacy. It becomes harder to identify foreign policies, much less measure their effects. It also becomes harder to implement one's own trade objectives. Intricacy raises the resource cost of estimating and monitoring, and slows down trade policymaking. In the United States, administrative intervention in trade, unlike tariffs, invades the turfs of regulatory agencies, congressional oversight committees, and sometimes even the judiciary.

Table 3.7 Nontariff Barrier Share of Own-Country Welfare Effect from Unilateral Abolition of all Protection[a] (post–Tokyo Round)

	Four-Region Model	Seven-Region Model
United States	42 to 57 percent	40 to 47 percent
European Community	52 to 62 percent	56 to 62 percent
Japan	58 to 75 percent	53 to 69 percent

Source: Whalley (1985, 181–82).

[a]Low number in each cell assigns *none* of the interaction effect from removing both tariffs and nontariff barriers together to nontariff barriers; high number assigns *all* the interaction effect to nontariff barriers.

Intricacy increases allegations of unfairness and discrimination because administered intervention is inherently opaque. Opaqueness heightens suspicions that something discriminatory and unfair is going on below surface appearances. Information about administered intervention can become so costly for noninsiders to obtain that extraordinary mechanisms are needful to obtain it, such as "protection balance sheets" and "surveillance reports" (GATT Wisemen's Report 1985, 35, 42). The value of information for maintaining coordinated cooperation is higher in environments with administered intervention than in those with more transparent trade policy instruments like tariffs, quotas, and export subsidies. Economists who applaud the benefits of price competition but are chary of nonprice competition (advertising and so on) might consider the trade policy analog. There may be much clearer benefits to "tariff competition"—negotiating coordinated concessions in the traditional way, threatening tax-based retaliation, and so on—than to competition and coordination among governments in administered intervention. All the features that make prices effective and efficient signals in private resource allocation make tariffs and other trade taxes effective and efficient signals in policy coordination. Among other things, this supports the recommendation sometimes heard for "re-tariffication" (e.g., Hufbauer and Rosen 1986).

Another implication of administered intervention is heightened "preemptive consciousness." Anticipations of a brave new world of coordinated (voluntary) export restraints, with market shares allotted according to the historical status quo, creates a race among large firms, and maybe entire industries, to "stake out claims" by penetrating and expanding quickly. Administered intervention may thus bring import surges upon itself. They are the rational response to expectations that a government will soon decide to vest the import "rights" of existing large suppliers in a set of "fair shares." Steel firms and automakers abroad observe that it happened in apparel and anticipate it for themselves; machine toolmakers abroad observe that it happened in steel and autos and anticipate it for themselves; and so on.[29] Tariffs and other transparent policy instruments have not historically created the same preemptive surges because both levels and changes were transparently bound into the GATT.

"Minilateralism." Allegations of unfair and injurious behavior on the part of large trading partners who have "caught up" with the United States have made it more vigilant about unfair trade from any source. Even small trading partners come under scrutiny. All developed countries view the catch-up growth of newly industrializing countries (visible most clearly for Brazil, Mexico, and Korea in table 3.4) with alarm and similar suspicions. (Indeed there *are* legitimate grounds for such suspicions as the economic environment includes more and more internationally coordinated multinational firms, as discussed in section 3.3.2). Although negotiation with dynamic small competitors may not seem worthwhile, exclusion of them from multilateral trade policy initiatives is easy and quite tempting. Isolation of "offenders" is a seemingly cheaper alternative to coordinated dispute settlement.

Thus the apparent growth of unfair trade becomes one of the forces behind "minilateralism," the tendency to circle the wagons, to reduce the number of participants involved in trade policy coordination.[30] This has virtue (section 3.2.2) to the extent that international catch-up pressures really do depend importantly on unfair practices. But to the extent that these are just fair and normal competitive pressures for new entrants, coordinated "minilateralism" is synonymous with barriers to entry and cartelization, and has little economic merit.

A closely related force behind minilateralism is the disparity of market dependence among GATT countries. Degrees of regulation vary, as does reliance on private rather than state-owned and state-supported firms (see below). Multilateral negotiations of a traditional kind have become increasingly cumbersome because of differences of objective and structural understanding.

These differences lead naturally to initiatives that narrow the geographical and sectoral scope of negotiations in order to make any progress at all. The 1986 report of the United States Trade Representative (USTR 1986, 61–62) is remarkably blunt:

> Nevertheless, multilateral negotiations are not an end in themselves. . . .
>
> America has decided to pursue *trade liberalization* opportunities *wherever* and *whenever* they exist, whether in a multilateral, plurilateral or bilateral context.
>
> Although the United States would prefer pursuing trade liberalization through multilateral negotiations, it is deeply concerned that

> the process may now be *too cumbersome* to achieve meaningful and timely results. Indeed, the increasing number of GATT Contracting Parties and growing divergence of their viewpoints guarantee ever more awkward and prolonged negotiations. . . .
>
> If the United States cannot reach timely trade agreements on a multilateral basis, it is prepared to progress on trade issues by negotiating on a bilateral or plurilateral basis with like-minded nations. . . .
>
> It is time to recognize that across-the-board discussions among all GATT members may not be the best way to promote GATT goals. There is a greater need for a variety of arrangements under the GATT umbrella so trade liberalization can progress on at least some fronts without waiting for *all* issues to be settled to *all* parties' satisfaction. When a group of countries can negotiate a trade liberalizing agreement, provision should be made for its acceptance under the GATT.

Consistent with this intent, the United States has in the past few years negotiated: a quite inclusive free trade agreement with Israel and sectoral liberalization with Japan (Market-Oriented Sector Specific initiatives) and Caribbean trading partners. Negotiations continue with Canada toward sectoral free trade. The EEC, of course, continues to expand the boundaries of its own preferential liberalization. And forty-eight of the largest developing countries agreed in May 1986 to begin trade negotiations among themselves under a Global System of Trade Preferences.

A worrisome implication of these minilateral trends is, of course, that the world may become fragmented into hostile trading blocs, Uruguay Round notwithstanding. There is a more promising perspective, however. It is that in today's policy environment only minilateral liberalizing coordination is feasible. More than that, it is an ideal crucible in which to experiment with new coordination techniques: new definitions, rules, monitoring arrangements, and dispute settlement procedures. Minilateral coordination within the EEC, for example, is almost surely going to involve important progress on coordinating trade policy in services, such as in telecommunications. Minilateral coordination between Canada and the United States is almost surely going to make progress on unfair trade rules and procedures. In the longer run, multilateral negotiations over new GATT codes and among "blocs" (a pejorative term in this context) may be usefully informed by the precedents and experiments of minilateralism.

It is undeniable that these minilateral and bilateral movements are retreats from multilateral coordination of the historic kind, resting on the MFN principle (unconditional in principle, but in the practice of nearly every country, quite conditioned). Strategic "retreats" may, however, allow trade policy coordination to regroup beneficially just as they do an army. They may furthermore be wise if increasing parity among countries in economic influence undermines MFN and enhances the idea of optimal coalition-building (see point 4 of "Relative National Strengths" in this section). In this light, it might be better not to call this a retreat from multilateralism based on MFN but, for example, to call it a "new" multilateralism based on a "*More*-Favored-Nation principle"![31] The GATT codes of the Tokyo Round can in fact be seen as an innovative vehicle for the new multilateralism.

GATT codes. GATT codes are an innovative device for adopting the best aspects of coordinated minilateralism, controlling the worst aspects of administered intervention, and maintaining the many GATT mechanisms that continue to be relevant to liberalizing coordination.

Five important codes were negotiated during the Tokyo Round of GATT negotiations: on subsidies, procurement, standards, import licensing, and customs valuation. Each was negotiated by a subset of GATT members, each on a trade policy issue of narrow scope. Each forms a supplement to the GATT, with five independent lists of signatories that do not include all GATT members. By restricting participation and focusing on narrow issues, the codes reduced the potential for hostile undermining of coordination. Their provisions are, however, applied in principle on an MFN basis (except by the United States whose application of the first three codes was conditional).[32] Each is administered by a Committee of Signatories serviced by the GATT Secretariat, and each has its own dispute settlement mechanism.

In general, the Tokyo Round codes aimed at rules and procedures for harmonization and transparency rather than at significant liberalization. This is one reason for not according undue weight to assessments of their "only modest" success, or to the general agreement among commentators that the subsidies code in particular has not worked well. They might be judged more optimistically as successful "standstill" agreements, strategic defenses against decoordination rather than catalysts of coordination.[33] They might also be judged successful for creating strategically ambiguous[34] GATT-consistent minilateralism. And they are commendable attempts to cope with administered intervention in a realistic way.

The Tokyo Round attempt to negotiate a safeguards code failed, however, and the subsidies code has room for considerable improvement, comments above notwithstanding. Acceptable codes on subsidies and safeguards are, in fact, especially needful because of important changes in the economic environment.

3.3.2 Shifts in the Economic Environment

Modern trade policy issues arise in economic environments that seem increasingly strategic and do not fit the orthodox competitive paradigm.

Mobile Multinational Firms

One essential aspect of a firm is coordination within itself; as firms have grown multinationally over the past few decades, corporate international coordination has grown apace. There are many reasons for this growth. The EEC, communications innovation, capital-market integration, and ambitious development plans all have encouraged coproduction, joint ventures, mergers, and global identity. In some global markets, the same few firms compete everywhere. In some national markets, a small number of firms vie for a "prize" that is essentially control of the whole national industry. The growth of trade has been more rapid in manufactures—with potential for firm-focused economies of scale, technological gaps, product differentiation, and taste for variety—than in agricultural and mineral products, as shown in figure 3.2. Within manufactures, the growth of trade has been more rapid in industries with a concentrated, oligopolistic market structure than in those with a competitive structure; trade in aircraft, electronic machinery, chemicals, and petrochemicals grew much faster between 1973 and 1983 than trade in wood, paper, and foods, as shown in table 3.8. Table 3.9 shows further that U.S. multinational firms maintained their shares of world exports over the past thirty years, even as the U.S. geographical share declined, and have grown in their shares of U.S. trade.

In concentrated strategic environments, firms clearly recognize the effect that their actions have on the behavior of other firms, and often

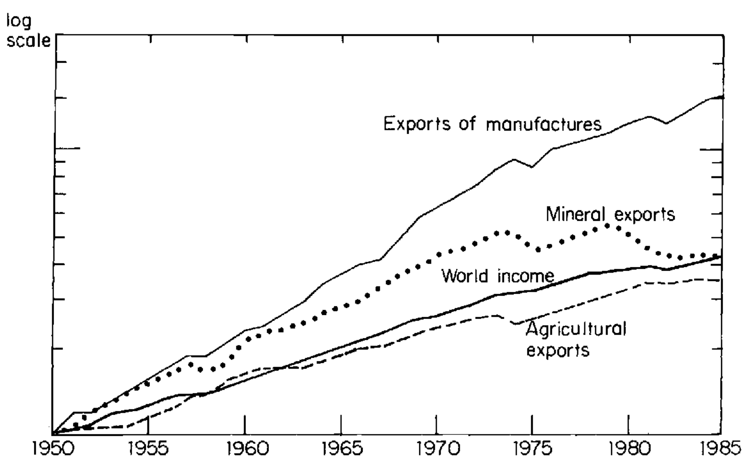

Fig. 3.2 Changing commodity composition of world exports, 1950–85 (broad categories; volume indices, 1950 = 100). *Source:* GATT (1986a, 12).

