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Volume Title: The Effects of U.S. Trade Protection and Promotion Policies

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Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-23951-9

Volume URL: http://www.nber.org/books/feen97-1

Conference Date: October 6-7, 1995

Publication Date: January 1997

Chapter Title: Introduction to "The Effects of U.S. Trade Protection and Promotion Policies"

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Chapter URL: http://www.nber.org/chapters/c0306

Chapter pages in book: (p. 1 - 7)

Introduction

Robert C. Feenstra

A magazine devoted to international economics recently asked a panel of experts to grade the performance of the Japan/trade policies undertaken by the Clinton administration ("Grading the Clinton Japan/Trade Policy" 1994). The results ranged from B+ to Z, with the latter being lower than an F. Less surprising than the range of scores (who would expect economists to agree?) was the attention given by nearly every person to the market-opening policies being pursued by the United States. Gone are the days in which the United States was evaluated by its ability to negotiate multilateral policies of mutual benefit to a broad group of countries; instead, the focus is on results-oriented policies in specific markets and with particular trading partners. There is little agreement, however, on whether the policies pursued have been helpful or harmful: the two lowest grades given to the Clinton administration came from individuals who felt that the actions taken toward Japan were either too harsh and a form of "affirmation action" promoting U.S. industries or too weak and "likely to prove ephemeral." Such is the state of affairs in the evaluation of recent U.S. trade policies!

The papers in this volume take a more dispassionate look at these policies and evaluate their effect with the benefit of hindsight and statistical inference. Of foremost concern are the policies affecting U.S.-Japan trade and investment, and nearly half the papers focus on these issues. A second section of the volume deals with the U.S. response to so-called unfair trading practices, while the final section contains an analysis of various industry- and country-specific trade policies. Three general themes arise from the papers. The first is that some policies can act as both import protection and export promotion. An ex-

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ample is provided by the recent policies directed at the U.S. automobile industry, as examined by James Levinsohn. In that case, the goal of increasing Japanese purchases of U.S. auto parts (export promotion) was implemented through the threat of high tariffs on U.S. imports of Japanese luxury autos (import protection), with the result that the two cannot really be separated. A more complex example comes from the negotiations on antidumping in the Uruguay Round, discussed by Robert E. Cumby and Theodore H. Moran, where U.S. exporting and multinational firms—pursuing their own agendas—did not act as an effective counterweight to domestic firms seeking greater protection from imports.

The second general theme is that the threat of protection can often have effects that are as pronounced as when policies are actually implemented. This is illustrated by the response of the Japanese to the threatened tariffs on luxury automobiles but also by their response to threatened protection in other industries, which involved making direct investments in the United States, as analyzed by Bruce A. Blonigen and Robert C. Feenstra. Threats also lead to measurable reactions from firms faced with possible antidumping duties, discussed by Thomas J. Prusa, and from countries faced with Section 301 actions, discussed by Kimberly Ann Elliott and J. David Richardson in the section on "unfair" trade. The third theme is that domestic regulatory policy has as much effect on trade and investment patterns as trade policy itself. This is illustrated by the paper by Andrew R. Dick, dealing with the telecommunications industry; by the paper by David E. Weinstein, dealing with foreign investment in Japan; and by the papers in the final section, which deal with the effect of macroeconomic policy on U.S. wheat exports and on unemployment in Canada following the free trade agreement with the United States.

Arguably, the automobile industry—defined to include both finished cars and the manufacture of automobile parts—received the most trade policy attention throughout the 1980s and 1990s. The import competition faced by U.S. producers during the 1980s was offset by the application of a "voluntary" export restraint (VER) with Japan. This restraint had the further effect of encouraging foreign investment in the United States, as a result of which, with Japanese nameplates being produced in the United States, the VER became redundant by the end of the decade. Attention then shifted to the automobile parts industry, which had a very low foreign market share in Japan. In an effort to expand this share, the Clinton administration proposed a 100 percent tariff on thirteen Japanese luxury cars and threatened to implement this tariff unless the Japanese agreed to expand their purchases of automobile parts. The choice of instrument was strategic: a uniform tariff against all Japanese automobile imports would not have been effective since the majority of Japanese cars were produced in the United States. In this case, the threat apparently paid off, in that the Japanese agreed to various quantitative goals for the purchase of automobile parts. Levinsohn considers what would have happened had the tariff on luxury cars been implemented. He finds that the reduction in profits of the

Japanese manufacturers would have been very large, which may explain their decision to agree to various goals for the purchase of automobile parts. Surprisingly, he also finds that U.S. prices would have risen by nearly the full amount of the tariffs: there would have been little incentive for the Japanese producers to absorb some part of the tariff and pass though only a portion to U.S. consumers.

