U.S. TRADE POLICY AND THE TOKYO ROUND OF MULTILATERAL TRADE NEGOTIATIONS

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PREFACE

Since early 1975, the United States has been participating in the Tokyo Round of multilateral trade negotiations in Geneva. These negotiations appear to be nearing their conclusion. If and when an agreement is reached in Geneva, the text of the proposed agreement and a program of implementing legislation will be submitted to the Congress for approval.

In preparation for its responsibilities regarding a proposed international trade agreement, the Subcommittee on International Trade of the Senate Finance Committee has requested that a number of organizations prepare studies on various aspects of U.S. international trade policy. This paper represents the Congressional Budget Office's contribution to this effort.

This paper does not provide a detailed analysis of the specific terms of possible trade agreements. Rather, it presents a discussion of the likely general effects of trade liberalization on the U.S. economy and of some of the longer-term problems--not all of which are being considered in Geneva--for U.S trade policy. Reports by other organizations will discuss the specifics of the proposed agreements. In keeping with CBO's mandate to provide nonpartisan and objective analysis, this paper offers no recommendations.

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SUMMARY

The multilateral trade negotiations (MTN) now underway in Geneva have become the focus of growing interest in U.S. policy toward international trade and, more generally, in the entire set of rules and practices that govern the conduct of international trade. These negotiations, in which 98 nations are participating, have as their goal the conclusion of multilateral agreements that will result in major tariff reductions, in substantial progress toward the reduction of a variety of nontariff barriers, and in general reform of the rules and procedures laid down for international trade in the General Agreement on Tariffs and Trade (GATT).

This round of negotiations has been underway since early 1975 and is now nearing its conclusion. On January 4, 1979, the President, in accordance with the terms of the Trade Act of 1974, notified the Congress of his intention to enter into a multilateral trade agreement. Ninety days after this notification, the President may conclude a trade agreement. He will then submit the text of the agreement, along with the required implementing legislation, to the Congress for approval, and the agreement will enter into force for the United States upon enactment of the implementing legislation.

The Trade Act of 1974 prohibits the Congress from amending the trade agreement after it has been formally submitted by the President. The terms of this agreement, however, are expected to be quite broad, allowing considerable leeway for interpretation. The exact content of the implementing legislation will be a matter for negotiation between the President and the Congress, and thus the Congress will exercise considerable influence over the ultimate effect that any new trade agreement will have on the U.S. economy.

Events of the last few years--oil price increases, worldwide recession, international monetary instability, widely varying rates of inflation, and the emergence of some developing countries as exporters of manufactured products--have placed strains on the trading system, shifting patterns of trade and producing large imbalances in the flow of trade. Some of these same factors have had the effect of disrupting domestic economies and causing

significant dislocation of workers. In these circumstances, it is not surprising that pressure for more restrictive trade policies is growing in many countries. Indeed, in the developed countries from which data are available, the last three years have seen a noticeable increase in official actions that have the effect of limiting imports. Although the primary goal of the Geneva talks is a significant liberalization of world trade arrangements, many see agreement in Geneva as necessary if the current liberality of trading arrangements is to be maintained. Without an agreement, these observers argue, it will be impossible for many governments to resist growing pressure for protectionist policies.

For the most part, the "new protectionism" that is emerging has taken the form of nontariff barriers to trade. Thus, most attention at Geneva has focused on agreements governing such practices rather than on the tariff reductions that will also be part of any agreement reached in Geneva. Unfortunately, the effects of reductions in many nontariff barriers are very difficult to quantify and must sometimes be excluded from formal analyses of the effects of liberalized trade.

THE PRESENT SITUATION

The most striking development in the international trade of the United States has been the emergence in 1977 and the continuation in 1978 of a large deficit for merchandise trade. The causes of this deficit are well established: relatively slow economic growth and thus weak demand for U.S. goods abroad, increased U.S. oil imports, and the delayed effects of some loss in U.S. competitiveness in world markets caused by relatively rapid inflation in the United States. Nothing that is decided in Geneva will weaken these influences, and thus a successful conclusion of these negotiations cannot be expected to eliminate or markedly reduce (or increase, for that matter) the U.S. trade deficit.

Of more relevance to the Geneva negotiations are some changes in the structure of U.S. trade, particularly trade in manufactures, that have been occurring in recent years. Traditionally, the United States has been an exporter of agricultural products and of manufactured products that embody highly sophisticated technology. The United States has been an importer of fuels and raw materials and of relatively simple, light manufactured goods. This characterization remains accurate today. If anything, the relative strengths and weaknesses of the U.S. economy have become

more marked over the last few years, with the U.S. surplus in heavy manufactured goods doubling between 1970 and 1977 and the U.S. deficit in light manufactured goods increasing two and one-half times during the same period.

In the cases of both heavy and light manufactures, most of the changes in the U.S. trade position can be accounted for by trade with the developing countries. U.S. exports of heavy manufactured goods to developing countries increased three and one-half times between 1970 and 1977, while imports of light manufactured goods from these same countries increased four and one-half times during the same period. The U.S. balance of trade in manufactures has held relatively constant with respect to the other developed countries, with the dramatic exception of Japan, which has increased its exports of heavy manufactures to the United States more than fourfold since 1970.

The significance of all of this for the MTN is that the changes that are occurring in the U.S. trade position are caused mostly by Japan and the developing countries, nations often cited as maintaining high barriers to foreign imports while aggressively encouraging their own exports. It would seem that an important aspect of any trade agreement would be how it affects U.S. trade with these countries.

THE IMPLICATIONS OF FREER TRADE

The arguments for free international trade are well known: if each nation specializes in the production of the goods that it can produce relatively efficiently and trades these for other goods produced relatively efficiently abroad, all nations benefit through a more efficient production of all goods. Freer trade can also serve to slow inflation by making foreign goods more readily available when these are less expensive than domestic products. Further, the potential for foreign competition can place pressure on domestic producers to moderate price increases. The world is much more complex, of course, than this simple model suggests, and numerous exceptions to the general proposition that free trade benefits all parties have long been recognized. Nonetheless, recent studies seem to indicate clearly that a general liberalization of trade arrangements could bestow measurable economic benefits on the United States.

What is beneficial to the economy as a whole is not, however, beneficial to all individuals within that economy. For

trade liberalization to be effective, it must result in some structural changes in the U.S. economy. For some U.S. industries, a general reduction of trade barriers will mean increased access to foreign markets, increased sales, and increased demand for workers in these industries. Inevitably, however, other industries in the United States are likely to suffer; increased foreign competition will reduce their sales and some of their workers will be displaced. The costs of relocating these workers must be included in any calculation of the net benefits of freer trade.

Recent studies have indicated that in the United States the most likely beneficiaries of freer trade will be those industries that exploit highly sophisticated or recently developed technologies or those that produce or process agricultural commodities. Highly skilled and agricultural workers will probably benefit from freer trade, as will the southern, western, and midwestern areas of the United States. Among the potential losers as a result of trade liberalization are relatively labor-intensive industries and industries that employ simple, well-known technologies. Semiskilled workers are likely to suffer the most from freer trade, and most of the jobs lost will be in the traditional, urban manufacturing areas of the North and East.

While the employment effects of trade liberalization may be large in particular industries, they are likely to be quite small for the economy as a whole. Estimates of net changes in employment that will result from trade liberalization of the sort being discussed in Geneva are generally less than one-tenth of one percent of the total labor force. A reduction in trade barriers would have only a small impact on the general rate of inflation--much smaller than the effects of federal fiscal and monetary policy. (Freer trade could prove a significant moderating influence on prices in a few particular sectors, however, and as such could constitute a useful element of a general anti-inflation program.) Nor would trade liberalization bring about major changes in the overall U.S. trade position. Finally, changes in the prices of internationally traded goods resulting from tariff reductions will be minuscule compared with the changes brought about by recent exchange rate movements. In sum, the short-term macroeconomic effects of trade liberalization are likely to be negligible.

Some longer-term benefits--not easily captured by traditional economic analysis--might also result from a general reduction in trade barriers. It is impossible to estimate the magnitude of these benefits--deriving from larger-scale production, from more

rapid innovation spurred on by increased competition, or from the ability of governments to adopt expansionary economic policies with less fear of inflation--but few would argue that such benefits are unlikely. Perhaps the most important effect of reaching a multilateral trade agreement, however, is not economic, but political. The Geneva negotiations represent a major effort on the part of most of the market-oriented economies of the world to cooperate in achieving common goals. The success or failure of these talks could have an important effect on the prospects for such cooperation in the future.

SOME SPECIAL PROBLEMS FOR U.S. TRADE POLICY

While the Geneva negotiations may contribute to the maintenance of a liberal world trading system, they will not provide a solution to some of the most difficult problems that will confront U.S. policymakers during the next few years. With the partial exception of government involvement in international trade, these problems are not even being addressed in Geneva.

The last few years have been marked by the widespread acceptance of, and in many cases demand for, government involvement in economic matters. Such involvement complicates the problems of setting rules for "fair" trade by introducing a host of mechanisms for government support or subsidization of exports and restriction of imports. To the extent that actions of other governments distort international trade flows, the traditional arguments for free trade are weakened, and free-trade policies that do not take account of these distortions may not be in the interest of the United States.

Often, government involvement is not intended primarily to foster exports or to restrict imports; rather, the intervention is undertaken for domestic reasons. It can, nonetheless, influence trade, and a major task facing the negotiators in Geneva has been to devise a set of guidelines for determining what types of government practices are acceptable. Some progress in this area is expected, but it is likely that only the most blatant cases of government intervention in international trade can be restricted by international agreement. The more subtle and complex forms of intervention will continue to cause difficulties, and perhaps the major contribution of the Geneva talks in this regard will be the establishment of a set of procedures by which future disputes over specific practices can be resolved. Growing trade with centrally planned economies (which are not represented at Geneva) will also

pose special problems in determining what constitutes "fair" international trade. This is so both because governments in these countries are involved in nearly every phase of economic activity and because these governments are not parties to the major international agreements on trade policies.

Problems are also created for the United States by a recent trend toward "bilateralism," the practice of concluding bilateral arrangements that bind two participating countries to accept specified levels of imports from each other--in some cases, over a period of several years. Such agreements have been most common between developed nations and oil-producing nations. Inasmuch as such bilateral arrangements can insulate large amounts of international trade from normal market forces, they can constitute important barriers to trade. Thus far, the United States has no clear policy on such agreements and has been less aggressive than other nations in concluding such agreements. Some observers have expressed the fear that in the future, the United States will have no choice but to enter into bilateral agreements if it is to maintain its present share of world trade.

It is sometimes alleged that the transfer of U.S. technology abroad by private firms has increased foreign competition to U.S. producers. That the transfer of this technology has aided other nations in establishing new industries cannot be doubted. It seems, however, that there is little that the United States can do to halt this flow. With very few exceptions, U.S. technology is available in other developed countries, and if U.S. firms cannot transfer it, firms in other nations will. Even if it were possible to restrict effectively the flow of technology, it would probably not be in the interest of the United States to do so. Capital goods, the principal embodiment of U.S. technology, account for one-third of U.S. merchandise exports. To restrict their sale abroad would hinder U.S. exports--most probably more so than does increased foreign competition.

Finally, a number of U.S. producers have claimed that the costs of meeting federal environmental and occupational safety standards have reduced the competitiveness of U.S. goods in world markets and that some protection should be offered to industries so affected. Direct protection, however, is prohibited by the provisions of the GATT and would be likely to bring forth retaliation by other countries. Subsidies for affected industries create a similar risk if they are seen as being intended primarily to keep domestic producers competitive with foreign producers. More fundamentally, many groups have suffered as a result of

recently imposed federal regulations; it would be hard to justify a program aimed at compensating only those engaged in foreign trade.

