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I. Background — The Concepts Underlying U.S. Trade Laws and Policy

I have something of a dilemma with regard to the topic originally set forth in the program materials, a topic which is to focus in substantial part on "Trade Adjustment Policies." My problem with that topic, to be brutally frank, is that trade adjustment has never been a very significant element of U.S. trade policy or practice. It is true that throughout the post-war era all U.S. administrations have professed to be squarely opposed to protectionism. It is also true that the United States recognizes, as does the General Agreement on Tariffs and Trade ("GATT"), that protectionism should be permitted in cases where temporary protection from imports will enable a seriously injured domestic industry to "adjust" to import competition and become competitive again.

In practice, however, no administration has ever really had a coherent trade adjustment policy, nor have there been more than a handful of cases in which the potential for adjustment (i.e., modernizing, reducing costs, developing new products or otherwise using a period of temporary import protection to regain competitiveness with foreign rivals) has been the decisive issue in a U.S. determination of whether or not to grant import relief under the escape clause section 201 of the Trade Act of 1974 or any other statute. Rather, U.S. decisions on trade issues are motivated by very different considerations.

In discretionary import relief cases,[1] decisions almost always result from the interplay of domestic political forces against diplomatic or strategic considerations — an interplay which *always* takes place against a presumption that import relief *should not be granted.* That presumption stems from the basic trade ideology shared to some extent by all post-war administrations that free trade is desirable, that protectionism is to be avoided, and that market forces instead of government intervention should determine success or failure in the marketplace. That predisposition against discretionary import relief is reinforced where import restric-

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[1] This encompasses decisions under the escape clause (§ 201), the market disruption statute (§ 406), the National Security Amendment (§ 232), the Agricultural Adjustment Act (§ 22), and § 301, which can deal with unjustifiable or unreasonable practices relating to imports, although it mostly deals with export-related issues.

tions are perceived to be a threat to continued good relations (diplomatic or strategic) with one or more important foreign countries. In recent years, the potential adverse effect of import restrictions on less developed countries' ability to repay their debts has also weighed heavily against the petitioners in certain cases. On the other side, some U.S. industries have achieved import relief simply because their political influence is so immense that some accommodation is thought to be necessary. The steel and automobile industries come to mind in this regard. The perceived need to ward off strong protectionist sentiment in the U.S. Congress can also lead to affirmative discretionary trade decisions. For example, in September 1985, President Reagan headed off a textile import restriction bill by announcing an aggressive increase in section 301 activity.

In very few cases, however, does the concept of adjustment play an important role in trade decisions. The case most often cited as embodying the adjustment principle is the 1984 Harley-Davidson escape clause action involving imports of heavyweight motorcycles. It is certainly true that a major element of Harley-Davidson's campaign was a comprehensive (and already partially implemented) adjustment program, encompassing cost reduction, implementation of Japanese-style management techniques, automation, new product development and a number of other facets. It is also true that, in retrospect, the case demonstrated that the escape clause statute can work effectively as a significant element in the resuscitation of an American industry. Harley-Davidson was granted five years of import restriction relief, yet returned after three and one-half years to announce that it had completed its adjustment program, was now fully competitive again and did not need the remaining period of relief.

Even in the Harley-Davidson case, however, a strong adjustment argument would not have been sufficient, by itself, to obtain relief. In addition, the filing of the case had to be timed carefully to take advantage of election year politics and, much more importantly, a juncture of particularly severe stress in U.S.-Japan trade relations. This meant that the administration was receptive to the proposition that tough action against Japan on a highly visible (but not massive in terms of trade) product would be a good way to deal with political pressures for tough anti-Japan measures. This strategy, together with using Harley-Davidson's high level of public visibility to generate substantial congressional interest, was at least as significant as the adjustment arguments in obtaining the restrictions.

In the other major category of U.S. trade cases[2] there is another set of considerations that must be understood if one is to deal constructively with U.S. trade law and policy. This set of considerations relates to what is considered "fair" and "unfair" in international trade. While often de-

[2] These are nondiscretionary proceedings under the antidumping and countervailing duty laws and under § 337, dealing with patent, copyright and trademark infringement.

rided by free trade ideologues and by some foreign observers as covert or contingent protectionism, these fair trade concepts have both a coherent rationale and an important political role in U.S. trade policy.

