MANAGED TRADE

The New Competition Between Nations

RAYMOND J. WALDMANN

BALLINGER PUBLISHING COMPANY
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PREFACE

The basic principle of free trade, the premise upon which all others rest, is that traders, businessmen, and investors should be able to make decisions based on market signals, with little or no interference from governments. The United States has continued to support free trade as the surest route to economic efficiency and increased general welfare. We continue to act as if all other countries adhered to our belief in the rightness of free trade.

But the postwar period has seen another development as important as the expansion of trade. That development is the growth of managed trade—the conscious control of trade and investment by governments. All governments, even those with highly capitalistic domestic markets, intervene in international economic matters in a wide and bewildering variety of ways. A large and increasing proportion of trade and investment is managed by governments.

Japan is noted for its ability to control both imports and exports; its spectacular growth encourages imitation. Many others attempt to manage trade, but few succeed as well. All East bloc communist countries control trade, for example, but their economies suffer for it. The prominence of barter, countertrade, and other government trade-balancing policies demonstrates yet another way governments intervene.

Trade in important sectors and commodities has increasingly become managed. OPEC manages, or attempts to manage, trade in the most essential of raw materials, crude oil. Trade in other basic commodities such as copper, sugar, coffee, tea, cocoa, and tin is ruled by government agreements that set price and quantity. Agreements control trade in textiles and apparel, automobiles, steel, electronics, aircraft, and a host of other products and services.

I have seen these developments firsthand during the last two decades. During the last half of the 1960s, I was a consultant working both with American firms establishing their first overseas operations and with the foreign governments that sought to attract them. These were the high-water years of American managerial optimism, the years when American technology and expertise were being applied and emulated everywhere.

During my first government job in 1970, as a staff assistant to the president, I worked on a variety of issues that brought home to me the enormous involvement of governments in international economic matters. It ranges from the global issues of foreign affairs to the nitty-gritty of trade promotion, agricultural surplus sales, trade disputes, and export finance for individual projects. During this time I worked with Pete Peterson, then Director of the Council on International Economic Policy (and later Secretary of Commerce) to draft the first government report on the subject of our international economy in 1971, still regarded as a pioneering effort. When I moved to the State Department, I was thrown into three of the most contentious areas of government involvement—aviation, shipping, and communications—where foreign governments have substantial ownership. Most recently, as Assistant Secretary for International Economic Policy, I participated in most of the major trade decisions of President Reagan's first term.

The basic conclusion I have reached from this experience is that all governments, the United States included, challenge the free trade system. We act, for the best of motives, to make the attainment of free trade impossible. Free trade depends on a series of prerequisites—that borders be open, that tariffs and other barriers to trade be reduced or eliminated, that investment flow without hindrance, and that economic efficiency rather than political expediency guide trade and investment decisions. Today none of these conditions has been fulfilled. As a result, we face unprecedented problems of trade policy that will call for dramatic solutions.

In the face of these developments the United States has held fast to the notion that managed trade is the exception rather than the rule.

We continue to urge free trade as the best policy for all countries because it has worked for us. In a sense, our adherence has provided a "nuclear" free trade umbrella allowing other countries to have it both ways—free access to the United States, the largest market in the world, while developing their own markets according to managed trade principles.

We must carefully examine the strategies and tactics of our trading partners and competitors. We must look at the "rules of the game" to test their fairness and biases, making sure our own house is in order and our own laws up to the challenges ahead. We must consider the role of international trade, finance, and development organizations in directing and influencing trade. And we must recognize, most importantly, the implications of the growing government involvement in international trade for our relations with other countries, especially those in North America, and those which also advocate free trade.

Should we continue to espouse a policy of free trade with fewer and fewer adherents? Or should we retreat behind protectionist walls? Are these the only two choices open to us?

I believe there is a middle ground for the United States of a realistic managed trade policy based on reciprocity. We can wisely and consciously use access to our market power to achieve wider adherence to free trade. Moreover, we should take the initiative to form a U.S.-led free trade bloc. The trade arrangements flowing from these policies would be consistent with our international obligations and the realities of today's world. These arrangements would build on the successes of the postwar trade agreements and would form the trade agenda for the United States for the remainder of this century.