CONCLUSION

A successful conclusion of the Geneva trade negotiations could provide some measurable, but small, net economic benefits for the United States. Of potentially much greater significance, however, is the possibility that, without an agreement in Geneva, it will be impossible to maintain the present level of liberality in the international trading system.

Agreement in Geneva will not solve all problems related to U.S. trade policy. Indeed, there is some question about whether these problems can be handled at all under the present framework for international trade agreements. A general liberalization of international trade may have the effect of intensifying some of these problems by leaving the U.S. economy more open to "unfair" foreign trade practices.

The most difficult problems arising from trade liberalization, however, may be domestic rather than international. Effective trade liberalization will cause structural changes in the U.S. economy, and inevitably some workers will be displaced. Present programs for compensating these victims of a liberalized trade stance are generally seen as inadequate, and it is widely thought that it will be politically impossible to implement new trade policies until these programs are expanded or substantially reorganized.

CHAPTER I. INTRODUCTION

For much of its recent history, the United States has been the most self-sufficient of the major industrialized nations, relying relatively little on foreign trade to satisfy its demands for goods and services and to provide markets for its products. While this traditional characterization of the United States remains valid today (see Table 1), there has been a marked trend in the last decade toward a greater U.S. economic dependence on foreign countries. Since the late 1960s, U.S. imports and exports of goods and services have grown much more rapidly than has the U.S. economy, and today they represent economic transactions equal to 10 and 9 percent of U.S. gross national product (GNP), respectively. Figure 1 details the growth of U.S. foreign trade as a share of GNP in recent years.

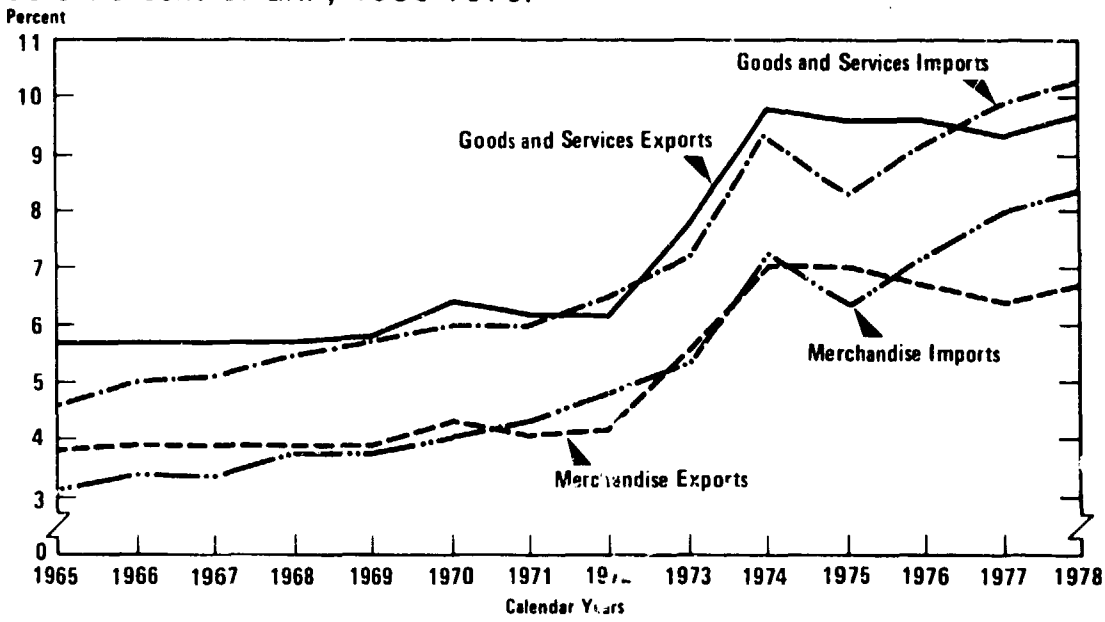
TABLE 1. EXPORTS AND IMPORTS AS A PERCENT OF GROSS NATIONAL PRODUCT IN SELECTED INDUSTRIALIZED COUNTRIES, 1977

Country	Goods and Services		Merchandise Only	
	Exports	Imports	Exports	Imports
United States	9	10	6	8
Canada	25	27	22	20
Japan	14	12	11	9
West Germany	27	25	22	18
France	22	23	16	17
Italy	30	29	23	23
United Kingdom	34	33	23	24

SOURCE: International Monetary Fund, International Financial Statistics (January 1979).

Figure 1.

U.S. Goods and Services and Merchandise Imports and Exports as a Percent of GNP, 1965-1978.



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

THE IMPORTANCE OF INTERNATIONAL TRADE TO THE U.S. ECONOMY

In large part, the recent rise in U.S. imports and exports as a share of GNP has been a reflection of a general expansion of worldwide international trade. The late 1960s and early 1970s--at least until the oil crisis and the recession of 1974-1975--were years of rapid economic growth throughout most of the world. With this growth came increased demand for foreign products in nearly all countries, and an expansion in total international trade was the result. Facilitating the expansion of trade were a marked increase in international credit to finance trade and important reductions in the costs of international transportation and communications. The sharp increase in oil prices in 1974 also contributed to the expansion of world trade, because oil-importing nations were forced to export more to cover the increased costs of imported oil and because increased oil revenues--whether in the hands of oil-exporting countries or "recycled" through international financial markets--placed increased amounts of foreign exchange at the disposal of potential importers. Finally, the worldwide expansion of international trade was aided by the adoption of export-oriented development strategies by a number of

developing countries, the increasing economic integration of Europe, and a general liberalization of trade policies in the late 1960s. 1/

Despite the relatively small size of U.S. trade relative to GNP, the absolute value of U.S. imports and exports is very large, far surpassing that of any other country. In 1977, U.S. imports of goods and services were valued at $187 billion and its exports at $176 billion. The comparable figures for West Germany, the next most active trading nation, were $130 billion and $142 billion. Japan was a distant third, with imports and exports valued at $84 billion and $96 billion, respectively.

Accompanying the growth in importance of U.S. foreign trade have been increasing concern and debate over appropriate U.S. policies toward international trade. In part, this increased concern has been a result of the simple increase in the volume of U.S. international transactions. Adding to this concern, however, have been a number of events in recent years that have focused special attention on U.S. international transactions. Most notable among these have been sharp increases in the price of imported oil, the emergence of unprecedented deficits in the U.S. trade and current accounts, the decline of the dollar relative to most other major currencies, and the emergence of new sources of foreign competition in traditional U.S. industries.

THE MULTILATERAL TRADE NEGOTIATIONS

A major focus for this increased interest in U.S. international economic policy has been the Tokyo Round of multilateral trade negotiations now underway in Geneva. 2/ These negotiations,

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1/ For a succinct history of the growth of international trade in recent years, see Bela Balassa, World Trade and the International Economy: Trends, Prospects and Policies, World Bank, Staff Working Paper No. 282 (May 1978).

2/ This round of negotiations, the seventh held under the auspices of the General Agreement on Tariffs and Trade (GATT), is known as the Tokyo Round because the call to and general outline for these discussions were contained in the communique issued at the conclusion of a ministerial-level conference held in Tokyo in September 1973.

in which 98 nations are participating, have as their goal the conclusion of multilateral agreements that will result in significant tariff reductions, in substantial progress toward the reduction or harmonization of a variety of nontariff barriers to trade, and in general reform of the rules and procedures laid down for international trade in the General Agreement on Tariffs and Trade (GATT).

Although this round of negotiations has been underway since early 1975, it is only now nearing conclusion. In accordance with the terms of the Trade Act of 1974, which gave the U.S. President the authority to negotiate changes in tariffs and trade policies, President Carter informed the Congress on January 4, 1979, of his intention to conclude an agreement in Geneva. After a period of 90 days (also stipulated by the Trade Act), the President may conclude such an agreement and submit it formally to the Congress for approval. An agreement could, then, be concluded as early as the first week in April 1979. Along with the text of any agreement, the President will submit to the Congress legislation to implement the proposed agreement. The new agreement will enter into force for the United States when and if the Congress enacts the implementing legislation. Thus, a new trade agreement will require a majority vote in each house of Congress to enter into force.

A number of issues in the negotiations are still unresolved, and thus there remains some doubt about when all parties will be able to reach final agreement. If the negotiations are to succeed, however, agreement must be reached by January 3, 1980. On that date, the statutory authority of the U.S. President to participate in the discussions expires. Without U.S. participation, the Geneva talks would likely collapse, and there is every expectation that some agreement will be reached by that date.

The Geneva trade negotiations cannot, of course, be expected to result in agreements that will ease all major international economic problems. Agreement on the relatively narrow set of trade-related issues being discussed in Geneva could, however, provide important benefits to the world economy by preserving a liberal system of world trade. Pressures are growing in many nations for the adoption of restrictive trade policies, and the widespread institution of such measures would certainly hinder the further growth of world trade. Many observers see a successful conclusion of the Geneva talks as essential if a marked increase in protectionist policies is to be avoided.

THE RECENT RISE IN PROTECTIONIST SENTIMENT

The pressures for increased protectionism arise from a variety of sources. Recovery from the recession of 1974 and 1975 has generally been disappointing among the industrialized nations, in part because some governments have found it difficult to adopt strongly stimulative economic policies--either for fear of inflation or because of weak balance-of-payments positions. Faced with continuing unemployment and excess industrial capacity, a number of governments have found policies designed to encourage exports or to restrict imports increasingly attractive.

To the problems caused by recession and slow recovery have been added those created by structural changes in the world economy. During the last few years, the more advanced developing countries have increased dramatically their production of manufactured goods. These goods are intended primarily for export markets, and nearly all of the developed countries have experienced an influx of manufactured goods produced in the developing countries. The growth of this trade has been rapid enough to begin displacing some workers in the developed countries, and import-competing industries have increasingly sought protection against what is sometimes seen as unfair competition from low-wage developing countries.

Pressure for protectionist measures has also grown out of increasing government involvement in economic and commercial activity. For a wide variety of reasons--social, political, economic, environmental--many governments have increasingly taken a direct hand in the financial and operational aspects of important sectors of their economies. Inevitably, such government involvement blurs traditional distinctions between government and business, and claims that foreign governments are offering unfair subsidies to their own exporters--and that, consequently, firms which must compete with these exports are entitled to some form of protection--are becoming more common. The other side of government involvement is reflected in claims--heard with increasing frequency in the United States--that environmental, health, and safety regulations place domestic producers at a disadvantage in relation to foreign producers and that domestic producers are therefore justified in seeking protection against imports.

Finally, a number of recent events--especially the large increases in the price of oil and the widely differing rates of inflation and economic growth among the industrialized countries--have led to large imbalances in international payments. In some

countries with large payments deficits, restrictive trade policies may be seen as alternatives to politically more difficult fiscal and monetary policies designed to reduce these deficits.

There is no single comprehensive measure of the level of protectionism prevailing at any given time, primarily because of the variety and complexity of trade-limiting arrangements and because many trade-limiting policies cannot readily be identified as such. Nevertheless, some evidence of increasing protectionism can be found; Table 2, for example, shows the number of specific trade-restricting actions taken by the United States, Canada, and the European Community (EC) since 1971. 3/ The figures in this table for different countries are not strictly comparable, and

TABLE 2. ACTIONS TO RESTRICT IMPORTS BY THE UNITED STATES, CANADA, AND THE EUROPEAN COMMUNITY, 1971-1977

Year	United States	Canada	European Community
1971	6	6	5
1972	18	7	9
1973	12	7	6
1974	9	8	4
1975	5	19	23
1976	26	26	13
1977	16	37	41

SOURCE: International Monetary Fund, The Rise in Protectionism, Pamphlet No. 24 (July 1978), pp. 26-34.

