U.S. Trade Policy at a Crossroad

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U.S. trade policy since the end of World War II has rested on two pillars: a multilateral approach to trade agreements and a commitment to rules rather than results. Support for each principle is rapidly eroding because of, among other things, record trade deficits and pessimism about the effects of exchange rate movements on trade flows. In fact, however, U.S. trade deficits are largely "homemade," and trade flows are responsive to changes in exchange rates. The U.S. has played a leadership role in promoting freer trade on a multilateral basis. Adoption of any one of a number of recently proposed alternative trade policy frameworks would be counter to that role.

SINCE THE END OF WORLD WAR II THE UNITED STATES HAS been perhaps the leading advocate among industrialized nations of liberalized international trade. It was the motivating force behind the General Agreement on Trade and Tariffs (GATT), the seven major trade negotiations pursued under its auspices, and the significant reductions in tariffs that these negotiations have produced.

Tariff liberalization, quite predictably, has promoted both trade and interdependence. The ratio of world exports to gross national product (GNP) has climbed throughout the postwar era, especially in the last two decades (Fig. 1). This is a healthy development. It implies that nations increasingly have found it cheaper to buy their goods abroad than to produce them at home, affording consumers around the world a wider choice of goods at less cost than if nations had continued to hide behind the high tariffs that they introduced in the 1930s.

Two principles underlie this success. First, the widespread reductions in tariff barriers were made possible only through multilateral bargaining. The industrialized countries formed GATT largely because of the economies in negotiation that could be purchased if a large number of countries reduced their trade barriers simultaneously rather than successively on a bilateral basis over a long period of time (*1*). Second, the GATT members agreed on the rules that should govern trade rather than on the results—import and export levels and balances of trade—that individual countries might find desirable or appropriate. In addition, the GATT parties agreed on a framework for resolving bilateral disputes over particular rules.

In the last few years, however, many in the U.S. academic, business, and policy-making communities have raised significant questions about each of these principles. The critics argue that the GATT multilateral framework is no longer viable: it is unsuited for reducing nontariff barriers, it lacks an effective enforcement mechanism, and the members themselves have lost interest in continued negotiations. One prominent economist, Lester Thurow, has even pronounced the GATT to be dead (*2*). The preferred alternative is bilateral or regional trade negotiations or even "free trade arrangements" (FTAs), such as those the United States recently completed with Israel and Canada.

Thurow and other critics go one step further. In their view, the new less-than-multilateral negotiations should specify outcomes. Unlike tariffs, which are easily observable and readily monitored, many nontariff barriers can be invisible and inherently difficult, if not impossible, to negotiate away. Results rather than rules should therefore become the centerpiece of trade negotiations.

There are many indications that support within the United States for the rules-oriented, multilateral approach to freer trade is rapidly eroding and that U.S. trade is indeed at a critical crossroad. In this article, we discuss the reasons for this trend, distinguishing along the way fact from myth. We then outline the major shifts in trade policy that critics of the old regime have advanced. We conclude that the critics are wrong. It is in the interest of the United States to vigorously renew its commitment to reducing trade barriers on a multilateral basis without specifying trade outcomes. But this country is unlikely to be successful unless it also undertakes certain measures at home to attack the major sources of current trade tensions.

Sources of Dissatisfaction

Four key factors have been undermining the commitment of U.S. policy-makers and business leaders to the GATT framework.

The trade deficit. The dominant influence, unrelated to the operation of the GATT, is the dramatic deterioration in U.S. trade performance. From a positive $7 billion balance in 1981, the U.S. current account (which includes trade in both goods and services) fell to a deficit of $154 billion only 6 years later, before improving modestly in 1988 to $144 billion.

As important as the U.S. deterioration is the dramatic improvement in the trade positions of the world's other two industrial leaders, the Federal Republic of Germany (FRG) and Japan. Until 1982 the ratio of the current account to total output in these three countries generally hovered within one percentage point of balance (Fig. 2). There has been a sea change since. The U.S. current account has fallen deeply into deficit (more than 3% of GNP); the mirror image is true for Japan and the FRG.

