Managed Trade and Economic Sovereignty

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Executive Summary

The Problem

The United States finds it very difficult to identify its national economic self-interest in the new globalized economy. American leaders are hamstrung by the habits of the United States' post-war geopolitical role and its associated ideology of ***laissez faire.***

Since 1945, the East-West conflict has dominated the American conception of its national security interests. As the leader of the trading system, the U.S. government feels constrained to indulge its trading partners' mercantilist practices in order to retain their allegiance in matters of high politics, such as the Cold War. In the 1940s and 1950s, when the U.S. was the world's towering economic power, that indulgence had acceptable costs and many advantages. But, in the 1980s, with a chronic trade deficit and the loss of key American industries to foreign competition, defining national security as merely military is no longer sensible. Yet the history of recent trade negotiations is replete with American tolerance of economic free riding on the part of its allies, and the subordination of trade objectives to military ones.

With a chronic trade deficit and the loss of key American industries to foreign competition, defining national security as merely military is no longer sensible.

This self-damaging economic policy has been obscured by a ***laissez faire*** ideology which contends that the actual pattern of global production and trade must be the result of natural market forces, which it would be folly to resist. In practice, however, other industrial nations practice a mix of free market capitalism and strategic trade. The response of U.S. leaders is to coax them to run their economies in the idealized American image. Such efforts inevitably fail. As a result, our own domestic economy becomes the captive of other nations' industrial policies.

American confusion about international trade and the national interest leads to both tactical and strategic paralysis. Our leaders and their economic advisers are uncertain whether the U.S. "ought" to pursue technological and manufacturing leadership, even in obviously key sectors, because this seems to be the sort of nationalistic behavior that undermines America's teachings to the world. Except when a clear military interest can be demonstrated, U.S. officials are reluctant to set industrial goals. Tactically, there is a similar uneasiness about taking a hard line with trading partners who overtly violate the norms of liberal trade, because any remedies or sanctions would themselves depart from the ***laissez faire*** norms we seek to inculcate. In the Orwellian vocabulary of trade debate, the "Super-301" provision of the 1988 Trade Act, which attempts to secure open markets abroad, was branded as protectionist. Paradoxically% our very support for free trade makes us all but powerless to insist that other nations honor it.

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Economic Theory

Since the early 1980s, standard economic theory has revised the traditional view of trade handed down from David Ricardo. Accepted theory now acknowledges that the actual worldwide distribution of production is not invariably, the result of natural endowments of resources, climate, and labor but that it is indeed possible for national policy to influence the location of production, to national advantage. As economic orthodoxy has retreated, the characteristic argument against intervention is no longer that strategic industrial and trade policies can never be advantageous, but rather that successful outcomes would be hard to guarantee given the characteristic interest-group politics of the United States.

But if economic theory now admits that we no longer dwell in a world in which economic possibility is dictated by the invisible hand, and that the textbook characterization of free trade as "first-best" does not describe reality, then it becomes advisable to consider the possible second bests-not textbook free trade, but freer trade. The vain attempt to pursue pure *laissez faire* not only disadvantages U.S. industry, but also leaves the world trading system with a dishonest and inefficient blend of subsidy, sub-optimal investment, and subterfuge.

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Second Bests

In practice, managed trade modes can improve on the free trade model, not as it exists in the textbooks, but as it actually operates in a world of nation states. Pure free trade is improbable, and different nations are likely to operate their domestic economics according to fundamentally different rules and structures. Yet it should nonetheless be possible to design a trade regime and a set of operating principles for U.S. policy that permit dissimilar nations to trade with one another without producing lopsided outcomes. To gain insight into both good and bad design elements of second-best trade regimes, the paper examines the actual experience of three industries in which the organization of U.S. trade has consciously departed from the principles of *laissez faire.*

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Textiles

In the case of textiles and apparel, the Multifibre Arrangement (MFA) provides a good illustration of a reasonably successful managed trade regime. The MFA seeks to manage the rate of import growth, thus allowing time for domestic producers to phase out of some production and to automate in other areas where advanced capital can compete with cheap labor. The limitation on a ruinous free-for-all has helped limit worldwide excess capacity, and has given new exporting nations the ability to predict and plan for their probable share in a steadily expanding market. Far from retarding innovation, the predictability has facilitated new capital investment in both the industrial and developing worlds.

Steel

The steel industry offers a good example of what happens when other nations' mercantilism coexists with the U.S. pretense that free trade reigns. In the 1970s, newly industrializing nations invested heavily in steel capacity. That new capacity came on line just in time for the global economic slowdown following the two oil shocks. The result was a worldwide squeeze on steel earnings and pressure to dump subsidized steel on the world's only large open market: the United States. Because of an unwillingness to admit forthrightly what was occurring, the U.S. government let serious damage occur before finally negotiating a *fourth*-best solution in the form of so-called "voluntary" export restraints. This is an industry which cries out for a regime that reconciles the desire of major nations to retain some domestic steel production with a common interest in reciprocal reduction of world-wide subsidy costs and global excess capacity.

Semiconductors

The semiconductor industry illustrates the reality that different nations simply play by different rules. The Japanese semiconductor industry is part of a conglomeration of horizontally integrated electronics firms. It epitomizes the Japanese habit of pursing technological prowess and market share, notwithstanding what in America would be unacceptable short-term losses. There is no GATT-wide conception of antitrust, and conventional antidumping remedies are not adequate to handle the complexities of semiconductor trade. Moreover, it is clear that the three major trading area-the U.S., Japan, and the European Community (EC)-each consider semiconductors so important that they are determined to retain domestic production capacity. Here, the U.S. even put aside its principles and negotiated a quasicartel with the Japanese, although this has failed to produce the U.S. market share in Japan that was promised. As in steel, the national and global interest would be served by a regime that acknowledges the reality of managed trade, yet promotes competition, innovation, and freer trade.

Different nations simply play by different rules.

Conclusion

The United States should abandon its hopeless quest for *laissez faire* trade, and begin designing a trade regime that accommodates reality. Such an effort would support our national economic interest in retain ing leadership in a broad range of manufacturing technologies and products, as well as the worldwide interest in a sustainable and balanced set of rules for the trading system.

The national and global interest would be served by a regime that acknowledges the reality of managed trade, yet promotes competition, innovation, and freer trade.

International trade remains a political act whether it takes place under a system of free trade or protection, of state trading or private enterprise, of most-favored nation clause, or of discriminating treatments.

-Albert 0. Hirschman (1945, p. 78)

Introduction

The contemporary problem of global political economy is that nations are losing sovereignty to private economic actors, yet the very turmoil of an unregulated market intensifies the pressure of nations to secure acceptable outcomes for their citizens. Despite the impetus towards an integrated global private economy, the nation state remains the instrument of political mediation. The state, not private corporations or banks, remains accountable to its citizens for their economic welfare. The state bears the ultimate fiscal responsibility. And the polity remains the arena in which social contracts are negotiated. Yet the growing imbalance between an integrated, unregulated global economy and a weakened set of national and supranational instruments for its governance deprives individual nations of the machinery to deal constructively with those dislocations. The Keynesian nation state has lost most of its economic rudder-not to supranational public authority, but to internationalized private capital.

The Keynesian nation state has lost most of its economic rudder.

The confusion about the appropriate role for the state and the market is at its most muddled in the thinking about the desirable norms for the trading system which governs cross border commerce, where the reach of the state is weakest and that of private capital strongest. The confusion is perhaps most severe in the United States, because the United States, as guarantor of the global system and purveyor of the ideal of liberal trade, is increasingly unsure how to reconcile those twin goals with its own national interest as an economy. For the most part, official opinion seems to think that the remedy for the dislocations of laissez *faire* is more *laissez faire*.

The United States, as guarantor of the global system and purveyor of the ideal of liberal trade, is increasingly unsure how to reconcile those twin goals with its own national interest as an economy.

The United States, as the hegemonic power and as the nation most ideologically committed to economic liberalism, also experiences these dilemmas most acutely because it has the least consciousness of them. By the lights of orthodox economics and the ideology of the Reagan and Bush Administrations, the remedy for the range of international economic problems is the perfection of free trade. But other trading nations, lacking the effortless commercial dominance that post-war America once enjoyed, feel far less guilty about using the economic instruments of the state. Long accustomed to higher levels of both exports and imports as a share of GNP, and lacking the American sense of special responsibility for the system as a whole, they developed survival skills and institutions of economic adjustment and development that the United States lacks.'

In some countries. such as Japan, Korea, France, and Brazil, these strategies have been overtly mercantilist. These nations have been willing to use the economic power of the state to promote industrial development, to shelter home markets, and to seek trade surpluses. Other successful small trading nations, such as Sweden and Austria, while supporting a generally open trading system, have devised their own mechanisms of adaptation and indirect subsidy that violate the norms of liberal trade in more subtle ways. Still other nations, of the Pacific basin, most of them small, have achieved rapid growth by combining entrepreneurial dynamism with very low wages and state support, turning themselves into export powerhouses by letting their domestic consumption lag their production for world markets. Though this is ostensibly a subsidy, it is better understood as a different form of free-riding on the trading system, since it depresses demand nationally and hence globally, and creates lopsided trade surpluses which are the reciprocal of other nations' trade deficits.

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In general, it is the United States that has been the advocate of the purest version of free trade. Most other nations have loyally given lip service to these U.S.-inspired norms, while devising pragmatic measures necessary for their survival in a global economy. At the same time, the United States' own practice has been far from the paragon of economic liberalism that is often professed. Yet because of our fierce ideological commitment to laissez *faire,* U.S. departures from it have typically been poorly thought out. lacking in long-term industrial goals, and generally not helpful either to the trading system or to America's own economic self-interest.

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There is thus a grave dilemma, both for the global trading system, and for the U.S. as its chief architect and sponsor, Many other nations have demonstrated, by their actions if not their words, that they are not interested in a system of pure free trade. By some calculations, more than half the cross-border trade which takes place today operates by some other standard then the norms of classical free trade.[2] Yet, curiously enough, the volume of trade continues to increase substantially faster than the growth of total world GNP. The sins against liberal trade vary from economic development initiatives undertaken by poor countries which might be justified as variations on the traditional "infant industry" loophole, to *de facto* industrial policies cloaked in national defense, to covert market-closing measures undertaken by the world's richest and most successful trade-surplus nations.