Among the quantitative goals gained in this "carwars" episode, the Japanese agreed that their firms in the United States, and elsewhere would purchase more automobile parts; that they would increase the foreign market share in Japan; and that they would expand their transplant production in the United States. It can be questioned whether some of these targets could have been met even without the U.S. threat. In particular, the number of Japanese manufacturers in the United States has been rising steadily, and these firms all do some business with U.S. parts suppliers. The changing magnitude of these parts purchases is studied by Deborah L. Swenson. She makes use of a unique data set collected from the foreign trade zones (FTZs) in the United States within which the Japanese automobile producers (and many other firms) operate. Since these data provide trade flows to and from FTZs, the separate purchases of U.S. and Japanese parts can be quantified, and the effect of exchange rates and other factors on the sourcing decision can be estimated. Swenson finds that exchange rate fluctuations are important, and that there is a tendency for Japanese purchases of U.S. parts to grow over time, but this growth is not enough for the differences between these firms and their U.S. counterparts to be eliminated.

It was suggested above that the VER with Japan in automobiles resulted in the inflow of foreign direct investment. It is surprising, however, that the number of transplant firms grew so large that the VER became redundant. This suggests that the foreign firms were responding, not only to the actual protection, but also to the threat of protection. This hypothesis is tested by Blonigen and Feenstra, who measure the threat of protection by the initiation of antidumping or "escape clause" cases filed against a particular foreign industry. They test whether the use of these cases results in additional inflows of foreign direct investment and, conversely, whether the foreign investment lowers the probability of future protection. Using data on inflows of Japanese firms to the United States, support for both these hypotheses is obtained. These results confirm the idea of quid pro quo foreign investment that has been advanced by Jagdish Bhagwati, among others (see the references to chapter 3 of this volume).

Looking at the opposite side of this issue, Weinstein investigates the level and determinants of foreign direct investment in Japan. The conventional wisdom has been that, measured by the share of employment or sales accounted for by foreign affiliates, the foreign presence in Japan is at most 1 percent. This is extremely low in comparison with other industrial countries. Weinstein argues that this estimate is in fact incorrect and that the actual foreign presence is at least 5 percent of sales or employment: still at the low end compared to other countries, but five times higher than the conventional wisdom! To explain why foreign investment has not been higher, many authors have pointed to the *keiretsu* system of cross-shareholding and corporate control. Weinstein questions whether this system developed in order to limit foreign takeovers. He suggests instead that various Japanese financial regulations have had the effect of encouraging cross-shareholding between manufacturing and financial firms and among related firms in the manufacturing sector.

Regulatory policies are also the focus of the paper by Dick, dealing with the telecommunications industry in the United States and Japan. In the early 1990s, the attempts of Motorola to enter the cellular telephone market in the Tokyo area led to extended discussions between government officials from the United States and Japan, which mirrored similar attempts to enter the market for radio pagers in the 1980s. Dick puts these actions into their historical context, arguing that deregulation in both countries since the 1970s, has had a profound effect on bilateral trade. Deregulation in the United States, including the divestiture of AT&T, had the effect of increasing imports from Japan (especially of terminal equipment) and other countries such as Canada (of network equipment). But deregulation in Japan had the effect of increasing imports from Hong Kong and Asia (of terminal equipment), with more limited increases of imports from Canada (of network equipment), with the result that the United States did not gain in terms of exports. The conclusion is that the vigorous enforcement of antitrust law in the United States (leading to the AT&T divestiture) had the effect of increasing the trade deficit with Japan, where comparable deregulation policies were not followed.

The second section of the volume is devoted to policies that are a response to "unfair trade," that is, situations in which the United States perceives that foreign industries or countries are engaged in practices particularly detrimental to domestic interests. An example is dumping: when foreign industries export their products at below their home prices or average costs. This practice has long justified the use of antidumping duties under U.S. and multilateral trade laws, but these provisions were renegotiated under the Uruguay Round of negotiations. The paper by Cumby and Moran argues that the new provisions are surprisingly lenient in terms of the criteria used to determine whether dumping has occurred and that they therefore protect domestic producers. The question that the authors pose is why the executive branch of the government did not act as an effective counterweight to industry demands in this instance. The answer leads to a fascinating insiders' account of negotiations during the Uruguay Round, in which, as one discussant observed, the "names were omitted to protect the guilty."

One reason that these authors focus on the antidumping laws is because these trade policies have been found to have very substantial effects, over and above those that occur when duties are actually applied. The paper by Prusa investigates some of these effects. Using highly disaggregated data for the same line-item tariff codes at which investigations occur, he finds that the investigation itself has the effect of restricting imports and raising the price from the countries named in the investigation; of course, these effects persist and are amplified if duties are applied. However, the net protection offered to U.S. firms is less than these results suggest because of significant trade diversion toward countries that are not named in the investigation. These countries are able to increase their import volumes to the United States and raise their prices following the application of duties on the named countries, with the result that the overall volume of imports continues to grow. In addition to quantifying the effect of antidumping investigations on import prices, Prusa provides the first estimates of the extent of trade diversion to nonnamed countries.