Table 3.8 **Changing Commodity Composition of World Imports, 1973–1983 (narrow categories)**

Rank			Percentage shares in value of world trade		Percentage shares in value of world trade excluding fuels	
1983	1973	Product categories	1983	1973	1983	1973
1	1	Crude petroleum	12.4	7.6	..	..
2	7	Petroleum products	4.9	2.4	..	..
3	4	Passenger motor cars	3.8	3.8	4.7	4.2
4	2	Iron and steel	2.8	4.6	3.5	5.1
5	3	Textile yarn, fabrics, made-up articles	2.6	4.1	3.2	4.6
6	9	Clothing	2.2	2.2	2.8	2.5
7	20	Office machines, data processing equipment, parts	2.2	1.4	2.8	1.5
8	8	Parts and accessories of motor vehicles	2.0	2.2	2.5	2.5
9	45	Gas, natural and manufactured	2.0	0.3	..	..
10	15	Artificial resins, plastic materials, articles of plastic	2.0	1.9	2.4	2.1
11	18	Organic chemicals	1.9	1.6	2.4	1.8
12	6	Wood manufactures, paper	1.9	2.4	2.3	2.7
13	5	Cereals and preparations	1.8	2.7	2.2	3.0
14	10	Fruits and vegetables	1.5	2.2	1.9	2.4
15	11	Oilseeds, vegetable oils, oil cakes	1.5	2.2	1.8	2.4
16	24	Aircraft	1.2	0.9	1.5	1.0
17	17	Telecommunication equipment, parts, accessories	1.2	1.6	1.5	1.7
18	37	Transistors, etc. (electronic components)	1.2	0.7	1.5	0.8
19	27	Coffee, tea, cocoa, spices	1.1	0.9	1.4	1.0
20	26	Lorries, special vehicles	1.1	0.9	1.4	1.0
		Total of above	51.3	46.6	..	..
		World trade (market economies)	100.0	100.0	..	..

Source: GATT (1985, 17).

Table 3.9 U.S. Multinational Corporate Presence in International Trade

	Percentage Share of World Exports		Percentage Share of U.S. Geographical Trade	
Year	from geographical U.S.	from multinational firms[a]	Exports[b]	Imports[b]
1957	22.7[c]	n.a.	n.a.	n.a.
1966	17.5	17.7	17.6	11.0
1977	13.3	17.6	26.7	21.7
1982	14.3	17.7	n.a.	n.a.
1983	13.9	17.7	n.a.	n.a.

Sources: Lipsey and Karvis (1986, 29) for columns 1 and 2; Little (1986, 44) for columns 3 and 4.

[a]Including majority-owned foreign affiliates.

[b]Trade between U.S. multinational firms and their foreign affiliates, majority-owned only, it would seem.

[c]1957A figure *x* (1966B figure/1966A figure), where A and B are different classification systems.

of governments. Governments recognize this, too. They have turned to firm-focused performance requirements for which firm-focused favors, such as tax incentives, are returned. Each firm or government conjectures how rivals and other agents will react to its own decisions. Governments, furthermore, are sometimes the owners and indirect managers of firms and may strategically "game" among themselves.

Large multinational firms might seem at first impression to be a force against discriminatory border policy and encouraging to coordinated liberalization of world trade—as influential constituents of many different governments simultaneously, whose flexibility and mobility would be enhanced most by free trade. This can be true but need not be in strategic environments. The Ford Motor Company supports protectionist initiatives in the United States, and Airbus Industries has depended on its sponsoring governments for support; Toyota and Nissan have not clearly suffered from auto voluntary export restraints, especially not in their competition with smaller Japanese automakers. Large firms will sometimes have the potential for influencing (exploiting?) groups without strategic size or power. Krishna (1983), for example, has shown how oligopolistic domestic *and* foreign firms may welcome voluntary export or import quotas. These quotas can facilitate implicit collusion among them, reducing competitive cheating by stabilizing market shares, at the expense of customers. Or, for another example, oligopolistic national firms wanting to avoid potential entry from abroad may be able to convince governments correctly that national economic welfare would indeed be higher with import barriers that protect their market power (Dixit and Kyle 1985). Oligopolistic national firms wishing to initiate entry into some unpenetrated market may be similarly correct to make a national-welfare case for export subsidies.[35]

Mobility of multinational firms and their professional work force also internationalizes ostensibly domestic policies,[36] accentuating their spillovers abroad and provoking foreign pressure for international policy coordination. There is, of course, always *some* tendency for a country's sectoral policies to spill over abroad in mirror-image fashion. But the size of these spillovers is much larger when corporate capital resources are mobile. Most countries' industrial policies, for example, entail corporate taxes and subsidies that encourage some domestic sectors at the expense of other domestic sectors, but also at the expense of the same favored sectors abroad. Alert multinationals may decide that their expansion can be shifted to whichever of their affiliates enjoys the most favorable sectoral policy incentives. Domestic subsidies and taxes can thus easily become instruments of strategic sectoral predation among countries.

It is no surprise, as multinational corporations have increased in size and strategic influence, that domestic subsidies, performance requirements, and unfair trade have become hard bones of contention in the policy environment.[37] The recent claim that strategically calculating policy can shape ("create," "destroy") a country's comparative advantage is correct, after all, where that same policy is capable of moving capital endowments from one place to another, using the mediating facilities of internationally coordinated firms, leaving labor and immobile endowments behind. One country's strategically active sectoral policy in that world can also deter another's from its beggar-thy-neighbor attempts to shift comparative advantage and desirable employment. Passive (more exactly impassive) policy does not have this capability for defensive deterrence. Policy coordination in such a world is an attempt to establish a peaceful equilibrium that may nonetheless be backed up by arsenals of strategic policy weapons!

It is for these reasons easy to endorse the idea that there is unique importance to the Uruguay Round negotiations on subsidies, including revision of the existing subsidies code.[38] At the very least, such negotiations will likely generate sharper definitions of spillovers and agreement on procedural rules (Hufbauer and Shelton-Erb 1984). And it may be timely for substantive rules and full-fledged attempts to exchange request-and-offer lists for reciprocal reductions of specified subsidies that would then be "bound" like tariffs.[39]

The more fundamental question this prospect raises is whether policy should be just as coordinated among governments as corporate planning is among national affiliates. Skeptics about the merits of markets, especially internationally integrated markets, tend to respond "yes." Skeptics about the merits of industrial regulation, especially when centralized on a global (coordinated) scale, tend to respond "no."[40]

Adjustment

Adjustment problems in the economic environment have become arguably more severe in the past fifteen years. Average unemployment rates and excess capacity are higher. Burgeoning, globally integrated, financial markets have created volatile changes in exchange rates, international competitiveness, and goods trade. These changes and the strategic sensitivity of multinational firms to governments and each other have aggravated the stimuli facing workers, farmers, and other owners of immobile resources. Their adjustment problems are made even worse by the potential for substitutability between goods trade and mobile corporate capital. When goods and firms are both internationally mobile, then only slight changes in the economic or policy environment can bring about striking changes in exports, imports, and the livelihood of immobile factors that are tied closely to them (Mundell 1957). To a large multinational firm, moving the goods and moving the plant across borders are close substitutes; they are not to its immobile workers and their unions. Displaced workers and mid-level managers who are unable to acquire or transfer skills useful to alternative sectors face long periods of unemployment and below-average earnings.

Table 3.10 hints at the size of the adjustment problem that might face immobile workers from trade liberalization in today's economic environment. Sector-by-sector employment changes are quite large, even though their aggregate (sum) may be small. They are much larger than similar estimates prepared for the Tokyo Round negotiations in the late 1970s by Baldwin, Mutti, and Richardson (1980, 419).

In brief, immobile workers seem to be saddled with sharper and more frequent unanticipated shocks from international forces than in the past (Grossman and Richardson 1985, 20–23). Some of the agents who represent them are strategically large within countries, although uncoordinated across them, such as unions, regional governments, and Departments (Ministries) of Agriculture. Strategic interaction between them and their own government can lead to indefinite protection—a kind of strategic paralysis of unproductivity.

In this environment the challenge to all policy, national and internationally coordinated, is formidable. Adjustment burdens can be reduced if national policy minimizes the economic hardship to immobile segments of the population, and sensible policy may include temporary and degressive protection (Diamond 1982). But commitment to eventual adjustment seems a necessity, since rational strategic agents will forecast future government action when contemplating a specialized investment. Government commitment to "preservation" makes no pri-

Table 3.10 Percentage Change in Japanese and U.S. Employment by Sector under Trade Liberalization

ISIC #	Sector	% of Change in Total Japanese Employment with Removal of U.S. and Japanese Tariffs and NTB's by Sector	% of Change in Total U.S. Employment with Removal of Japanese Tariffs and NTB's by Sector
1	Agric, Forestry & Fisheries	−50.2%	+96.6%
310	Food, Beverages & Tobacco	+9.4	−4.9
321	Textiles	+18.8	−24.1
322	Wearing Apparel	−1.3	−0.6
323	Leather Products	+0.3	−1.7
324	Footwear	+0.1	−0.1
331	Wood Product	−0.7	−1.3
332	Furniture and Fixtures	+0.2	−0.1
341	Paper and Paper Products	+2.9	−2.0
342	Printing and Publishing	+0.4	−0.7
35A	Chemicals	+4.7	−3.7
35B	Petroleum and Rel. Prod.	−9.5	+0.2
355	Rubber Products	+1.7	−2.2
36A	Nonmetal Min. Products	+2.3	−1.0
362	Glass and Glass Products	+0.4	−0.5
371	Iron and Steel	+26.0	−7.8
372	Nonferrous Metals	+1.3	−1.4
381	Metal Products	+1.9	−2.5
382	Nonelectric Machinery	+5.0	−2.8
383	Electric Machinery	+3.4	−2.8
384	Transport Equipment	+4.2	+1.0
38A	Miscellaneous Manuf.	+13.3	−14.9
2	Mining and Quarrying	+4.3	−2.8
4	Electric, Gas & Water	+2.7	−1.2
5	Construction	−3.2	0.0
6	Wholesale and Retail Trade	−9.3	−12.6
7	Transportation, Storage and Communication	+1.1	−3.3
8	Finance, Ins. & Real Est.	−2.6	−3.4
9	Commercial, Social and Personal Services	−18.7	−2.2

Source: Saxonhouse (1986, 242), combining estimates in Deardorff and Stern (1986) and Staiger, Deardorff and Stern (1986).

vate adjustment the strategic and equilibrium response. Government commitment to unspecified "eventual" adjustment makes waiting the strategic and equilibrium response. Only credible commitment to adjustment makes it possible for anticipations of government reaction to alter ex ante location and allocation decisions.