A different order of problem is the institutional disjuncture between trade negotiations, debt negotiations, and the other policymaking machinery that establishes rules for the global economy. One set of diplomats, at the General Agreement on Trade and Tariffs (GATT) in Geneva, is hectoring Third World nations to open their markets to U.S., European, and Japanese manufactured goods. A different set of bureaucrats, associated with the World Bank, the International Monetary Fund (IMF), and the Private creditor banks, is pressing debtor nations to reduce their imports and increase export earnings. Finally, the most pressing, over-arching trade questions, such as the problem of chronic Japanese and West German surpluses, and U.S. deficits in manufactured goods, are widely acknowledged, but these issues are not part of the GATT portfolio; they seem to be on the diplomatic agenda everywhere *but* at the trade talks. Once again, the assumption of liberal economics is that if "barriers" are removed then the "correct" pattern of trade will naturally ensue. The question of Japan's chronic surplus, or of balance in the trading system, are not issues *per se,* except to the extent that illegitimate trading practices can be demonstrated. Desperation remedies such as the Gephardt amendment are then branded as illegitimate because they flout the stated norms of the trading system that the U.S. champions.

The GATT system, of which more shortly, has only limited criteria for differentiating "good" violations of *laissez faire* from bad ones. Aside from giving nations the right to countervail, and being somewhat indulgent of statist policies in developing nations, the GATT does not effectively parse out departures from free trade; it has no mechanism for assuring rough balance in the total calculus of mercantilism. The basic GATT norm is non-discrimination, and the basic GATT goal ever freer universal market access. All "trade distorting" subsidies are presumed to be bad. All departures from the principle of multilateral non-discrimination are deemed regrettable. Economic development schemes, viewed through the GATT lens, are generally damned as merely protectionist and it is never conceded that they might have positive-sum benefits in the form of technological gains or redistributions of production.

Advocates of liberal trade tend to see themselves as possessors of special virtue, maintaining the dikes against tides of self-serving protectionism.

Advocates of liberal trade tend to see themselves as possessors of special virtue, maintaining the dikes against tides of self-serving protectionism. It is presumed that more laissez *faire* is invariably better than less, even though economic theory says this is not necessarily true in an imperfect world. There is no taxonomy for sorting out a world of necessary second bests in practice, and little recognition of the necessity of economic management, except through the reluctant toleration of escape clause relief and other "safeguards," in GATT jargon, which are supposed to be temporary and used sparingly

There is no taxonomy for sorting out a world of necessary second bests in practice, and little recognition of the necessity of economic management.

If this is a problem for the GATT system, it is a special problem for the United States, which tends to see its own self-interest as identical to the liberalism of the trading system as a whole. The U.S. seems to view it as its special mission to bring *laissez faire* to the world, rather than to hammer out with its trading partners a sustainable mixed system, which tolerates some state involvement in the economy, but with rough overall balance, and in which the United States has an equitable share of benefits and costs.

The prevailing U.S. ideology of economic liberalism eschews industrial goals for the United States. In principle, it is none of the government's business where steel, or automobiles, or semiconductors, or VCRs, or civilian aircraft are produced. If production migrates, this must be the market speaking. If the invisible hand operates through the guiding hand of foreign industrial policies, this is deemed to make no significant difference. Classical trade theory holds that if other nations are stupid enough to subsidize their export industries, American consumers ought to welcome the gift. These presumptions have four consequences, all of them negative for the U.S. national self-interest and confusing to the trading system.

First, the lack of a set of U.S. industrial goals means that it is impossible to have any trade goals for U.S. policy, other than to exhort other nations to practice ***laissez faire*** in the American image. In practice, this makes America's industrial fate partly the captive of other nations' industrial policies. Second, because the U.S. continues to view itself as the political leader of the western world, we are reluctant to play tactical hardball on trade issues, lest we alienate key geopolitical allies. Third, when exhortation fails to achieve equitable results, or to open markets, the United States is reluctant to resort to explicit market-sharing remedies, because this of course would be a version of the managed trade we claim to disdain, and would violate the very ideology we are promoting. And finally, and perhaps most seriously, our devotion to the ideal of ***laissez faire*** means that those U.S. departures from liberal trade which do intermittently occur, are undertaken guiltily and without strategic purpose, and are seen by U.S. officials as unfortunate concessions to domestic politics rather than as economic development initiatives.

The lack of a set of U.S. industrial goals … makes America's industrial fate partly the captive of other nations' industrial policies.

The cases are legion. For example, we disingenuously imposed a quota regime on autos, disguised as voluntary export restraints (VERs). This allowed the Japanese to determine just what was exported to the U.S. and to capture the quota rents; it also exposed us as perfect hypocrites. The United States backed into an "industrial policy"-for motorcycles (!)-via a trade relief case, but disdained one for the far more consequential machine tool industry. It has long had a highly protectionist regime for agriculture, which it does not know how to dismantle except by having everyone else forswear all price regulation for farm products, which other nations regards as unrealistic and probably cynical. It has had an extensive and unacknowledged industrial policy for aircraft, via the Pentagon. And because national defense is the one available loophole in the otherwise seamless ideology of ***laissez faire, we*** have lately witnessed the Pentagon sponsoring an industrial (and trade) policy for semiconductors, for high definition television, and even an advisory body to the Secretary of Defense drawing the seemingly logical conclusion that the Pentagon should widen that sole loophole and simply take over the task of modernizing *all* of American industry.3

Our devotion to the ideal of laissez faire means that those U.S. departures from liberal trade which do intermittently occur, are undertaken guiltily and without strategic purpose.

An even more stunning example of the self-defeating cost of political hegemony married to ***laissez faire*** economics is American export control. The U.S. takes a far harder line than its allies in restricting the export of advanced technologies to Soviet bloc nations. This policy not only requires extensive export controls on East-West trade, but also limits the ability of U.S. high-tech producers to export to friendly nations (lest sensitive products be transshipped to the East). As a consequence, U.S. producers lose billions of dollars worth of export business-a 1988 report by the National Academy of Science conservatively estimated the 1985 annual export loss at $9.3 billion-while other nations understandably view the U.S. stance of promoting free commerce with one hand while tightly regulating it with the other as confusing if not idiotic.

In the prevailing ideology, perfect *laissez faire* is presumed to be not only the first best, but the only defensible goal. As even most orthodox economists will admit when pressed hard enough, it is neither. But because we have no criteria or taxonomy for sorting out second bests in a necessarily mixed world economy which can never attain pure free trade, this self-defeating pattern keeps recurring. It is the purpose of this paper to help us understand and evaluate the available second bests. Contrary to the standard assumptions of free traders, the case for managed trade is not simply a set of special pleadings on behalf of retrograde industries, but reflects a dissenting analysis of political economy, of the dynamics of trade, and the interconnections between trade and geopolitics.

The case for managed trade is not simply a set of special pleadings on behalf of retrograde industries.

History

To understand the deep confusion in American thinking about trade, it is helpful to recall the remarkable period of the late 1940s when the present global trading regime was conceived. In the revisionist memory of the 1940s, the western nations under U.S. leadership set the post-war economy on its present course of economic liberalism, gradually dismantling wartime controls and looking towards ever freer movements of capital and goods. "The Bretton Woods conference, held in 1944," wrote influential economist Jagdish Bhagwati, "had designed an institutional infrastructure that embodied the principles of a liberal international order."[4]

Post- war reconstruction *aimed at a compromise between fhe anarchy of laissez faire capitalism and the autarky of state planning.*

But post-war reconstruction did nothing of the sort. The statesmen of the 1940s who devised the Bretton Woods regime, the IMF, the World Bank, the stillborn International Trade Organization (ITO), the GATT, and the first European common market in coal and steel, were mindful of avoiding two extremes that had been burned into their consciousness by recent experience: the extreme instability of ***laissez faire*** capitalism in the 1920s, and the destructive failure of global economic cooperation and retreat into currency blocs and autarky that followed in the 1930s, which together led to mass unemployment, popular revolt against liberal democratic rule, extreme nationalism, and world war.

Post-war reconstruction aimed at a compromise between the anarchy of ***laissez faire*** capitalism and the autarky of state planning. This blend of opposite impulses often seemed contradictory President Roosevelt, early in his first term, called American representatives home from the world economic conference of 1933 (which aimed to restore a stable international monetary regime) because he had no intention of holding his domestic recovery policies hostage to the deflationary constraints of an international gold standard. Yet a year later, his Secretary of State, the free-trader Cordell Hull, successfully promoted the Reciprocal Trade Agreements Act, which enshrined the principles of non-discrimination and multilateral most-favored nation (MFN) policy as American trade objectives. These of course took on new life after the war. The Roosevelt Administration simultaneously sought freer trade, and a freer hand in pursuing domestic stabilization policies unfettered by the constraints of global finance. This seeming contradiction required a new set of public multilateral institutions, which relieved the dependency on self-serving private banks, and opened up fiscal space for nations to resist the turbulence and inequity .of pure ***laissezfaire*** at home.

Most of the western nations were governed by people who believed deeply in a mixed economy, full employment, . . . trade unions, … and a welfare state.

In the aftermath of World War II, most of the western nations were governed by people who believed deeply in a mixed economy, in which the state assumed responsibility for full employment, trade unions were important counterweights to private capital, and a welfare state was an economic extension of political citizenship in a democratic society The far right had been discredited by fascism; the far left was outside this consensus. Even the nationalist conservatives of the day—

de Gaulle, Churchill, and the moderately conservative Christian Democratic movement of Adenauer, Schuman, and de Gasperi-believed strongly in this brand of mixed economy

Moreover, in the immediate post-war period, the issue of protectionism was largely moot. From the perspective of war-ravaged Europe, the question would have been, protection of what? For the U.S., the question would have been, protection ***from*** what? With global undercapacity rather than overcapacity as the problem of the day, the politics of liberalization were easy And rather than pressing its advantage to obliterate its competitors, the U.S., as protector of the trading system, moved to reduce its own trade surplus from about 4.5 percent of GNP in 1947 to about one percent during the early 1950s.5

In the immediate post-war period, the issue of protectionism was largely moot.

Taken as a whole, the initiatives of the 1944-49 period sought to restore international commerce, but within a framework which left substantial room for policies of social welfare and domestic economic reconstruction and stabilization. A bitter lesson of the interwar period was that a pure gold standard was deflationary; nations were constrained to balance their external accounts at the cost of economic contraction at home. In the 19th century this system more or less worked because the Bank of England played the role of flywheel by furnishing credit and anchoring a regime of fixed exchange rates based on the price of gold. But in the interwar period, with nobody playing the role of central banker, the result was a beggar-thy-neighbor game of competitive deflation, which added up to world-wide depression.

In response to depression, many countries cut loose from the world economy, or negotiated bilateral trade and monetary deals, which reduced the overall flow of commerce and added up to a drag on global economic growth. This did, however, provide room for relatively autarkic strategies of reflation and internal growth. These ranged from democratic in New Deal America and socialist Sweden, to authoritarian in Imperial Japan and Nazi Germany The architects of the post-war system wanted to restore multilateral commerce, but with room for domestic stabilization. John Ruggie, in his classic essay on international regimes, summed up: "This was the essence of the [post-war] compromise: unlike the economic nationalism of the 1930s, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism."[6]

The architects of the post- war system wanted to restore multilateral commerce, but with room for domestic stabilization.