ACKNOWLEDGMENTS

As in any work of this type, the debts owed to teachers, advisors, associates, and mentors extend over decades and would make dull reading for all except those mentioned. And what about those left out? My solution is simple—I gratefully acknowledge first, the support and advice of my wife Mary who suffered through my late nights and weekends at the computer; and second, the help of my colleagues in government and in Washington, D.C., who reviewed the manuscript and offered criticism: Harvey Bale, Michael Czinkota, Bo Denysyk, Gary Horlick, Tim Houser, Peter Levine, Tom McVey, and Clyde Prestowitz. To all others who have influenced this work in one way or another, you have my gratitude for your time and energies educating and guiding me this far, but I hereby release you from any responsibility for the product, which must of necessity remain with me.

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INTRODUCTION

1 WORLD TRADE TODAY

International trade and investment have increased dramatically in the last forty years. The growth of world trade has surprised even the experts as new products are exported, new countries develop new industries, and new patterns of trade emerge. In the last two decades alone, from 1960–1980, world trade has expanded from $200 billion to over $2000 billion, a tenfold increase. The United States, along with all other traders, benefited from this growth.

Not only has trade mushroomed but its importance has increased. In 1960 exports as a percentage of the world's gross national products amounted to about 8 percent. Today the percentage is more than 16 percent, having doubled in just twenty years. Most countries are increasingly attentive to international competition, trade relations, and the rules governing trade and investment.

In no other country is this increased awareness more evident than in the United States. Today its international standing is discussed on the editorial pages, debated in Congress, and demagogued on the campaign trail. Of growing concern are the perils of the trade deficit, the consequences of jobs lost to foreign competition, the impact of possible default by foreign borrowers, and the need for an effective U.S. response.

Yet much of this debate is uninformed about the true nature of the challenge facing the United States. Fundamental trends affecting the future have yet to be grasped. The United States has been lulled into a false sense of security by the very enormity of its domestic economy and the outstanding results of the postwar period. These safety nets, however, may not alone be enough to sustain the country in the years ahead.

The trade policy problem facing the United States can be simply stated: Whether to adhere to the policies of the past in the expectation that they will continue to be effective, or to consciously adopt new strategies to deal with the changing world. This is the fundamental dilemma of today's policymakers. It arises in many forms and contexts and affects a vast number of decisions, policies, and practices. The analysis that follows draws basic conclusions about U.S. trade policy for the remainder of this century.

FUNDAMENTAL TRENDS IN THE INTERNATIONAL ECONOMY

The trade policy problem is better understood by first noting some of the factors influencing the international economy. One of the most significant trends has been the almost universal spread of manufacturing technology, skills, and management—referring not to the most advanced scientific developments, but rather to the stuff of day-to-day production. For example in 1965 the proportion of scientists and engineers in the U.S. workforce was three times that of Japan; today the proportion is roughly equal (Samuelson 1984). Europe and Japan now account for a majority of U.S. patents issued. In developing countries engineers and technicians are graduating in numbers that far exceed available jobs. Techniques, skills, machines, processes, even "trade secrets" appear wherever entrepreneurs have the vision and the initiative to use them.

As this technology spreads, local businessmen and investors realize the benefits of moving into higher value-added products that command higher prices in the markets of the world. No longer are nations satisfied to be the exporters of commodities, low-wage, or low value-added products alone. They also seek to upgrade their economies, improve their industries, and earn more foreign exchange through higher value-added production. This has enormous ramifications for education and training, development strategies, scientific exploration, and of course trade. All of these goals are a part of the overarching goal of many countries to industrialize as rapidly as possible.

The third fundamental trend occurring as a result of the spread of technology and the pressures to industrialize is the increasing freedom felt by nations to choose their economic futures. Much of this freedom is misperceived; countries cannot have a completely free choice and must be limited by their resources, their people, and their history. Nevertheless, more and more countries are misled by the promises of planners, the notion of directed economies, and the false premise of creating an economic comparative advantage that will lead to success in the international marketplace.

Consider for example the notion that government support for a research center on computers will allow any country to compete successfully in this fast-changing industry. By creating "comparative advantage" in this sector, the research center is expected to flourish and even export. Other, less favored sectors may fail, but that is accepted as the cost of staying abreast of the latest technology. Yet experience in many industries, including the computer industry itself, shows the folly of relying on such financial patronage unless the fundamental factors also support the health of the industry. This is an extensive problem only touched on here, but one of the most important aspects of government thinking about its role in industrial planning, and thus in international trade.

The fourth trend is the increasing tendency of governments to intervene in international trade. In its most extreme form, government management challenges the basic assumption of free trade on which postwar trade has been built. This assumption, embodied in treaties and international organizations, is that the private sector maximizes the public welfare by acting in its own self-interest and without government direction or control.