Yet it is hard for a national government on its own to guarantee credibly that protection is only temporary or degressive. If the conditions that justified the protection continue to exist, the incentives are nearly irresistable for the government to repeat its "temporary" dose at similar intensity, and to repeat it again and again. If strategic agents sense how irresistible this pattern is, they will refuse to believe in the proclaimed temporariness of the trade policy and will remain active in the protected sector rather than exiting. Their continued activity keeps conditions the same as those that warranted the trade policy in the first place and seduces the government to repeat its temporary protection. The sequence then repeats. It should be clear that this cycle represents a strategic equilibrium, a position of rest in which temporary or degressive trade policy is impossible (that is, not sustained by the postulated strategic behavior).[41]

Strategic policy coordination among governments can help alleviate this problem. Under GATT rules, trading-partner governments can already request consultation and compensation when a temporary trade policy becomes permanent. If the consultation/compensation mechanism were working well, then the first government's pledge of transience would become more credible. Private agents would be more likely to exit. Such consultation and compensation have been largely abandoned, however, as have other safeguard procedures under Article XIX of the GATT. This heightens the urgency of safeguard revisions in the Uruguay Round negotiations and explains the possible appeal of a standing "adjustment committee" (GATT Wisemen's Report 1985, 43–44) that would monitor temporary, degressive protection and facilitate international pressure on a government to keep its degressivity credible to domestic constituents. A standing committee with this charge illustrates how an "independent agent" can sometimes help strategic rivals to achieve coordination by making their promises credible, as discussed in section 3.3.1 above.[42]

There are reasons, of course, why trade policy may not be the ideal insulator of an economy from unforeseen shocks, nor the most desirable catalyst for adjustment. A less wasteful alternative for achieving the same goal might be a loan and insurance scheme for worker experience and investment in human capital (Grossman and Richardson 1985, 26), providing benefits (contingent on payment of premiums) dependent on the state of competition from abroad. Under such a program, countries would continue to enjoy the benefits of low-priced imports, and incentives for factor reallocation might be preserved.

Strategic policy coordination could have a role to play here as well, in that some of the beneficiaries from "our" smoother adjustment are "their" firms, workers, and unions who take over the market. These agents might therefore fairly be expected to contribute to the insurance premiums that help fund our adjustment. More exactly, since successful adjustment creates *favorable* foreign spillovers, coordinated international loan and insurance schemes may some day be worth consideration, perhaps financed most easily by a small tax on all international transactions (capital movements as well as trade), or possibly by a more targeted but larger tax on trade surpluses, administered by a GATT standing adjustment committee as described above. Coordinated international loan and insurance programs might also be more resistant than national schemes to moral hazard problems and to "capture" by political forces (e.g., the U.S. government's use of trade adjustment assistance to assuage autoworkers in the late 1970s).

Notes

This paper has benefited immeasurably from the detailed comments of Robert E. Baldwin and Geoffrey Carliner on an earlier draft. It was written as part of the NBER's research program in international studies, but the opinions expressed are my own.

1. So, too, might students of other kinds of international policy coordination; see Cooper (1986) for an instructive linking of public health to macroeconomic coordination.

2. See Cooper (1987, 299–301) or Baldwin (1984b, 5–9) for an account along these lines of the growth of the U.S. Trade Agreements Program. It is easy to forget that the genesis of those agreements was the burden of trade repression during the hostile trade wars of the early 1930s. For the United States, which legislated the infamous Smoot-Hawley tariffs in 1930, the constant-dollar value of trade (exports plus imports) fell 35 percent between 1929 and 1934, almost half again further than real GNP, which fell 24 percent (U.S. Department of Commerce 1976, 324). Overall world trade volume declined 25 percent (GATT 1986a, 31) during the same period.

3. Framers of trade policy are always quite mindful of other governments, as are a few analyses as well, most notably Johnson (1954). Otherwise brief mentions of retaliation, but little analysis, appears in traditional economic commentary.

4. There *are* fundamental insights about policy coordination from analysis of competitive environments, but such analysis nevertheless begs the central question. Traditional competitive analysis can generate the ideas that open international trade is a global public good, that some governments may be tempted therefore to "free ride," and that a country's trade barriers create impacts abroad of the same character as externalities (spillovers). Some sort of mechanism would be desirable to alleviate the public good/free rider/externality problems and seems on the face of it to require international policy coordination. The crucial question being begged, though, is what incentive motivates any one of a large number of competitive governments to create and maintain coordination with others. What "internalizes the externalities"? Perfectly competitive assumptions rule out much of the motivational impetus for policy coordination from the start. If someone protests that in reality a number

of governments are large, not atomistic, then such a protestor has implicitly accepted the need for strategic analysis, perhaps without realizing it, and has also pointed to the kind of strategic bargaining (pricing) that *does* internalize the externalities in the fashion of Coase (1960).

5. See Brander's (1986, 36–43) or Richardson's (1986, 270–74) account, each of which applies to trade policy the extensive research of political scientist Robert Axelrod (1983) on repeated prisoner's dilemma games.

6. The word "surveillance" in GATT parlance entails each signatory's obligations to publish all trade measures, to consult, and if necessary, to participate in dispute settlement procedures. In essence, each member thereby monitors all the others; no central institution does so.

7. In the primitive model of table 3.1, each government agrees that the objective is to maximize its own country's feasible gains without regard to what the other country achieves. Since +3 is infeasible without luck, foolishness, or coercion (a kind of coordination by force), each government prefers +1 to −1 and is attracted to proposals to create coordination devices.

8. The obvious characterization of this objective is "cutting off one's nose to spite one's face." It is an all-too-familiar posture for agents in hostile conflict. Trade embargoes are a good example.

9. Objectives might then seem to be common again, but they are not. "My" goal is the distance between me and you; "yours" is the distance between you and me.

10. See, for example, the Uruguay Round invocation of these principles in GATT (1986b, 3). Camps and Diebold (1983, 55) remark that:

> The approach we suggest is based on reason. . . . But governments are apt to be driven by more immediate aims, by a sense of damage and a wish to rectify matters.

11. The sheer number of participants can matter, too, for reasons described in note 4. Having too many potential participants makes the negotiating environment more competitive, less strategic, and reduces the motivational incentives for each government to contribute toward cooperative initiative. Thus to limit the scope by limiting the number of participants enhances coordination in its own right; choosing like-minded participants enhances coordination further. It is in this light that one can understand why each of the Tokyo Round "codes" for nontariff measures was negotiated by an interested subgroup within the GATT, and why each maintains its own list of signatories—with implicit discrimination against nonsigners. See further discussion in section 3.3.1.

12. The issue of common understanding of payoffs and behavior is discussed further in Cooper (1986) and Holtham (1986).

13. Baldwin (1987) gives a useful account of both principles.

14. Camps and Diebold (1983, 29–30) illustrate this tension nicely:

> The goal is . . . to improve the conditions of international agricultural trade. . . . But there is also a need to protect the rest of the GATT system from the impact of fierce disputes about agriculture . . . [which] can hinder progress on other subjects.

So does the Uruguay Round declaration (GATT 1986b, 2), albeit with the appearance of doublespeak:

> Balanced concessions should be sought within broad trading areas and subjects to be negotiated in order to avoid unwarranted cross-sectoral demands.

15. See Keohane (1984) for an extensive discussion.

16. One might think of this as the "bad-ideas-are-better-botched" principle.

17. See Oudiz and Sachs (1984) for an approach to this question for macroeconomic policy coordination.

18. Parenting offers many illustrations. So does the discussion of how "constitutions" come about and what they contain, as applied to trade policy notably by the late Jan Tumlir (1985) and Banks and Tumlir (1986).

19. Proponents of free trade and skeptics about the virtue of coordination of course argue that this schizophrenia is "good." See Price (1986) and Goldstein (1986) for descriptions of these different constituencies and their influence on U.S. trade policy. Destler (1986) contains an excellent up-to-date evaluation of U.S. internal coordination of trade policy.

20. Baldwin (1986a) and Destler (1986, 42–47) provide informative perspectives on the material in this subsection.

21. Again environmental changes can be seen to interact with each other. The convergence in per capita income among the countries in table 3.4 encourages especially the growth of intraindustry trade, based on product differentiation, variety, and scale. These characteristics often engender imperfectly competitive market structures and significant reshufflings of narrow product "niches" among firms as technological change and other shocks occur, with consequent volatility for immobile factors (see section 3.3.2 below).

22. Baldwin and Richardson (1987, 143) list several reasons why trade policy coordination among coequal governments might be just as stable as hegemonic coordination. They also mention, however, that it suggests different "styles" or "tactics" of trade policy for all the participants.

23. See the discussion of hostile environments in section 3.2.1.

24. See Richardson (1987a, 289; 1986, 97). See also Destler (1986, 48–49), who remarks that

> . . . [S]ince the new competitors were slow to assert leadership in multilateral trade negotiations, there was a growing divergence between the loci of trade-political activism and trade-economic power.

A similar reasoning underlies the observation that the United States still has strong leadership to *preserve* present trade policy coordination by refraining from hostile and/or uncoordinated initiatives, yet has lost leadership power to *advance* coordination. See Baldwin and Richardson (1987, 123–24), for example.

25. The GATT has never technically "been" an "institution" at all—only a "compact with signatories"—unlike the IMF with its executive directors, standing committees, rules of order, and representation of membership.

26. For descriptions of implicit coordination in the context of oligopoly and trade policy, see Friedman (1977), Jensen and Thursby (1983), Rotemberg and Saloner (1986), and Lambson and Richardson (1987).

27. On an industrial counterpart to these issues, see Lambson and Richardson (1987). One among several conclusions they draw for the case of price-setting supergames is that symmetry among firms stabilizes implicit collusion, making "punishment" shorter and less likely, compared to slightly asymmetric configurations of firms.

28. They seem to be a more meaningful way to measure the relative importance of administered intervention than alternatives, such as tabulations of the share of trade affected in some fashion by nontariff barriers. See Balassa and Balassa (1984) and Nogues, Olechowski, and Winters (1986a, b).

29. Each is playing a rational strategy for an "end game," as illustrated, for example, by Lawrence and Lawrence (1985). An end game is one in which a future equilibrium is known, in this case cartelized industrial structure, and agents choose optimal strategies for approaching it over time.

30. Curzon and Curzon (1985), for example, recommend that the (fair) traders within the GATT form a coalition that aims at a free trade area that would "eventually" cover "substantially all" trade, thereby attaining consistency with Article XXIV, and isolate the non (unfair) traders.

31. "New" multilateralism is the term used by Camps and Diebold (1983). "More-Favored-Nation" treatment is a term suggested by Thomas O. Bayard.

32. See Stern, Jackson, and Hoekman (1986, 6). This paper is a thorough evaluation of the operational features of the codes, although not their economic effects or legal standing.

33. Liberalizing coordination is, however, a logical future step, involving probably "trade in concessions across Codes"—accession by one country to one code in return for accession to another by another, forgoing insistence on some provision in one code for a rival's concession in another code, and so on.