As John Maynard Keynes and Harry Dexter White conceived the Bretton Woods arrangements, the central objective was to decouple domestic economic policy from the deflationary influence of a simple global gold standard, yet still maintain some discipline and encourage the restoration and expansion of world commerce. A related goal was to replace the traditional deflationary bias of external discipline with an expansionary one. Traditionally, a gold standard compelled debtor nations to contract, because shipments of gold overseas to balance accounts reduced the domestic supply of money and credit. In an open global economy yoked by a gold standard, the contraction imposed on debtor nations exported deflationary pressures to the entire system.

Under the proposed Bretton Woods arrangements, Keynes' alternative was to compel creditor nations to expand. Exchange rates were fixed; central banks were to intervene to help maintain those rates, which could be revised in extreme circumstances. New reserves were to be created through the IMF, and these reserves were to be advanced to correct short-term imbalances; exchange rates could be adjusted when imbalances proved chronic. The machinery invented at Bretton Woods included an International Monetary Fund-Keynes wanted an overdraft facility with $25 to $30 billion in new liquidity-and a World Bank, which was to provide development capital. Keynes and White both imagined that nations would cede a significant degree of sovereignty to these two institutions. These departures from the traditional world monetary system were radical both in their expansionary (Keynesian) bias, and their public character, since the power of private banks and national treasuries was substantially ceded to new supranational and public institutions.

Because the U.S. was momentarily preeminent both economically and politically, … influential U.S. politicians saw no reason to cede … economic sovereignty.

In practice, however, neither the IMF nor the World Bank attained the influence anticipated, mainly because the U.S. was momentarily preeminent both economically and politically, and influential U.S. politicians saw no reason to cede that degree of economic sovereignty Instead, under pressure of the emerging Cold War, the dollar rather than Keynes' imagined "Bancor" became the *de facto* global currency, and the Marshall plan rather than the World Bank became the principal engine of recovery. Keynes' "scarce currency clause," permitting member nations to discriminate against the exports of nations with chronic surpluses was included, but conflicted with free trade norms and never worked as envisioned. The proposed International Trade Organization, which was conceived as far broader than the GATT, was never ratified, for much the same reason. (The Havana Conference of 1948 was conceived as an "International Conference on Trade and Employment," and one of the notions was that liberal trade had to be subordinated to domestic full employment.) In the truncated GATT, which emerged as the locus of the trade regime by default, such IT0 issues as anti-trust, international investment, and of course full employment, were excluded; but the twin, somewhat contradictory goals of promoting multilateralist principles and expanded trade while also safeguarding domestic stabilization policies were maintained, though within a narrowed domain.

Though the GATT is popularly regarded as the citadel of free trade, paradoxically it was predicated on rather mercantilist assumptions.

Though the GATT is popularly regarded as the citadel of free trade, paradoxically it was predicated on rather mercantilist assumptions. The pure free traders of mid-19th century Britain insisted that countries which practiced protectionism were only hurting themselves, and that reciprocal trade liberalization was both impolitic and unnecessary Richard Cobden, the crusader for free trade, argued "We should abolish Protection for our own selves, and leave other countries to take whatever course they liked."[7] For that reason, the initial British tariff reductions of the 1830s and 1840s were unilateral. But free trade of the Cordell Hull variety, which became the GATT norm, viewed tariff reductions as "concessions''-limitations on a nation's economic sovereignty-which required reciprocal concessions by trading partners. It presumed that nations started out as mercantilist, for whom a reduction in a tariff meant giving something up. The GATT dealt with the world as it was; it realistically assumed a world of multiple barriers to liberal trade, which could be reduced only by mutual negotiation, since in practice nations preferred exports to imports. For a variety of reasons, mostly expedient rather than theoretical, much trade remained outside the GATT regime.

The global political economy which emerged after 1945 was thus in many respects contradictory and misleading. It was intended to be a necessary compromise between the one ideal of multilateral, free commerce among nations, and the other imperative of domestic interventionism. It was further complicated by the Cold War, which required further departures from liberal trade in the form of export controls and which seemed to require the U.S., as hegemon, to tolerate substantial lapses in nations that were mercantilist but Cold War allies. In practice, despite the presumption that the domestic economics of Keynes coexisted with the international economics of Adam Smith and Ricardo, in reality capital controls and high tariffs provided substantial insulation against international free movement of goods and money as well. And so did the fact that the new instruments of monetary governance were accountable to public rather than private agencies.

The Cold War … seemed to require the U. S., as hegemon, to tolerate substantial lapses in nations that were mercantilist but Cold War allies.

This, however, also involved a paradox. Nominally, a degree of authority had been conceded to supranational institutions. But in practice, much of the political power in these institutions was tightly held by the then preeminent United States, which retained the voting power to control the IMF, the World Bank, and the political power to set agendas for other nominally supranational institutions. That Europe was also dependent on American military force to restrain an expansionist Soviet Union intensified that U.S. influence. So, although the post-war period was a uniquely successful era of multilateral institutions, in reality, as John Ruggie observed, the forms of multilateralism could flourish because they were extensions of the power of the United States.[8]

Conservative Americans accepted nominally transna tional public institutions only because they were surrogates for American power.

One further paradox: though the global economic order devised in the 1940s was emphatically a mixed regime with Keynesian and social democratic stabilizers rather than a classically liberal one, the nation which was the essential guarantor of the entire system, the United States, had the least appetite for departures from economic liberalism and the least enthusiasm for genuinely supranational authority. Those twin concerns reinforced each other, for ceding sovereignty was not only objectionable per se to American nationalists at the very moment of American preeminence—it was doubly objectionable since it meant ceding power to a bunch of collectivists.

Thus the very departures from *laissez faire* that helped anchor a mixed system were not entirely acknowledged by the system's prime sponsor. Conservative Americans accepted nominally transnational public institutions only because they were surrogates for American power. They accepted restrictions on the free flow of private capital as temporary leftovers from the war. And they tolerated the Keynesian welfare states of Western Europe as suboptimal economic arrangements that had to be endured tactically for the sake of a common anti-communism. When ***laissez faire*** again became fashionable and private capital again became mobile, it was in the U.S. that the resurgence of economic liberalism was greeted with particular glee.

Yet as the ethic of *laissez faire* capitalism has gained new ground in recent years at the expense of the social democratic/Keynesian ethic of a mixed economy, it has done so precisely in parallel with the decline in the influence of the United States. The U.S. is the most fervent booster of ***laissez faire,*** yet its economic and political influence within the trading system has waned. So its effort to inject its own preferred norms into the policies of other nations, while retaining its cherished role as system leader, comes at escalating cost to America's own (poorly grasped) economic national interest.

As America becomes relatively less dominant economically, the cost of hegemony increases.

As America becomes relatively less dominant economically, the cost of hegemony increases. This has been conventionally understood primarily in military terms, as the increasingly unsustainable cost of maintaining American empire. But the more serious and subtle costs have to do with the stresses between America's national economic interest and its hegemonic role in the trading system.

Hegemony and Ideology

The relationship between American geopolitical dominance, the norms of the trading system, and the American ideological devotion to liberal trade is central to the current American impasse on trade policy, and is not well appreciated. Charles Kindleberger's classic work on the 1930s, ***The World in Depression***[9] has spawned a whole genre of scholarly writing on what is now generally known as the theory of hegemonic stability.[10] According to this view, an international trading system with relatively liberal norms tends to be unstable in the absence of a dominant power, or "hegemon."

The functions of the hegemonic nation include . . . maintaining relatively open markets for imports (and encouraging other nations to do likewise).

The reason, according to Kindleberger, has to do with the essential anarchy of global capitalism and the destabilizing tendencies which result when national capitalisms freely complete without a set of rules that reconcile open commerce with monetary stability, trading norms, macroeconomic balance, and growth. The functions of the hegemonic nation include guaranteeing the peace, maintaining relatively open markets for imports (and encouraging other nations to do likewise), providing the dominant currency and surplus investment capital, and serving as lender of last resort. The hegemon therefore functions as the ballast of the global economy, giving it a quasi-Keynesian stability that would otherwise not operate at the level of the global economy where no general political authority and hence no macroeconomic policy functions. In Kindleberger's conception, the leadership of the hegemon must be relatively light-handed and benign. By definition, a Kindleberger-style hegemon has to believe in economic liberalism; otherwise membership in the hegemon's system is coerced on the basis of sheer military or economic power rather than invited on the basis of shared benefits.

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To oversimplify, it is generally held that Britain played the role of hegemon in the 19th century in three respects: through the role the Bank of England played in anchoring the classical gold standard, freely buying and selling gold and manipulating domestic interest rates in order to maintain exchange rates and price stability; through Britain's willingness to provide generally open markets for other nations' exports; and through the Royal Navy's guarantee of freedom of the seas. A roughly similar hegemonic role has been played by the United States during the post-war era. In the interwar period, much of the instability resulted because no nation was both able and willing to play the hegemonic role, no supranational scheme functioned as an effective substitute, and the world economy degenerated into self-serving national polices which together destroyed the global economic order.

Much of the recent scholarship in this vein has assessed the dilemmas of the United States as "hegemon in decline." These dilemmas include the military costs of what Paul Kennedy" called "imperial overstretch;" the inevitable failure of the dollar to maintain its role as provider of global liquidity without compromising its stability as a national currency (known as the Triffin dilemma[12]); and the instability and unpredictability resulting from the monetary gyrations of the post-Bretton

Woods floating exchange regime. Another symptom of hegemonic decline is the anomalous and ultimately unsustainable position of the U.S. as simultaneously economic hegemon and major debtor, Not only has the U.S. ceded relative influence to other nations, but nation states generally have ceded influence to private market institutions, such as multinational corporations and banks, and have lost a degree of control over liquidity creation, as well as policy control over such issues as the Third World debt. The resurrection of ***laissez faire*** ideology has welcomed the creation of relatively unregulated multinationals, while new technology has facilitated the worldwide dispersion of technology and private capital.

Being a member in good standing of the U.S.-sponsored trading system brings with it the important perquisite of access to the U.S. domestic market.

The political science literature on this dilemma[13] has focused on such issues as whether the benefits of America's hegemonic role still outweigh the costs, and whether pluralist alternatives to a hegemonic regime are sustainable. What is briefly noted in this literature, but has received somewhat less attention, is the logical connection between the role of geopolitical hegemon and the norms of free trade. That connection is central to our discussion here. The logic of hegemony requires that the hegemon be a devout free trader; otherwise other nations have far less reason to defer to the hegemon's leadership. Being a member in good standing of the U.S.-sponsored trading system brings with it the important perquisite of access to the U.S. domestic market. Moreover, it is logical for the hegemon to see the system which it sponsors as an extension of itself, and to subordinate the narrow nationalist goals which lesser nations pursue to system-wide goals, Free trade as an overriding virtue and desideratum thus becomes burned into the consciousness of the hegemon's governing elite.