It is no coincidence that in 1985, around the time these trade imbalances became substantial, the U.S. Congress began debating the original version of what eventually became the 1988 Trade Act (*3*). Although complex and technical in nature, that proposal essentially was designed to dramatically weaken the U.S. commit-

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ment to multilateralism in trade policy. Instead, the bill proposed a unilateral tightening of U.S. laws against unfairly traded imports—those that are dumped, unlawfully subsidized, or in violation of our intellectual property laws. Perhaps most controversial was the amendment to the original proposal offered by Richard Gephardt (D–MO), now House majority leader, that would have rejected the "rules-oriented" principle of trade law as well (*4*). It would have required certain of our major trading partners, notably, the FRG, Japan, and Brazil, to reduce their trade surpluses with us over a 10-year period, or otherwise be subject to U.S. import tariffs and quotas to achieve that objective.

Fearing that a congressional trade initiative would turn strongly protectionist and thus risk a round-robin of retaliatory measures by our trading partners, the Reagan Administration followed a two-part strategy to weaken support for the legislation. First, it displayed a new "get tough" policy on unfair trade by launching complaints against South Korea and Brazil under the prevailing version of Section 301 of the U.S. trade law (*5*), authorizing retaliation against countries that unreasonably discriminate against the importation of U.S. products. Second, abandoning the previous free-market attitude toward exchange rates, newly installed Secretary of the Treasury James Baker negotiated in September 1985 a coordinated depreciation of the dollar against major European and Japanese currencies. The Plaza Accord, as it was called, was designed to reduce the overall U.S. trade deficit by cheapening U.S. exports in terms of foreign currency while raising the dollar price of U.S. imports. In fact, during the following 18 months, until the dollar was stabilized in the Louvre Agreement, the dollar fell by roughly 35% in real terms (adjusted for differences between countries in the rate of inflation) against an average of ten major currencies (*6*).

The Administration's initiatives bought valuable time and helped ease the political pressure for a protectionist trade bill. In particular, the depreciation of the dollar eventually halted the monthly rise in the trade deficit figures. The monthly deficit hit its peak in the fourth quarter of 1987 at $14 billion, but by mid-1988 was down to roughly $10 billion. Still, with so much political time and energy invested in trade legislation, Congress was not to be deterred from taking some action, which it did in the summer of 1988.

Significantly, the final bill signed by President Reagan contained a modified version of the original Gephardt amendment that continued to reflect a new unilateral direction in U.S. trade policy. Quickly dubbed "Super 301," this provision requires the U.S. government (not the GATT) to identify the countries that we (not the GATT) believe most burden our exports through their "unreasonable" policies (whether or not they violate GATT or any other international agreement) and then authorizes the President to retaliate against them if they do not agree within a short period to change those policies. Super 301 gets its name from the preexisting Section 301 of the trade law, which contains similar authorization without requiring the President to so publicly identify specific countries as priority "unfair traders."

Exchange rate pessimism. The pressure for the United States unilaterally to take even more aggressive actions against trading practices of other countries nevertheless remains and is likely to intensify. The principal reason stems from a phenomenon labeled by some as "exchange rate pessimism," a powerful second force for weakening the long-standing U.S. commitment to a multilateral rules-oriented trade policy.

Simply put, the pessimists submit that movements in exchange rates do not have a significant effect on trade patterns and thus trade rules must be changed to guarantee an improvement in the U.S. trade balance (*7*). For example, it is thought in some quarters that the substantial decline of the dollar since 1985 did not "work" because the U.S. trade deficit continued to deteriorate through

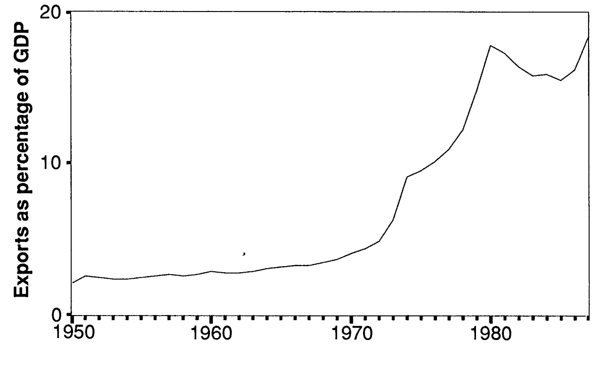

Fig. 1. Ratio of world exports to world gross domestic product, 1950 to 1987 (*31*).