34. Ambiguity can sometimes be a bargaining strength. See, for example, Dixit (1987, 274).

35. See Brander's and Spencer's contributions to Krugman (1986) and other work referenced there. These examples are from the new analytical thinking on trade policy in strategic environments, also surveyed by Grossman and Richardson (1985) and Richardson (1987b).

36. This is the twin of the observation that trade policy has become increasingly "domesticated," drawn, for example, by Ahearn and Reifman (1984).

37. Camps and Diebold (1983, 22) illustrate this when they write that:

> one of the basic principles that we think should guide the new multilateralism . . . [is] that the international community has a legitimate concern with domestic actions when they have important external effects.

38. Camps and Diebold (1983, 39) comment that:

> It is no exaggeration to say that the damage will ultimately lead to the collapse of the system of cooperation unless better ways are found to deal with the conflicts among national industrial policies.

Policy coordination on subsidies and countervailing duties is also near the top of Canada's list of reasons for pursuing bilateral trade liberalization with the United States.

39. Baldwin (1986b, 28–34, among other places) outlines a detailed plan for such negotiations in which modalities from historic rounds of tariff liberalization are adapted to subsidies. One reason this makes sense is the inherent (admittedly complex) measurability of subsidies as compared to more administrative intervention, hence their susceptibility to coordination by rules (see section 3.2.2 above).

40. Many economists believe that policy competition among governments exercises a healthy discipline on costly abuses of their regulatory powers. The framers of the United States Constitution ambiguously reserved to Congress the power "to regulate . . . commerce among the several states" (Article I, Section 8.3), implicitly excluding state governments from coordinating interstate trade policy, yet nevertheless reserving the authority to do so for a centralized body.

41. This policy problem is known technically as time inconsistency—this year's optimal value for next year's policy intensity will no longer look optimal when next year rolls around. The same problem can afflict all temporary policy. See Staiger and Tabellini (1986) and Feenstra (1986) for further applications of the idea to trade policy.

42. The same reasoning underlies the independence of a central bank from political forces and accords the IMF, or a new intermediary, an independent role in helping debtors' promises appear credible to creditors.

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2. *Robert S. Strauss*

Current Issues in U.S. Trade Policy

In response to the comment about the Europeans not being fully represented, after listening to Helmut Schmidt yesterday, I would say that the Europeans were in fact a bit overrepresented. As was to be expected, Helmut was impressive enough and strong enough to last for two days and thoroughly presented the European position.

This morning, when I was thinking about addressing this group on the subject of trade and economic issues which each of you know so much about, I was reminded of an incident that happened to me several years ago when I was testifying before the Senate on trade issues. In the question-and-answer session, one senator was not only addressing me but also perhaps lecturing me a bit on negotiations, in particular on how to negotiate with the Japanese. Senator Hollings interrupted and told this story, which is a bit crude but also relevant and amusing, and you will forgive me if I relate it to you.

Senator Hollings noted that our colloquy reminded him of a story about Jesse James, the old bank robber. As Jesse and his gang held up a Texas bank, they got everyone out and put the men on one side of the room and the women on the other, and Jesse said to them, "Now, if you'll just behave, nobody's going to get killed. We're going to take the valuables, the guns, and the money from the men, and then we're going to ravish the women, and we're going to leave quietly. No one will be killed." And with that, one of the men spoke up and said, "Now wait a minute, Mr. James, you can have our money and our valuables, and you can have our guns, but you can't put a hand on our women." In response, a woman over on the other side spoke up and said, "Now, Fred, don't go telling Jesse how to rob a bank." In speaking to this group on trade and economics, I feel as if I'm telling Jesse how to rob a bank.

But let me get started.

I've been asked to cover a number of things, including an overview of where we are and where we're going in the current round of trade negotiations, and to talk a little bit about the Tokyo Round of trade negotiations and relate that to the real political world and what's currently going on in the United States with respect to trade.

It occurred to me while I was making my notes for this talk that I could open and close by saying that trade relations today are characterized by a great deal less multilateralism, more bilateralism, some minilateralism, and a great deal of ill-thought-through unilateralism. That would just about summarize what I have to say on the issue of trade. More seriously, however, let me begin by talking about trade negotiation.

To be honest, when President Carter asked me to take the position of Trade Ambassador, I wasn't sure whether this was a good decision. Did it make sense to ask a fellow who had absolutely no background in international trade matters, but whose background was in law, politics, and negotiation, to be Trade Ambassador? At the time, I thought it was a questionable decision and, frankly, I was concerned when I accepted the responsibility because of my lack of expertise in the field of trade. I might add, of course, that a great many others were also concerned.

In retrospect, I believe it was a very good decision in terms of the type of person he chose. And I'm not talking specifically about myself, Bob Strauss, but rather about the type of person that the job really requires. Because as I became involved in the Tokyo Round negotiations, it became readily apparent that someone who had skills in moving the political process was needed a great deal more than a specialist in international trade issues and problems. And frankly, the skills that were necessary in that particular negotiation, insofar as the political process was concerned, just couldn't have been acquired or mastered in time to get through a very troubled Congress. With the help of a first-rate staff, I was able to deal with the substantive issues.

Protectionism in 1977–78, you will recall, while not in the shape it is today, was serious and the fires were raging. We were talking about protectionism in terms that we had not talked about since the days of Smoot-Hawley. The country's trade policy was under some attack, and I can assure you that good trade policy can only exist where there is a political consensus to support it. When I came on the job, there was no political consensus for the Tokyo Round or for a progressive, sensible trade policy for the United States. Therefore, the first thing we really went about doing was to fashion a consensus on the importance and goals of U.S. trade policy.

My first months on the job were spent in doing two things: one, trying to learn the trade issues; and two, going around the country, personally and with members of my staff, to hundreds of congressional districts and media centers, telling the story of America's self-interest. That's what trade really boils down to in the United States. What really drives the political process on trade and what we had to get across was the self-interest that people around the country—politicians, labor leaders, businessmen, farmers—really had in the trade negotiations.

It took that same kind of approach to entice our trading partners back to the table in a real negotiating posture. The Japanese, particularly Prime Minister Fukuda, were committed and supportive of the Tokyo Round negotiations, but the Prime Minister wasn't prepared to really get in front and lead the charge. The Europeans were reticent and hesitant, with the French openly hostile to many of the positions and goals we had outlined, as they are today. They were particularly concerned with what might happen to the common agricultural policy and other programs. But after much work, we were able to get everybody to the negotiating table and begin the process.

The key in moving the negotiating process forward was the strong leadership exercised by the various heads of state. I am deeply concerned that one thing that was present throughout the Tokyo Round, that is not present today as we begin the Uruguay Round, was a deep commitment by the leaders in each country to the trade negotiations.

During the Tokyo Round, Fukuda, Schmidt, Callaghan, and Carter were each committed to an aggressive trade negotiation. Moreover, these leaders also understood the issues thoroughly and were able to talk about these issues among themselves and were comfortable in discussing them with their various constituencies.

Let me just give you an example based on my relationship with President Carter. As far as President Carter was concerned, within an hour after a phone call I could get into the Oval Office and tell him that he needed to speak with Fukuda or with Schmidt, for example, on an intractable problem that we just couldn't move the negotiators on. His ability and willingness to pick up the phone, again within a very short time period, and have a responsible, in-depth, substantive conversation with the Prime Minister or Chancellor or whoever, was a tremendous help and we never would have been successful without that. I would also add that Mike Blumenthal, who was deeply involved in the Kennedy Round as Secretary of the Treasury, was committed to the negotiations and was a strong force in the Carter Administration as were Cy Vance and Richard Cooper at State.

Unfortunately, we don't have that type of strong network right now. Clayton Yeutter doesn't have that kind of support, and I see no reason to expect that his successor, whether he be a Democrat or a Republican, will have that support. I am also not certain that the support that Chancellor Kohl or Prime Minister Thatcher has given, or might give, is in any way comparable to what their predecessors gave. And that is unfortunate because, if nothing else, to complete a meaningful multilateral negotiation with all the attendant problems, you must have strong leadership and support for that leadership in each of the main countries. You cannot successfully complete trade negotiations with ministers or cabinet officers nibbling around the edges of the problem. In today's climate, the world needs heads of government who understand the issues in depth and who are willing to break them down and put their muscle and their political power behind efforts to solve seemingly intractable problems.

On a positive note with respect to the Uruguay Round, let me say that I think a great many people sold Ambassador Yeutter short. His predecessor, Bill Brock, commanded respect on the Hill, in the press, and with our allies and trading partners. I think Brock could have had a trade policy for this country had he had an Administration that focused on one. Yeutter came in with a good deal less going for him, and the outlook was pessimistic. I can assure you, however, that he has his hands on the controls. You can agree or disagree with certain actions, but he has launched the Uruguay Round much better than most observers ever dreamed he would be able to do. He deserves great credit for it, and I know his colleagues around the world have been cooperative and respect him. Within the government, he has had good support from Secretary of Commerce Baldrige and Secretary of Agriculture Lyng, but really little else to lean on.

As for specifics, I think the Uruguay Round has a very good chance of making progress in some very needed areas. For example, Yeutter and company have done a splendid job of kicking off the process in the area of services. He has gotten countries that I never thought would be interested, such as Brazil, involved in the process. With respect to agriculture, the problems are intense, but I think there is reason to believe they can make some progress. During the Tokyo Round we just couldn't move any further on agricultural subsidies or very far on subsidies in general, because the time wasn't right and the only thing I could say when we signed off was that we'll be back another day. Agriculture still needs a lot of work, but I think they can now make some progress in the area of subsidies generally because the timing has improved. All in all, I think we have reason to hope that over the next three to five years something positive will come out of the Uruguay Round.

Moving on to the issue of the U.S.-Canada Free Trade Arrangement, I think it's worth noting that everyone in Canada, as some of you know, is well aware of the negotiations. It's a key political issue. In the United States, however, I don't think anyone knows that the negotiations are going on, including two-thirds of the members of Congress. The fact that we're engaged in these negotiations really has been one of the few things that hasn't leaked out of this Administration.

For Prime Minister Mulroney, the successful conclusion of these negotiations is essential to his political career. Mulroney has staked a substantial portion of his political prestige on the fact that we told him that a U.S.-Canada trade agreement was a wonderful thing. And then we promptly lost interest in it on this side. In the United States, much of the burden of sustaining and supporting the negotiations has shifted to the private sector. Fortunately, important members of the American business community, such as Ed Pratt and Jim Robinson, have stepped in and initiated a private sector effort to try to build a bit more of a fire under the public sector, especially the Congress, to see if we can build a political consensus in favor of a balanced agreement.

Let me now talk a bit about the impact of the political process on trade issues. In my opinion, if we can make the political process begin to function again effectively between the Congress and the Executive Branch, then we can begin to grapple seriously with some of this country's trade and monetary problems. Otherwise, we will be unable to cope effectively with the problems facing us in international trade and the forces that continue to erode our competitive position in the world.

Unfortunately, over the past few years the political process hasn't worked at either the domestic or international levels. Without effective coordination between the political parties in this country or between our government and the governments of our main trading partners, there cannot be any public support for good trade policy. In the absence of public support, there is a void, and the result more often than not is bad trade policy. I'm sorry to say that we've seen more and more of that in recent years.