3/ Included in these figures are anti-dumping duties, special duties imposed on imports that injure domestic industries (so-called "escape-clause" or "safeguard" actions), countervailing duties imposed on subsidized exports of other countries, quantitative restrictions, special import surtaxes, and, in the case of Canada, voluntary export restraints negotiated with other countries.

no attempt is made to measure the total value of the products affected by each action. Nonetheless, the figures do reflect a growing number of cases in which governments have chosen to erect barriers to particular imports.

In addition to being limited by formal import barriers, world trade is being further restricted through less formal arrangements between governments. Often these arrangements take the form of "voluntary" restraints agreed to by exporting nations, in many cases with the understanding that voluntary restraint will reduce the likelihood of formal actions by importing countries. Further, the extension of such voluntary arrangements to a large number of sectors was suggested at the May 1977 economic summit meeting in London by French President Giscard d'Estaing when he called for a system of "organized free trade" through which each country's share of important world markets would be established by international agreements and be maintained by voluntary export controls.

Thus, the trade negotiations in Geneva are proceeding in an environment that is decreasingly favorable to liberalized trade. Few of the governments participating in these negotiations desire increased protectionism; many would prefer fewer trade restrictions. Yet, without important concessions from other governments, few are likely to be able to resist domestic pressures for more protection. The importance of the trade talks, then, is that they provide a forum in which these concessions can be arranged and, it is hoped, increased protectionism forestalled.

CONGRESSIONAL ACTION

Whatever the outcome of the negotiations in Geneva, different sectors of the U.S. economy will be affected differently. Some industries may expect to gain important new markets abroad if barriers to international trade are significantly reduced, and consumers of some products may find lower-priced foreign goods more readily available. Other industries, however, must be expected to lose sales to increased foreign competition if U.S. barriers to imports are lowered, and some workers will inevitably be displaced. A failure of the Geneva talks and the possible continued rise of restrictive trade policies would also result in an uneven distribution of costs and benefits throughout the U.S. economy. A Congressional decision to accept or to reject an agreement that is reached in Geneva will necessarily require a balancing of these competing interests.

The Congress will have little opportunity to alter the formal terms of any agreement reached in Geneva. Technically, before an agreement is concluded, the Congress may suggest changes in the text of the agreement. While it is possible that changes suggested in this manner could be adopted, the complexity and difficulty of international negotiations involving so many participants is such that the likelihood of making last minute changes must be seen as quite small. No amendments to the proposed agreement will be permitted during the formal Congressional debate over its approval. The Congress will have to vote for or against the agreement as it stands.

This is not to say that the Congress will be without influence in forming U.S. trade policy in the near future. The agreements that emerge from the Geneva talks will likely be of a very broad nature, allowing a great deal of latitude for interpretation. The Congress will be called upon to enact a broad program of implementing legislation to bring U.S. law and policy into conformance with any new agreement. In doing so, the Congress will exercise a powerful influence on just how a multilateral trade agreement will affect the U.S. economy.

This paper provides an outline of the major implications for the U.S. economy of a significant multilateral liberalization of trade policies. Since, at this writing, a number of issues have yet to be resolved in Geneva, no attempt is made here to analyze in detail the implications of specific provisions of possible agreements. Enough is known about the broad outline of possible agreements, however, to allow a discussion of the general and long-term effects of trade liberalization.

Chapter II of this paper provides a brief discussion of the present state of U.S. international trade and identifies major changes in this trade in recent years. Chapter III discusses some of the more important implications of freer trade, identifying in particular which groups within the United States stand to gain from freer trade and which stand to lose. Chapter IV discusses some special problems for U.S. trade policy that are likely to be intensified by a general liberalization of world trade. Chapter V provides a summary of the arguments of the preceding chapters and draws some conclusions about the effects of trade liberalization.

CHAPTER II. THE PRESENT SITUATION

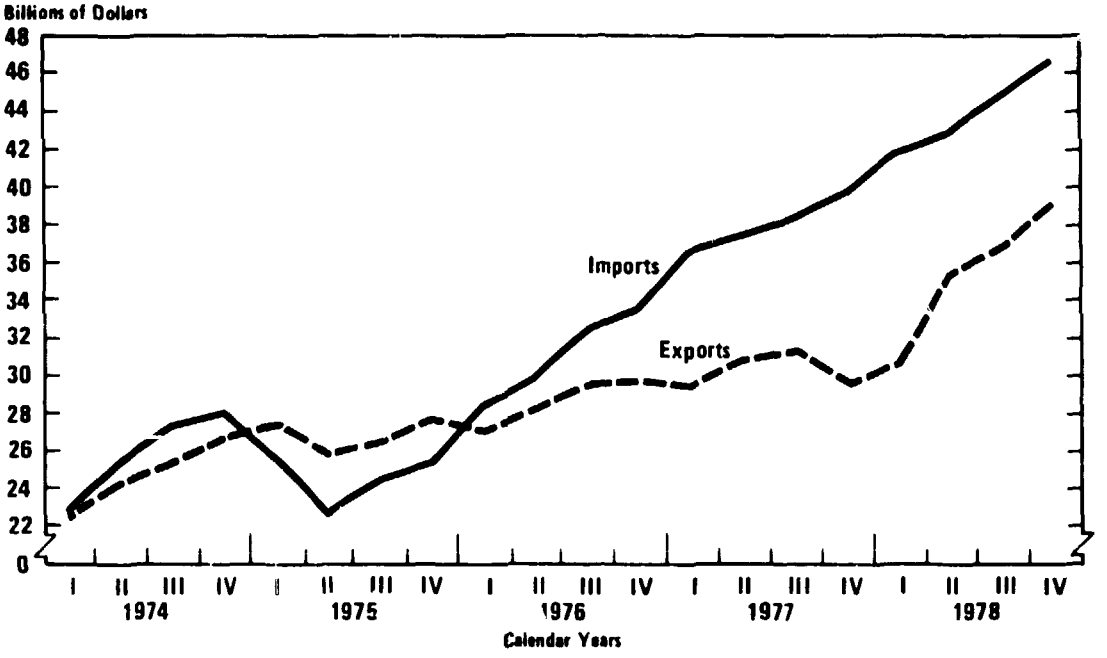
The U.S. balance of merchandise trade has shifted over the past three years, falling from a surplus of $9 billion in 1975 to a deficit of $31.1 billion in 1977. This deterioration continued in 1978, with the deficit increasing to $34.2 billion. 1/

A major contributing factor to the deterioration in U.S. trade balances was the quadrupling of oil prices in 1974, which served to increase significantly U.S. expenditures for imported fuels. Furthermore, as Figure 2 shows, U.S. exports remained nearly constant between the second quarter of 1975 and the fourth quarter of 1977, while imports increased rapidly over that period. This increased U.S. demand for foreign products was caused by a more rapid economic recovery in the United States than abroad from the 1975 recession, compounded by the effects of an overvalued dollar and relatively rapid inflation in the United States during 1974, which served to keep the relative prices of foreign products low.

In addition to the recent downswing in the U.S. trade balance, some long-term changes in the pattern of U.S. trade are also taking place, particularly in the manufacturing sector. Trade of manufactured goods accounted for the largest portion of U.S. exports and imports in the post-World War II period. Despite the recent increases in the price levels of raw materials, foodstuffs, and fuels, manufactures continue to play a critical role, accounting for 50 percent of imports and 70 percent of exports in 1977 (see Table 3). Trade in manufactures is also important, because this has historically been the category in which the United States has accumulated most of its trade surplus. Recently, there has been a considerable amount of rearrangement both in the markets to which the United States sells its manufactures and in the areas from which manufactures are purchased.

1/ U.S. Department of Commerce, Bureau of Economic Analysis, "U.S. Department of Commerce News" (February 11, 1979). These numbers are calculated on a "balance-of-payments" basis; calculated on a "census" basis, the 1978 merchandise trade deficit was $28.4 billion.

Figure 2.
U.S. Merchandise Imports and Exports, by Quarters, 1974-1978.



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

While some types of manufacturing industries have maintained their competitiveness and therefore have fared well in the face of the rapidly changing trade patterns of the 1970s, others have become very sensitive to pressure from foreign competitors. Table 4 presents data for ten manufacturing categories: the five with the largest surpluses in 1970 and 1977 and the five with the largest deficits. These data show that the United States had surpluses in categories that make use of advanced technologies, such as computers; categories that employ complex manufacturing techniques, such as chemicals and aircraft; and categories that are highly capital intensive, such as industrial and electrical machinery. Conversely, those industries that employ standardized technologies, such as automobile maufacturers, and those that tend to be more labor intensive, such as footwear and clothing manufacturers, have experienced the largest deficits.

TABLE 3. U.S. EXPORTS AND IMPORTS BY MAJOR COMMODITY GROUP: PERCENT OF TOTAL BY VALUE

	1970	1973	1977
U.S. Exports			
Foodstuffs	16	24	19
Raw materials	10	9	8
Fuels	4	2	3
Manufactures	70	65	70
Total	100	100	100
U.S. Imports			
Foodstuffs	16	14	10
Raw materials	12	11	8
Fuels	8	11	30
Manufactures	64	64	52
Total	100	100	100

SOURCE: U.S. Central Intelligence Agency, National Foreign Assessment Center, The Role of LDCs in the U.S. Balance of Payments (1978).

This pattern of surpluses and deficits is very much in line with the relative strengths and weaknesses of the U.S. economy. The U.S. economy is strong on technological innovation, rich in capital, and tends to pay relatively high wages. This high wage structure forces production techniques to be labor saving rather than labor intensive. Consequently, the most competitive industries are those that require relatively small inputs of labor for production. Chemicals, industrial machines, and computers are good examples of such industries. The United States in fact continues to be highly competitive in world markets with these products. Between 1973 and 1977, the U.S. share of world exports of chemicals increased from 19.1 percent to 21.1 percent; the U.S. share of trade in electrical machines also increased from 21.6 percent to 23.2 percent; while the U.S. share of trade in nonelectrical machines remained constant at 25

TABLE 4. BALANCE OF IMPORTS AND EXPORTS OF SELECTED MANUFACTURING CATEGORIES FOR 1970 AND 1977: IN MILLIONS OF DOLLARS

	1970	1977
Largest Surplus Sectors		
Industrial machines	3,492	8,999
Chemicals	2,391	5,478
Aircraft	2,281	4,868
Electrical machines	1,403	3,512
Office machines, computers	1,052	2,093
Largest Deficit Sectors		
Motor vehicles	-1,460	-4,860
Clothing	-1,062	-3,502
TV, radio, phonographs	-983	-2,561
Miscellaneous consumer goods	-756	-2,085
Footwear	-619	-1,834

SOURCE: U.S. Central Intelligence Agency, National Foreign Assessment Center, The Role of LDCs in the U.S. Balance of Payments (1978).

percent. 2/ Conversely, those U.S. industries that do not utilize advanced technologies, thereby necessitating higher inputs of labor, are at a competitive disadvantage in world export markets. Footwear, clothing, and light consumer goods are examples of products that require large inputs of labor; the increasing volume of imports in these categories, coupled with a growing deficit, reflects their decreased competitiveness.