Post-war America followed this pattern. While it was establishing itself as hegemon of the new trading system in the late 1940s, many of the "carrots" offered by the United States were economic. Given the overriding economic supremacy of the U.S. economy at the time, this offer seemed to be a relatively costless form of enlightened self-interest. The economic carrots included the Marshall Plan, other foreign aid, footing the lion's share of the bill for the Atlantic and other regional alliances, paying a disproportionate share of the costs of multilateral organizations, making lopsided tariff concessions in the early GATT rounds, and providing dollars to create international liquidity through sustained U.S. balance-of-payments deficits.

American hegemony meant that the United States tolerated a good deal of "free riding" on the part of its geopolitical allies by keeping its own market open.

More subtly, with respect to the trading system, American hegemony meant that the United States tolerated a good deal of "free riding" on the part of its geopolitical allies by keeping its own market open to the exports of trading partners whose economic practices were rather more mercantilistic than our own. It meant that in order to promote industrial recovery in Europe and Japan, and in order to reduce the enormous dollar surpluses of the early post-war era (which were dollar shortages overseas), the U.S. government encouraged American industry to set up production facilities overseas rather than export goods. All of this seemed to serve the broader American foreign policy interest in a strong Western political-economic system, by cementing the loyalties of trading partners to that system. It was assumed that America's national economic self-interest would take care of itself. But these hegemonic habits-providing open markets while tolerating mercantilism in allies; exporting capital rather than goods; seeing a laissez ***faire*** system as necessarily identical to American national self-interest; placing geopolitical objectives ahead of geoeconomic ones-hardened into habits that were difficult to shake as the global economic realities changed.*

The openness of the U.S. market and the free flow of capital and merchandise came to be two of the bedrock principles of American foreign economic policy, not just out of ideological conviction, but because they were two key policy instruments that linked our allies to our economic orbit during the first three post-war decades. They also seemed consistent with steady global economic growth. Given that membership in the U.S.-sponsored system was essentially voluntary rather than coerced and given American commercial supremacy, the U.S. refrained from demanding full reciprocity in market access overseas, and resisted wielding economic weapons lest it alienate key allies.

It was assumed that America's national economic self-interest would take care of itself.

These habits, of course, have outlived the economic underpinnings of American hegemony Though the U.S. is no longer as economically preeminent as it was in the immediate post-war period, its role of hegemon requires that we still provide the world's most open market. In fact, the weaker the U.S. economy becomes relative to its trading partners, the more desperately the U.S. clings to the hegemonic role, which provides a number of benefits useful to a hegemon-in-decline, including the unique ability to incur (and devalue) foreign debt in its own currency. And the more the U.S. behaves as if it had the surplus economic wealth to function as hegemon-exporting private investment capital without regard to industrial consequences, incurring foreign debt, weakening its currency as a substitute for strengthening its

These hegemonic habits . . . were difficult to shake as the global economic realities changed.

* Jagdish Bhagwati, in his recent jeremiad, *Protectionism,* writes, but without quite grasping the geopolitical significance: "Although GATT was a contractarian arrangement, the United States looked the other way when it came to requiring other GATT members to fulfill symmetric obligations. In the political interest of building a stronger Europe, for example, the United States allowed asymmetric access to markets during the long period when Europe was shifting to convertibility in current account transactions" (Bhagwati, 1988, p. 40).

Lipson (1983, p. 257) notes that in the first 20 years of the GATT, the U.S. gave roughly two scheduled concessions for every one that it received. In the early years of the GATT, the U.S. gave significant tariff concessions to several European nations in order to induce them to make their own concessions to Japan whose entry into the GATT system the U.S. favored, again for national security reasons. Despite the prevailing view that the GATT is a temple of multilateralism, actual trade negotiations are typically bilateral.

Bhagwati also contends that VERs are a relatively "porous" form of protection which the GATT-supporting U.S. government deliberately chooses in order to mislead domestic protectionist interest groups (Bhagwati, 1988, p. 57). A better explanation of why a government ostensibly committed to free trade would choose quotas has to do with their value as benefits to be bestowed selectively on trading partners by the hegemon. (See below).

underlying competitiveness, and tolerating free riding by its allies-the more it weakens its domestic economy,

Moreover, the hegemonic habits of the post-war era created a now deeply ingrained set of attitudes among American diplomats and economic officials. To be a member of the American foreign policy elite is to be a devout believer in free trade as an intrinsic good whose logic is beyond question. To raise questions about the reality of free trade is to be suspect as an incipient mercantilist. The assumed virtue of a selfless double standard on liberal trade vis-a-vis American allies (you mercantilist, me liberal), which initially reflected a conception of U.S. self-interest that fit the economic and geopolitical realities of 1955, has hardened into a dogma which no longer fits the world balance of economic and financial power.

To be a member of the American foreign policy elite is to be a devout believer in free trade as an intrinsic good whose logic is beyond question.

Fundamentally, the doctrine of free trade rests on the classical economic theory of comparative advantage, originally promulgated in the work of David Ricardo in 1817.[14] This theory assumes that there are certain commodities which each nation can produce relatively more efficiently, given its natural resources, labor force, and technological capabilities. If all countries specialize in the commodities in which they have comparative advantages, exporting these goods and importing all others, an optimal allocation of world resources will result. The welfare of each individual country, as well as of the world as a whole, is maximized with perfectly free trade. It follows that any effort to protect a domestic industry necessarily involves a sacrifice of aggregate national welfare, although it is admitted that some classes within society (e.g., English landlords in Ricardo's time) may benefit at the expense of others.

The Ricardian approach to international trade originated as a liberal critique of aristocratic privilege in early 19th century England, where the landed gentry wanted to protect English agriculture and the industrial capitalists wanted free trade. This doctrine served Britain well in the mid-19th century, at the height of British hegemony In America, however, the industrial interests were more protectionist from the beginning, as early American manufacturers realized that they could not initially compete with cheaper British imports (the famous "infant industry" argument). Paradoxically, the United States industrialized largely behind tariff walls in the 19th and early 20th centuries. But when the U.S. achieved a dominant position in the world economy in the 1940s, the Ricardian doctrine of comparative advantage was invoked to justify this country's conversion to a free-trade stance.

Devotion to the theory of comparative advantage . . . is taken to require not only that the U.S. reject industrial policies at home, but also that it wink at them abroad.

In reality, of course, free trade has coexisted with various forms of managed trade ever since the dawn of organized commerce. Yet in the American diplomatic corps today, as well as among economists with policy influence, one finds an almost universal devotion to the theory of comparative advantage as both politically and scientifically essential. This view is taken to require not only that the U.S. reject industrial policies at home, but also that it wink at them abroad. Just as Britain maintained free trade even with mercantilist trading partners in the late 19th century, so the United States clings to this position (at least in principle, if not in practice) at the end of the 20th.

The Ricardian view has been internalized and treated as gospel by American diplomats precisely *because it is so congruent with the logic of American hegemony.* The idiom of free trade theory is one in which all departures from free trade are protectionist, opportunistic, politically motivated, and self-defeating. Protectionism, in this view, does not merely alienate our friends and allies; in addition, it sacrifices economic efficiency, harms domestic consumers, and causes the protected industries to stagnate.

Moreover, the rhetoric of free trade is littered with misleading metaphors. It is said, after an aphorism first attributed to the French philosopher Frederic Bastiat, that even if other nations are stupid enough to "throw rocks into their harbors," apparently meaning barricading themselves against commerce, it doesn't mean we should do likewise.[15] But what if they dredge their harbors and build port facilities, the better to export? It is also said that free trade is "like a bicycle"-you have to keep pedaling ever faster or you tip over. Whoever thinks that never rode a bicycle!

The rhetoric of free trade is littered with misleading metaphors.

Good free traders are supposed to be constantly vigilant against "backsliding." They must persuade trading partners (who are even more subject to protectionist pressures than we) to strive for free trade, by constantly setting a good example. Protectionist pressures are seen by free traders as an unfortunate and short-sighted result of misguided macroeconomic policies, never as the result of structural imbalances or other nations' mercantilism. For example, the "Statement on Trade Policy" issued by 38 prominent economists on April 10, 1989, warns that U.S. trade policy is "at a perilous turning point," that sector-by-sector managed trade targets are in the offing, and that the real sources of the U.S. trade imbalance which need to be addressed are the budget deficit and inadequate rates of savings and investment. This view is arrived at deductively, from the premise that trade policies ultimately don't matter because by definition they can't matter.

In fact, U.S. rates of (gross) investment during the 1980s have been at about historic norms. The national savings rate has declined during the 1980s, primarily because the public deficit has consumed private savings, and also because the personal savings rate has fallen. The gap has been made up by borrowing from abroad and by net sales of U.S. assets. However, if other nations are pursuing sectoral and trade policies that capture advantage for their own industries at the expense of U.S. industries, it is entirely possible that the U.S. suffers both from macroeconomic imbalance and imbalance in the trading system as well.

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Moreover, the cause and effect relationship in the way macroeconomic and trade measures are used to ameliorate the current imbalances can run in either direction. Macroeconomic shifts (smaller public deficit, higher domestic savings, lower interest rates, cheaper dollar) can indeed produce benefits for the trade balance. But an improvement in the competitive position of U.S industry (whether for structural reasons or as a result of different trade policies) can also produce macroeconomic benefits (more U.S. exports, more jobs, higher growth, higher incomes, more private savings and tax revenue, higher profits and more investment, lower real interest rates, external balance with a stronger currency) at a lower cost to American well-being. The strategy of cheapening the dollar has produced only modest trade benefits, but has put U.S. assets on sale, and has generated inflationary pressures.

In the orthodox view, any form of national economic planning is seen as a departure from the free market's chosen allocation of capital, and is hence both an inefficient economic distortion, and a political threat to the logic of the GATT. As the eight rounds of multilateral negotiation have progressed, the American support for purer and purer *laissez faire* has grown more intense. By the Kennedy round of trade liberalization, most tariffs had been lowered to relatively moderate levels. By the Tokyo Round (1973-79), the U.S. began pursuing "non-tariff barriers," such as government subsidies, technical standards, and preferential procurement. Although the Tokyo Round did produce a minimalist subsidies code, it did not produce clear criteria on what was a "trade distorting subsidy," nor a remedy other than the traditional right to countervail. In the past decade, free traders have lamented that as tariff barriers have fallen, nontariff interventionism has increased, in the form of national industrial policies abroad-subsidies, market closings, recession cartels, preferential capital allocation schemes-as well as subterfuges such as orderly marketing agreements and VERs demanded of trading partners by the United States.

As the eight rounds of multilateral [GATT] negotiation have progressed, the American support for purer and purer laissez faire has grown more intense.