The rationale for vigorous enforcement of statutes directed against "unfair" trade practices is a corollary of the basic free trade practices of U.S. international economic policy. If the United States says to its manufacturers and other industries that it expects them to behave in an economically rational manner, making decisions on the basis of market forces, then it is implicitly being said as well that those companies have the right to expect that the success of those decisions will be determined by market forces, undistorted by the actions of foreign governments or by anticompetitive or unfair practices of foreign competitors. Under this rationale, it is unfair for the foreign competitors to take business from the more efficient U.S. company by means of dumping (discriminatory or below-cost pricing) or by virtue of costs made artificially low by subsidization. In short, there are certain "rules of the game" which the United States has a right to expect that foreign governments and foreign exporters will follow. Where those rules are violated, the integrity of the free market is undermined.

From a political standpoint, most U.S. administrations have also believed that the unfair trade remedies serve as a safety valve to deal with pressures for protectionism. Thus, pressure on the President to erect quotas for the protection of specific industries, or to retaliate against countries with large trade surpluses against the United States, can be met by the response, "We can't do that, but we can deal with these problems by tough enforcement of the laws against unfair trading practices." Similarly, petitions for protectionist measures on behalf of domestic industries are often met with the response, "It's not our policy to take the type of protectionist action you want, but if you can find unfair foreign trade practices, we will move aggressively against them."

U.S. trade laws and policies cannot be meaningfully analyzed by starting from the assumption that their basic purpose is to promote adjustment of U.S. industries to import competition. Rather, both law and policy are more accurately understood as preserving the integrity of the free market in two ways. First, by establishing and enforcing rules of fair trading which eliminate distortions of the free market caused by foreign government intervention (principally through subsidies) or by unfair pricing tactics (discriminatory or below-cost pricing) by foreign competitors. Second, by balancing the political pressure arising from the loss, or threatened loss, of domestic jobs to import competition against the diplomatic, political and economic adverse consequences of protective measures, and by striking that balance in a way which ensures that protection will be the exception, not the norm.

II. The Looming Crisis for U.S. Trade Policy

We stand today at a juncture at which these trade laws and policies will be subjected to enormous stresses. The reason, of course, is that the U.S. trade account has incurred massive deficits, $170 billion in 1987 alone. This has occurred at a time when substantial impediments stand in the way of corrective macroeconomic action. The federal budget deficit, in particular the fact that the nation has increasingly turned to foreign lenders to finance the budget deficit and the high levels of private U.S. indebtedness, constitutes a major constraint on currency devaluation. The great danger is that foreign lenders, should they perceive a continuing decline in the value of the dollar, may stop supplying the funds needed to sustain increasing U.S. debt levels, or even worse, may start to pull their money out of U.S. debt markets. This would provoke a credit crisis, a sharp rise in U.S. interest rates and a deep and perhaps uncontrollable U.S. recession.

With governmental, business and consumer debt all at extremely high levels it is unlikely that the trade account can be improved by an induced recession and a consequent contraction in demand for imports. In the current debt-heavy situation, a recession could lead quickly to debt defaults, foreclosures and the type of severe deflationary pressures that could create a downward economic spiral reminiscent of the 1930s.

Also, the U.S. savings rate has lagged badly behind that of other developed countries. This will make it more difficult to achieve the modernization of U.S. industry necessary to improve U.S. international competitiveness. The situation is exacerbated by an emphasis on personal and corporate income taxes for funding government at all levels. This reliance seems likely to continue in light of the strong political opposition to consumption taxes (sales, excise or value-added taxes).

Finally, as the U.S. debt-driven demand has continued to grow, utilization of capacity in U.S. manufacturing has risen rapidly over the last year. This raises a serious question as to how much further progress can be made in increasing U.S. exports.

III. Present U.S. Trade Policy, and Why That Policy Is Likely to Fall Short

The Reagan administration has sought to deal with the trade deficit by means of a novel, and to date largely unsuccessful, combination of trade-related policies.

A. *Selective Dollar Protectionism*

Since the Plaza Agreement of September 1985, the major U.S. policy tool for rectifying the trade imbalance has been the encouragement of a steep drop in the value of the dollar against the Japanese yen and the major currencies of Western Europe. So extreme has been the dollar's decline that a charge that rivals or exceeds that of the old Smoot-Hawley

Tariff has been imposed against competitive merchandise from those countries. In the case of Japan, this charge now exceeds 100%. This currency devaluation, however, has been distinctly selective. Canada, Latin America, Australia and the export-oriented countries of the Pacific Rim[3] have been largely unaffected by the dollar's fall. In some cases, as in Latin America and Australia, the dollar has actually risen against the local currencies.

B. *Pressure for Foreign Economic Stimulus*

Since September 1985, the Reagan administration has continuously, and at times stridently, urged Japan and the major European nations (principally West Germany) to adopt macroeconomic policies aimed at stimulating domestic demand in those countries, including tax cuts, interest rate reductions and increased government spending on public works. The theory has been that increased consumption in those countries would reduce their exports as companies devoted more of their production to supplying the domestic market and creating demand for imports from the United States.