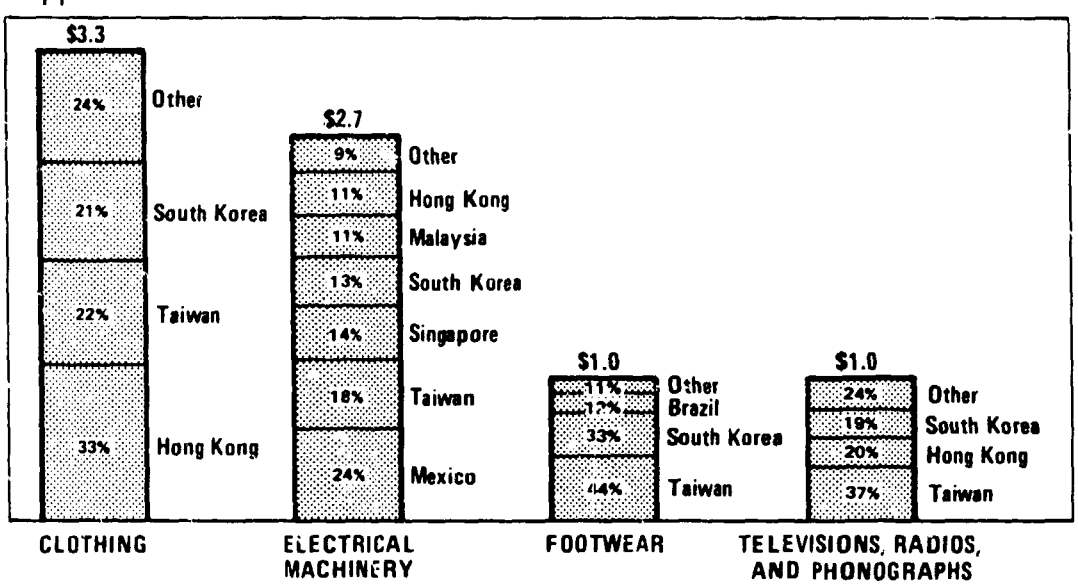
U.S. imports of light manufactures are increasingly supplied by the developing countries (LDCs), particularly those developing countries that have managed to build a significant capital and infrastructural base. Among the fastest growing suppliers to the U.S. market are the group of newly industrialized

2/ U.S. Department of Commerce, Commerce America (June 19, 1978), p. 9.

countries (NICs)--that is, Singapore, Taiwan, Hong Kong, South Korea, Brazil, Mexico, and Malaysia. These seven countries accounted for 55 percent of U.S. imports from non-OPEC developing countries in 1977. Moreover, in certain light manufactures, just three of these countries (Taiwan, Hong Kong, South Korea) accounted for at least 50 percent of U.S. imports from developing countries (see Figure 3).

Intense competition from abroad for American light manufactures industries is not a new phenomenon. In the 1950s and 1960s, as the EC countries and Japan increased their industrial base, their light manufactures dominated U.S. imports. As the levels of technology and capital expanded, these countries increasingly shifted their emphasis to heavy manufactures, with the NICs taking up the slack in the supply of light manufactures. As Table 5 shows, as recently as 1970 the developed countries

Figure 3.
U.S. Imports of Major Commodities from Leading LDC Suppliers in 1977: in Billions of Dollars



SOURCE: U.S. Central Intelligence Agency, National Foreign Assessment Center, *The Role of LDCs in the U.S. Balance of Payments* (1978), p. 63.

TABLE 5. U.S. TRADE WITH SELECTED REGIONS FOR 1970 AND 1977: IN MILLIONS OF DOLLARS

	World		Developed Countries a/		European Community		Canada	
	1970	1977	1970	1977	1970	1977	1970	1977
U.S. Exports	43,226	120,163	30,498	75,375	11,300	26,476	9,084	25,749
U.S. Imports	39,963	147,848	29,420	79,935	9,226	22,382	11,091	29,759
Balance	3,263	-27,685	1,015	-4,560	2,074	4,094	-2,007	-4,010
Exports of Heavy Manufactures e/	28,052	77,384	19,511	46,815	6,941	14,994	6,858	19,798
Imports of Heavy Manufactures e/	19,397	61,039	17,961	53,003	6,163	15,686	6,781	17,771
Balance	8,655	16,345	1,550	-6,188	778	-692	78	2,027
Exports of Light Manufactures f/	2,186	6,524	1,512	4,388	525	1,603	537	1,722
Imports of Light Manufactures f/	6,128	16,316	4,282	7,864	1,576	2,806	309	673
Balance	-3,942	-9,792	-2,770	-3,476	-1,051	-1,203	228	1,049

(Continued)

SOURCE: U.S. Central Intelligence Agency, National Foreign Assessment Center, The Role of LDCs in the U.S. Balance of Payments (1978).

a/ The member countries of the Organization for Economic Cooperation and Development.

b/ Organization of Petroleum Exporting Countries (OPEC).

TABLE 5. (Continued)

	Japan		OPEC b/		Non-OPEC LDCs c/		Newly Industralized Countries d/	
	1970	1977	1970	1977	1970	1977	1970	1977
U.S. Exports	4,652	10,522	2,053	14,019	9,950	27,724	4,422	14,481
U.S. Imports	5,875	18,902	1,678	33,019	8,613	33,759	4,106	18,664
Balance	-1,223	-8,380	375	-19,000	1,337	-6,035	316	-4,183
Exports of Heavy Manufactures e/	1,786	3,456	1,504	11,336	6,738	18,404	3,015	9,708
Imports of Heavy Manufactures e/	3,634	15,236	34	147	1,313	7,607	899	6,179
Balance	-1,850	-11,780	1,470	11,189	5,425	10,797	2,116	3,529
Exports of Light Manufactures f/	158	305	85	536	555	1,529	225	678
Imports of Light Manufactures f/	1,961	3,211	11	37	1,802	8,128	1,473	6,973
Balance	-1,803	-2,906	74	499	-1,247	-6,599	-1,248	-6,295

c/ Non-OPEC less developed countries (LDCs).

d/ Mexico, Brazil, Hong Kong, Taiwan, South Korea, Singapore, and Malaysia.

e/ SITC categories 5, 6, and 7, excluding category 65 (textile yarn and fabric).

f/ Textile yarn and fabric; clothing; footwear; televisions, radios, and phonographs; and miscellaneous consumer goods.

supplied 70 percent of all U.S. imports of five major light manufactures groupings, 3/ while the NICs supplied only 24 percent. By 1977, the share of the developed countries had dropped to just 43 percent, while the share of the seven NICs had increased to equal the developed countries' share at 43 percent. Japan, in particular, has been shifting from light to heavy manufactures at a very rapid pace. In 1970, 22 percent of all Japanese exports were of the light industrial type, centering on textiles; 72 percent fell into the chemicals and heavy industry categories. By 1977, light manufactures had dropped significantly to just 12 percent of total exports, while heavy industrial products had risen to 84 percent. 4/

These trends in U.S. and developed countries' trade are hardly startling. U.S. products that rely heavily on those factors that are abundant in the American economy (that is, capital, skilled labor, and innovative technology) continue to perform well in world markets. Whereas the increasing U.S. trade deficit in light manufactures is noteworthy, concern with this aspect should not be disproportionate to the implications raised. The historical pattern of world trade reveals that products follow a relatively predictable cycle. Innovation takes place in those economies that have sufficient resources to make the necessary expenditures on research and development. As a product gains acceptance in world markets and the methods of production become standardized, the relative competitiveness of the various producers becomes a function of the cost of the labor component of the final product. While the United States has an edge at the front end of this cycle, its advantage is diminished at the latter stages.

The United States has been following a trade pattern that reflects this type of cycle (see Table 5). As would be expected, the United States performed well in trade of heavy manufactures, almost doubling its surplus between 1970 and 1977. The bulk of the trade was with the developed countries, and a fairly sizable deficit developed with respect to them because of the rapid increase in U.S. imports of heavy manufactures from Japan. (In

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3/ Textile yarn and fabric; clothing; radios, televisions, and phonographs; footwear; and miscellaneous consumer goods.

4/ United States - Japan Trade Council, Japan's Trade in 1977, Council Report No. 29 (June 23, 1977).

1970, the United States had a deficit of $2 billion in heavy manufactures trade with Japan; by 1977, the deficit had mushroomed to $12 billion.) This deficit in trade of heavy manufactures with the developed countries was more than offset by a huge surplus with OPEC and the developing countries, leading to an overall surplus of $16 billion in 1977 in trade of heavy manufactures.

In trade of light manufactures, the U.S. deficit increased from $4 billion to $10 billion between 1970 and 1977. The NICs accounted for about two-thirds of this deficit, increasing the level of their exports to the United States dramatically over the period, by both volume and value measures. It is noteworthy, however, that in 1977 the United States had a surplus in trade of manufactures as a whole with non-OPEC developing countries of about $4 billion. The existence of this surplus would seem to indicate that manufactures trade with developing countries has a beneficial net effect on the overall U.S. economy insofar as it creates jobs, although specific industries may suffer severe displacements as a consequence of this trade.

In short, U.S. trade balances in those goods that employ resources that are abundant in the U.S. economy have improved between 1970 and 1977, while balances for goods that require larger inputs of labor have deteriorated. This pattern of surpluses and deficits is not surprising; it is in fact a logical consequence of the relative scarcities and abundances of labor, land, and capital that prevail in the U.S. economy.

CHAPTER III. THE IMPLICATIONS OF FREER TRADE

THE BENEFITS OF FREER TRADE

The arguments in favor of free international trade are well known. Free trade allows each nation to specialize in the production of those goods and services that it can produce relatively efficiently. The export of such goods allows each country to pay for imports of other products that can be produced more cheaply abroad. With each nation concentrating its productive efforts in those areas in which it is relatively efficient, total world output is maximized and all nations stand to gain. Consumers in each country benefit through the availability of foreign products at prices lower than those charged for similar domestic products. Even when domestically produced goods are cheaper than imports, free trade can benefit consumers by forcing domestic producers to moderate their price increases lest they lose sales to foreign competitors. Efficient producers are able to expand their operations to serve the larger markets opened by free trade; relatively inefficient producers, unable to compete with foreign products, are forced to reduce their scale of operation, thus freeing workers and capital for other--presumably more efficient--employment.

This case for free trade has always recognized certain exceptions--cases in which free trade was not necessarily desirable. Domestic production in certain industries should, for example, be maintained even if foreign production were cheaper in order to reduce the threat that international political developments could interrupt the supply of essential goods. Protection from foreign competition might be offered to new domestic industries during the years required for them to achieve full international competitiveness. Domestic industries facing predatory foreign competition might in some cases require protection since, if such competition succeeded in destroying a domestic industry, thereby leaving a foreign supplier as the sole source of supply, the foreign producer would be left free to raise prices in the future. Temporary protection from foreign competition might also ease the adjustment to changed economic conditions of workers in industries that are no longer competitive in international markets. Finally, import restrictions

might in some cases be employed strategically in retaliation for similar barriers imposed by other countries. 1/

Despite this variety of rationales for trade restrictions, cases in which trade barriers are appropriate have generally been considered to be the exception rather than the rule. They have been regarded as a set of interesting, but quantitatively minor, exceptions to the general proposition that policies of free international trade would benefit all nations.

The world is, of course, considerably more complex than is suggested by the foregoing simple arguments for free trade. Further, it is precisely those aspects of international trade that are not well accounted for in the traditional theory of trade that pose the greatest obstacles to the formation of practical trade policies. Nonetheless, the general conclusion that free trade is a desirable goal remains extremely robust.

Two recent studies--the most comprehensive examinations of the effects of trade liberalization currently available--provide empirical support for this proposition. Both of these studies were completed before the Geneva negotiations entered their final phase, and as a result both calculate the effects of tariff reductions somewhat larger than are likely to be agreed on in Geneva (which are expected to be between 30 and 40 percent spread over eight or ten years). The conclusions of these studies do, nonetheless, indicate the general direction of the effects of trade liberalization.

