DILEMMAS OF INTERNATIONAL TRADE

Bruce E. Moon

DILEMMAS IN WORLD POLITICS

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Bruce E. Moon

Acronyms

CAP	Common Agricultural Policy
CGE	computable general equilibrium
CUSTA	Canada–United States Trade Agreement
DM	Deutsche mark
EC	European Community
ECSC	European Coal and Steel Community
ECU	European currency unit
EEC	European Economic Community
EFTA	European Free Trade Association
EIB	European Investment Bank
EMS	European Monetary System
ERM	Exchange Rate Mechanism
ESC	Economic and Social Committee
ESF	European Social Fund
EU	European Union
EURATOM	European Atomic Energy Community
FDI	foreign direct investment
FTC	Federal Trade Commission
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
H-O	Heckscher-Ohlin (theory)
IBRD	International Bank for Reconstruction and Development (World Bank)
IMF	International Monetary Fund
ISI	import-substituting industrialization
ITO	International Trade Organization
LDCs	less developed countries
MFA	Multi-Fiber Agreement
MFN	most favored nation
MITI	Ministry of International Trade and Industry (Japan)
MOF	Ministry of Finance (Japan)
MPs	members of Parliament

NAFTA	North American Free Trade Agreement
NICs	newly industrializing countries
NTBs	nontariff barriers
OECD	Organization for Economic Cooperation and Development
OMAs	orderly marketing arrangements
PRC	People's Republic of China
PRI	Mexican Partido Revolucionario Institucional
SII	structural impediment initiative
TRIM	trade-related investment measures
TRIP	trade-related aspects of intellectual property
VAT	value-added tax
VIE	voluntary import expansion
VERs	voluntary export restraints
VRAs	voluntary restraint agreements
WTO	World Trade Organization

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Trade and Trade Issues

This book has two missions. The first is to explain the fundamental dilemmas that surround international trade and trade policy issues. How we respond to these trade dilemmas will not only shape our economy but also determine the kind of society in which we will live. Too often, trade is treated purely as an economic phenomenon that is—or ought to be—divorced from politics. In fact, because the political and the economic components of international trade are intertwined, neither can be understood without the other. I examine the dilemmas of trade in the context of several contemporary controversies, especially the Japanese-American trade relationship, the **European Union** (EU), the **North American Free Trade Agreement** (NAFTA), and the **Uruguay Round** of the **General Agreement on Tariffs and Trade** (GATT).

The second mission is to introduce the basic principles of international political economy by examining how politics and economics interact to shape trade policies. To provide historical and theoretical perspective, I discuss nineteenth-century British trade policy and the evolution of the **Bretton Woods** international economic system of the modern era.

THE THEMES OF THE BOOK

Whenever people purchase products made abroad, they unknowingly act in accord with one set of interests, values, and theories concerning international trade but in discord with another set. This book demonstrates that the consequences of these individual choices pose fundamental policy dilemmas for governments. States seek many outcomes from trade—full employment, long-term growth, economic stability, power, security, and friendly external relations—yet discover that these desirable outcomes are frequently incompatible. The resulting dilemmas can be seen with clarity only when the standard economic theories of international trade are understood to be partial and incomplete. They must be augmented with treatments rooted in the perspective of international **political economy**.

Since the nineteenth century, **economic liberalism** has been the dominant theoretical perspective on international trade. Liberal economic theorists maintain that free markets establish prices that result in the most **efficient allocation of factors of production,** such as land, labor, and **capital**. Thus, from the time of Adam Smith (1723–1790), they have concluded that **free trade** is the surest path to economic prosperity and growth. Consequently, they have urged that governments refrain from interfering with private entrepreneurs and free markets in international trade. Yet in the intervening two centuries, virtually no national government has followed this advice.

This book probes the reason for this curious disparity between accepted economic theory and established political practice, rejecting the interpretation proffered by some economists that the discrepancy results from irrational or corrupt policy. Instead, the book's political economy perspective acknowledges that governments seek to influence trade because markets generate multiple consequences, many of which exceed the boundaries of economic theory yet touch the fundamental responsibilities of government. For example, just as trade affects the prices of individual products, global markets influence which individuals and nations accumulate wealth and political power. They determine who will be employed and at what wage. They determine what natural resources will be used and at what environmental cost. They shape opportunities and constraints in foreign policy. Because trade affects such a broad range of social outcomes, conflict among alternative goals and values is inevitable. As a result, governments, which seek to balance all the interests and values of society, confront dilemmas that require painful choices.