Japan has gone far in complying with U.S. requests of this nature, and imports into Japan have increased, but not U.S. imports. Japanese exports have remained at high levels. In the case of West Germany, U.S. pleas for economic stimulus have fallen on deaf ears, owing primarily to that country's tremendous fear of inflation. Indeed, inflation concern is high throughout much of Western Europe, and there is widespread talk today of the possibility of Europe-wide increases in interest rates in an effort to head off a perceived resurgence of inflationary pressures.

C. *"Toughness" Against Unfair Foreign Barriers to U.S. Exports*

Contemporaneously with the Plaza Agreement, the Reagan administration sought to defuse U.S. political pressure for protection against imports (especially in the form of a bill to limit textile imports) by announcing a new "get tough" policy against unfair practices by foreign governments. The main vehicle for the new policy has been section 301 of the Trade Agreements Act of 1979, which permits the U.S. Trade Representatives to respond to U.S. industry concerns about unfair foreign government practices by negotiating agreements to eliminate those practices, by filing complaints under GATT dispute resolution procedures, and by recommending to the President that he order retaliation against imports from a country that refuses to abandon its unfair practices.

Prior to September 1985, section 301 had fallen into disuse, owing largely to skepticism in the U.S. business community that forceful action

[3] In recent years, Korea, Taiwan and to a lesser extent Singapore, have grudgingly permitted their currencies to appreciate against the dollar by relatively small percentages compared with Europe and Japan. All three nations are now resisting further appreciation.

could be obtained under this entirely discretionary statute. All that changed with the 1985 announcement. To emphasize the new policy, the administration even commenced a practice of initiating cases without waiting for industry petitions. Viewed in the context of specific cases, the record to date has been good. Most of the cases since September 1985 have reached resolutions that have significantly improved the competitive situation of the aggrieved U.S. exporters. The cases involving the large dollar amounts, however, have proved most intractable. The Brazil "informatics" case is a good example. The overall impact of these cases on the U.S. trade deficit has to date been quite small.

The Reagan administration is optimistic that these policies will eventually eliminate, or significantly reduce or stabilize, the massive U.S. trade deficit. It would be surprising in the extreme if such a huge currency depreciation against many of our major trading partners did *not* have substantial trade effects, but those effects have certainly been delayed. To date, the benefits have been seen almost entirely in terms of increasing U.S. exports, and imports have shown a distressing tendency to keep rising even faster than exports in most periods.

In short, results to date must be described as disappointing. There are a number of reasons why this policy mix has not worked better, and why further improvement in the U.S. trade account (especially on the import side) may prove difficult without new policies or a major change in economic conditions, such as a recession. There are six major factors working against success of the administration's trade policies.

1. The Selectiveness of the Dollar Depreciation

As noted earlier, the dollar decline has focused almost entirely on the currencies of Japan and Western Europe. A major consequence of this phenomenon is that U.S. manufacturers do not necessarily benefit from reduced price competitiveness on the part of Japanese and Western European sellers. Rather, exporters from Canada, the Pacific Rim newly industrialized countries, or other low currency countries gain a substantial part of the U.S. market lost by the Japanese and West Germans. This phenomenon will be especially pronounced when, as is the case now, manufacturers in those countries tend to be at a cost advantage over U.S. rivals and expanding capacity more rapidly.

2. Tactics by Foreign Exporters to Offset Currency Savings

Currency depreciation can affect trade flows only by changing the price relationship between foreign and U.S. produced merchandise. The problem for the United States is that foreign firms have adopted pricing policies with respect to their U.S. exports that have greatly reduced the impact of the change in currency values. Specifically, they have kept their U.S. prices lower than their home market prices, and in many cases lower than the fully allocated cost of production, in order to remain competitive with U.S. merchandise and to retain U.S. market share.

American manufacturers, on the other hand, have seen foreign firms' U.S. price increases as an opportunity to raise their own prices rather than increase market share. There are two main reasons for this divergence in pricing behavior. First, foreign manufacturers are more oriented to market share and production level maximization than are American firms, who tend to put immediate profit maximization as their top priority. For many foreign firms, maintenance of U.S. market share is especially important because this is their largest export market. Second, many foreign manufacturers view exports differently than home market sales and differently than U.S. companies view exports. The purpose of exports, in the planning of these foreign companies, is to utilize that portion of manufacturing capacity not filled by domestic sales. Under this system, it is profitable to continue making export sales even when export prices fall below fully-allocated cost so long as prices are sufficient to recoup variable costs. This means that a currency swing of thirty percent or more will be absorbed by the foreign seller rather than result in a change of its U.S. prices. American companies, in contrast, tend not to make a distinction between the functions of exports and domestic sales. Rather, they price all sales at essentially the same ratio to cost of production.