For example, while the Administration has been strong and effective in many areas, the White House has been a nonplayer in the field of trade despite the efforts of Brock, Yeutter, and Baldrige. Policy vacuums don't last for long in Washington, and the House of Representatives moved quickly in 1986 and passed a bad piece of legislation. Fortunately, nothing came of it. In 1987, the Administration has continued to resist protectionist legislation but has resorted to a series of ad hoc measures which have done little to remedy the country's trade position and even less to improve trade relations with our allies.

With respect to the political climate, and I mean no offense to my Japanese friends, I'm afraid the Japanese share much of the blame for their inability, not altogether their unwillingness, but their inability and unwillingness to deal with some of the problems their trade practices and trade surplus create in this country. I think Japan's inability to stem the trade costs borne by the United States has led directly to the sharp erosion in this country's support for a good trade policy. In my opinion, we've gone overboard on Japan bashing and retaliation, but the Japanese have responded poorly to the problem. I am seriously concerned that what we are dealing with today is far bigger than beef, citrus, autos, or semiconductors, because what we are talking about is the basic Japanese-American relationship. This relationship is precious and important to both of us.

Given this setting, it is essential that the West's leaders take charge, consult regularly, and work together to resolve the principal conflicts that threaten to seriously undermine world trade. On the domestic front, it is essential that the U.S. government articulate effectively to the American public the importance of the Uruguay Round. Trade must be emphasized as a top priority. That means, of course, that the United States must face up to the underlying economic fundamentals that lead to trade crises. The only real way to address Japanese procurement problems and European agricultural problems is for the United States to candidly recognize that a principal culprit of the country's trade problems is our own domestic economic policy. While it may be politically very pleasant to blame the trade deficit on foreigners because foreigners don't vote, we're not going to solve the trade problems until we've come to grips with our macroeconomic policies. Foreign unfair trade practices may be a part of the U.S. trade deficit, but they are certainly not the major cause.

So how do we come to grips with these macroeconomic policies? Those of you here today understand the problems better than I do, but in my opinion we're not going to deal with them until the public is ready to, and I don't know when that's going to happen. U.S. politicians of both parties are guilty of not keeping the American people fully informed of the difficult choices that face us. It's easy to talk about dealing with the budget deficit and how we can go about reducing it. Unfortunately, our meager efforts have generally stopped there. When the leadership of the country goes to the American public with an honest assessment of where we are, what our problems really are, and a sensible strategy to deal with them, they will find support. Until then, there will never be a political consensus to deal with the subject.

The White House and the Congress must level with the American people on the economic steps that must be taken to restore a semblance of balance to the country's fiscal policies. The budget deficit remains an intractable issue, largely because there is a lack of political will to deal with it firmly. With Congress distracted by trade issues and the Iran-Contra affair and the White House trying to salvage a presidency, there is little hope for action on the federal deficit in 1987. There is even less likelihood of decisive action being initiated in 1988 in the middle of what should be a hotly contested presidential election campaign.

Unfortunately, neither the U.S. economy nor the world economy can afford to wait for the American political system to sort itself out. The United States cannot afford to go on being dependent on foreign capital to finance our excessive spending. Any moves to cut this dependence, however, must be made very carefully, as the world economy cannot afford a U.S. austerity program. The problems we face today simply will not go away without firm leadership and decisive policies.

Without being overly pessimistic, it is worth recalling that the U.S. deficit has continued to grow during a period of near record economic growth. If U.S. policymakers cannot manage the budget when things are going well, what will happen when the cycle turns down? In my opinion, it is absolutely essential that policymakers stand tall and put the country back on a sound economic footing. Not only is a large federal deficit unhealthy in economic terms, but in political terms it reflects a weakness in leadership that is equally damaging. Therefore, it is important that we not squander opportunities to make real progress in dealing with the broad range of interrelated economic and trade issues.

That is why I strongly believe that it is important for the Uruguay Round to be successful. The world cannot afford to pass up this golden opportunity to deal with the serious trade problems confronting us.

In summary, I would like to relate a few of the broader lessons I have learned from my experience in the public and private sectors.

One: On trade and other international economic issues, the Executive Branch must speak with one voice. International economic policymaking must receive the personal attention of the President and his White House advisors. I can't emphasize this point enough. No foreign nation will take our policies and negotiations seriously unless they believe that the President is personally involved in the process.

Two: The search for new ideas is a phrase that has become meaningless. The search for new policy ideas or clever strategies is not a substitute for effective action. Trade policy in particular has been the focus of significant study and great rhetoric during the past few years. The country's trade position, however, has continued to deteriorate. We must no longer postpone action.

Three: Neither the Congress nor the Administration can make good trade policy or economic policy on their own.

And four: Partisan policy generally equals bad policy. I've addressed the need of forging a political consensus on trade. As Trade Representative, I worked closely and constructively with leaders of both parties. Broad bipartisan support was essential to the drafting and almost unanimous passage of the 1979 Trade Agreements Act in both the House and Senate.

In conclusion, it is vital that politicians and governments recognize that the way out of the present trade morass begins with a commitment to deal honestly, and, I might add, bluntly, with the political and economic realities faced by each country. No country can go it alone, and no country can solve its own problems without an understanding of the problems faced by others in the world. Further, to deal with trade disputes requires that the political process at both the domestic and international levels function effectively, leading to political consensus. In democracies, it is only through the political process that successful and lasting compromises can be achieved and, once achieved, maintained. Our problems were not created overnight, and there are no overnight quick fixes. But we can succeed over time with persistence. The people in this room today have a responsibility to lead that effort.

3. *Michihiko Kunihiro*

International Trade Policy and Trade Negotiations

International trade today is confronted with three major problems. They are: (1) inordinate trade imbalances between major trade partners, (2) instability in exchange rates, and (3) growing debts of developing countries.

International trade has provided incentives for economic growth, but it may now function to hamper economic growth if we fail to address these problems effectively.

Inordinate Trade Imbalances between Major Trade Partners

The huge trade imbalance between Japan and the United States is now called "intolerable" and is even described as a "threat" to the free trade system. We can mention a number of factors that have brought about such a huge trade imbalance. Among them, I believe, the insufficient coordination in macroeconomic policies between the two countries is most responsible.

The Ushiba-Strauss Communiqué of 1979 dealt with this aspect, but the U.S. negotiators in the present Administration showed little interest in discussing macroeconomic policy implications until recently. Perhaps they were not inclined to be involved in demand management, or perhaps they were wary that the Japanese negotiators might divert the issue from market barriers.

The U.S. Congress now seems serious about reducing the budget deficit, even if the Gramm-Rudman-Hollings requirement seems increasingly unattainable. It would be helpful if Congress succeeded in convincing the world that further budget deficit reduction would be in train for years after fiscal year 1988.

Japan has for some years been engaged in a historic task of restructuring its government system. It was expected to reinvigorate the private sector by deregulations, cuts in subsidies, slimming the government agencies, and so on. But the resources made available as a result of these endeavors have been absorbed by another urgent national endeavor: the reduction of the government debt. Under these circumstances, the Japanese trade negotiators were not in a very convenient position to launch macroeconomic arguments forcefully. The deflationary effect caused by the recent yen appreciation is now prompting Japanese policymakers to try more seriously to expand domestic demand. The Paris meeting of G-7 last February helped to change the current. The immediate question is what measures Japan will be able to announce after the 1987 budget bill has passed the Diet.

The EEC has been more consistent in bringing up macroeconomic issues to Japan, although I am not well informed about how the issue has been addressed between the EEC and the United States.

Instability of Exchange Rates

Since the Plaza agreement, we have learned something more than the classic J-curve effect; the rampant fluctuations of exchange rates paralyzes business by making planning and decision-making extremely difficult.

A sizable appreciation of the currency forces structural adjustment to the economy. But, the repeated fluctuations hamper necessary investment decisions, precipitating the deflationary effect caused by the currency appreciation.

On the other hand, an excessive depreciation of the currency delays industrial adjustments, entailing much greater difficulties when industry eventually faces the need for the structural changes necessary to remain competitive.

The flexible exchange rate very often produces overshooting, but we have not found a feasible, better alternative.

It is agreed that better coordination of economic policies among major countries provides a base on which the stability of exchange rates can be sought. The policy coordination efforts envisaged in the Tokyo Summit declaration led to the Baker-Miyazawa talks in October 1986 and the Paris talks in February 1987, but it is yet to be seen how much each country will be prepared to bend its domestic policies for the sake of exchange rate stabilities.

The Growing Debt of Developing Countries

The retreat of heavily indebted developing countries from international trade is causing serious difficulties not only to those countries themselves but also to industrial countries, particularly the United States. The most urgent need is to alleviate the debt service burden of the most heavily indebted countries, but they must undergo growth-oriented structural adjustment at the same time to diversify export income resources and to strengthen domestic supply bases. We should not forget that the real key to the solution is to increase their export capabilities.

On the part of the industrial countries, they should aggressively promote structural adjustments so that they can provide more markets for products from developing countries. Here again, better coordination between domestic economic policies and trade policies bears particular importance.

The Erosion of the GATT System

As reviewed so far, the measures required to deal with the three basic problems in today's international trade are closely related to, and require adjustments in, domestic economic policies. But, in addition, international trade policies must assume their own responsibilities.

The basic framework of the postwar international trade policies has been the GATT. Indeed, it has been instrumental in bringing about the development of international trade, which has helped the world economic growth. But the function of GATT has eroded over the years. While not an exhaustive list, here are some examples of what I mean:

a) frequent resort to the so-called gray measures, such as voluntary export restraint agreements;

b) diminishing effectiveness of the dispute settlement mechanisms;

c) recourse to countertrade requirements by developing countries;

d) inability to deal with agricultural issues;

e) lack of authority in dealing with services and other "new" issues.

These matters are of vital importance and warrant an early start of the Uruguay Round.

Worrisome Trend in Bilateral Trade Negotiations

The Uruguay Round, however, will take a few years to conclude, and a major trade bill will, it seems, pass the U.S. Congress in a few months. Perhaps it is too early to predict the final shape of the trade legislation, but we are concerned that whatever may happen in trade statistics and trade negotiations in the coming weeks and months will affect congressional decisions on U.S. trade policy. It is a right moment, indeed, to look back on what has been happening in trade negotiations in recent years.

Fair Trade

I shall start with the "fair trade" issue. In my memory, it was during the course of the 1984 election campaign that the U.S. Administration began to juxtapose "fair" with "free" in pronouncing its trade policy. The policy sharpened its edge on September 23, 1985, when President Reagan announced his new trade initiatives. There should be no objection to seeking fairness in international trade. But the basic problem of the U.S. approach is the fact that the USTR who negotiates to correct "unfairness" is also authorized to determine if "fairness" is achieved or not. He is even authorized to determine how much countermeasure will be necessary to restore "fairness." In the eyes of foreign trade partners, this procedure is "unfair" in itself. They insist, therefore, that the issue should be dealt with in accordance with the GATT.