In this book I describe the dilemmas resulting from the distributional consequences of trade, the competing values affected by trade, and the impact of trade on the concerns of the state. I also explain how various governments (and individuals) respond to these dilemmas and why.

The Meaning of Economic Liberalism

The term "economic liberalism" is *not* to be confused with the ambiguous way that the term "liberal" is applied in American politics. Economic liberalism is wary of government interference with the market, whereas those called liberals often advocate it.

THE IMPORTANCE OF TRADE AND THE TRADE BALANCE

Most economists and policymakers believe that expanded levels of trade provide substantial benefits for individual nations and the global economy as a whole. Exports are valued because they produce jobs for workers and profits for corporations. They also earn revenue that can be used to purchase imports. The very fact that individuals choose to import implies that some products produced abroad are of higher quality or lower price than could be obtained from domestic producers. Thus, import expansion implies an increase in welfare for the citizens of the nation because they can acquire more for their money. Of course, some imported products are not available from domestic sources at all. Thus, governments are frequently advised to adopt policies that will maximize the volume of trade.

Trade has become an important element in the economies of all developed nations, but there is considerable variation both across nations and over time. In Table 1.1, which shows the importance of exports in selected nations in 1970 and 1992, two patterns can be seen within that variation. First, larger nations, which have sizable domestic markets of their own, tend to rely less on trade than smaller nations. The United States, for example, with exports constituting only a little over 10 percent of its **gross national product** (GNP), is less reliant on trade than virtually any other country in the world. Even Japan, with its reputation as a great trading nation, is much less dependent on trade than any European nation. Despite its shortage of natural resources, the sheer size of Japan's economy, second only to that of the United States, enables it to meet most of its own needs

TABLE 1.1 Exports as a Percentage of Gross National Product

Nation	*1970*	*1992*
United States	6.8	10.6
Japan	11.3	10.1
Germany	22.6	33.4
Canada	22.9	27.7
Mexico	6.7	12.8
United Kingdom	21.9	23.6
South Korea	14.0	29.5
France	15.8	23.3
Netherlands	45.0	52.4
Belgium	43.5	70.6

SOURCE: Based on data for exports of goods and nonfactor services from World Bank, *World Tables 1991* and *World Tables 1994* (Baltimore: Johns Hopkins University Press, 1991, 1994).

and to consume most of its own production. Smaller nations, such as Belgium and the Netherlands, as well as most Third World countries, must engage in greater levels of trade because they can neither supply goods to meet all their own needs nor provide a market sizable enough for many industries to produce in the large volumes required to be efficient.

Even if we allow for those differences in size, however, trade has been more significant for European economies than for those of North America. Part of the explanation is that their relative proximity to one another lowers transport costs, but part also lies in government policy, especially the establishment of regional organizations like the European Union that facilitate trade within Europe. The precedent set by the EU encouraged the creation of a North America Free Trade Agreement designed to allow a similar growth of trade among the United States, Canada, and Mexico. Together with the advent of an East Asian group centered around Japan, these developments may foreshadow a world of **trade blocs** in which free trade may prevail within each bloc but trade between blocs is restricted.

The second pattern revealed by this table is the greater role that trade has assumed, increasing from 1970 to the early 1990s more than 50 percent in the United States as a percentage of GNP, for example. With such heavy reliance on jobs in the export sector and on foreign products to meet domestic demand, it is evident why trade issues have become so politically explosive in recent years. With exports now constituting about a quarter of the economy in most countries and well over half in some, any major reduction in trade would require a vast economic restructuring that would entail huge welfare losses. Table 1.1 also helps to explain why the trade issues that have occupied Europe for decades have entered the policy agenda in the United States only quite recently. Though American trade reliance has increased dramatically, it has still not reached the level that was common in Europe decades ago.

Liberal economic theory claims that trade benefits all nations because it permits each consumer to buy the most desirable products and each **entrepreneur** to invest resources in the most productive way. As a result, consumption is maximized by the **efficient allocation of resources,** and both the global economy as a whole and each nation within it are better off. Considerable evidence supports the view that trade improves productivity, consumption, and therefore welfare. The growth of the global economy has been most rapid during periods of trade expansion, especially after World War II, and has slowed when trade levels have fallen, especially during the **Great Depression** of the 1920s and 1930s. Periods of national growth have also coincided with trade expansion, most notably in Germany, Japan, and Korea. There is some uncertainty about whether trade leads to growth or growth leads to trade, but there is little doubt