1987. Frequently noted is the anti-import bias in Japan relative to other industrialized countries. In 1986, for example, Japan imported only 4.4% of its manufactured goods, compared to 13.8% for the United States and 37.2% for the FRG (*8*). This apparent discrimination against imports, it is said, accounts for the fact that despite the near doubling of the value of the yen against the dollar between 1985 and 1988, the U.S. trade deficit with Japan has actually remained stuck at roughly $50 billion (*9*).

In fact, economists have repeatedly shown through statistical tests that the pessimists are wrong: trade flows are clearly responsive to changes in prices of both imports and exports (*10*). Roughly speaking, these studies demonstrate that for every one percentage point change in prices, the volumes of both exports and imports also change by at least one percentage point. To be sure, not all movements in exchange rates are reflected in prices of traded goods. Foreign exporters to the United States, in particular, have not passed on in the form of higher dollar prices to U.S. consumers a substantial fraction of the dollar depreciation since 1985 (*11*). Nevertheless, several well-known econometric models have tracked U.S. trade performance remarkably well through the 1980s by using the standard statistical relation between trade flows and exchange rates.

For example, Helkie and Hooper, whose statistical estimates of U.S. trade behavior are used at the Federal Reserve Board, projected in 1984 the U.S. current account 2 years ahead (*12*). Their projections for 1985 and 1986 erred by only 1.1%. More recently,

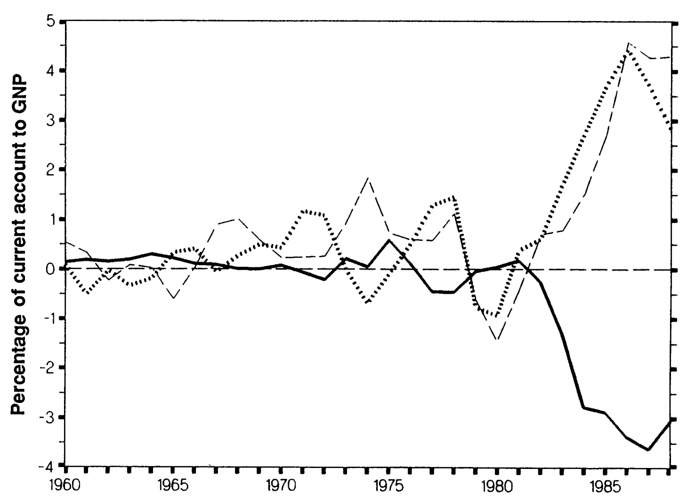

Fig. 2. Ratio of current account to GNP for the United States (solid line), Japan (dotted line), and the FRG (dashed line), 1960 to 1988 (*32*).

Bryant averaged the current account forecasts of five well-known trade models made both in January 1987 and December 1987, correcting for changes since the earlier projection in dollar exchange rates, oil prices, and GNP (*13*). The projections are highly accurate for 1988 (Table 1). The revised current account projections for 1989 appear somewhat optimistic, but the dollar rose in value after those projections were made, which helps account for the slower rate of current account improvement likely to be recorded in 1989.

Why then has the U.S. trade picture brightened so modestly in the face of the substantial dollar depreciation since 1985? The principal answer lies in the mathematics of the trade deficit and the sheer momentum for continuing deficits that the numbers build in. In 1984, before the dollar began to fall, the dollar volume of U.S. imports exceeded U.S. exports by nearly 60%—$346 billion to $224 billion. Thus, even if both exports and imports continued to grow at the same rate thereafter, the trade deficit would have widened simply because imports have been able to advance from a larger base. Indeed, without the dollar's decline since 1985, it has been estimated that the U.S. current account would have fallen into deficit by roughly $200 billion in 1988, instead of the $127 billion that was actually recorded (*14*). Similar reasoning explains why the U.S. bilateral trade deficit with Japan has barely moved since 1985 (*15*).

This is not to deny the real nontariff trade barriers maintained in Japan. Lawrence has calculated that based on its state of economic development, Japan's imports of manufactures are approximately 40% below international standards (*15*). But despite these barriers, movements in the yen-dollar exchange rate have clearly affected trade between the two countries. Between 1980 and 1985 when the dollar rose in nominal terms against the yen by 5%, Japanese purchases of U.S. goods increased by just 6% (from $20.8 billion to $22.1 billion). But from 1985 to 1988, a period when the dollar fell by 53% against the yen, U.S. exports jumped by 70% (from $22.1 billion to $37.4 billion) (*16*).