The use of antidumping duties is only one means by which the United States responds to perceived unfair trade, and, by necessity, this practice is restricted to particular commodities and countries. A more general response is contained in Section 301 of the Trade Act of 1974, which authorized the president to take action against "unreasonable, unjustifiable, or discriminatory" practices of foreign trade partners. These provisions were extended in the so-called Super 301 provisions of the Omnibus Trade and Competitiveness Act of 1988, which authorized the annual compilation of a list of countries engaged in egregiously unfair practices and subsequent negotiations to eliminate these practices. If the practices are indeed eliminated, then the action can be judged as "successful" from the U.S. point of view. Elliott and Richardson investigate the factors contributing to the perceived success or failure of the Section 301 actions. This study extends the work presented in Bayard and Elliot (1994) and adds to it a statistical analysis of the factors determining success (the earlier study used case methods). Among other conclusions, the authors find that the vulnerability of the foreign country influences the success of a 301 action, as does the simplicity of the foreign policies being targeted and the linkage of the action of some measure of reciprocity. In contrast, there is no evidence that cases involving the highest U.S. stakes are necessarily the most successful.

The final section of the volume turns to U.S. policies that have targeted specific industries or countries. Of chief concern to advocates of industrial policy has been the high-technology industries, which are sometimes argued to benefit other industries in a spillover process and to be of strategic interest for national security. Both these arguments have been used to justify U.S. support for the development of flat panel displays, as described by Kala Krishna and Marie Thursby. Much of the information on this industry is proprietary, and these authors provide details that are not readily available, including the very high magnitude of subsidies provided by the Clinton administration. Rather than evaluating the overall social cost or benefit of these subsidies, Krishna and Thursby focus on one particular aspect that is also of relevance to other industries: whether subsidies are provided to capacity acquisition or to R&D expenditures. Both these policies were considered under the National Flat Panel Display Initiative. These authors find that subsidies to capacity acquisition can have the perverse effect of reducing the steady-state level of R&D, which implies that the R&D subsidy is the preferred instrument for achieving long-term cost reductions.

The second industry considered—agriculture—is at the opposite end of the spectrum in that the subsidies provided cannot be justified by any technological spillover or national security argument but rather are the result of political economy considerations. One program that has been in effect since 1985 is the Export Enhancement Program (EEP), which provides export subsidies to a range of commodities, especially wheat. In 1985, exports of wheat were very low by historical standards, leading to a large accumulation of U.S. stocks. Pinelopi K. Goldberg and Michael M. Knetter argue that these events should be attributed to the appreciation of the U.S. dollar during 1980–85. With the subsequent depreciation, export volumes should have returned to their historical levels, but this was not the case: exports were lower than expected. One explanation for this finding is the increased productivity and export subsidies provided to wheat by the European Community. These findings suggest that the EEP was ineffective in stimulating wheat exports and that, to the extent that it led to the increased use of subsidies within Europe, it may even have been counterproductive.

Attention is turned from policies favoring specific industries to those favoring specific geographic locations in the paper by Gordon H. Hanson. Under the offshore assembly provisions of U.S. tariff laws, components that are exported, assembled abroad, and reimported into the United States receive preferential tariff treatment. Predictably, this provision has had the effect of encouraging the location of plants in Mexico near the U.S. border. Surprisingly, however, it has also encouraged the location of "twin plants" in the United States, at border cities near to their Mexican counterparts. Hanson estimates that fully half the growth in durable-goods activities in these U.S. cities is due to the expansion of assembly plants in Mexico. He also discusses how the choice of location is likely to be affected by the North American Free Trade Agreement (NAFTA).

The final paper, by Keith Head and John Ries, considers the other American border—that with Canada—and the effect of the Canada-U.S. Free Trade Agreement of 1988. While this agreement attracted less attention in the United States than the subsequent agreement with Mexico under NAFTA, it was widely debated and criticized in Canada. The fear was that Canadian industries would not be able to compete head-on with U.S. industries and would therefore be forced to downsize and lay off workers. In fact, in the years following the agreement, there was unusually high unemployment in Canada, but this was due at least in part to the restrictive monetary policy. Head and Ries attempt to disentangle from industry-level data the changes in Canadian output and employment that were consistent with trade liberalization and the remaining changes that appear to be due to other factors. Using a model of monopolistic competition, they find that a significant part of the reduction in Canadian output cannot be explained by this framework. They explore the extent to which macroeconomic policy, or other factors, is consistent with the additional unemployment that occurred.

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