A study of the effects of a 60 percent multilateral reduction in all tariffs, for example, shows gains to the United States as a whole equivalent to an increase in national income of about $1 billion a year in 1974 prices at 1974 trade

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1/ The imposition of a tariff will reduce demand for imported products and, all other things being equal, reduce the price of the affected commodity in world markets. In some cases, this price reduction and the revenues of the tariff collected by the government can be sufficient to offset the losses to consumers who must pay the tariff. In such cases, the imposition of a tariff can result in a net gain in welfare to the nation imposing the tariff. The problem with such "optimal tariff" schemes is that the gains can be eliminated if some other nation chooses to retaliate.

volumes. 2/ A similar study, based on 1971 prices and trade flows and assuming a 50 percent multilateral tariff reduction, also shows significant gains for the United States as a whole. 3/ Not included in these estimates are additional benefits of liberalized trade arising from a variety of sources such as increased efficiency due to a larger scale of production, increased investment, increased stimulus to technical change, and more stimulative macroeconomic policies made possible by reductions in inflationary pressures. Further, these figures exclude the gains that could be realized through the reduction of nontariff barriers and most of the gains that would result from liberalized agricultural trade. One would expect, therefore, that these figures underestimate the total benefits of trade liberalization.

Offsetting these benefits to a degree are the one-time costs of moving workers and capital from one industry to another in response to changed patterns of economic activity. Both studies estimate these one-time costs to be small in comparison with total benefits--in one case, the costs are estimated to be fully recovered in the first year's benefits of reduced tariffs, and in the other case, in less than two years. 4/ These estimates leave little doubt that, on balance, the United States would reap significant rewards from tariff reductions of the sort being considered in Geneva.

GAINERS AND LOSERS AS A RESULT OF TRADE LIBERALIZATION

The problem with such figures for the net gains of liberalized trade policies is that they can hide the fact that these gains are not evenly distributed. While consumers and producers

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2/ William R. Cline, Naboro Kawanabe, T.O.M. Kronsjo, and Thomas Williams, Trade Negotiations in the Tokyo Round: A Quantitative Assessment (Washington, D.C.: The Brookings Institution, 1978), p. 86.

3/ Robert E. Baldwin, John H. Mutti, and J. David Richardson, Welfare Effects on the United States of a Significant Multilateral Tariff Reduction (University of Wisconsin-Madison: April 1978; processed), p. 21.

4/ See Cline and others, Trade Negotiations in the Tokyo Round, p. 130; and Ibid., pp. 21-22.

of some products may benefit greatly from freer trade, some businesses will be forced to close and some workers will lose their jobs because of increased foreign competition. It will, of course, be of small comfort to these businesses and workers to learn that the gains accruing to others are much greater than the losses they themselves are suffering.

There is no way to predict with any accuracy exactly how much particular sectors of the U.S. economy will gain or lose as a result of agreements reached in Geneva to liberalize trade policies. The distribution of such gains and losses will be highly dependent on the details of the tariff reduction formulas and on the nontariff barrier reductions that finally emerge from the negotiations, and as yet all of these details have not been worked out. The average tariff reductions of 30 percent to 40 percent that are expected will result from a wide range of reductions for specific products. A number of particular products will be accorded special treatment or excluded entirely from tariff reductions. Needless to say, each nation has its own set of products for which it seeks special treatment, and in the closing phases of the negotiations there could be important changes in the treatment of particular products.

Even if it is impossible to estimate accurately the impact of trade liberalization on particular industries, it is possible from such studies as the two cited above to get some indication of which types of industries will gain and which will lose as a result of trade liberalization. In general, the industries that will suffer as a result of trade liberalization are those that are relatively labor intensive or that make use of simple, well-known technologies. Among the industries that could potentially suffer the most as a result of tariff reductions are those producing footwear, leather products other than shoes, pottery food utensils, steel products, radios and television sets, and jewelry. 5/

5/ Robert E. Baldwin and Wayne S. Lewis, "U.S. Tariff Effects on Trade and Employment in Detailed SIC Industries," U.S. Department of Labor (1978), p. 255. This list includes industries that would suffer if tariffs were reduced. As a practical matter, producers of nonrubber footwear and television sets face no such potential injury, since these products have been excluded from any tariff reductions agreed to in Geneva.

In addition to those industries, the textile industry is often cited as the U.S. industry likely to suffer most severely as a result of trade liberalization. 6/ According to one estimate, job losses in the textile industry could account for nearly 43 percent of all jobs lost in the United States as a result of tariff reductions if tariffs on textiles were reduced by the same proportion as tariffs on other commodities. 7/ Estimates of the effect of tariff reductions on the textile industry are particularly unreliable, however. Most observers expect tariff reductions on textiles to be significantly smaller than reductions in other tariffs. Further, imports of textiles are limited by a series of bilateral agreements negotiated within the general framework of the international Multi-Fiber Agreement, and nothing that is being negotiated in Geneva will alter the terms of these agreements. To estimate how large an increase in U.S. textile imports might result from textile tariff reductions, it would be necessary to do a careful analysis of the many categories of textiles covered by each bilateral textile trade agreement, an undertaking that is beyond the scope of this paper.

Trade liberalization will have the reverse effect on a number of industries whose exports have been restricted by high tariffs abroad. Lower duties on the products of these industries will bring about increased demand and eventually will result in higher employment. By and large, the beneficiaries of freer trade will be those industries that exploit highly sophisticated or recently developed technology or that process U.S. agricultural commodities. Among those likely to benefit most are industries producing tobacco products, semiconductors, computing machines, office machines, mechanized measuring devices, electronic components, aircraft, and aircraft equipment. 8/ Also making important gains

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6/ The textile industry includes producers both of woven cloth and of apparel. The United States is a net exporter of woven cloth and would presumably remain so after tariff reductions. The portion of the U.S. textile industry that is threatened by trade liberalization is, more accurately, the apparel industry.

7/ See Cline and others, Trade Negotiations in the Tokyo Round, p. 136.

8/ Baldwin and others, Welfare Effects on the United States of a Significant Multilateral Tariff Reduction, p. 24.

will be the U.S. agricultural sector, particularly if liberalization includes not only tariff reductions but also a lowering of agricultural nontariff barriers by the European Community and by Japan.

The brunt of job layoffs in the United States resulting from trade liberalization will be borne disproportionately by semiskilled workers--primarily machine operators, assembly line workers, and nonfarm laborers. Highly skilled workers will be more in demand as a result of general trade liberalization, with the need for research and development workers and production-related technical workers growing most rapidly. Demand will also increase for all types of agricultural workers. 9/

Geographically, most of the net job losses resulting from trade liberalization will take place in the urban areas of the North and East, particularly in Illinois, Massachusetts, Michigan, New York, Ohio, and Pennsylvania. Relative to their populations, the four New England states of Maine, New Hampshire, Vermont, and Massachusetts will suffer the largest displacement of workers. Newly created jobs would be concentrated in the southern, midwestern, and western areas of the United States, with especially large increases in the agricultural regions of Kansas, Minnesota, and the Dakotas. 10/

The distribution of jobs lost and gained throughout the United States could have some important social consequences. Because those losing jobs will be predominantly semiskilled production workers, the burden of adjusting to a regime of freer trade will fall more heavily on lower-income and minority workers than on the higher-income, mostly white male workers in highly technical jobs. Often it will be those workers hardest to place in new occupations who will be thrown out of work by trade liberalization. This is particularly the case in the textile industry, in which 23 percent of the workers are minorities and 65

9/ Baldwin and Lewis, "U.S. Trade and Tariff Effects on Trade and Employment in Detailed SIC Industries," p. 253.

10/ Ibid., p. 254. These estimates of the geographical distribution of job losses and gains do not include the jobs lost by textile workers, located primarily in the southern United States.

percent are women. 11/ Many jobs in the textile industry are located in rural and economically stagnant areas where opportunities for alternate employment are few, and many textile workers possess few work skills of use in other occupations.

Among the beneficiaries of lowered trade barriers would be consumers in the United States. In many cases, trade barriers have been erected specifically to protect particular domestic industries from lower-priced foreign competition. One would expect, therefore, that the removal or reduction of such trade barriers would result in increased availability of lower-priced goods in the U.S. market. Estimates of the effects of tariff reductions consistently show such price decreases. In general, the sectors in which these price reductions are estimated to be most significant are the same sectors in which job losses resulting from liberalization would be the largest. This is not surprising, since it is exactly those domestic industries in which prices are much higher than those of foreign producers that are most dependent on trade restrictions for their continued survival. 12/ Further, it is widely believed--although difficult to prove--that increased foreign access to U.S. markets will aid U.S. consumers by bringing additional competitive pressure to bear on U.S. producers, thus restraining domestic price increases.

The nature and distribution of gains and losses due to liberalized trade are such that one might expect opposition to less

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11/ Joint Statement of Fifteen Fiber, Textile, and Apparel Industry Associations and Labor Unions to the Subcommittee on International Trade, Senate Committee on Finance (August 15, 1978; processed), p. 4.

12/ The areas in which the potential consumer gains from freer trade are estimated to be greatest--veneer and plywood, nonrubber footwear, leather products other than shoes, pottery food utensils, cutlery, radios and television sets, motorcycles and bicycles, and sports and athletic goods--are among those areas in which employment losses are likely to be greatest. Net welfare gains (the benefit to consumers minus the costs of adjustment for idled workers and capital) are summarized succinctly in Cline and others, Trade Negotiations in the Tokyo Round, p. 130, Table 3-15. Specific changes by industry are found in Baldwin and others, Welfare Effects on the United States of a Significant Multilateral Tariff Reduction, p. 26.

restrictive policies to be better organized and more vocal than support will be. The negative effects of trade liberalization will fall heavily on a relatively small group of industries and workers. But because the losses suffered by this group would be severe--plant closings and the loss of jobs--and because the adversely affected groups would be concentrated in a few locations and would in general be relatively well organized, strong opposition to trade liberalization is likely to develop. The beneficiaries of trade liberalization, on the other hand, will be many and generally unorganized. The benefits accruing to each consumer will be only marginal--perhaps not even easily discernible--and the workers finding new jobs are likely to be widely scattered and often without organized unions. Support for liberalized trade policies by these groups will, therefore, be relatively muted. The relative organization of opposition to trade liberalization should not obscure the fact that trade liberalization could lead to significant net gains for the United States. Neither should it be forgotten, though, that some groups will pay heavily for these overall gains.

Some mechanisms exist in the United States to redistribute the gains of freer trade and to mitigate the injury suffered by displaced workers. These mechanisms--unemployment compensation and trade adjustment assistance are the most obvious examples--are far from adequate, however, to compensate fully those who suffer as a result of action that will bring a larger gain to the rest of the economy. Inevitably, a decision to approve any agreement calling for liberalized trade must hurt some workers and help others. The Congress cannot avoid this dilemma, and the best it can do is consider carefully which groups will be aided and which injured. If it chooses to approve a trade liberalization agreement, it may wish to consider expanded or restructured programs providing relief to the losers.

THE MACROECONOMIC EFFECTS OF TRADE LIBERALIZATION

Trade liberalization could bring important benefits to particular industries and groups of workers. It could also result in marginal gains for consumers and, as the figures noted earlier suggest, in net gains for the whole United States economy. It is important, however, to keep these gains in perspective. Many other influences both in the United States and abroad also affect employment, income, and economic growth in the United States. In many cases, these other influences

overshadow the effects that might be expected to arise from trade liberalization. For the U.S. economy as a whole, the effects of trade liberalization, while positive, will be quite small in comparison with the effects of other recent economic developments.

Consider, for example, the effects of the tariff reductions being negotiated in Geneva. It appears that agreement will be reached on a scheme that will reduce tariffs by 30 to 40 percent gradually over the course of eight to ten years. The average tariff rate for all dutiable products imported by the developed countries is less than 11 percent, and the average tariff rate on all imports is only about 6 percent (see Table 6). The use of average tariff levels obscures the effect of some particularly high tariffs imposed on specific products in one country or another. Nonetheless, these figures do suggest that tariff reduction agreements that may be reached in Geneva will lower the prices of imports only some 2 or 3 percent on average over the course of the next eight or ten years.