In the current Uruguay Round, the U.S. proposed a grandiose series of objectives intended both to extirpate "non-tariff barriers," to strengthen the dispute settlement machinery of the GATT, and to bring the GATT norms of liberal trade to areas currently outside the GATT, such as trade in services and agriculture. The Administration convinced itself that a natural U.S. comparative advantage in a garbage can category called services (which includes repatriation of profits from sunk investments as well as banking, insurance, and construction) might offset the escalating trade deficit in visible exports. Politically, the Reagan Administration sought to build a constituency for trade liberalization and a counterweight for the forces of "protection" by organizing those segments of American capital with a self-interest in liberalized markets, most notably multinational corporations, financial service businesses, and industries looking towards expanded opportunities for export and/or direct foreign investment.

Concurrent with this intensified rush to wards ever freer trade was a series of halting and rather guilt ridden [protectionist] measures.

Concurrent with this intensified rush towards ever freer trade was a series of halting and rather guilt-ridden measures undertaken by the free-market Reagan Administration which were, by its own definition, protectionist. The most recent agricultural legislation gave the Administration enhanced ability to subsidize farm exports. The 1986 semiconductor agreement with Japan, after a series of failed earlier agreements, resorted to a market share target for U.S. exports to Japan (which has not been reached), as well as a domestic industrial policy to maintain U.S. competitiveness in chips. After the failed efforts of previous administrations to stabilize the steel industry, the Reagan Administration imposed quantitative restraints (VERs) on steel imports. Textiles continue to be subject to a managed trade regime, under the Multifibre Arrangement (MFA). And the VER on automobiles with Japan has continued. Despite its railing against bilateral trading blocs as an affront to the fundamental multilateral logic of the GATT, the Administration pointedly negotiated bilateral Free Trade Agreements with Israel and Canada, a regional Caribbean Basin trade pact, and has made grandiose noises about similar deals with Mexico and even Japan.

The Administration has never been clear, either with itself or its allies, about which of these are temporary adjustment expedients; which ones are merely tactical maneuvers intended to be bargained away for reciprocal liberalizations; which ones are adjuncts of domestic industrial policies; which ones are craven capitulations to domestic pressure groups; and which are necessary long-term regimes in industries that simply don't lend themselves to Ricardian trade. And as this creeping protectionism has burgeoned, the Administration, like an intermittent alcoholic, has intensified its crusade to persuade its trading partners to abandon all forms of mercantilism in one grand pledge of mutual temperance.

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Viewed casually, these opposite thrusts seem hypocritical if not incoherent. But understood in terms of the logic of the hegemonic role, they make a certain amount of sense. Quotas are an instructive case in point. As neoclassical economists constantly point out, an allocated quota is probably the most inefficient form of protection. It gives the foreign exporting nation the power to rig the market, and if that nation is a mercantilist country like Japan, this is a formidable power indeed. It raises prices for one's own consumers, while delivering the quota rents to the trading partner. Unless it is coupled with a careful domestic program to restructure the protected industry (which is ideologically anathema to conservatives), the domestic industry is very likely to take a free ride on the import restraint, raising its own prices but not its productivity If the quota is a quantity of units rather than a sum of dollars, the quota also encourages the exporting nation to move upscale and capture a richer segment of the protected market.

Why. .. would a nation devoted to a free trade system … resort to, of all things, allocated quotas? The answer. . lies in the logic of geopolitical hegemony.

Economists urge that if one must have a spell of protection, tariffs (which are at least transparent and marketlike) are always preferable to quotas; and if one must resort to quotas they should be auctioned-so that the low cost foreign producer gets them, while we capture the quota rents. This is all clear enough and the logic is seemingly irrefutable. Why, then, would a nation devoted to a free trade system and to free market principles resort to, of all things, allocated quotas? The answer, once again, lies in the logic of geopolitical hegemony.

As a form of protection, a multilateral tariff or an auctioned quota leaves you with nothing to selectively bestow on your friends. But an allocated quota is a form of geopolitical currency, because it is discretionary. Whenever the U.S. departs from the principle of multilateral MFN, its stated norm for the trading system, the US. as hegemon prefers departures that provide some bargaining counters. This has been the case with oil, where import quotas were bargained and allocated, with steel, with textiles, and with farm products. If steel quotas were auctioned rather than allocated, this would enrage our high-cost producer friends, which include debtor nations like Brazil. Allocating import quotas is a long standing hegemonic habit. When Fidel Castro became an intolerable thorn in ‘the side of the U.S., what did we withdraw? Cuba’s sugar ***quota.*** Moreover, a quota disguised as a “voluntary” restraint on the part of the exporting nation also complies with the letter of the GATT, even though it is in reality an overt form of bilateralism as well as a departure from free trade which fools no one. Yet the hegemonic nation, because of its systemic responsibilities, cannot be in the position of breaking the rules. In each of these instances, a political objective drowns out competing economic objectives and makes the US appear foolish and disingenuous.

A quota disguised as a “voluntary” restraint on the part of the exporting nation … is a departure from free trade which tools no one.

The National Interest

Much of the debate about free trade, managed trade, industrial policy, and so forth, is confused by implied conceptions of the "national interest." From the perspective of traditional economic liberalism, questions of national interest are limited to narrow military and geopolitical security There is also a supposed abstract and generalized "consumer" interest in free trade, which is treated in isolation from the influence of trade on domestic productive employment. To the extent that an open trading system wins friends for the United States, liberal trade complements traditional national security goals. In this conception, there is no room for an economic national interest defined in terms of industrial objectives, nor are there geopolitical economic goals beyond those that supposedly flow naturally from free markets. By definition, the freest possible market yields results that are "natural" and hence optimal. Even if other trading nations violate those norms, the U.S. still allegedly gains both economic and geopolitical advantage by practicing liberal trade. The possibility of a national interest colliding with Ricardian trading norms is thus neatly excluded by definition.

This perspective, however, begs several questions. In practice, one can identify several concrete goals for the U.S. economy, which do not necessarily result from a conventional free-trade environment—particularly when that environment is lopsided. These goals include full employment at decent wages, rapid productivity growth, rising levels of real income distributed equitably, retention of technological leadership in a broad spectrum of major industries, maintenance of a skilled workforce, and so on.

While it is conventional to argue that "we" must do this or that for the economy to thrive, it is not always clear who "we" refers to. For example, the interests of American-based banks and multinational corporations, which are key advocates of liberal trade, are not always identical to the goals of high and rising living standards for American citizens and the maintenance of technological leadership within the United States. The relative merits of different approaches to trade policy need to be weighed against true national objectives (rather than narrow corporate ones), and in the context of other U.S. foreign policy objectives, with which trade objectives sometimes compete.

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The interests of American-based banks and multinational corporations ... are not always identical to the goals of high and rising living standards for American citizens.

The New View

Interestingly enough, American policy has embraced a purer and purer devotion to free-trade principles at precisely a moment when some orthodox economists are having serious second thoughts about whether the traditional theory of comparative advantage is reliable, either as a description of how trade really works or as a norm for optimal policy. The New View has emerged in the work of Paul Krugman, an eminently respectable neoclassical economist at the Massachusetts Institute of Technology and once the staff trade specialist on the Reagan Council of Economic Advisors; and in related work by Avinash Dixit, James Brander, Barbara Spencer, and numerous others.[16]

American policy has embraced a purer and purer devotion to free-trade principles at precisely a moment when some orthodox economists are having serious second thoughts.

In order to understand the significance of the New View, it is important to recall some of the implications of the Old (Ricardian) View. According to the Old View, countries have *inherent* comparative advantages in particular products due to some intrinsic national characteristics. Ricardo himself simply assumed that international differences in resources and technology would give each country a comparative advantage in certain goods which it could produce with relatively lower labor costs. Later, the Swedish economists Eli Heckscher and Bertil Ohlin argued that comparative advantages were due to differences in "factor proportions": the relative abundance of land, labor, and capital in each country, compared with the relative intensities with which these factors are used in producing various commodities.[17] As formalized by Paul Samuelson, this theory required the assumptions of identical technology in all countries as well as perfect competition in all markets.[18] Under these and other, more technical, conditions, each country will export those goods which incorporate relatively more of its relatively abundant factor(s).

Whether in the traditional Ricardian or more modern Heckscher-Ohlin-Samuelson (HOS) variant, the Old View had the powerful implication that *there is a naturally ordainedpattern of trade.* The location of industries is not arbitrary: with free trade, industries will automatically be located where they can be most efficiently operated. There are some subtle differences between the two variants. The Ricardian emphasis on different technological capabilities of nations implicitly admits that social institutions and public policies can potentially affect a nation's "inherent" comparative advaritages. The HOS view, on the other hand, implies a more extreme bias against intervention, since this theory holds technology constant and assumes that only natural and immutable "endowments" of productive factors matter to trade. But both theories imply that there is a unique allocation of industries among countries which is economically efficient at any point in time, and that this allocation can only be achieved through free trade.

The New View asserts that the location of manufacturing production in the world is not a reflection of any inherent comparative advantages.

The New View rejects this conclusion of the Old View. The New View asserts that the location of manufacturing production in the world is not a reflection of any inherent comparative advantages in the traditionally understood sense, but. is essentially the result of historical accidents. The indeterminacy of industrial location reflects several characteristics of the advanced global economy. These include increasing returns to scale and the ability of firms to "slide down the learning curve." In essence, innovators compete on the basis of entrepreneurial and technological prowess rather than factor endowments. Technological leadership can sometimes flow from such arguably "natural" endowments as a skilled labor force (which itself reflects the policy influence of education and training interventions), but it can also be the deliberate result or fortuitous by-product of more explicit national policy to promote technology.

The significance of the New View is borne out by, among other indicators, the large amount of intra-industry trade, in which trading partners both export and import similar products-a phenomenon that is not predicted by the standard theory of specialization based on comparative advantage. As Klaus Stegemann has observed in studying intra-industry specialization in the context of European integration, "Which country makes which products within any manufacturing industry ... cannot be explained exclusively on the basis of differences in natural ability or factor proportions. Variables such as entrepreneurial initiative, investment in human capital, research and development, product design, economies of scale, and learning by doing were recognized to be crucial for the expansion of intra-industry trade."[19] These, in turn, are subject to policy intervention. Such intervention, if it leads to technological breakthroughs, may even produce positive-sum benefits.

Technological leadership can ... be the deliberate result ... of more explicit national policy to promote technology.

A somewhat narrower strand of the New View holds that much international trade can be understood as a form of imperfect competition, in which some producers enjoy supernormal profits, or "rents," Contrary to standard theory, such rents are not instantly competed away, but persist as innovators enjoy an array of niche positions. Given that these rents are widespread, a nation which captures them gains an advantage over its competitors, both in the form of profits and in the continuation of technological dominance. Particular trade policies (tariffs, subsidies, export taxes, etc.) can, under certain circumstances, be shown to raise national income by extracting more of these rents at the expense of foreigners. The deliberate use of such instruments is referred to as "strategic trade policy." These insights embellish an older literature on imperfect competition in international trade, dating back to early 1900s. However it is not necessary to demonstrate the presence of oligopolistic rents in order to show that the capture of leading industries can produce beneficial externalities, or that the location of industries may be historically contingent. These points are logically separate.