The U.S. negotiators complain that the GATT procedure takes too much time. It is true. We should strengthen the dispute settlement function of the GATT. By nature, the countermeasure to restitute "unfairness" will not offer compensation. This makes it all the more necessary to place the whole procedure under the GATT discipline. As the U.S. Administration frequently wields Section 301 against almost all major trading partners, the American public gets the impression that everybody around the United States is unfair and develops an antagonistic attitude toward major trading partners. Another concern is that Section 301, especially if its retaliatory threshold is further lowered, will become "Cheap 201" or "backdoors to protectionism." Section 301 will then serve purposes for which it was not designed.

Voluntary Export Restraints

Another method used to circumvent the GATT scrutiny and the burden of compensation has been the "voluntary export restraint" (VER). At an early stage, it had the merit of limiting the damage of trade restriction to one or two exporting countries, rather than subjugating all trade partners to a nondiscriminatory import restriction that might otherwise have been applied. The VER is also a quick fix, isolating the restriction in a particular sector, avoiding a general protectionist policy. On the part of the exporting countries, the VER has the merit of cartelizing exporters to their own benefit.

Since then, the VER has proliferated in terms of both products and countries involved. Although it always starts as a temporary or even an emergency measure, the VER has an intrinsic nature of perpetuation. The textile agreement does have reluctant GATT blessing and is subject to GATT discipline, if only nominally, but almost all other VERs are short of transparency and GATT discipline. As the VER become a mainstream type of trade restriction, rather than an exception, third-party countries become concerned about its adverse effects on them.

The automobile is a case in point. The U.S. Administration maintains the position that it no longer asks for the restraint, but the congressional reaction will be more than obvious if Japan terminates the VER on autos. Under the present circumstances, Japan has no other choice, and yet the Japanese auto industry is blamed for opting for restraint to maintain higher prices. The fact is that the industry wants to discontinue the restraint because the industry is keenly aware that idling on the quota system erodes its vitality. The EEC, on the other hand, claims that Japan's VER agreement with the United States is shifting Japan's auto exports to the EEC market. Actually, in the U.S. market, Japanese auto exports may have reached a saturation point in view of the increased supply from Japanese factories inside the United States and the price effect of the yen appreciation. But it is the political heat in the Congress that is preventing Japan from terminating the VER at this juncture.

At any rate, the VER needs a thorough review, and it also calls for a review of the GATT safeguard mechanism.

Industrial Overproduction

It seems GATT is confronted with the new situation of industrial overproduction as a result of the worldwide industrialization helped by technological development. We see such a trend in textiles, steel, shipbuilding, semiconductors, and so on. To cope with the textile overproduction, the Multi-Fibers Agreement was introduced, but there is a growing discontent about it on the part of the developing countries.

For steel, both the United States and the EEC formed de facto international cartels on their own. As regards shipbuilding, the OECD has been trying for an informal coordination whose effect is not altogether clear. Perhaps the waning of traditional shipyards in countries, including Japan, may be the inevitable eventuality as far as export is concerned.

At one stage, a U.S. official suggested that we should refrain from extending the EX-IM credit to finance a new steel mill in Korea because the whole world is suffering from excess capacity. Was it a right approach? Even if it were, what should we do about other industries where the catching up of newly industrialized countries is bringing about excess facilities?

The semiconductor gives us a very perplexing problem. For the moment, Japan concluded an ad hoc agreement with the United States to deal with today's singular situation, causing a great deal of displeasure in other countries, particularly the EEC. It seems that much of the problem derives from the fact that Japan invested too much in the new chip facilities. Whether the estimate of the Japanese industry on the future demand was right or not, the fact remains that the increased production of more efficient semiconductors at very low prices will be possible by means of a comparatively small amount of investment and with relatively simple skilled labor, probably in many countries other than Japan. Can we stop it? Should we?

Other high-tech products may follow suit. A few highly educated scientists and gifted entrepreneurs in developing countries can start a business, possibly in joint venture with foreign firms, with facilities purchased at a relatively low cost and with standardized labor locally available, and produce products that will be able to compete well with those from industrial countries. Isn't it a dream-come-true story for many developing countries?

Yes, but the industrial countries don't know for sure yet what to do with this new situation. One orthodox answer is for the developed countries not to do anything but endeavor toward higher technological progress. A pragmatic approach might be to authorize importing countries to limit imports of that kind of product to a certain level, for example, 25 percent of the domestic consumption, while prohibiting any restrictive measures below that level. Of course, I support the former approach, but one might argue that the latter may be better than all the mutual recriminations and threats of destroying the world trading system that we are experiencing these days.

In any event, we should always bear in mind that the whole purpose of international trade policy is economic growth of *all* countries. The trade policy advocated by leading industrialized countries should not have the effect of denying industrial growth to developing countries.

Agriculture

Another situation of overproduction with which international trade policy is confronted is in agriculture.

It is mainly the product of heavy subsidies in developed countries, particularly the EEC and the United States, although technological progress also accounts for it. The increasingly heavy agricultural subsidy is imposing an unbearable budgetary burden in both the EEC and the United States. It is rendering damage to farmers in countries like Australia, New Zealand, and Canada. It is also causing distortion in agriculture in developing countries. We should urgently discuss some concerted actions, first to freeze the subsidy level and then to reduce it progressively.

The budgetary constraint will work as leverage for reducing subsidies, but our attempt should go further than overcoming the budgetary difficulties, because otherwise we would not achieve much more than a standstill.

The immediate problem in the agricultural trade policy is the export subsidy, but it may be difficult to discuss the export subsidy entirely separately from agricultural subsidy in general.

It is often said that, in agricultural policy, every country is a sinner. It may be that, all for political reasons, none of us will be able to save ourselves completely from this sin for a long time. For all practical purposes, we may have to work out agricultural trade policy on that premise. If so, we had better admit it and try to agree on a common rule that is different, to the extent necessary, from the one applied to industrial goods. In the particular case of agricultural trade, I am personally inclined to lean to the "minimum access" approach as suggested in the GATT study.

Reciprocity

Finally, we should touch upon the reciprocity issue. It is natural that we insist on reciprocity as a general guiding principle in trade negotiations. But what we should go after is reciprocity in opportunity for overall trade benefit. If we demand reciprocity on a sectoral basis and retaliate when the sectoral reciprocity is not given, the spiral of retaliation will lead to contraction in the total trade.

The so-called aggressive reciprocity on a sectoral basis is advocated for the reason that otherwise the importing country that maintains trade barriers would not feel compelled to eliminate them. But the recent argument pronounced by U.S. negotiators on some of the issues sounds more emphatic on countermeasures than mutually opening the market. The remedy, if necessary, should be sought in accordance with Article XXIII of the GATT.

International trade is experiencing its most crucial year in the postwar era. In my view, the realignment of exchange rates has already produced a definite change in trend, only it does not show up in statistics in U.S. dollars. Japan's real GNP growth last year was sustained by the contribution of domestic demand making up for the negative contribution of external demand. It will be a matter of another few months when we will see a marked improvement in the international trade balance also in U.S. dollar figures.

What I am very much worried about is the growing impatience in the Congress and the irritated attitude of the U.S. trade negotiators. On the part of the Japanese, many are feeling they are being penalized with the appreciation of the yen because their industry is suffering from heavy loss of profit and increasing unemployment. But they should take it to heart that just enduring the yen appreciation is not enough. I think the experience in the past year and a half has made the Japanese realize that, unless they import more, they will have to face a stronger yen which will inflict damage on Japanese industry.

And yet the U.S. Congress appears to be intent on "tough" legislative actions and urging the Administration to take further "tough" actions on Japan, and perhaps on a number of other countries with which it has a large trade deficit as well. The rhetoric used is even assuming the sound of vengeance. Policies like this will in the end have an effect of antagonizing America's trade partners who are, in fact, time-honored customers of American products. Indeed, we are at a very crucial moment when we all should see the whole problem in its true perspective.

Note

Opinions expressed in this paper are the personal opinions of the writer.

4. Edmund T. Pratt, Jr.

Changing Realities: The Need for Business-Government Cooperation

When Marty called me a number of months ago and asked me to come down here, my first reaction was that he probably had the wrong Pratt. Plain old businessmen like myself are not usually invited to august sessions of economists and former government leaders and the like. As a matter of fact, I haven't even been to a summit meeting!

And it's a little strange, when you stop to think about it from the businessman's point of view, that you don't find more of us represented at sessions like this. We could argue that the macroeconomic policies, debt concerns, and financial arrangements that are under consideration are primarily concerned with creating an atmosphere in which business can flourish or fail to flourish.

Therefore, after a little thought, I agreed to come—with some trepidation. And I have to say, I'm much appreciative for the invitation. I thought the debates and discussions yesterday were very, very revealing and interesting and, therefore, very helpful and important to me.

As I thought about it though, the idea of getting more businessmen involved in these discussions, although it's rational, may not be as good as our old policy. Under that policy we left issues like those discussed during this conference to the academics, governments, and bankers and then complained like heck when they blew it.

As a matter of fact though, I think it is fair to say that the business community has come a long way from earlier days when we relied on that strategy. The Business Roundtable, the NAM, the Chamber of Commerce, and all the various business organizations over recent years have made landmark changes in the way the business community approaches our relationship with other policymaking members of society. Perhaps one of the most critical things that has happened in the business community during my membership is our realization that all members need to be more involved in policy issues that impact us. If there is anything more critical to our country during an age of keen world competition, it is the fact that our competitiveness depends on better integration and cooperation with academia, government, and other elements of our society. We in the business community have the resources now to join in these debates and have been trying to influence policy.

I would like to follow up on Mike Blumenthal's comments and provide another businessman's perspective on how major U.S. companies like ours approach discussions on such policy issues as trade and investment. A little bit of background may be interesting and necessary to help understand how we approach the current debates.

Most of the major U.S. companies, indeed, I guess, in the world these days, are multinational companies. I've been a part of two of them. I spent the first half of my career with IBM and the second half with Pfizer. Our company, like Mike's, could well be considered a classic multinational company. Two-thirds of our employees are located outside the United States. We have about 160 manufacturing plants, two-thirds of those are outside the United States. Roughly half of our sales and somewhat less than half of our profits come from operations outside the United States.

And why is that? Why did companies like Pfizer and IBM over the last thirty or forty years aggressively go abroad and become part of the local communities rather than staying at home and exporting, which really would have been much simpler. We try to explain this to our tax people, and they say we did it for tax reasons. As a matter of fact, we did it for a very simple reason—it was the only way we could do business. We had currency problems in those days, and we had balance of trade problems, too. Almost every country in the world, when we started strongly going abroad from America in the years after World War II, had inadequate dollars to pay for our products. We would have been nowhere had we not found a way to solve that problem, not by negotiation but by unilateral reaction to the conditions from the businessman's point of view.

As a result of that, we now find ourselves with operations in nearly every country, in nearly every currency in the world. And we are therefore affected in a different way than those organizations that depend on trade and the relative balance of exchange rates to determine whether they can sell their products or not. We have effects from changing currency values, but they are more accounting effects than "ability to sell" effects.