During the year ending in September 1978, however, the trade-weighted value of the U.S. dollar declined by 8.2 percent, bringing with it a roughly equal increase in the price of most U.S. imports. (Crude oil, the price of which is set in U.S. dollars, is an important exception.) Other countries have experienced rapid appreciations of their currencies. In the same year ending in September 1978, the West German mark appreciated by an average of 5.6 percent and by 34 percent, on a trade-weighted basis. These currency rate movements have had the same effects as would have resulted if all other countries had placed large tariffs on German and Japanese products and at the same time sharply cut their tariff rates on U.S. goods: U.S. goods have become relatively cheaper in world markets, and Japanese and German goods have become more expensive. What is most striking, though, is that the import price changes that will be brought about by tariff reductions negotiated in Geneva will be quite small compared with those that have been caused by recent exchange rate movements.

The effects of trade liberalization on the U.S. balance-of-payments position are also very small compared with the effects of other recent developments. Cline, for example, estimates that a 60 percent reduction in tariffs and agricultural nontariff barriers would result in an increase in net U.S. exports of about $1 billion a year at 1974 prices and trade

TABLE 6. AVERAGE TARIFF RATES FOR ELEVEN INDUSTRIAL COUNTRIES, 1973

Product Category	All Imports				
	Total a/	United States	Canada	Japan	EC
All Products	6.2	7.1	6.7	6.3	4.2
Raw Materials	1.5	2.3	0.4	3.8	0.3
Semifinished Manufactures	6.6	6.0	10.6	6.2	5.9
Finished Manufactures	9.4	9.0	6.7	12.0	8.9

(Continued)

SOURCE: GATT, Basic Documentation for the Tariff Study: Summary by Industrial Product Categories (Geneva, March 1974), as quoted in William R. Cline, Naboro Kawanabe, T.O.M. Kronsjo, and Thomas Williams, Trade Negotiations in the

volumes. 13/ Baldwin and Lewis estimate that a 50 percent reduction in tariffs and nontariff barriers (including U.S. quotas on textile and apparel imports, which were not included in Cline's study) would result in a net trade loss of $0.7 billion a year in 1971 prices and at 1971 trade volumes. 14/

13/ See Cline and others, Trade Negotiations in the Tokyo Round, p. 185.

14/ Baldwin and Lewis, "U.S. Trade and Tariff Effects on Trade and Employment in Detailed SIC Industries," p. 259. Not surprisingly, increases in U.S. imports of textiles and apparel

TABLE 6. (Continued)

Product Category	Dutiable Items Only				
	Total a/	United States	Canada	Japan	EC
All Products	10.7	8.9	14.2	11.2	9.0
Raw Materials	5.7	4.4	6.3	10.6	3.5
Semifinished Manufactures	10.5	9.5	14.5	8.9	9.9
Finished Manufactures	11.3	9.5	14.2	12.5	9.2

Tokyo Round: A Quantitative Assessment (Washington, D.C.: The Brookings Institution, 1978), p. 10.

a/ Includes United States, Canada, Japan, EC, Austria, Finland, Norway, Sweden, Switzerland, Australia, and New Zealand.

There is no simple way to update these figures to provide estimates of what effect the actions now being discussed at Geneva might have on the U.S. trade position. Of course, prices have increased and the volume of U.S. trade has grown substantially since the years that provide the basis for these estimates, and one might expect the effects of these reductions in trade barriers to be somewhat larger today. On the other hand, it is extremely unlikely that tariff cuts or reductions in nontariff barriers will be as great as those on which these estimates are based.

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are responsible for this deterioration in the trade balance. If these textile imports are excluded, the U.S. trade position would improve by about $0.2 billion.

The fact remains, however, that changes in the net U.S. trade position of $1 billion or $2 billion one way or the other--particularly when spread out over a period of years--are quite small compared with total U.S. merchandise imports and exports, which were $176 billion and $141.7 billion, respectively, in 1978. These changes are also small relative to the changes that could arise as a result of changes in the international economic environment. If, for example, Japan, Canada, and the developed countries of Western Europe had grown as rapidly as the United States did following the 1974/1975 recession, the U.S. current account balance would have improved by more than $7 billion a year by the end of 1977. 15/

The overall employment effects of trade liberalization are likely to be very small when compared with the employment effects produced by shifts in U.S. domestic economic policies. Because wages in the United States are high relative to those in most of the rest of the world, freer trade might be expected to result in at least temporarily reduced employment in the United States. This expectation is borne out by estimates of net changes in employment that are the immediate results of trade liberalization. Table 7 lists these estimates for selected programs of trade liberalization. These estimates are derived from data from different years and, to provide some common measure of comparison, changes in employment are given both in absolute terms and as a fraction of the total labor force in the base year. In only one case is the net change in employment greater than one-tenth of one percent of the total labor force.

In putting the employment effects of changes in U.S. net exports in perspective, it is helpful to remember that the impact of increased or decreased net exports on employment is roughly equal to the impact of a similar increase or decrease in spending by the federal government for goods and services. 16/ The

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15/ This estimate is derived from a CBO simulation of the effects of more rapid economic growth abroad, using the Data Resources, Inc. quarterly econometric model of the United States.

16/ For more on the size of these effects and the speed with which they are felt, see Congressional Budget Office, The CBO Multipliers Project: A Methodology for Analyzing the Effects of Alternative Economic Policies, Technical Analysis Paper (August 1977).

TABLE 7. EMPLOYMENT EFFECTS OF SELECTED TRADE LIBERALIZATION POLICIES

Policy	Net Change in Employment	Base Year	Net Change in Employment as Percentage of Labor Force	Source
50% Linear Tariff Reduction	900 to -37,300	1971	0.001 to -0.04	Baldwin and Lewis, p. 257 a/
60% Linear Tariff Reduction	-28,900	1974	-0.03	Cline and others, p. 125 b/
50% Reduction in Tariff Equivalent of Nontariff Barriers	-70,400 to -108,500	1971	-0.08 to -0.13	Baldwin and Lewis, p. 259 a/

a/ Robert E. Baldwin and Wayne S. Lewis, "U.S. Tariff Effects on Trade and Employment in Detailed SIC Industries," U.S. Department of Labor (1978).

b/ William R. Cline, Naboro Kawanabe, T.O.M. Kronsjo, and Thomas Williams, Trade Negotiations in the Tokyo Round: A Quantitative Assessment (Washington, D.C.: The Brookings Institution, 1978).

distribution of jobs gained and lost as a result of trade liberalization and the speed with which these changes in employment occur will differ markedly, however, from what would happen if the federal government reduced, say, defense spending. The fact remains, though, that the total number of jobs gained or lost is relatively independent of the source of changes in the demand for U.S. products.

The removal of trade barriers may increase or decrease U.S. net exports by $1 billion or $2 billion over the course of several years. In fiscal year 1978, however, the U.S. federal government spent $8.4 billion less than had been anticipated in the Second Concurrent Resolution on the Budget for that year. Thus, the overall employment effects of trade liberalization can be swamped not only by major shifts in domestic fiscal policies, but also by the errors that the federal government makes in estimating its outlays in any given year.

Finally, the price effects of trade liberalization are also likely to be quite small. If trade liberalization leads to a reduction in U.S. import prices of 2 or 3 percent over the course of the next ten years, this will lower the consumer price index by only about one-half of one percentage point over that same period. 17/ This is not a large change when one considers that, even if inflation is held to 6 percent a year, consumer prices will rise by 79 percent over ten years. Although the overall price effects of freer trade may be quite small, the effects in a few important sectors could be significant. In these cases, liberalized trade policies could constitute a useful element of a general anti-inflation program.

Trade liberalization may have important economic consequences for particular sectors of the U.S. economy, and both the U.S. and world economies could gain significantly through the increased specialization of production allowed by freer trade, the increased availability of imported products, and the long-term improvements in production efficiency fostered by increased competition and larger-scale production. Nonetheless, the near-term macroeconomic gains to the United States that will arise from freer trade are probably quite small. It seems that macroeconomic considerations will not serve to argue strongly either in favor of or in opposition to liberalized trade.

17/ This estimate was derived by reestimating an equation originally reported by Rudiger Dornbusch and Paul Krugman in their article, "Flexible Exchange Rates in the Short Run," Brookings Papers on Economic Activity, 3:1976 (Washington, D.C.: The Brookings Institution, 1976), pp. 537-75. The equation was originally estimated using data for the years 1955-1975. The reestimate used data for 1955-1977.

THE INTERNATIONAL POLITICAL EFFECTS OF TRADE LIBERALIZATION

The most important effects of trade liberalization may not be economic at all. Rather, the importance of the current round of trade negotiations may lie in the effect that its successful conclusion will have on the political climate that produces national trade policies.

For all of the reasons outlined in the introduction to this paper--disappointing recovery from recession, structural changes in the world economy, and increased government involvement in heretofore private commercial activities--sentiment for protectionism is rising, and there seems little reason to expect that the motivations for this sentiment will be reduced significantly in the near future. There are some indications that various national governments have been using the prospect of the new trade agreements to hold off this growing protectionist sentiment; they have argued that new restrictions should not be imposed at a time when they might be threatening to agreements that would benefit all countries. If the talks fail, the ability--and indeed the desire--of individual governments to continue to resist protectionist pressures will be weakened. Although it is impossible to predict with any certainty what the consequences of such a situation might be, it is clear that one possible outcome--and to many observers a likely one--is the rapid proliferation of new trade barriers and a subsequent reduction in world trade. In a sense, then, the current round of trade negotiations is important not for what it may accomplish, but rather for what its successful conclusion may prevent.

Beyond questions of trade restrictions and the growth of international trade, the final outcome of the Geneva negotiations may have implications for the future prospects of international cooperation on a number of economic and political issues. The Tokyo Round of trade negotiations is only one of a number of settings in which the United States is seeking economic and political cooperation from the other developed countries. Stabilization of international monetary arrangements, reduction of the large recent imbalances in international payments, and coordinated policies for the development and equitable distribution of energy and natural resources are all important goals of U.S. economic and foreign policy, and none of these can be achieved without the active cooperation of all of the developed market economies. Further, these same countries--Japan and Western Europe in particular--are the strongest and most important political allies of the United

States. Continued cooperation with these countries is necessary for the furtherance of a wide variety of U.S. national objectives. The Geneva trade negotiations represent a highly visible cooperative enterprise among these developed countries. The success or failure of these negotiations may well affect the willingness of the major participants to pursue other cooperative goals in the future.

Similarly, the trade negotiations constitute an important link between the industrialized nations and the developing nations--and particularly between the industrialized nations and the most advanced of the developing nations, which stand to gain much from increased access to markets in the developed world. For these newly industrialized countries, the new role of an important international trader brings with it new opportunities for economic growth, new domestic political and economic problems, and new responsiblities for the maintenance of the international economic order. The United States and its industrialized allies have strong interests in how the rapidly developing countries meet these opportunities, responsibilities, and problems. They also have, therefore, a strong interest in maintaining close contact with the developing countries through such channels as the trade negotiations. A satisfactory conclusion of those portions of the talks that deal with relations between developed and developing countries could serve as a step to further helpful consultations on a variety of other issues.

CHAPTER IV. SOME SPECIAL PROBLEMS FOR U.S. TRADE POLICY

The most difficult questions facing makers of trade policy today are not really questions about the desirability of a liberal trading environment: few would argue that a general increase in trade restrictions would be beneficial. Rather, the pressing questions--particularly for U.S. policymakers--have to do with how a liberal trading system can be made to work effectively and equitably despite a variety of influences with the potential to disrupt international trade patterns.