Capturing industries that enjoy supernormal profits also benefits that nation's work force.

Brander and Spencer, a husband and wife team now at the University of British Columbia, term the process of capturing such rents "profit shifting."[20] Work by Lawrence Katz and Lawrence Summers adds the idea that since most of industry's costs are ultimately labor costs, capturing industries that enjoy supernormal profits also benefits that nation's work force (a.k.a. its citizens). Workers can capture a share of the profit in the form of wage premiums, or "labor rents," and over time may earn these "rents" by becoming more knowledgeable and hence more productive.[21]

If the location of production, especially in advanced industries, is fundamentally arbitrary, then it is arguably subject to manipulation by national policy interventions, whether microeconomic ones aimed at capturing positions in emerging industries, human capital policies aimed at improving the quality of the workforce, or macroeconomic ones intended to influence savings rates, capital costs, and so on. However, the more orthodox version of the New View, while it has blown a big hole in the traditional theory of comparative advantage, has stopped well short of advocating industrial policies for two reasons, one ideological and the other technical.

The New View radically alters the context of debate.

Ideologically, most orthodox economists remain sufficiently steadfast neoclassicists to harbor grave doubts about the competence of collective action, particularly on the part of politicians responsive to interest groups, to undertake economically optimal policies that could improve on decisions of the market. This enterprise is deemed particularly perilous for the United States, whose political system is said to be uniquely vulnerable to special interest groups. ("The trouble with picking winners," Senator William Roth recently declared, "is that each Congressman would want one for his District."** Secondly, the technical economics demonstrating the possibility of welfare-enhancing strategic trade policy are dependent on the assumptions of the particular model. Changing an assumption can change whether a particular policy instrument (e.g., tariff or subsidy) ought to be used. Since there are potentially grave informational difficulties in knowing which model can be applied to any given industry, it may be safer to do nothing than to risk using the wrong instrument.

The typical new view paper, especially by economists wishing to keep their neoclassical union cards, takes care to include the disclaimer that even if profit shifting or interventions aimed at generating positive externalities are possible in theory, they are implausible in practice. According to Krugman, most economists who subscribe to the New View are very uneasy about giving aid and comfort to mercantilists. Krugman concluded a rueful essay titled "Is Free Trade Passe?" by threading his way between contradictory positions: "To abandon the free trade principle in pursuit of the gains from sophisticated intervention could. … open the door to adverse political consequences that would outweigh the potential gains. It is possible, then, both to believe that comparative advantage is an incomplete model of trade and to believe that free trade is the right policy."[23]

Orthodox economists now concede that advocates of industrial policy are not, by definition, economic illiterates.

Nonetheless, the New View radically alters the context of debate, for it removes the premise that nations such as Japan which practice strategic trade could not, by definition, be improving their welfare. It means that orthodox economists now concede that advocates of industrial policy are not, by definition, economic illiterates. And it invites a far more subtle policy debate on the instruments and the purposes of departures from Ricardian trade, which is no longer optimal by definition, after all.

Towards a Mixed System

Let us recapitulate the argument thus far and summarize why we are uneasy with Ricardian trade either as a description of a systemic norm, or a strategy that serves the interest of the U.S. and the world. Trade theory now holds that the location of production in manufactures is not necessarily dictated by inherent comparative advantages. In an imperfect world, national policies can and do capture or create advantages. Substantial trade in which cheap labor, climate, or the presence of natural resources significantly affect relative production costs still proceeds along Ricardian lines. But semiconductors, for example, can and will be produced most efficiently wherever the best technology has been developed and applied. This is not only true for "high-tech" products; German firms have successfully applied advanced production technology to the- textile industry, and remain competitive in global markets on the basis of efficient capital rather than cheap labor,

In an imperfect world, national policies can and do capture or create advantages.

Politically, the United States has pursued free trade, not because it is necessarily economically optimal either for the U.S. or for the world economy (though we have convinced ourselves that it is), but because liberal trade is a logical imperative if one cares to play the role of hegemon. This made sense in the early post-war period, when as the leading nation the U.S. gained from free trade because its industry was dominant and its products were superior. But America's system goals as hegemon and its national goals as an economy are no longer identical. In order to maintain its hegemonic role, the U.S. has tolerated asymmetries in the trading system and contorted its domestic responses to the pressures of trade, in a fashion which has done serious harm to the U.S. domestic economy, as well as to the sustainability of the global trading system.

America's system goals as hegemon and its national goals as an economy are no longer identical.

Laissez faire fails, either as an empirical description of what is, or as a normative ideal for what should be, on several grounds. Contrary to classical economics, economies are not self-regulating. History shows that purely private economic forces, left to their own devices, wreak social havoc, distributive injustice, and economic instability, which in turn produce political consequences that are far worse than a preventive dose of economic management. It is not even clear that free markets "optimize" outcomes in the narrow sense of allocative efficiency.

However, to acknowledge that ***Caissezfaire*** is a false lodestar, and that the costs of a hegemonic role have become economically unsustainable for the United States, is not to know precisely what a mixed system ought to look like. It is tricky enough to design a mixed system within national borders, where sovereignty is a settled question. A mixed system is far more difficult to fashion across national frontiers, in a realm where political sovereignty is widely dispersed. Clearly, a mixed system is far messier than a system of perfectly free trade-though the fairer comparison is with the existing system, which is also highly messy. And even if one could design an ideal system to regulate a global mixed economy, there remains the political problem of negotiating one's way from here to there.

In the U.S. trade debate, there has been a remarkable confusion of ends with means, and of goals with tactics. Advocates of tactical hardball aimed at opening closed markets overseas find themselves accused, incredibly, of sabotaging "free trade"-as if enforcing fair play among all trading partners were a betrayal of the principle. Thus, in discussing managed alternatives to free trade, one needs to clarify when these are merely tactical responses to other nations' refusal to honor free-trade norms, as the "Super-301" provision of the 1988 Trade Act is held to be, versus economic development initiatives that make sense in their own terms. Because of the widespread support among American conservatives for laissez *faire,* domestically as well as globally, departures from Ricardian trade are usually defended only in tactical terms, and seldom as necessary measures of domestic industrial development.

Managed trade makes sense … in order to get nations to operate according to rules that are at least universal and reciprocal.

The presumption of this paper is that departures from Ricardian trade in most countries are seldom merely tactical. Moreover, there are sectors in which managed trade makes sense both for the sake of stabilization and to enhance productive innovation, and in order to get nations to operate according to rules that are at least universal and reciprocal, if not Ricardian. We should not manage trade in, say, semiconductors, merely as a lever to win concessions that move the entire system towards freer semiconductor trade. For the moment, retaining and restoring U.S. capacity in that crucial sector takes priority over "liberalization" of markets as a trade system goal, especially if our major trading partners insist that they wish to develop and maintain their own semiconductor capacity. It is not helpful to disguise that goal as merely a tactic aimed to make Japan "play fair" and open its market-to products that the U.S. may no longer make, thanks to earlier Japanese mercantilism.

Managed trade can have positive sum benefits for the system as a whole in the form of technological innovation, stabilization, and diffusion of productive wealth.

On the other hand, there may be industries and moments when nations conclude that the sum total of interventionist subsidies and other market manipulations are imposing total costs which exceed benefits, and may wish to negotiate reciprocal limits on such subsidies and greater mutual market access. Agriculture-in which trade does take place more nearly according to comparative advantages-is a case in point. One must also be clear about whether allowing room for industrial policy and complementary managed trade is to be understood as a unilateral attempt to capture advantage at the expense of other nations, or whether managed trade can have positive sum benefits fcr the system as a whole in the form of technological innovation, stabilization, and diffusion of productive wealth. To the extent that the U.S. wishes to remain an influential and well behaved citizen of the trading system (though perhaps not its hegemon), we do not wish to revert to Japan-like unilateralism. Therefore, let us consider various forms of managed trade, their costs and benefits, and the several rationales for their pursuit.

Market Allocation in a Growing Industry: The MFA

The Multifibre Arrangement provides a good contemporary example of a reasonably successful managed trade regime. It was gradually imposed on new textile- and apparel-exporting nations by the established producing nations, primarily because the latter nations did not wish to entirely give up these domestic industries. Moreover, since cotton is a protected commodity whose domestic U.S. price is held above the world free market price, free trade in textiles would substantially undermine the internal managed trade regime in cotton. By the same token, since textiles are the primary input in apparel and since textiles purchased by apparel makers are often purchased locally, a managed trade regime in textiles also required some forward linkage to managed trade in apparel.

The Multifibre Arrangement provides a good contemporary example of a reasonably successful managed trade regime.

This regime sought to regulate trade in natural fibers and apparel, and subsequently synthetics as well, not by allocating rigid quotas *per se*, but by limiting the rate of growth of imports, and engaging in bargaining about shares of that increase. While the growth of imports was supposed to be held to an annual rate of 6 percent, the actual growth rate reached 17 percent in the 1980s. Under this flexible form of protection, the rate of inflation in textiles and apparel lagged the general inflation rate by 7.8 percent during the MFA's first decade, and by 27.5 percent during its second. Productivity gains in textile were the second greatest of any U.S. industry, save microelectronics.?*

Textiles and apparel are a case where the doctrine of comparative advantage would argue that the wealthier producer nations in Europe and North America should have simply "let go." Moreover, unlike, say, semiconductors, it is not self-evident that textiles and apparel are key industries with important linkages or broader dynamic technological benefits that would justify a departure from Ricardian trade on either national security or "learning curve" grounds. In addition, textiles (and more precisely apparel) are seen as examples of labor-intensive, relatively low-technology industries which give newly industrializing nations important experience in the organization of production and entrepreneurship for world markets. Therefore, the presumptive case against managed trade in textiles and apparel is strong indeed. In the current GATT round, relief from the limits of the MFA has been demanded by several debtor nations, who are under pressure from the industrialized countries to extend intellectual property protections and to liberalize trade in financial services, as well as to increase their exports in order to pay their foreign debts.

Textile products may be "low-tech," but the textile production process can be "high-tech."

The systemic, as opposed to the self-interested, arguments in favor of the MFA boil down to two. First, although protection is popularly held to result in stagnation and excessive wage levels in the protected industry, in fact productivity growth in American and European textile production has been about double the industrial average. Textile products may be "low-tech," but the textile *production process* can be "high-tech." And wages have remained among the lowest of all manufacturing wages, although this is more true in the U.S. than in Europe because the

U.S. has lower minimum wages and generally tolerates much greater wage dispersion.