The U.S. faces these fundamental challenges to its economic position, yet simple solutions abound. For example, conventional wisdom states that the dollar's high purchasing power causes most of the symptoms of economic concern, and its fall will eliminate them. The determination of the true impact of the dollar on the international trade position of the United States is beyond the scope of this book. The analysis herein does not rely on the short-term and transient phenomenon of the high value of the dollar relative to historic values as the major cause of problems, nor will these problems be cured by a "return" to more "normal" values.[1]

THE UNITED STATES AS TRADER

The trend toward government management of trade and investment will influence every person in the United States. The United States now relies on international trade for about 14 percent of its GNP. Consider just a few indications of our reliance on trade:

- 1 of every 4 U.S. farm acres produces for export
- 1 of every 9 U.S. manufacturing jobs produces for export
- 1 of every $7 of U.S. sales is to a foreigner
- 1 of every 5 cars, 9 of every 10 television sets, half of all shoes, 2 of every 3 suits, and every video recorder sold in the United States is imported
- 1 of every $4 of U.S. government bonds and notes is issued to foreigners to finance the deficit

Without foreign earnings on overseas investments, the U.S. payments deficit would be three times as large. This reliance on international trade and investment must be considered by every citizen before voting, by every politician before legislating, by every businessperson before planning or investing for the future.

The United States is by far the largest trading nation in the world. In 1982 the United States exported $230.0 billion and imported $254.9 billion worth of merchandise.[2] U.S. exports that year amounted to 13.5 percent of the world's exports, which was 20.3 percent or one-fifth of the exports of the twenty industrial countries. The next largest exporters that year were West Germany ($138.2 billion), Japan ($114.0 billion), France ($113.9 billion), the United Kingdom ($93.9 billion), Italy ($76.2 billion), the Netherlands ($73.6 billion), Belgium ($56.9 billion), Canada ($48.4 billion), Saudi Arabia ($37.6 billion) and the USSR ($35.9 billion).

Exports from all thirty-three countries of Asia, excluding Japan, amounted to $150.0 billion. All of South and Central America exported $90.7 billion, and Africa $45.9 billion (not including the oil-exporting countries in those regions). The oil-exporting countries together accounted for $144.2 billion of the world's trade. U.S. exports were only slightly less than those of the next two largest exporters (Germany and Japan) combined, twice those of Japan, only slightly less than those of Asia and the Americas combined, and over six times more than those of the world's second largest economy, the USSR.

The aggregated exports of the ten countries of the European Economic Community amount to slightly more than 50 percent more than those of the United States.[3]

Although the United States has the largest export volume in the world, that volume is nonetheless a smaller proportion of total production than for most trading countries. As a percent of GNP, U.S. exports amount to only 5.9 percent compared with 12.4 percent in Japan, 17.9 percent in France, 19.8 percent in the United Kingdom, and 25.7 percent in Germany. For many other countries, both developed and underdeveloped, the proportion is even higher, especially in one-export countries. This explains why until recently, Americans considered international trade a comparatively obscure subject.[4]

The United States is also the largest importer, accounting for about 13 percent of the world's imports. For a large number of countries, the U.S. world share is even greater: In 1982, for example, the United States bought 16 percent of India's exports, 18 percent of Indonesia's, 20 percent of Brazil's, 26 percent of Japan's, 32 percent of the Philippines', 44 percent of Nigeria's, 56 percent of Mexico's, 65 percent of Canada's, and 78 percent of Haiti's. The United States buys twice the share of imports from developing countries that Europe does and 7.5 times as much as Japan does (*U.S. News World & World Report* 1985). Among the industrial countries, the United States imports the highest proportion of developing countries' products. These include many of the raw materials, commodities, textiles, footwear, and other manufactured products upon which their survival depends. Through these purchases the United States supports firms, industries, and even entire economies throughout the world. This is the most effective form of aid and assistance possible.

For decades the purchases of the United States have been the "economic locomotive" pulling many countries out of recessions and spurring growth in sluggish economies. The return from the 1981–83 recession is no different. The United States has run an unprecedented trade deficit with the rest of the world. With imports over $100 billion more than exports in 1984, business opportunities and jobs were ensured for all those supplying the U.S. market.

In 1985 the United States ran merchandise trade deficits with most of its trading partners (see Tables 1 and 2). Furthermore, the trade balances were worsening with every region of the world except the communist countries (*Business America* 1985). U.S. trade deficits mean prosperity for foreign exporters. In fact, this trade impact far exceeds