In one form or another, these influences--the most important are government involvement in international trade, the international transfer of technology, bilateral rather than multilateral trading arrangements, and the effects of government environmental and safety regulations--have always posed problems for trade policy. They have been ignored in the past because more pressing--and more easily resolved--problems have captured the attention of policymakers. Today, however, they are increasingly difficult to ignore, partly because easier solutions such as simple tariff reductions have already achieved nearly as much as can be expected from them, but also because present-day economic and political events have made these influences much more important in recent years.

With the exception of growing involvement of governments in international trade, these issues are not being discussed in Geneva. Their relevance to the Geneva talks lies in the fact that in a less restrictive trading environment these influences will be more strongly felt. Without some multilateral agreement on how to approach these problems, they have the potential for preventing the continued liberalization of the international trading system.

GOVERNMENT INVOLVEMENT IN INTERNATIONAL TRADE

Since the conclusion of the Kennedy Round of trade negotiations in 1967, there has been a marked increase in the involvement of national governments in international trade and in economic activity in general. This involvement has taken a wide variety of forms, including export subsidization, the formation of

special ministries to encourage exports, nationalization of major industries, government support for research and development, price support arrangements, environmental regulations, and special programs to mitigate the effects of economic dislocation.

The problem that government involvement creates for trade policy is that a set of new actors--national governments--now figure prominently in international transactions. Because these new actors do not have the same simple profit-maximizing objectives that are postulated for individual firms in traditional trade theory and because these actors have powers not possessed by individual firms, their activities can--and indeed usually are designed to--subvert the usual forces of economic adjustment. The results are often the creation of distortions in world trade patterns, the delay of necessary adjustment to changed economic conditions, and conflict among inconsistent policies adopted by several countries.

An often-cited example of the problems that can be caused by government involvement in international trade matters is the case of the British steel industry. Many critics have argued that the United Kingdom, with relatively high labor costs and an obsolete capital stock and without large deposits of iron ore, should not be in the business of producing steel. Steel, it is argued, could be produced more cheaply in other countries and exported to the United Kingdom in return for other goods and services that England could produce more efficiently. Such an arrangement would benefit all concerned (after provision had been made for relocating displaced British steelworkers), with other nations being able to export more steel and British consumers of steel being able to purchase steel more cheaply.

Without government intervention, the British steel industry would, it is argued, gradually disappear. Continual losses would force private companies out of business until eventually no steel producers would remain. But the British steel industry is not in private hands. Rather, it is state owned and its operating losses ($857 million in 1977) are absorbed by the government. It can, therefore, continue to produce steel at a loss almost indefinitely. Other nations, whose steel industries might be competitive in world markets, face a difficult choice as a result of the subsidization of the British steel industry: they can either allow their own steel industries to suffer through competition with subsidized British steel, or they can take steps to protect their industries by imposing countervailing duties on imports of British steel or by subsidizing their own

steel industries. Neither choice is attractive, and neither serves to promote the most efficient production of steel. If a number of countries simultaneously attempt to protect their steel industries--and this is in fact the case today--the result will be global overcapacity in the steel industry. Rather than shutting down, inefficient or obsolete steel plants remain in operation, tying up resources that could be better utilized elsewhere, and international economic tensions are heightened as various countries vie for shares of a world steel market too small to support all of them.

Government intervention in international trade poses particularly serious difficulties for the United States. The size of the U.S. market and the high level of U.S. income make the United States an attractive market for many foreign exporters, and governments intent on expanding exports have often made the U.S. market a target for their efforts. Even if trade expansion is not the primary motivation for government intervention, the relative openness of the U.S. economy has allowed the effects of export-supporting policies to be felt in the United States.

The United States is not exempt from charges of intervening in private markets to stimulate U.S. exports. Critics in foreign countries point to heavy government subsidization of the U.S. electronics and aircraft industries through defense-related research and development contracts. These contracts, it is alleged, have allowed U.S. firms to develop technologies easily adapted to civilian purposes, giving the United States a commanding lead over other producers of sophisticated electronic gear and aircraft. Some criticism of the United States has also arisen with respect to U.S. farm price support policies, which from time to time have resulted in massive overproduction of agricultural commodities and in a necessity for U.S. producers to export their crops. Indeed, it is generally recognized that the major U.S. food aid program (the Food for Peace program authorized by Public Law 480) was designed not only to aid poor nations, but also to maintain domestic agricultural prices by increasing U.S. food exports.

In neither of those cases was the primary motivation for government action an attempt to increase U.S. exports. The government supported research and development in the electronics and aircraft industries in order to produce a sophisticated defense hardware. Farm programs and food aid programs were instituted to preserve certain kinds of agricultural production deemed valuable, to dispense with large stockpiles of excess

products, and to aid the world's hungry. Nonetheless, these actions may have had important effects on patterns of international trade. The same is true of many actions undertaken by foreign governments, and herein lies the real problem with government involvement in trade matters.

There seems to be general agreement that governments should refrain from actions designed specifically to subsidize exports at the expense of similar industries in other countries. Few would dispute, however, the right of governments to pursue important domestic goals through economic intervention even if this intervention alters trade patterns. Perhaps more to the point, few governments would subscribe to international agreements that limited their freedom to engage in such intervention. The difficulty lies in separating these two kinds of actions in some practical way.

The so-called subsidies code being negotiated in Geneva is an attempt to identify at least some types of government practices that will be considered improper. The variety of rationales for government intervention in economic matters and the subtlety of tactics by which this intervention may be accomplished are sufficiently great, however, that any code will be able to proscribe only the most flagrant attempts to encourage exports at the expense of other nations. Indeed, most observers expect that the subsidies code negotiated in Geneva will contain little that is new in this regard; most of the practices that will be prohibited by the new code are already considered unacceptable under the terms of existing trade agreements. The most important product of the Geneva negotiations regarding government involvement in international trade is not likely to be clear agreement on which kinds of government practices are acceptable and which are not. Rather, it will be agreement on a mechanism for resolving the inevitable disputes that will arise over specific government policies.

A particularly troublesome instance of government involvement in international trade is posed by the growing trade between centrally planned economies and the market-oriented economies of the rest of the world. Because government involvement in economic activity is so pervasive in the centrally planned economies, the internal prices of many commodities can deviate sharply from the prices of comparable commodities in market-oriented economies. When the prices of important factors of production--labor, electricity, steel, or fuel oil, for example--are so affected, the result can be a bewildering assortment of implicit taxes and

subsidies that strongly affect the prices at which finished goods can be offered for sale in international markets. Because of the complexity of arrangements in these nonmarket economies, it is difficult to determine whether or not the net effect of state intervention is to subsidize exports. Thus, in some cases there is little basis for judging whether exports from a centrally planned economy are competing fairly with those of market-oriented economies.

Unfortunately, the problems of trade with centrally planned economies are not being discussed in Geneva. This is because none of the major centrally planned economies is a party to the GATT, and consequently none is represented at the trade negotiations in Geneva. As trade with these countries becomes increasingly important for all of the market-oriented economies, some means will have to be found for including the centrally planned economies in future negotiations over the conduct of international trade.

"BILATERALISM"

There has been a growing tendency in the past few years for pairs of countries to conclude special bilateral trade agreements whereby each party to the agreement undertakes to purchase a specified amount of the other's products. These agreements can take a variety of forms. At one end of the spectrum are agreements involving relatively small volumes of trade through which a private firm will agree to build a plant in a developing or a centrally planned economy, accepting subsequent output from the plant as payment. Such arrangements have been common for a number of years--particularly between Western European multinational corporations and the governments of Eastern European countries. During the past few months, a number of highly publicized contracts of this sort between firms of various nationalities and the People's Republic of China have been concluded.

A newer phenomenon has been the conclusion of much larger-scale agreements between two governments. These have been most common between the governments of industrialized nations and the governments of oil-exporting countries. Japan, for example, has entered into agreements with both Iran and Iraq committing it to buy specified amounts of oil from these countries over the course of several years and requiring the two oil-producing countries to purchase Japanese equipment and services in amounts

equivalent to the value of their oil exports to Japan. Similar arrangements have been concluded between Japan and Mexico and between France and Mexico.

These arrangements (which have been referred to as examples of a new "bilateralism") have been criticized as placing some international economic transactions beyond the influence of market forces and, as such, constituting important obstacles to fair and open international trade. In essence, these arrangements reserve some fraction of a nation's total imports for particular countries. Products from other nations not party to bilateral arrangements can be displaced, even if these products are cheaper than those that the importer has agreed to buy. Because these arrangements typically extend over several years--in some cases, as many as ten--they can freeze the shape of at least a part of world trade flows no matter how economic conditions may turn out in the future.

Further, because many of these bilateral arrangements--especially those involving larger volumes of trade and extending over longer periods--are concluded through government-to-government negotiations rather than through private commercial channels, there is widespread fear that such arrangements may mark excessive governmental intervention or that they may be concluded for political rather than for economic reasons.

While all nations would presumably be better off if all international transactions were subject to market forces, there are strong incentives for individual countries to enter into such arrangements. Developed nations may find in such arrangements an opportunity to gain an advantage over other countries by tying up some part of lucrative, fast-growing export markets. For the developing countries and for the centrally planned economies, these arrangements provide an alternative means of financing industrial development outside the normal channels of international lending. Indeed, the original motivation for these arrangements lay in the difficulties encountered by some nations in finding conventional commercial financing for the installation of new plants and equipment. By entering into what were essentially barter arrangements with firms in developed countries, the industrializing nations sidestepped the need for international financing. With bilateral arrangements, the burden of obtaining financing is left with the firm in the developed country. In cases where capital formation is not an explicit part of the bilateral contract (as in cases where oil is traded for unspecified commodities), the developing country has the advantage of being able to

negotiate large purchases of foreign goods at one time--sometimes getting better terms by buying in volume and minimizing the need for extensive managerial staffs (often lacking in developing countries) to arrange and execute international transactions.

Bilateralism poses a particular problem for the United States. Because the federal government has relatively little control over the private firms in the United States that carry out the bulk of U.S. international transactions, it cannot enter into bilateral arrangements as easily as can governments that exercise effective control over important industries. Not surprisingly, the United States has been much less aggressive in pursuing bilateral arrangements than have other countries, and there does not seem to be any clear U.S. policy toward such arrangements. If these arrangements continue to proliferate, the United States could find itself at a disadvantage in relation to some other developed countries that do seek to establish special bilateral ties.

Without some international agreement to limit the spread of bilateral trade arrangements, it may be impossible for individual nations to resist the incentives to enter into such arrangements. If other nations are making bilateral deals, then a nation will only injure itself by refraining from making similar deals. At present, no multilateral agreement governs bilateral arrangements, and no such agreement is being discussed in Geneva.

But formulating an agreement to limit bilateral trade arrangements will not be a simple matter. Many have argued that, by necessity, trade negotiations in the future will be of a bilateral nature. Some support is lent to this position by the difficulties that have been encountered in reaching agreement among the many participants in the present round of multilateral trade negotiations. Further, all indications are that, for the near future at least, the most pressing matters for negotiation will be specific practices by individual countries that may be alleged to harm the interests of other countries. Such disputes may be much better handled on an ad hoc bilateral basis than through multilateral negotiation, and few observers see any prospect for another round of multilateral trade negotiations in the near future.

By their nature, bilateral trade arrangements constitute discriminatory treatment by a nation of its potential trading partners, and as such they are contrary to the spirit of the framework that underlies the present trading system. At the same

time, there is no reason to expect that the motivations to enter into such arrangements will weaken appreciably in coming years. Indeed, there are reasons to think that further progress in opening up world markets will come only as the cumulative result of many bilateral arrangements. Bilateralism, then, is likely to remain a problem for international trade policy--and for U.S. trade policy in particular--for some time to come.