Still, although the pessimists may severely understate the effects of exchange rate movements, if the level of the dollar remains roughly where it has been through most of 1989, pressures almost certainly will intensify for the United States to move away from its traditional multilateral, rules-oriented trade policy even further. Given the arithmetic momentum behind continued trade deficits, exports must grow at a substantially faster pace than imports in the future simply for the U.S. trade deficit to remain where it is. But that is not likely to occur unless U.S. exports get significantly cheaper in terms of foreign currency, that is, unless the dollar continues to fall. For example, four well-known trade models project that improvement in the overall U.S. current account will bottom out in 1990 and resume its upward climb thereafter (Table 2), given various levels of the dollar exchange rate from December 1987 through November 1988, when the value of the dollar was lower than at this writing and thus even more hospitable to trade improvement.

Table 1. Average projections of the U.S. current account deficit of five econometric models (*13*).

Projections	Billions of dollars		
	1987	1988	1989
January 1987 projections	141	133	146
Adjusted projection for December 1987 exchange rates, oil prices, and GNP growth	142	125	108
Actual	144	127	121*

*Annualized figure based on extrapolation of first two quarters.

Table 2. Alternative projections of the U.S. current account balance (*29*). OECD, Organization for Economic Cooperation and Development; DRI, Data Resources Institute.

Study	Date	Real exchange rate basis	Projections (billions of current dollars)			
			1989	1990	1991	1992
OECD	December 1988	2 November 1988	−116	−108		
DRI-Gault	December 1987	July 1988	−134	−154	−177	−201
Bryant	January 1988	December 1987	−108	−113	−127	
Cline	November 1988	4th quarter 1987	−119	−130	−143	−153

A multipolar world. Perhaps no event in the 1980s has been more unexpected than the significant easing of East-West tensions. At the same time, U.S. economic hegemony has disappeared. The United States is now a net debtor nation, owing increasing sums to Japan, the FRG, Taiwan, and other nations with large trade surpluses. In short, in both economic and political spheres the bipolar world that we lived in before 1980 has been replaced by a world increasingly governed by multiple centers of economic and political strength.

Paradoxically, the emergence of a multipolar world may be weakening commitments to the system of multilateral trade rules and negotiations. The GATT was formed in 1948 very much as the free world economic counterpart to the formal and informal political-military alliances formed between the United States and many other countries after World War II. In particular, at least in its early stages, the GATT was dominated by the United States and was seen in a bipolar context. The Soviet Union was not a founding member and still does not belong today, although recently it has expressed interest in joining.

The thawing of the Cold War and the splintering of economic and political influence around the world weaken the relative importance of the United States and thus subtly undermine continued commitments by other nations to the multilateral trade process. In addition, whereas in the United States freer trade was perceived to be in the interest of many industries because they were more productive than their foreign counterparts and thus wanted access to their markets, now many U.S. industries have lost their competitive edge (*17*). In such an environment, freer trade can mean severe disruption, loss of jobs, and lower profits—outcomes that make it politically difficult at home for the United States to continue its leadership of the trade liberalization movement.

Weaknesses in the GATT. Finally, the GATT itself has weaknesses. These have existed since the GATT was formed, but they have been seen as more irritating as tariff barriers have been reduced and as other trade tensions have surfaced.

First, the GATT lacks an effective enforcement mechanism. Ironically, it was the U.S. Congress that was primarily responsible for this defect when it rejected the formation of a multilateral enforcement arm for GATT, the International Trade Organization. Second, the GATT fails to cover large areas of trade: agricultural products, services, and textiles (governed by a multicountry system of quotas arranged under the Multi-Fiber Arrangement) (*18*).

Third, and perhaps most important, an increasing share of trade within the industrialized countries is being burdened by nontariff trade barriers, especially so-called "voluntary restraint agreements" (VRAs) designed to circumvent the letter of the GATT (*19*). VRAs are technically legal because they are negotiated "voluntarily" between importing countries, such as the United States (one of the worst offenders in the 1980s, with restrictions on imports of steel

Table 3. U.S. investment-saving balance, expressed as percentage shares of net national product (*30*).