3. Foreign Firms' Cost Reductions

Especially in the case of Japan, exporters have been adept at reducing costs by shifting component production and raw materials sourcing to low-currency countries on the Pacific Rim or in Latin America.

4. Foreign Government Intervention

In the trade areas that involve a very large volume of goods, and consequently large domestic employment, governments are often unwilling to permit currency changes to cause a shift in production away from their country. Instead, they attempt to offset the exchange rate adversity by industry-specific subsidies, import restrictions or other schemes.

Examples of this phenomenon during the recent dollar decline range from European subsidies for Airbus Industrie to Japanese agricultural import restrictions and European Community subsidies in the agricultural sector to more complex schemes such as the Japanese programs for the aluminum industry which entailed import protection on finished aluminum, together with subsidies to facilitate the transfer of primary aluminum production to Japanese-controlled facilities in low-currency countries.

5. The Disappearance of U.S. Production

In a number of industries, ranging from radios, televisions and videocassette recorders to substantial portions of the semiconductor industry, the disappearance of U.S. producers leaves foreign competitors free to raise their U.S. prices as the dollar falls. American consumers pay a higher price for those products and the trade deficit is increased by the higher value of the imports.

6. Capacity Limitations on U.S. Export Growth

The administration is fond of describing how American industry has reduced costs in the last few years, becoming "lean and mean." This is certainly true, but this increased cost-competitiveness has been achieved in significant part by measures which reduce production capacity: employment reduction, older plant closure, and production consolidation into fewer facilities. Such capacity reductions are one reason why many U.S. industries are now operating near the effective limits of their capacity. This suggests that, until and unless industry can expand capacity significantly,[4] further growth in exports may be much slower than has been experienced over the past several years.

IV. Prospects for Policy Change in the Next Administration

With less than a year remaining in office, it is clear that the Reagan administration will embark on no major changes in trade policy. Accordingly, we must look to the campaigns of Vice President Bush and Governor Dukakis for any significant initiatives. In this regard, one should understand that a U.S. presidential campaign is not the time to expect prescriptions for strong medicine of the type that may ultimately be necessary to deal with the trade deficit at the macroeconomic level. The types of plans needed include: specific proposals for the serious reduction of the budget deficit, such as defense cuts, social security reductions, and tax increases; shifting a significant part of U.S. taxation from income taxes to consumption taxes; inducing a recession to reduce demand for imports, or providing systematic governmental guidance of or assistance to investment and exports, and; long-term business planning (pejoratively referred to as an "industrial policy").

Indeed, this campaign year seems to be characterized by an aversion to specific proposals, especially in the economic area. Nevertheless, there are some legitimate observations that can be made as to the trade approaches of both leading candidates.

A. George Bush

For a man who once derided "voodoo economics," Vice President

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[4] Recent figures on industrial investment and on capital goods sales and imports are encouraging for long-term prospects. This is provided the investment is for expansion, not simply for replacement of outmoded equipment.

Bush now seeks, to a surprising extent, to identify himself with the economic policies of the Reagan administration. On the trade issue, Bush's rhetoric is more free trade, more anti-interventionist than Reagan's.

In general, a Bush administration could be expected to rely almost entirely on macroeconomic approaches to the trade deficit: further dollar depreciation and more pressure on Japan and West Germany to stimulate domestic demand. Moreover, like Reagan, Bush displays a distinct preference for dealing with the deficit by increasing exports rather than by reducing imports. Finally, the Vice President's background and previous pronouncements suggest that diplomatic and strategic considerations will continue to take priority over trade and economic considerations in international decision making and even in specific trade cases.

B. Michael Dukakis

In the early stages of the campaign, Governor Dukakis did not stress trade as a major issue. This is likely to change, however, as the Trade Bill deadlock between Congress and the president moves the Democratic Party toward greater emphasis on trade as a campaign issue.

Dukakis professes a basic preference for free trade, yet stresses the need for a greater government role in improving U.S. competitiveness. Although the governor has refrained from addressing specific trade issues, his campaign literature advocates "vigorous enforcement" of the laws dealing with unfair trade practices, including section 301 as well as the antidumping and countervailing duty laws. It also mentions an increased willingness to grant temporary escape clause protection to import-injured industries in return for commitments by those industries to take steps to regain competitiveness. Finally, his literature suggests a "New Global Economic Bargain" with major U.S. trading partners, involving reduction of the U.S. budget deficit, reform of Japan's international economic policies, greater growth in Europe, creative approaches to the less developed countries' debt crisis and commitment to a successful resolution of the GATT Uruguay Round.