TRANSFERS OF U.S. TECHNOLOGY ABROAD

Another issue that has caused concern, particularly among labor groups, is the negative effect that unrestrained exports of technology are having on the trade balance of the United States. Some observers have argued that, by making American know-how and technology available to foreign producers, the United States is creating competitors for its domestic industries. With the acquisition of U.S. technology, foreign producers will begin to replace U.S. products in their home markets. As these producers increase their output beyond the absorptive capacity of their domestic markets, the logical next step will be to begin exporting into foreign markets. Their exports will compete with U.S. export products--at first, in third-country markets and, eventually, in the U.S. market as well.

Labor groups have suggested that, by imposing restrictions on the export of capital goods, many of the problems associated with technology transfers might be ameliorated. Attempts to stem the outflow of technology from the United States might, however, serve to shift the cause of the problem but would most probably not solve it. Export restrictions of this sort would eliminate a good deal of the foreign demand for the output of U.S. industries. Because exports of capital goods that are technology intensive play such an important role in U.S. exports, accounting for one-third of all goods sold abroad in 1977, this induced drop in foreign demand would also result in excess productive capacity at home, leading to plant closings and worker layoffs. With the imposition of export restrictions, job losses due to increased competition would be replaced by job losses due to export restriction. The net effect would be very similar under both circumstances.

The recommendation to curtail exports of capital goods makes the erroneous assumption that technology is the critical factor in determining competitiveness. The most widely accepted explanations of international trade, however, postulate that

competitiveness--or comparative advantage--is a function not only of technology (capital), but also of the composition of the labor force, as well as of the natural resources with which the nation is endowed. So, even if all nations were to enjoy the benefits of having identical technologies, equal competitiveness would still not be guaranteed.

It becomes clear from the above that a policy of restricting exports of capital goods is not the best means of ameliorating the effects of foreign competition. In this context, although the United States is the major supplier of capital goods to world markets, it is not the only supplier. Technologies similar to those available from the United States can also be obtained from other industrialized countries. Presumably, if the United States were to cut back on its sales of capital goods, these countries would be more than willing to take up the slack in supply.

While recognizing that unlimited transfers of technology might have some negative implications for the U.S. economy, the proposed solution of imposing export restrictions is hardly a desirable alternative, nor does it seem likely to be effective.

THE EFFECTS OF FEDERAL REGULATIONS ON U.S. INDUSTRIES

Industry as well as labor representatives have expressed concern about the effect that government regulations have on domestic employment, the level of activity in the domestic economy, as well as the competitive position of U.S. industry. This concern has emerged as a reaction to the imposition of regulations in areas such as occupational safety, pollution control, and product safety.

Industry representatives in particular have argued that the expense of compliance with these regulations has raised their production costs, particularly in such industries as steel, chemicals, and metal manufacturing. Federal regulations unquestionably have prompted industry to make large investments for pollution-abatement equipment. In 1977, U.S. industry as a whole spent a total of $7 billion for pollution abatement, representing about 5 percent of total expenditures for new plant and equipment. 1/

1/ U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business (June 1978), pp. 34-35.

The proportion spent by some industries was a good deal larger: 10 percent for the chemicals industry, 15 percent for steel works and blast furnaces, and 17 percent for nonferrous metal manufacturing. The industries claim that the high cost of compliance with federal regulations has forced them to increase the price of their finished goods to such a degree that they now find it difficult to compete in world markets.

Some observers, while agreeing that there is validity to these allegations, contend that the negative effects of the regulations have been rather limited. They point out that very few firms have suffered such a severe loss of competitiveness as a consequence of the regulations that they have been forced to close. The Environmental Protection Agency estimates that, between 1971 and 1977, a total of 119 plants were closed in the United States because of environmental regulations. These plant closings have resulted in the direct loss of 21,900 jobs. 2/ Nevertheless, not all of these plants produced goods that were traded internationally; thus, only a portion of these job losses can be attributed to changes in international competitiveness.

These observers also contend that the regulations have not seriously affected the international competitive position of most U.S. industries. A recent, still uncompleted study by the U.S. Department of Commerce which seeks to analyze the effect of environmental regulations on competitiveness has drawn the preliminary conclusion that environmental control costs have had little, if any, effect on reducing exports or increasing imports. 3/ The study seeks to analyze the problem by comparing the outlays an industry made for pollution-abatement equipment with the volume of trade of the industry; it has found no significant correlation between them.

Although these results are valid for many industries, it is undeniable that some producers have suffered a loss in competitiveness as a consequence of regulatory actions, and it might be proper for the government to provide some form of relief to the most seriously affected industries.

2/ Council on Environmental Quality, Ninth Annual Report, 1978, p. 432.

3/ Ibid., p. 436.

Some analysts have made the allegation that many of the most robust competitors of those U.S. industries that have sustained injury derive their advantage from being located in countries that have not enacted pollution control or occupational safety regulations. Copper producers are a good example of an industry that has suffered injury because of increased exports to the United States by producers who are not subject to environmental regulations. The Copper Environmental Equalization Act of 1977 was an attempt to provide relief for the copper industry; the legislation, however, was not enacted into law. The bill proposed to increase the duty on imported copper by an amount that offset the cost incurred by U.S. producers in meeting domestic environmental regulations. Using the tariff structure in this way, however, presents a number of problems. One of these problems is that Article II of the GATT prohibits unilateral alteration of import duties on a good that has been subject to trade concessions. By raising the import duty on copper, the United States would become subject to claims for compensation from its trading partners or to retaliatory actions against U.S. exports.

An alternative means that has been suggested to offset the effects of regulatory action would be to implement a subsidies scheme that is designed to make the affected U.S. industries competitive again in world markets. Using subsidies to promote exports, however, has been a major issue of contention in the GATT system; in fact, Article XVI of the GATT agreement prohibits the enactment of subsidies if their explicit intent is to promote exports. The current round of trade negotiations has in fact made an effort to resolve this issue, and it remains to be seen how much has been accomplished.

Because only a fraction of those industries that are affected by regulatory actions trade their goods internationally, a complicating feature of both of these relief schemes is that they would aid only some of the affected industries, while they would do little for those industries that do not engage in international trade. And it would seem difficult for the government to offer a rationale for a policy that aids only international traders.

While government regulations have had some negative economic effects, it should be kept in mind that the reason for imposing them was to improve the quality of life in the United States. It is generally held that the regulations have made a contribution to this effort. Other nations, however, may conclude that maintaining or even marginally increasing their share of international trade is worth having a somewhat more hazardous workplace and a

less clean environment. The somewhat cynical conclusion could be drawn from this that, whatever problems these regulations have caused for U.S. producers, American consumers have enjoyed the benefit of cheaper products, while foreigners have borne the environmental and occupational costs.

Ultimately, the only way to resolve the trade problems associated with nations enacting different regulatory measures is to negotiate a set of uniform international standards. While most developed countries have imposed measures similar to those enacted in the United States, some differences still remain, and these differences may provide a competitive advantage to certain industries. Most of the developing countries, however, have not enacted regulations, primarily because of a fear that regulatory action would hamper their efforts to modernize and develop their economies. The prospects for negotiating a set of uniform international regulations in the near future, given the complexity of the divergent political and economic priorities that are involved, would appear to be rather slim.

CHAPTER V. CONCLUSION

Not even the most determined optimist would hope for the agreements that may be reached in Geneva to provide solutions to all the problems that the United States faces in its trading relations with other nations. Many of these problems are the results of international economic disturbances and imbalances that have little to do with trade policy, and the Geneva negotiations were never intended to correct these disturbances and imbalances.

Neither will trade liberalization of the sort being contemplated in Geneva have important macroeconomic effects in the United States. Some jobs will be lost as a result of changing trade patterns; others will be gained. The net change in employment, however, will probably be very small. Freer trade may act in some small way to restrain price increases in the United States, but these effects will be swamped by the effects of domestic fiscal and monetary policies. Even the size of the tariff reductions likely to arise from the Geneva negotiations are small when compared with the changes in international prices that have come about as a result of recent currency market fluctuations.

At a microeconomic level, however, the Geneva negotiations could have important consequences. In a few areas--textiles and agriculture are the most immediately obvious examples--trade liberalization could lead to major changes in the distribution of production, with relatively efficient producers assuming a larger share of world markets. These shifts in production would impose some costs for adjustment to changed conditions, but they would also result in generally higher efficiency in production and lower costs. After accounting for the costs of adjustment, these and similar shifts in production could be expected to result in measurable economic gains for the United States.

These gains would be very small when compared with total U.S. GNP, but then so are the economic effects of nearly all international economic developments. The U.S. economy is so large and international transactions constitute such a small portion of overall economic activity that very few international economic initiatives can be justified on the grounds that they will bring about large changes in the U.S. economy. Perhaps of more relevance is the fact that trade liberalization could

lead to gains which, although small in comparison to the total economy, are substantial in an absolute sense.

The most important gains likely to result from trade liberalization, however, are not captured by simple calculations of short-term gains and losses. Difficult to quantify, these benefits arise only over the course of several years. Increased competition may spur faster technological progress; larger-scale operations may allow production efficiencies; reduced inflationary pressure may allow more expansionary monetary and fiscal policies. Most important of all, agreement on some rules for international trade arrangements may be necessary to avoid a general return to more restrictive trade policies. As noted above, sentiment for protectionism is rising in a number of countries, and some observers have noted that, if the Geneva negotiations accomplish nothing more than maintaining the present level of liberality in the trading system, they will have served an important function.

Although the near-term, easily measurable effects of the Geneva talks on the United States are likely to be small, the United States--perhaps more than most other nations--has much to gain in the long run if some agreement can be reached on what constitutes acceptable behavior in the conduct of international trade. Because the U.S. economy is relatively open and decentralized, it is highly susceptible to the effects of trade-supporting policies in other nations. Without international agreement on which policies are to be permitted and which are not, there is every prospect that government involvement in international trade--and the adverse effects that this involvement can have on U.S. industry--will continue to grow. In such a situation, the United States would be faced with the unsatisfactory choices of allowing government-encouraged foreign enterprises to usurp U.S. markets, taking actions to protect threatened U.S. industries, or involving the U.S. government more directly in private economic activities in an attempt to encourage U.S. exports. Clearly, some negotiated restraint in government support of international trade would be preferable.

Even a highly successful conclusion to the Geneva talks will leave a number of difficult problems for U.S. trade policy. Policies will have to be devised for dealing with specific cases of involvement by foreign governments in international trade and for regulating the growing volume of U.S. trade with nonmarket economies. The United States will have to formulate some sort of policy toward large bilateral trade arrangements. Some means will have to be found either to compensate or to

protect from foreign competition U.S. producers who incur increased costs as a result of environmental, safety, or health regulations. Finally, and perhaps most important, the United States must have the capability to implement any agreement that is reached in Geneva. Some current U.S. government practices may have to be altered; other nations' compliance with new trade accords will have to be monitored; decisions will have to be made in cases of industries that seek relief under the terms of the new agreement; and the U.S. government will have to aid domestic producers in understanding a new agreement and in taking advantage of the opportunities it may offer. All of these functions will require an active and effective concern with trade matters on the part of the federal government.

The most difficult problems that will have to be faced as a consequence of liberalized trade, however, may well be domestic and not international. Effective liberalization of international trade will require some important structural realignments in the U.S. economy. Inevitably, these structural changes will lead to a loss of jobs in some industries. In many cases, the workers most likely to suffer from trade liberalization are those least able to move easily into other occupations, and the federal government is widely seen as bearing some social and economic responsibility for the relocation of affected workers. Perhaps more immediately relevant is the political reality that, unless some provision is made to compensate dislocated workers, it is unlikely that any significant trade liberalization will be approved by the Congress. Few would argue that present programs for trade adjustment assistance provide adequate relief for workers and firms injured by increased foreign competition or that these programs provide the aid and incentives necessary to encourage adjustment to changed conditions. Restructuring of these programs will most likely be an important element of any set of policies designed to promote or take advantage of a liberalized system of international trade.

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