Savings and investment	1951–1980	1984–1986	1987–1988
Saving			
Private	9.2	8.1	6.3
Government deficit (state and federal)	−1.2	−5.0	−4.0
Total national saving*	8.0	3.1	2.4
Domestic investment	7.6	6.2	5.9
Net U.S. investment abroad* (current account balance)	0.4	−3.2	−3.5

*Totals may not add due to rounding.

and automobiles), and their exporting trading partners. But the "voluntariness" of VRAs is clearly a fiction, and it is widely understood that they run afoul of the spirit of the GATT.

To many, the weaknesses in the GATT highlight the futility of the organization and the multilateral process of negotiation that it represents and encourages. To others, the missing links in the GATT, much like the nuclear weapons stockpiles of the major military powers, represent challenges for future negotiators to overcome. The GATT members are now addressing this challenge as part of the current Uruguay round of trade negotiations, scheduled for completion by the end of 1990 (*20*).

Options for U.S. Trade Policy

The factors weakening the U.S. commitment to the postwar multilateral, rules-oriented trade regime have prompted a vigorous debate within the political and academic communities in this country about what principles should govern U.S. trade policy in the future. Three schools of thought, somewhat overlapping, have emerged.

The first, and least revolutionary of the alternatives, advocates that the United States itself fill the enforcement void in the GATT by playing the role of "super-cop." The United States has already embarked down this path, not only in adopting the new Super 301 provisions of the 1988 Trade Act, but in President Bush's decision in May 1989 under those provisions to single out Japan, Brazil, and India as countries engaged in discriminatory practices and thus "priority" targets for our retaliation if those practices are not soon ended (*21*).

The second alternative also focuses on rules, but it advocates bilateral FTAs with other like-minded countries—Mexico, South Korea, Taiwan, and even Japan—modeled on the recent FTAs the United States negotiated with Canada and Israel, as well as the more ambitious integration effort now under way in Europe. The FTA policy model, which urges the bilateral negotiation of new rules on many subjects not covered or imperfectly covered by GATT (including investment, services, and agriculture), is thus more forward looking than the "super-cop" approach, which seeks unilateral enforcement of existing rules (that the United States sets) on a case-by-case basis.

Frustration with the slow pace of GATT negotiations has been a principal rationale advanced for the United States to seek more FTAs. The Tokyo Round, for example, took 6 years to complete (from 1973 to 1979). The current Uruguay Round was launched in the early 1980s and may not even be completed on schedule in 1990. Thus, the Reagan and Bush Administrations have pushed FTAs precisely in order to prod the GATT to move faster. Three well-known economists have recently offered a different justification: The world trading system is going "bilateral" in any event, so we might as well accept that fact and ensure that that process moves in a constructive rather than destructive direction (*22*).

The third trade policy alternative would jettison not only the emphasis on multilateral action but on rules as well. Instead, it would "manage trade" by having the United States set bilateral trade targets with our trading partners. The targets could cover only our exports to them or our overall trade balance (as the Gephardt amendment advocated). Similarly, the targets could be set for individual products or industry sectors or could cover all trade (*23*).

A Critique of the Critics

Each of the suggested alternatives to the traditional multilateral, rules-based trade policy followed by the United States has its appeal. But each also holds dangers that we think outweigh any benefits they may achieve.

The least risky, but also least promising, alternative is the United States as super-cop. As President Bush's decision under the Super 301 provision demonstrated, there will always be competing foreign policy objectives that any chief executive must take into account in deciding whether to single out individual countries as "unfair traders." It is widely assumed, for example, that the Administration exempted the European Community nations from the priority list primarily in order to avoid exacerbating then-worrisome tensions within the North Atlantic Treaty Organization over an appropriate response to the Soviet Union's nuclear arms reduction proposals.

But even President Bush's minimalist 301 effort has its risks. Several of the practices targeted by the President, notably India's trade-related investment measures and its insurance practices, are not covered by the GATT. If, therefore, we retaliate against these measures, our actions would violate the GATT and entitle the targeted countries lawfully to retaliate against us. Critics also have been too quick to dismiss the efficacy of the GATT enforcement mechanism. Of the 75 disputes brought before the GATT through September 1985, 88% were settled or dropped by the complaining country (*24*). By circumventing the GATT dispute resolution mechanism, we weaken the commitment of other nations to lawful settlement of trade disputes.