There is an interesting point here. Governor Dukakis' "Massachusetts economic miracle" strongly emphasized the emerging, high-technology industries, implying a willingness at the national level to facilitate the transfer of resources from older industries to these newer and more competitive businesses. The points listed above, taken from his campaign literature, suggest a different orientation, one toward protecting and revitalizing basic, traditional areas of the U.S. industrial sector.

V. Probable Trends in U.S. Trade Policy

Regardless of which party wins the 1988 election, certain trends are likely to emerge in U.S. trading policy. Irrespective of philosophy, the next President will have to deal with the trade pressures arising from a likely recession sometime early in his term, and with the necessity of achieving at least a neutral trade balance, if not a surplus, by early in the 1990s.

A. *Increased Import Relief Litigation*

With the dollar having fallen against the currencies of Europe and Japan, most exporters in those countries are now maintaining U.S. market share by some degree of discriminatory or below-cost pricing or, less frequently, with the aid of government subsidies. When the U.S. economy begins to soften, with the result that U.S. industries will become able to prove injury, this condition will give rise to a large number of antidumping cases and a smaller, but still substantial, increase in countervailing duty cases.

There is an open question whether or not the next recession will also see an increase in discretionary import relief cases under sections 202, 406, and 232. The key factor here is the attitude of the next administration toward such cases. Presumably, a Dukakis election victory would be a signal to major industries that such cases would be more likely to succeed than was the case under the Reagan administration.

B. *Continued Use of Section 301 to Open Foreign Markets*

With U.S. industry increasingly competitive because of cost reductions and the lower dollar, elimination of foreign barriers to U.S. imports will become increasingly important. Any U.S. administration would prefer to see the trade gap closed by increased exports rather than by reduced imports. The major questions are whether or not foreign countries' resistance to U.S. exports will increase as their domestic industries become relatively less competitive, and whether or not the next administration will be more ready than President Reagan was to use U.S. retaliation as a lever to open foreign markets.

C. *"Wholesale" v. "Retail" Trade Negotiation*

Many in Congress, and not a few in the upper levels of the U.S. trade bureaucracy, have become increasingly frustrated with the perceived slow pace of progress in trade negotiations with a number of countries, notably Japan, Korea, Taiwan and Brazil. Proposals have begun to emerge for a change in U.S. negotiating practice away from "retail" talks dealing with a specific industry or government policy, toward some "wholesale" approach which would cut across product lines and encompass a number of industries or even the total spectrum of trade between the United States and that country. Both the Gephart and Super 301 amendments in the Trade Bill represent approaches of this type. A basic problem is that such a "wholesale" approach would represent a move away from eliminating unfairness and toward governmental management of trade volumes.

D. *Bilateralism*

A related trend is the use by the United States of bilateral, rather than multilateral, approaches to the setting of trading rules. The U.S.-Canada and U.S.-Israel Free Trade Agreements are examples of this approach, and a framework agreement has been reached for talks with Mexico. Even Japan has expressed interest in such talks. Whether this trend will continue depends largely on the progress in the GATT Uruguay Round. If those GATT negotiations were to bog down or to fail, a turn to bilateralism could be an attractive option for the United States.

E. *Attention to Adjustment — That's Right, Adjustment!*

Despite the historic lack of attention to trade adjustment, and despite the pessimism with which I began these remarks, circumstances may now be developing which could force the next administration to pay serious attention to the development of a trade adjustment policy. In a long-term perspective, the U.S. economy is in an era of fundamental change, moving away from reliance on the traditional "basic industries" (metal, autos, heavy manufacturing) toward a greater emphasis on information industries, services and the high technology manufacturing area. These changes will inevitably cause serious dislocations in terms of job loss and loss of the economic base of cities and regions.

Trade pressures are a major force behind these shifts. Therefore, government policies aimed at easing the pain of these economic changes (worker retraining or relocation, plant modernization, coordination between government and industry in investment and plant location decisions) are in a real sense "trade adjustment" policies. Under the Reagan administration, policy has been aimed at minimizing government intervention and allowing market forces to govern these changes. The extended economic recovery has made it politically possible to continue such policies despite some severe regional pains. However, the onset of a recession is likely to make it politically necessary to adopt policies to ease the burdens on laid-off employees, affected industries and economically injured communities. Thus, trade adjustment may well become a significant U.S. policy concern. The Dukakis campaign seems to be anticipating that possibility already.