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# Introduction

Robert C. Feenstra

*International competitiveness* has become a keyword of policy debates and indicates the ability of a country's export or import-competing industries to maintain their market share. Recent concerns that the United States is lagging in international competitiveness has led to numerous studies and policy proposals. Consider the following views, for example, drawn from different sectors of the U.S. economy. The first comes from a survey done by the *Harvard Business Review* on the question, "Do you think there is a competitiveness problem?" Nearly four thousand readers responded, and the results are summarized in the following three statements ("Competitiveness Survey" 1987, 8):

America's competitiveness is declining—largely because of the performance of U.S. managers—and it is up to them to respond to the challenge.

While the government shares part of the blame, government remedies—particularly a national economic strategy—are not solutions to the problem.

Basic U.S. values—such as the work ethic, pride in quality, and deferred gratification—have slipped and must be restored if the country is to get back on track.

These statements can be taken as representative of the business sector. The views of the U.S. Congress are reflected in the Trade Bill of 1988 (*Wall Street Journal*, 22 April 1988, p. 18):

House Ways and Means Committee Chairman Rostenkowski said the trade bill, which he called the most comprehensive ever considered by Congress, would for the first time "establish a policy that will make America a winner in international markets." House Speaker Wright declared: "We can be No. 1 again."

Robert C. Feenstra is associate professor of economics at the University of California, Davis, and a research associate of the National Bureau of Economic Research.

Finally, of course, we should consider the views of academic economists. The papers in this volume illustrate current academic research on the topic of international competitiveness. But, for a single statement from a distinguished source, we have (Samuelson 1988, 281):

In chapter 31 Ricardo discovers what he has elsewhere gratuitously denied: that an improvement abroad can hurt Britain under free trade (or, as needs to be said today, that an improvement in Japan can hurt the American living standard).

These quotes demonstrate the wide range of opinions on international competitiveness. So too, the range of research topics in this area is diverse. The chapters in this volume explore the effects of macroeconomic and strategic trade policies on competitiveness; the recent influx of foreign direct investment to the United States, much of it from Japan; conversely, the extent to which Japanese trade barriers may have restricted imports; and the market structure of Canadian industries, with application to the U.S.-Canada free trade agreement. A brief summary of these papers will help to put them into perspective.

In the first chapter, Goulder and Eichengreen contrast the effects of “saving-promoting” and “investment-promoting” policies on exchange rates and industry output. In this case, international competitiveness is measured by the profitability and growth of U.S. export industries. The authors demonstrate how policy actions by the U.S. such as a shift from income to consumption taxes, or the restoration of investment tax credits, would have very different effects on the growth of exports. Their analysis draws a direct connection between policy actions and the competitive position of the United States.

In chapter 2, attention is shifted from *domestic* to *foreign* investment in the United States. Ray gives a comprehensive description of the pattern of foreign direct investment and its possible explanations. The recent influx of investments is indirectly a result of U.S. policies, particularly the balance of payments deficit, and poses a competitive challenge within U.S. borders. One expects that foreign direct investment will become an issue of growing importance for trade policy in future years.

The next two chapters of the volume investigate the empirical and theoretical basis for “strategic” trade policies. This phrase has come to indicate policies that may be in the national interest under an imperfectly competitive market structure (see Krugman 1986). Katz and Summers document the persistent pattern of interindustry wage differentials in the United States and other industrial countries. According to this pattern, there are some industries that consistently pay higher than average wages (even after correcting for skill differences) and that should be promoted from an efficiency viewpoint. They argue that the gains from promoting high-wage industries outweigh the potential benefits from strategic trade policy. These views are challenged, however, by the comments following chapter 3.

In chapter 4, Driskill and McCafferty directly address the modeling of strategic trade policy, particularly the use of conjectural variations. They show that the equilibrium of a dynamic duopoly game gives rise to a term similar to a conjectural variation but that this term is itself a function of policy parameters. In this sense, trade policy models that use conjectural variations are subject to the Lucas critique: that is, the model parameters change with policy.

Discussions of international competitiveness are incomplete without referring to the Japanese success story, now being repeated by other newly industrialized countries. An open question is whether the Japanese success is due to socioeconomic factors, such as the work ethic and educational system, or direct government support for industries. Saxonhouse addresses part of this question by testing whether the Japanese trade pattern, including intraindustry trade, can be explained by that country's unique factor endowments. He answers this question in the affirmative, implying that tariff and nontariff barriers do not comprehensively restrict Japanese imports. For an alternative view, the reader is referred to the comment on chapter 5 by Tyson.

The final two chapters deal with Canada's position in international markets. Schembri specifies and estimates a model of an imperfectly competitive exporter and uses it to study the effect of exchange rates on industry prices. His results support the idea of "pricing to market," under which exporters retain foreign market share by not passing through changes in exchange rates. Turning from a specific industry to the entire economy, Brown and Stern report results from a computable general equilibrium model dealing with U.S.-Canada trade. They investigate how different assumptions on market structure and product differentiation affect the outcome of a bilateral tariff elimination, as proposed with the free trade agreement. International competitiveness is indicated by entry and exit within industries and by changes in overall trade.

These chapters demonstrate the wide range of trade policies that affect international competitiveness. In the first chapter, the trade policies are macroeconomic: tax policies to affect savings and investment. In the third and fourth chapters, the trade policies are "strategic," that is, targeted at imperfectly competitive industries. More conventional policies—tariffs and nontariff barriers—are examined in the country studies of chapters 5 and 7. The remaining chapters (2 and 6) focus on topics that have important implications for the choice of trade policies: foreign direct investment and the exercise of monopolistic pricing in international markets.

In summary, these papers draw on current research to study how trade policies affect international competitiveness. While the topics covered are not exhaustive, the range of issues and research methods is impressive (for other studies of competitiveness, see Feldstein 1988 and Spence and Hazard 1988). Taken together, the chapters show the importance of macroeconomic and industry policies in determining competitiveness and, conversely, how patterns of trade and investment may influence future policies.

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