Domestic producers responded by automating because the MFA regime struck a good balance between providing a partially protected market (which made it rational to invest) and allowing some import penetration (which maintained competitive pressure to invest). The import growth occurred both via the MFA and through various leakages, including the proliferation of substitute materials not initially covered by the MFA, and the entry of new producer nations not party to the MFA. In effect, domestic producers were able to calculate that they remained under pressure from imports, but were not at risk of being obliterated by them. This climate dictated a strategy of investing in productivity-enhancing automation.

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Domestic producers concluded that the way to compete with very low-wage imports was to automate and become more productive. The principal trade unions in textile and apparel appreciated this logic, and cooperated with automation. The "leakage" of imports, both subject to MFA restraints and in circumvention of them, as well as the intraindustry competition from industrialized competitors (British suits, Italian and French fashions, etc.) kept the competitive pressure high. Significantly, there has been more "leakage" of Third World textile imports into the U.S., which has absorbed a far higher share of such imports than western Europe. The reason is that the U.S., with its perceived hegemonic responsibilities, enforces MFA limits far more liberally than European nations.[25]

Secondly, there is more than a little evidence that many of the new producing nations were not entirely unhappy with the MFA, because it offered predictability in an otherwise chronically unstable market. It gave their producers some ability to forecast market share and hence needed capacity, and therefore some basis for making costly investments. It would also be hard to argue that the MFA has seriously impeded enterprise, since Third World textile and apparel production are hotbeds of entrepreneurship. In this sense, though it is a regime that "regulates" markets, the MFA stops well short of "cartelization." There is widespread competition, and much of it is price competition. Despite a good deal of spuriously precise calculation by neoclassical economists of the cost of textile protection to American consumers-William Cline puts it at exactly $135,000 per job-and of the markets lost to Third World producers,[26] it is all but impossible to predict what would have ensued in the absence of the MFA or something like it.

It is very unlikely that the same degree of productivity-enhancing investment in textiles in the industrial nations would have occurred in the absence of some form of managed trade regime.

The New View of trade invites the insight that the worldwide division of labor is in principle indeterminate, even for low-wage products such as textiles and apparel, because of the endless possibility of technical innovation. It is very unlikely that the same degree of productivity-enhancing investment in textiles in the industrial nations would have occurred in the absence of some form of managed trade regime. Rather, more production would have migrated that much faster to low-wage countries with less reason to replace cheap labor with expensive capital. The result might well have been overcapacity, flat wages, overproduction, low profits, less investment in more productive machinery, and pressure for some other more rigid form of cartelization-not textbook “perfect competition.” This sequence must logically be understood as an integral aspect of the dynamics of trade, not as an alternative to it. Moreover, if private cartelization resulted, it would be even more inequitable for smaller developing countries which are trying to enter the market. This is even more important to appreciate when the major new entrant is a nation with the characteristics of the People’s Republic of China, which does not use a price system like the western system, and which measures the production capacity of its knitwear factories by the million-dozen.

Thus, it is reasonable to argue that a free-trade regime in textiles and apparel is improbable, and that the MFA regime has brought benefits in the form of relative price and earnings stability and hence greater productivity-enhancing capital investment. But this conclusion of course does not tell us whether the present MFA is more or less “fair” or economically “efficient” than some other theoretically possible system. What it does suggest is that regimes such as the MFA take into account a factor that is often left out of conventional static economic analysis, namely *time*. Substantial shifting of the world’s textile and apparel production to lower wage developing countries has indeed occurred under the auspices of the MFA. But it has occurred at a sufficiently slow rate to permit industrialized nations to retain a share of world textile production and to invest in advanced production technology (which itself is soon diffused to the Third World).

A free-trade regime in textiles and apparel is improbable.

Can the MFA be defended as friendly to both economic efficiency and to the needs of the Third World? If efficiency includes the value of some insulation against mutually ruinous competition and incentives to increase productivity rather than relying on cheap labor, it probably can. Should MFA-type managed trade be extended to other industries? Not necessarily Other industries have very different structural characteristics. Is the MFA fairer or more efficient than some other possible managed trade regime for textiles? Quite possibly not. Economic theory does not tell us whether Third World textile imports to the U.S. should grow at six percent a year or one percent a year or some other number. That is why standard economics is so seductive, because it leaves all such questions to the invisible hand. However, in a trading system where the balance of benefits is subject to constant negotiation and refinement, and where the U.S. as hegemon (or a successor trilateral regime led by the U.S., the EC, and Japan) cares about the stability, growth, and political friendship of the Third World, we can expect sectoral departures from pure free trade to continue, and they need to be evaluated case by case.

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The industrialized nations may decide at some point that their own self-interest in the health of Third World nations, and their own desire for freer exports of financial services or high-tech exports and for greater protection of intellectual property requires a bargain that concedes a greater share of their textile and apparel markets to Third World producers. Or they may conclude that a limit on the rate of import penetration is consistent with both productivity, domestic employment needs, and stabilization of world textile trade. That may push the MFA in the direction of *freer* trade, though not free trade. It is important to note that the MFA is a relatively flexible framework. It can accommodate faster or slower import penetration into industrialized countries as a result of future bargaining. But in any case a revised MFA is not the same thing as totally *laissez faire* trade in textiles and apparel, and is likely to be more efficient than the alternative prospect of mutually ruinous competition, diminished investment in productivity, and stagnant wages.

A revised MFA… is likely to be more efficient than the alternative prospect of mutually ruinous competition, diminished investment. … and stagnant wages.

As the insight of Albert Hirschman which serves as this paper's epigraph suggests, in the absence of a world government, cross-border trade is always subject to rules that must be politically negotiated among nations which are sovereign in their own realm but relatively powerless outside their borders. Those who finds that reality an affront to an idealized sense of allocative efficiency are obliged to offer a practical case for regional political-economic integration, if not for world government. If world government seems a utopian concept, a regime of pure Ricardian trade across national frontiers is that much more radically utopian.

National Subsidy, Cartels, and Glut: The Case of Steel

Depending on one's choice of lens, the steel industry can be seen either as a case of a bungled managed-trade regime, or as an industry that cries out for more managed trade. Rightly or wrongly, most of the world's major nations (and many minor ones, too) have decided that a domestic steel industry provides positive externalities. These may include everything from import substitution benefits, to the prospect of sliding down the learning curve in advanced metallurgy, to labor rents, to status benefits of having one's own steel mills. If completely free markets left to their own devices produce excess capacity, falling profits, competitive overproduction, and a pressure for cartelization, unorganized nation-by-nation mercantilism produces an even more extreme *case* of the same. What is important to realize is that the present trade regime in steel, such as it is, is the cumulative result of individual national mercantilist strategies, and not a deliberate global system.

Rightly or wrongly, most of the world's major nations … have decided that a domestic steel industry provides positive externalities.

As recently as **1975, world** steel production and consumption were roughly in balance. In the 1970s, new industrial powers such as Japan, South Korea, and Brazil made massive investments in steel capacity. Established steel producing nations in Western Europe defensively invested in the modernization of their plants, in order to meet the competition of the more productive newer entrants. Virtually all of this new steel capacity, with the exception of that in the U.S., Canada, and West Germany, was the result of national market-distorting subsidy programs, which included cheap loans, grants, wage subsidies, import restraints, recession cartels, and every other known form of mercantilism. Just about the time that some 40 million metric tons of new capacity were coming on line, the twin oil price shocks of the 1970s and the recessions of 1975 and 1980-82 sharply reduced the demand for steel. By the early 1980s, worldwide capacity was nearly double worldwide output.[27]

Within Western Europe, which has had a common market regime in steel since 1952, the EC pursued a common program of plant modernization, rationalization, and politically negotiated closings of outmoded facilities, attempting to spread around the painful costs of making the industry more efficient and reducing capacity. However, this politically allocated burden-sharing meant that while EC steelmaking grew generally more productive, the industry did not necessarily migrate to the most efficient producers within Europe. The EC also used price controls, allocation of market shares, and import controls. Between 1980 and 1985, steel subsidies in the EC exceeded $35 billion.[28] The immense subsidy also left the industry in an artificially competitive position, since capital costs that had to be amortized by U.S. producers playing by market rules were often written off in advance, embedding subsidy in ostensible European production costs for years to come.

Most other steelmaking nations … solved the problem of worldwide excess capacity simply by excluding imports and regulating their domestic prices.

Most other steelmaking nations, such as Japan, Korea, and Brazil, solved the problem of worldwide excess capacity simply by excluding imports and regulating their domestic prices. The flipside of this story of domestic overcapacity and cartelization is a tremendous pressure to dump excess production, since the per unit cost of steel falls sharply when capacity is more fully utilized. Unlike textiles, steel production has important economies of scale, while steel demand is price-inelastic. If one producer lowers his price, that mainly shifts market shares rather than increasing the overall demand for steel. Steel, unlike textiles, involves extremely expensive and long-lived plant and equipment. As a result, the market for steel is slower to equilibrate shifts in supply and demand-that old devil time, again-and adjusts even more slowly when governments contribute subsidies. (Purists might reflect on the fact that U.S. investment tax credits, pension bailouts, bankruptcy reorganizations with payoffs at so many cents on the dollar, and even ESOPs and worker retraining schemes are also subsidies, however nonstrategically they may be deployed.)

In the 1970s and 1980s, the only major steelmaking nation substantially open to imports was … the United States.

In the 1970s and 1980s, the only major steelmaking nation substantially open to imports was, of course, the United States. This position was perfectly consistent with the hegemonic imperative to confer the benefits of open import markets on your trading partners, however mercantilist their own practices. It also comported with the prevailing American ideology of free trade. In the accounts of the growing uncompetitive position of American steel, what got the attention of economists and editorial writers were the relatively high wages paid to steelworkers and the poor capital investment decisions of American managers, The reality of foreign mercantilism and the risks of losing an industry as basic as steel were seen as minor details. Most editorialists accepted the Old View of Ricardian trade theory-that if foreign nations were dumb enough to subsidize their shipments to us, we should gratefully accept the gift, regardless of the long-term consequences and costs. (Trojan Horse is not a metaphor known to Ricardian economists.)

Moreover, the remedy sanctioned by both GATT law and domestic trade law-anti-dumping suits-tends to make American administrations very uneasy since it leads to actions perceived as unfriendly directed against geopolitical allies. This is another aspect of the burdens of hegemony (uneasy is the head that wears the hegemonic crown). If membership in the U.S.-sponsored GATT system is cajoled rather than coerced, then American administrations will go to great lengths to avoid resorting to remedies that engender intra-alliance conflict. The EC, abjuring both hegemonic perquisites and responsibilities, is far more willing to let antidumping complaints go the route.

American administrations will go to great lengths to avoid resorting to remedies that engender intra-alliance conflict.