An interesting figure that opens most Congressmen's eyes is that approximately 80 percent of all manufactured American export goods are done by multinational companies. And approximately 40 percent of all U.S. manufactured goods actually are exported to the foreign-owned subsidiaries of American companies.

These figures begin to give you the feeling of what the "trade" situation really is for many of us and for our country in general. We believe that the argument can well be made, as it has always been made, for freer trade, but it is just as important to have freer economic relationships. International economic cooperation, the subject of this conference, comes closer to describing what it is we have now. We don't have just international trade, we have international economic relationships.

Given the emergence of this new environment, the American business community has recognized that the GATT of the past really is inadequately focused to handle the problems we have relative to international business. Tariffs and trade barriers are important to us, but they're not the critical issues today.

Investments are now much more important to most of us; that is, the ability to continue to invest and to operate in other countries without being discriminated against. We've spent a lot of time in the last few years explaining this to our own government and our own Congress.

Services, investment rules, protection of intellectual property rights are for most of us the key issues of the day, not barriers and tariffs.

Certainly the importance of all of these things, international trade as well as international investment, we believe, is a win-win situation. Again, our discussion yesterday came to the rather obvious conclusion that a different kind of investment is needed in debt-ridden countries where traditional sources of money to relieve debt burdens in the future are less available. Strangely enough, in spite of the problems of their balance sheets, most of us in business are still willing to take the required risks and to invest sizable funds in these countries, given halfway reasonable rules in order to make those investments worthwhile.

Although macroeconomic policies play a more significant role in creating a favorable business environment today, trade policies do remain important to us. We continue to work in those vineyards, as we have for many years.

After World War II, the first really serious signs of protectionism began to emerge in the United States about twenty years ago. Certain industries began to be severely impacted by the industrial revival of major foreign competitors of the past and the emergence of the lesser developed countries. Those of us in the companies that had gone abroad years earlier, and to whom foreign markets were a critical part of our operation, formed an organization called the Emergency Committee for American Trade (ECAT). It included about sixty-five of the major American companies, a very large chunk of our industrial capacity.

It was created as an "emergency committee" to lobby Congress and the government as they began to consider the first protectionist activities that we had seen in a number of years. The ECAT companies recognized that somebody was going to pay for protectionist moves (very likely the sixty-five of us) and that it was in America's own interest, and certainly in ours, that we do something about it.

Interestingly enough, that committee was formed and we all put up some funds to create it with the agreement that we would get in there, do the job, and self-destruct. I've been Chairman of ECAT for the last twelve years. It still keeps going, and after over twenty years, we've wondered whether we should rename it, since the Emergency Committee for American Trade perhaps is not descriptive of a twenty-year-old situation. We've concluded, however, that we've had a continuing emergency for all that time. ECAT continues to be extremely involved today and, I believe, has played a major role in holding off many undesirable protectionist activities.

The U.S. private-public sector advisory network also plays an important role in the development of U.S. trade policy. Created by the Congress, the growing advisory network provides private sector input to the government on trade matters, including negotiations. This makes a lot of sense since the trade negotiators are negotiating *our* rules for international economic relationships. This advisory group embraces more than a thousand people who are actively involved in the process—labor leaders, lawyers, agricultural people, academics, business leaders, and so on. Representatives of this advisory network attend major international meetings, such as the Punta del Este meeting.

American business has generally always supported GATT—the obvious logic of what GATT is trying to achieve is clear to us. Having said that, it would be unfair not to tell you that the general feeling of the U.S. business community is that GATT, in general, has not been particularly good for America. In every negotiation, no matter how relatively successful, our country gave up more than it got. I realize that people in every country probably feel that way, but the facts suggest that in the aggregate our country has freer conditions than just about any other.

During the days of previous trade negotiations, our conceding more than we got was viewed as a reasonable outcome. It could almost be visualized as part of the Marshall Plan syndrome of the time. It was in our long-term interest to reach out to the countries that needed more help. But the situation has changed. Now many businesses in *this* country are in trouble. There is a growing concern that any further negotiations *not* proceed along that same path.

When the idea of the current Uruguay Round came up, members of the government's advisory network were canvassed on their reactions to a new round. You won't be surprised to hear that what we got, at best, was lukewarm agreement that another round was a good thing. Why? Because everyone was concerned that we were likely to lose more than we gained out of such a negotiation, if past history is any guide.

Indeed, the same reaction is what's behind the seemingly unconcerned attitude of American business leaders about the negotiations for a U.S.-Canada Free Trade Agreement. To our credit, even with the doubts that we have, American business has never opposed trying to promote trade agreements. But here again, when asked for our views, there was very lukewarm enthusiasm for such talks. The business community in general does not believe that the Canadians are likely to go very far in giving up things that they would have to give up to make such a negotiation of interest to us and in order for us to give up whatever we must in return.

Given the lukewarm support among American business for a new GATT round, we told our Administration we would support it only with certain provisions. In addition to the normal discussion items of the functioning of the GATT system itself, agriculture clearly is a critical item that needs serious attention in a multilateral framework. Second, in the manufacturing area, unless we included services, investment rules, and intellectual property, we would not support a new round of negotiations. The U.S. government did agree to those conditions and, in fact, has been particularly responsive in these critical areas that are new to GATT.

On investment, for example, we were never before able to get an American Administration to do more than say they weren't against direct foreign investment by U.S companies. Yet, we got a strong statement of support from the Reagan Administration, not only on the importance of investment but also on services and intellectual property protection. In a country whose competitiveness has been threatened by recent events, certainly our strongest suit is our innovation and technical competence.

The business community has also received increasing support from this Administration on bilateral trade actions against countries that disregard intellectual property rights and condone unfair trade and investment practices. While I strongly believe in the multilateral approach, it is also very clear to me that many of the major gains in the short run will continue to be on a bilateral basis.

However, some believe the Congress is trying to take U.S. trade policy too far on a bilateral basis, to the detriment of our multilateral obligations. The business community still has a moderating influence with respect to Congress and potential trade legislation. Nevertheless, we are in a much more aggressive mood concerning the role the Executive Branch should have in carrying out the existing rules and regulations relative to fair trade and, indeed, to critical economic policies. We don't understand, for example, why we should continue to sustain intolerable deficits with strong countries, particularly with Japan. We don't understand why we should continue to tolerate discrimination against us, even in the developing countries, which undoubtedly need special concessions from us in some areas. But the argument can be made, I think rightfully, that conditions leading to freer investment and trade flows with the developing countries are good for both sides. We should not continue to tolerate their closing us out.

After years of blaming the government for any problems U.S. industry had, now government leaders and others are pointing the finger more and more at the "competitiveness" of U.S. industry and arguing that it's really the main issue. A recent NBER study showed that American multinational companies have sustained their competitiveness in terms of holding onto their market share of world trade exports. This suggests that American management per se has not gone down for the count. It also suggests that there are some special problems related to our country and its ability to compete in today's world markets that are perhaps more significant than American management itself.

The business community understands that the key problems today are macroeconomic. It has for the last three or four years been demanding as strongly as it could from all of its organizations that the government get its act together on fiscal policy.

Finally, as far as American competitiveness is concerned, there is a whole list of domestic items that are critical to making us more competitive that have nothing to do with foreign trade. For instance, our export administration laws, where we regularly shoot ourselves in the foot to try to achieve some unachievable issue of human relations or security, have been proven over the years not to work and have been a sizable detriment to our operations. We have antitrust laws that tend to make us less competitive. Our tax policy has never put its effect on international competitiveness as a high priority, and our last tax bill was basically anticompetitive.

One of the critical issues we face which alone can end up making us noncompetitive in the world is the issue of tort reform. We have a huge number of lawyers in my company now, and it's not really that big a company. The millions of dollars and huge amount of time that is spent fighting off the growing hoards of ambulance-chasing lawyers is enough by itself to make you noncompetitive.

We probably need law changes, as much as we hate to say it, relative to the abusive takeover situation. In general, the extreme cases are negative to our economy and a diversion of resources in the American business community.

In summary, the U.S. multinational business community has recognized the new global economic environment in which it operates. We are responding to the challenging new policy issues facing us. Trade policy and competitiveness in American business need to also claim a higher priority in our government's action than they ever have before. The cooperation of policymakers in all segments of our society is a key factor to our continued economic vitality and competitiveness.

Summary of Discussion

Blumenthal once asked former Secretary of State Christian Herder why he came to the USTR from the State Department. Herder responded that he liked politics best, and that in his experience there are more politics wrapped up in trade issues than anywhere else. Trade, Blumenthal stated, is a political issue. Blumenthal argued that to make meaningful progress on trade problems it is important to have relative economic stability and growth, but that it is essential to have both domestic and international political consensus. In the current international environment, LDC debts, large current account imbalances, and exchange rate swings make successful trade negotiations much harder to achieve. Blumenthal felt that the last truly successful trade negotiations were the Kennedy Round because the key form of protection under negotiation was still tariffs. Much of the early postwar success with trade negotiations followed from the willingness of the United States to give up more than it would extract. This was true throughout the 1950s and early 1960s.

To this, *Anthony Solomon* added an anecdote of his own. As the Kennedy Round negotiations were concluded, Lyndon Johnson held a cabinet meeting in which several advisers discouraged him from signing. Many of the prospective trade flow numbers presented at the meeting showed the United States would not be getting as much as it was giving. At one point, Solomon mentioned to the President that the assumptions behind the numbers were very arbitrary and that minor modifications would easily yield a different bottom line. Johnson said nothing, but at the end of the meeting announced his decision: he would approve the Kennedy Round on the condition that Solomon "fix up the numbers."

Blumenthal also noted that at the time tariffs were the major form of protection. Governments held to the letter of the agreement but found new ways, which are far more difficult to regulate, to protect the industries of their choice. The protectionism typified by the agricultural policies of the United States and the Common Market has turned out to be more costly than ever imagined. Blumenthal was skeptical but did not rule out the possibility for progress at the Uruguay Round. He felt that any meaningful pact would require specificity and new enforcement machinery. The best that can happen until 1989 is that nothing happen.

Strauss assured Blumenthal that the nastiest provisions of the Gephardt bill, such as legal recourse to treble damages for industries injured by imports, would be dropped in conference. The modified Gephardt bill, which is likely to get through the House of Representatives and the conference committee, will focus primarily on countries that have large bilateral surpluses vis-à-vis the United States. Gephardt's presidential ambitions have allowed the unpopularity of an aggressively protectionist stance to soften the bill. He wants to finesse this bill without looking like a hawkish protectionist, but at the same time he needs to look good in Iowa. *Richardson* added that the bill had the positive and important feature that it would extend the negotiating authority for trade talks beyond December.

Blumenthal defended recognizing in the bill the question of bilateral imbalances. He argued that older concepts, such as reciprocity, were no longer as relevant as before. Even assuming that Japan's trading behavior is perfectly fair, large bilateral imbalances are *politically* unsustainable. Reciprocity and fairness are important in their own right, but, ultimately, trade is a political issue.