Bilateral or regional FTAs do not offer a much better solution, and conceivably, could produce a worse one. The premise underpinning the case for more FTAs—that GATT negotiations take too long—is questionable. In fact, once the parties in the Tokyo Round got down to hard bargaining, agreement was reached in only 18 months, about the same time that was consumed in the United States–Canada talks (*25*). Similarly, the tough negotiating in the current Uruguay Round did not really begin until President Bush assumed office, and even if completed late, in 1991 for example, would take less than 3 years—a major accomplishment given the round's ambitious objectives.

Moreover, as pioneering as they were, the FTAs with Canada and Israel were relatively limited in scope. Neither dealt with the highly controversial issues that are now being discussed in the Uruguay Round, including agricultural subsidies, protection of intellectual property rights, and restrictions on services and investment, or the subjects that inevitably would be on the table in future FTA discussions with other countries. Indeed, if the advocates are right that many restrictions against imports are extralegal and thus not amenable to international agreement—such as the complex Japanese distribution system, for example—then FTAs could disadvantage the United States; we would further open our market without meaningful reciprocal concessions.

More FTAs could actually harm world trade. In purely economic terms, such arrangements have two offsetting effects: although they may promote more efficient location of production within the areas covered by the agreements and thus enhance trade and consumer welfare, they may also divert trade from other countries outside the agreement to those inside. Although the net effect of these two tendencies will differ in different cases, it is noteworthy that three of the recent advocates of more bilateral arrangements have also estimated that the 1992 integration effort with the European Community will divert more trade than it creates (*26*).

More fundamentally, however, further movement by the United States—the leader of multilateral trade liberalization efforts since the end of World War II—toward bilateral or regional pacts runs a serious risk of undermining, if not unraveling, the GATT. Indeed, given the current inward-looking focus of the Europeans and Canada's new-found partnership with the United States, who would be left to lead the liberalizing process in the GATT if we, too, abandon our commitment to multilateralism? The answer is no one.

Instead, nations would quickly enter a free-for-all to obtain from each other the best deal each could. The world trading system would thus degenerate into a complicated maze of discriminatory bilateral and regional arrangements. Frictions would dramatically increase over "rules of origin" because it would then become all-important to know from which country imports and exports had "originated." In a world of multinational enterprises that often manufacture products in multiple locations, disputes about rules of origin could lead to serious trade rifts and would lead to substantially more red tape and uncertainty for all those involved in international trade.

Finally, the managed trade alternative rests on equally shaky premises and holds perhaps the greatest dangers of all. The principal argument for managed trade—that product-specific bilateral negotiations, especially those with Japan, are worthless—is simply not correct. As Lawrence has shown, the Advisory Committee for Trade Policy and Negotiations has unwittingly provided data in its report recommending managed trade that, in fact, demonstrate the success of previous negotiations with Japan (*27*). Between 1985 and 1987, U.S. exports to Japan of medical drugs and equipment, electronics, forest products, and telecommunications—sectors targeted by the U.S. trade negotiators—collectively increased by 47%, or twice the growth of all U.S. exports to Japan during this period.

In any event, the setting of trade targets would be counterproductive. If the targets were bilateral trade balances, it is more than likely that foreign countries would be happy to comply by restricting their exports to the United States rather than liberalizing imports. Like the VRAs that have limited the exports of Japanese cars and steel, these new restrictions would simply raise the price of goods exported to the United States and increase the profits of the foreign producers. Meanwhile, forcing foreign consumers to buy U.S. products they have not voluntarily chosen to purchase can hardly enhance the attractiveness of American goods overseas.

Preferred Trade Policy

If none of the alternative trade policy regimes offer significant advantages, what then should be done about America's obvious trade problems—reflected in its $100 billion–plus trade deficit?

The answer most economists have given has been frequently heard, routinely ignored, but still remains correct. In a world of flexible exchange rates, a nation's trade balance—or more accurately, its current account balance—is fundamentally determined not by its trade policies but rather by its spending patterns.