Schultze was less sanguine about the trade bill, even though its most monstrous features have been removed. Schultze believed that provisions of trade legislation that require the President to impose penalties unless he declares that doing so would be contrary to the national interest are not a good thing. Each time the President refuses to take the hardline position, he will expend some political capital. Eventually, it will become necessary for him to make an example out of a case in order to demonstrate that he is willing to act. This loophole is not without costs. Schultze pointed out that seemingly innocuous details of a bill often turn out to be costly. The definition of dumping in the 1974 Trade Act as sales below full cost has become a big problem.

Strauss responded that concerns about the Gephardt bill voiced by Schultze and Blumenthal were justified. The United States will now pay a price for the Administration's refusal to reverse the budget deficit and the rise of the dollar. But one must confront reality: there is going to be trade legislation. The only question that remains is what kind of bill we will have. He thought that the Administration will get involved when the bill is in conference. Waiting until such a late stage may prove to be a mistake.

Branson seconded the notion that this bill is moderate. The shift in emphasis to an active trade policy based on opening foreign markets, away from a reactive policy of closing domestic markets, is desirable. A likely outcome, one more important for politicians than for economists, is that the U.S./Japan bilateral balance will be improved.

Richardson was more optimistic about the medium-run outlook for trade policy coordination. He felt that there is a growing emphasis in trade policy on multinational interests, labor interests, and GATT codes instead of MTNs over tariffs. There is interest in a safeguards code that would alleviate back-door escape-clause proceedings via unfair-trade remedies. We therefore need not be so bleak about the medium-run possibilities for improved trade coordination, which would include the Japanese.

Sachs emphasized that large trade imbalances are ultimately a macroeconomic problem. Both the U.S. and Japanese current accounts have changed dramatically over the past five years, while commercial policies have remained virtually the same. Japanese savings as a percentage of GNP has not changed over the past six years. Instead, private and public investment have fallen by 1 and 3 percent of GNP, respectively. If Japanese macro policies are to blame, what can be done to reverse them? First, Sachs suggested that Japan reverse the drive for domestic financial market liberalization. Most of the controls that have been removed previously acted to keep Japanese savings within

Japan. Second, Japan has room for fiscal expansion. Third, the Miyakawa reforms could be explored more actively. There is no serious work being undertaken in Japan to ascertain the effects that tax changes and land use changes might have on the interest rate or savings. While Japan is confused about a course of action, the United States continues to pound the table over trade issues which do not speak to the heart of the problem. Several participants agreed that the trade problem was really a macroeconomic issue.

Feldstein added that the Japanese capital outflow was not only private: about one half of the net outflow from the second quarter of 1986 to the first quarter of 1987 was generated by purchases of U.S. assets by the Bank of Japan. Indeed, net purchases of dollar assets by the Bank of Japan in January 1987 were $9 billion, a figure larger than Japan's trade surplus in that month.

Strauss felt that in spite of the furor over trade, Congress had not overreacted. The United States may be frustrated by Japan, but the Japanese feel equally put upon. Each day C-span carries the speeches of congressmen trying to please their constituents. Their rhetoric rarely finds its way into policy, but audiences in Japan rightly think that the United States is nuts. Such TV diplomacy is becoming a serious problem.

Kunihiro asserted that Japan regarded as vital their relations with the United States, and that they were willing to make sacrifices to maintain a good relationship. Japan has no intention of undermining U.S. industry: they want the United States to be strong. Kunihiro felt that Section 301 tends to be counterproductive because it generates moral accusations which are often unfair in the eyes of the trade partners and that the Japanese would better understand if the recourse were made to the 201 cases filed in the United States, the avenue open to U.S. industries damaged by imports. He wondered, however, if justice had been done in the U.S. retaliation for alleged Japanese noncompliance with the semiconductor agreement.

Kunihiro also offered his comments on the semiconductor agreement. He acknowledged that the 100 percent tariff placed on $300 million of imports is a reaction to a growing frustration with Japan and that semiconductors themselves are not the only issue. The timing is unfortunate, in that considerable changes are already taking place in Japan. He felt that Japanese negotiators interpreted the semiconductor agreement as offering more latitude than the United States was comfortable with, particularly in third-country markets. The United States did warn Japan that a time limit for compliance had elapsed, but the Japanese were not convinced that all avenues had been pursued. Kunihiro was not optimistic about the future.

Blumenthal felt that the United States would have to pound the table in order to get results from Japan. When dealing with the Japanese on trade matters it seems that logic is useless and facts are irrelevant. He felt that Japan's confusion is a political reality and must be confronted. The fact is that the bilateral imbalance is egregious, and Japan must be convinced of this. What the Japanese choose to do to eliminate the current account surplus is their problem; they will act when it is in their interest to act.

Strauss suggested that Blumenthal had overstated his case. First, the Japanese need not bring their current account into balance; their surplus could be sent, for instance, to the LDCs. Second, bilateral balances do not really matter as much as some seem to perceive. *De Menil* concurred that the situation with Japan should not be viewed as a bilateral problem. He speculated that if the dollar fell to 120 yen by the summer, we might expect to see a significant reduction in Japan's current account. *Blumenthal* agreed with Strauss that a Japanese current account of zero is not required, but reiterated his view that bilateral imbalances of such magnitude were politically untenable.

Fischer commented that the rising yen helps ease the disparity between savings and investment, not only by increasing Japanese demand for foreign products but also by reducing income in Japan relative to its trading partners. A reduction in income forces an increase in government spending and lowers savings more than proportionately, thereby helping to reduce the current account surplus. Fischer also made the point that while bilateral balances are not important in principle, the United States is a good candidate to be close to bilateral balance with Japan. Japan is a major importer of goods, such as raw materials, oil, and agricultural goods, which we export. *Feldstein* added that if the United States were to drop its restriction on shipping oil from Alaska the perception of the bilateral balance problem would be reduced.

Rosett spoke as a U.S. consumer who has bought, and bought cheaply, many Japanese products. He wondered whether any politicians would capitalize on the support from consumers to continue the availability of cheap imports. *Greenspan* underscored the fact that it is very hard to hit Japan without hitting the U.S. consumer where it hurts. There may be a big backlash when the prices of these products double.

Attali shared Blumenthal's view that the imbalances are so large as to be a predominantly political problem. In the coming months the solution will be found more through a continued depreciation of the dollar than through any changes in commercial policy. He went on to say that the trade issue for the United States is the tip of the iceberg and that underlying economic reforms must be made. He compared the current situation of the United States with that of the United Kingdom in the early twentieth century. Perhaps a kind of reverse Miyazawa report should be written for the United States, detailing desirable changes in incentives, where profits are made, and where youth and the elite are going. In any event, solutions to trade issues will not be found in trade legislation.

Marston was encouraged to hear the blame for trade imbalances placed primarily on macroeconomic matters. Suppose, he suggested, that the macroeconomic problems were solved and that exchange rates were stabilized at an appropriate level. He was curious whether Ed Pratt thought the United States would be able to compete in high-tech areas. Research by Paul Krugman indicates that U.S. firms were blocked from competing in the Japanese market for 16K semiconductor chips. This strategy gave Japan a foothold and allowed them to overtake the United States in subsequent chip designs.

Pratt responded by saying that the United States continues to retain its advantages in many high-tech areas and that it spends more on research and development than does Japan. A policy of blocking foreign products is not new there. Unlike most of the rest of East Asia, there are no U.S. automobiles in Japan. On the other hand, his company, Pfizer, has been successful in getting into Japanese markets by investing there instead of trying to only export to Japan. Nevertheless, the outcome of Japan's protectionist policies has been to keep imports out once they have capacity in place. We have mistakenly allowed Japan to do this. *Blumenthal* added that the Japanese really have not been so successful in computers. Unisys is one of the largest producers in Japan. But for the difficulty in reaching Japanese markets, Unisys would have been even bigger.

Ruggiero agreed with Blumenthal that it will be hard to sign any trade agreement whose intention is to expand the scope of the system at a time of such worldwide economic uncertainty. Nevertheless, one need not be uniformly pessimistic. For example, great progress can be made on the Common Market agricultural program. There is a consensus building that the current situation is unsustainable, and the ECC is already beginning to tackle the problem.

De Menil felt that trade issues can also spill over to affect investment. An example would be Fujitsu's failed attempt to acquire Fairchild Semiconductor from Schlumberger. The intimidation of Fujitsu was a mistake for the United States; a revitalized Fairchild would have been good for employment here. He felt that Fairchild's competitors created enough emotion about the transaction that it was no longer a business decision.

McNamar said that once an issue had reached a kind of bumper-sticker mentality, it was hard to control. Hence, the unwarranted focus on the bilateral imbalance with Japan or the Schlumberger-Fairchild affair. He thought that the current U.S. strategy of using a bilateral agreement between the United States and Canada on services as a model for the Uruguay Round was not a good one. A better approach would have also involved Mexico in a North American free trade zone.

He pointed out the contradiction between the current U.S. negotiating emphasis on open investment rules and the U.S. reaction to the proposed Schlumberger sale of Fairchild to the Japanese.

Gergen asked Strauss what kind of leadership we could expect in 1988. He was doubtful that in two years we will have solved the budget problem; candidates seem willing to make too many campaign promises for lower taxes and higher agricultural subsidies. The United States needs leadership, and those running are not inspiring.

Strauss agreed that there will be excessive bidding for the protectionist vote and that tax commitments will be made which shouldn't be fulfilled. He regretted that, their importance notwithstanding, economic issues will take a backseat. The next presidential election and foregoing primaries will be decided by issues such as abortion, ERA, Aids, and even whether the U.S. embassy should be located in Tel Aviv or Jerusalem. When these are the issues of the day, it is hard to get the best people to seek office and win. He felt that neither the Republicans nor the Democrats had put up their best candidates for 1988.

The thought of letting Iowa and New Hampshire narrow the field is crazy, and the incentives to make campaign promises that should not be kept are overwhelming. While the unknown candidate needs the early primary as a means of gaining notoriety, Strauss felt that the loss of the dark horse candidate is a worthy sacrifice for making the entire process more rational. He suggested that Sam Nunn is possibly the most capable man the Democrats could nominate, but that Nunn couldn't get votes in Iowa. Perhaps it would not be long before a frontrunner adopted the strategy of not going to Iowa at all. Perhaps this is why Cuomo dropped out.

Kunihiro said that he had listened to the criticisms, warnings, and advice of the conference participants. He realized that the political clock was running faster than the economic clock. The Miyazawa report has been and would be influential in changing the Japanese way of thinking. It would raise awareness that 40,000 steel workers, shipping workers, etc., will be unemployed in the years to come if nothing is done. Kunihiro stressed the effects of the high yen: an exodus of production from Japan, reductions in employment, an increase in imports of manufactured products beginning in the fourth quarter of 1986. All of these are working as a strong lever for structural adjustment. While manufacturing imports from the United States have not increased substantially, imports from other countries have. There is no reason why the United States shouldn't do as well if U.S. firms take the Japanese market seriously. He agreed that the current bilateral imbalance with the United States was unsustainable and stated that Japan would act to reduce it. The overall surplus of Japan, however, is partly due to the reduction in mineral fuel prices, which alone improved the current account by $19 billion last year.

Pratt, in closing, reiterated his admiration for Japan. He looked forward to the opportunity of solving the problems together.