By definition, the current account balance measures the difference between a nation's saving and investment. High-saving countries like Japan that do not invest all of their savings at home export the surplus and invest the proceeds abroad. Low-saving countries like the United States that invest more than they save must import the difference and borrow from abroad to finance their current account deficits. Exchange rates are the primary medium through which shifts in spending patterns influence the trade balance. As a nation increases its saving relative to its investment, its interest rates fall and so does its exchange rate, as investors seek assets denominated in currencies where yields are higher. Conversely, as a nation decreases its saving relative to its investment, its interest rates rise and so does its exchange rate.

Table 4. U.S. trade balance by region (*16*).

Country	Billions of dollars 1980	Billions of dollars 1988*
Canada	−0.5	−12.1
Japan	−8.6	−49.2
Western Europe	12.4	−15.1
OPEC	−30.5	−9.8
All other countries in the world	−0.1	−38.9

*First three quarters at annual rate.

Until the 1980s, the United States invested what it saved and thus ran a current account balance near zero. In this decade, however, U.S. savings rates as a share of net national output, both public and private, have fallen dramatically relative to our investment rates, which have also fallen (Table 3). The shortfall in domestic saving required for investment has required us to import the difference, both in capital and goods, from abroad (*28*).

In short, the cure for our trade imbalance lies in either substantially raising the fraction of national income that is saved or lowering the fraction that is invested. Clearly, the first of these choices is more palatable, if more painful, than the second.

It is not widely appreciated, however, that the removal of foreign trade barriers will have little effect on our trade position. In the short run, lower barriers would permit an increase in our exports and thus reduce the overall deficit. But a declining deficit shrinks the available supply of dollars on the market and thus drives up the dollar exchange rate. A higher dollar, in turn, discourages exports and encourages imports. Over the long run, therefore, lower trade barriers have no effect on the trade balance.

By the same reasoning, it is a mistake to blame the deterioration in our trade accounts on unfair trade. Between 1981 and 1988, the U.S. trade position declined with every major trading area around the world, except the nations of the Organization of Petroleum Exporting Countries (OPEC) (where the United States benefited greatly from the drop in oil prices) (Table 4). This pattern makes it difficult to believe that a worldwide conspiracy to discriminate against U.S. imports could have suddenly developed only in this decade.

It is, nevertheless, in our interest to remove unfair impediments to our exports; doing so will raise the dollar exchange rate at which the United States can achieve balanced trade. A higher value of the dollar, other things being equal, permits American citizens to buy more imports for a given dollar expenditure and thus to enjoy a higher standard of living. The critical trade policy question, therefore, centers on what strategy can best be used to achieve a significant reduction in foreign trade barriers.

In our view, the best approach lies not in abandoning the rules-oriented, multilateral strategy that the United States has pioneered since World War II, but instead in reaffirming the commitment to that strategy and enlisting the vigorous participation of our trading partners. At a purely political level, we think that other countries that maintain trade barriers are more likely to lower them in response to international pressure, lawfully applied through the GATT, then solely in response to U.S. complaints. Indeed, our "lone ranger" attitude toward other nations' trade barriers runs a severe risk of tarnishing our broader political influence. For example, U.S. relations with both Japan and South Korea have already been severely strained as a result of our constant pressure on particular trade issues. Resentment builds, meanwhile, as the United States continues to demonstrate an inability to significantly reduce its national overspending, which other countries think, quite correctly, is the overwhelming reason for their trade surpluses with us.

The United States even runs broader geopolitical risks if it abandons its mantle of leadership on multilateral trade liberalization. It is fitting to recall the history of the period between the two major world wars of this century, when the rise of rival trading blocs contributed significantly to the tensions that led to World War II. Similar tensions led to repeated conflicts in the 17th and 18th centuries. Only when Great Britain, espousing the free trade principles of Adam Smith and David Ricardo, emerged as the dominant world power in the 19th century did these conflicts abate. The United States assumed this mantle of leadership toward free trade after World War II and until now has promoted increased liberalization, more trade, and improvements in living standards around the world.

It would be a severe mistake for the United States to abandon its leadership role simply because of its inability to address the root causes of trade difficulties abroad and its economic weaknesses at home. In the long run, we should realize that trade is still a positive sum game, not the zero sum game some have now contended. We should not be distracted by current tensions into wrecking the multilateral trade system that has helped bring all of the nations that participate in it to unprecedented levels of economic well-being.

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