Constrained by its geopolitical objectives, the U.S embarked on series of halfhearted measures attempting to reconcile a degree of import restraint with marketlike principles and respect for the formal norms of the GATT. The first of these was the ill-starred trigger price mechanism of the Carter Administration, which regulated imports according to a pricing formula supposedly based on the unsubsidized Japanese cost of production. This, however, let European steelmakers dump steel at the Japanese price, which was below European costs, created a glut on U.S. markets, and failed to slow the accelerating rate of import penetration. Eventually, after several false starts, it fell to the free market Reagan Administration to impose a quota regime, characteristically disguised as VERs. Giving up the hegemonic concession of totally open access to the U.S. market, the U.S. government nonetheless retained something of diplomatic value: the ability to allocate quota shares.

VERs have worked rather well in steel, in spite of the quota rents lost to foreign producers. Prodded by Congress, the Administration insisted that the profits earned from the protection of domestic steel production must go into steel modernization. The domestic industry, after being underpriced for a decade by subsidized foreign steel, turned profitable in 1987, and even more so in 1988. Steel capacity has been reduced from about 144 million metric tons in 1977 to about 73 million metric tons in 1987.[29] The remaining capacity is now among the world's most productive. At current exchange rates, America can produce cheaper steel than Japan. Yet, characteristically, too, this managed-trade-regime-cum-minimalist-industrial-policy was widely depicted not as something economically sensible in its own right, or even as a necessary adjustment to the cartelization of the world steel industry, but as a scandalous and GATT-defying capitulation to a domestic special interest group.

VERs have worked rather well in steel, in spite of the quota rents lost to foreign producers.

Some questions: What is our long-term goal both for the U.S. steel industry and for the world trading system as it involves steel? The orthodox view is that the protectionist remedy-in this case VERs—never should have been used at all, and in any event should now be phased out as quickly as is politically possible. But obviously, as long as immense steel overcapacity exists and most countries are willing to keep dumping their steel at whatever price is necessary to unload surplus products, open U.S. markets are simply not compatible with the goal of retaining a domestic integrated carbon steel industry, if that is indeed our goal.

The implicit industrial goal in the advocacy of unilateral free trade in steel is the ultimate disappearance of much of America's steel industry. The missing policy debate here is not so much free trade versus managed trade (since managed trade is what most of the world has), but whether or not the U.S. should maintain and develop the capacity to make basic steel at state-of-the art productivity The claim that we should simply allow subsidized producers to supply our steel ignores the time-tested double edged nature of cartels. A cartel that can dump can also gouge. A quasi-managed regime has the virtue of protecting domestic steel consumers (and producers) both against cyclical swings in price, and against the price gouging that can occur when foreign suppliers form a cartel.

At bottom, what should American goals be for the worldwide organization of steel and for the U.S. economy? Traditionally, U.S. diplomats have insisted that the VER regime is a regrettable, temporary expedient, and that the ideal solution would be a mutual agreement to swear off subsidies and import restraints. In the meantime, the U.S. will try to set a good example, and keep its markets more open than those of other nations-the hegemonic sacrifice. But why, if other nations almost unanimously have chosen to operate mercantilist policies for steel, should it fall to the U.S. to purify the world and to begin by giving up much of its own steel industry? Why should the U.S. expend scarce diplomatic capital-and in this case real capital as well-to sell *laissez faire* steelmaking to a skeptical world?

Why, if other nations almost unanimously have chosen to operate mercantilist policies for steel, should it fall to the U.S. to purify the world and to begin by giving up much of its own steel industry?

If the rest of the world isn't buying the American brand of *laissez faire,* what is the best of the possible second bests? Perhaps it is a more coherent and reciprocal managed trade regime. The U.S. VER regime has allowed an import penetration level of about 20 percent of the market in the late 1980s. That has been sufficient to provide imports to lubricate any domestic bottlenecks; in addition, the VER regime allows a safety valve in the form of "short supply" petitions, which allow steel users to circumvent the import quotas when a product is unavailable.

The problem with the current regime for steel is that, unlike the MFA, it is not really a regime at all. Most countries subsidize, protect, and dump the excess where they can, with no common set of norms or rules. Logically, if most nations wish to retain domestic steelmaking capacity, one possible regime would require all participants to concede a share of their domestic markets to open import competition, and to agree to a common program for the gradual reduction of levels of subsidy and excess capacity If the import penetration level were set at, say, 25 percent, those quotas could be auctioned by the importing nation, and the quota receipts used to subsidize a program of capacity phase-out and worker retraining. A worldwide goal might be set of restoring steel capacity to its historic level of about 125 percent of average production.

The problem with the current regime for steel is that, unlike the MFA, it is not really a regime at all.

In this regime, each country would be assured of its ability to supply most of its own steel needs. Each country could pursue polices of its choice to promote domestic competitiveness. The benchmark worldwide capacity goal would provide ample steelmaking capacity to give each member country the imported steel that it needed. The presence of import competition would keep pressure on domestic producers to keep their facilities modern and productive. Nations wishing a more *laissez faire* approach could raise the import quota whenever domestic supplies grew tight, or profits became supernormal. The most productive steelmaking nations would capture the lion's share of the export markets.

This program, of course, would not be "free trade." But it would be a far more viable, efficient, and balanced system than the current one.

Most importantly, in order to have access to the available (unprotected) domestic import markets of member nations, all such participating nations would have to agree to the common program of 25 percent market opening and the gradual phase out of subsidies and excess capacity. This program, of course, would not be "free trade." But it would be a far more viable, efficient, and balanced system than the current one. It would also reflect what seems to be the clear preference of most major trading nations-near self-sufficiency in steel-and would give major nations the ability to pursue variations in their domestic strategies for steel. It would relieve the U.S. of its current Atlas-like burden, of attempting to shoulder the entire burden of the world's gap between stated ideology and reality in steel.

This general approach also permits and encourages cross border direct foreign investment. It creates some of the same incentives as a content requirement, though in a more indirect manner. If Japanese capital thinks it has the best steelmaking techniques, it can of course set up shop in Youngstown, alone or in partnership with American firms. This puts the American steel industry under competitive pressure from Japanese technology and Japanese management, though without exporting steelmaking jobs to Japan.

American steel mills are now among the world's most productive.

To be sure, this regime would not be a perfect one. There would need to be continuous negotiation and refinement. It would be complicated by the multiplicity of steel products, and development of new products. It would need to make room for emerging nations that wished to join the steelmaking club. However, if we believe that new entrants typically enjoy low unit labor costs, then 25 percent of the steel consumption of steel-making nations plus 100 percent of the domestic markets of non-steelmakers is a good sized market for which to compete. New entrants, like old producers, would have to subscribe to the same rules of 75 percent domestic supply, 25 percent imports. Perhaps poorer nations could be permitted 85 percent domestic supply for a period of ten years.

The steel case suggests one problem with the way that most Americans view the trading system. We believe in our hegemonic soul that agreeing to a stated set of norms that falls short of pure free trade is simply sinful. Paradoxically, the proposed regime in steel, though a form of managed trade, would be substantially more marketlike than the present one. Presumably it would leave plenty of room for domestic competition, as long as a given nation chose to enforce its antitrust laws. Moreover, it would benefit the U.S. industry, since our country is the only major industrial nation which is now a net importer of steel. American steel mills are now among the world's most productive, and we could presumably compete for a share of newly opened foreign markets. The fact that advanced production technology is portable and that most trade does not reflect pure Ricardian comparative advantage means that allocative efficiency does not in truth require all nations to import their steel from the "most efficient nation;" what may matter more is that nations keep their seat at the steelmakers' table. This system would even allow Ricardian purists to gamble that Ricardo was right, and throw their entire markets open-although even Mrs. Thatcher doesn't seemed inclined to do that.

In this case, the U.S. could use the familiar diplomatic leverage of access to our own markets in order to pry other markets open, but stopping well short of trying to reorder the world according to the dictates of Ricardian trade. Here again, as in textiles, the system goal seems to be freer trade, but not free trade. The paradox of our quixotic quest for free trade is that it denies us freer trade. The American goals, for our own nation and also for a stable world system are, first, a balance of benefits and obligations, and second, some assurance that our domestic industry will remain in operation and under competitive pressure to grow ever more productive.

The paradox of our quixotic guest for free trade is that it denies us freer trade.

Bargaining Chips: The Case of Semiconductors

The semiconductor industry offers yet another case-a dynamic industry with a rapidly evolving technology and only a few producer nations. It also suggests some important lessons about the relationship between the issues of free trade versus managed trade and bilateralism versus multilateralism. Compare the problems of the bilateral U.S.-Japan semiconductor accord with some hypothetical multilateral semiconductor arrangement, U.S. semiconductor manufacturers complained that Japanese semiconductor firms were simply playing by different rules. The Japanese goal was long-term growth, technological supremacy, and a gradual increase in the market share. Although there was not much identifiable government subsidy in the traditional sense, this was clearly a coordinated strategy between government and industry. The fact that Japanese electronics and semiconductor manufacturers are largely integrated gave Japanese firms market power not available to their U.S. competitors. U.S. firms argued that Japan was dumping--selling below cost-both in the U.S. and in third markets. But dumping is another of those economic phenomena that requires the injection of a time factor. Looked at over a 20 year time horizon, the Japanese semiconductor strategy was profitable indeed. Japan might be selling below its cost this month or this year, but over time as market share and technological prowess increased, the overall strategy was profitable indeed.

The Japanese goal was long-term growth, technological supremacy, and a gradual increase in the market share ... This was clearly a coordinated strategy bet ween government and industry.

When earlier approaches failed, and the U.S. semiconductor industry suffered to the point where militarily-defined national security concerns emerged, the U.S. at last put aside its ideological qualms about managed trade, and negotiated a quasicartelization of semiconductor trade. The Japanese pledged to cease selling below cost in the U.S. and third markets, and promised to set a 20 percent market share target for U.S. semiconductor exports to Japan. While Japan did stop dumping steel in the U.S., it continued to dump in third markets until threatened with sanctions in 1987, and never kept its promise of buying U.S. semiconductors. In the summer of 1989, the U.S. and the Japanese announced yet another agreement to fulfill previously broken promises.

In any event, this attempted regime was also a clear violation of the GATT. Europe, the world's number three producer, loudly and justifiably complained that it had been left out of the negotiations, and that its semiconductor market was likely to become a virtual prisoner of Japanese industrial policy. Depending on market conditions, semiconductors exported from Japan to Europe would sometimes be "too cheap," which would undercut Europe's fledgling attempt to develop its own semiconductor market, and would sometimes be "too expensive," which would disadvantage the users-European electronics manufacturers-by pricing their end products out of the market. Europe then defensively negotiated its own semiconductor deal with Japan.

If Japan has a fundamentally different long-term strategy than the U.S. . . . this gives the U.S. . . . an effective choice either of ceding markets or fighting fire with fire.

Seemingly, there is a case for a managed trade arrangement in semiconductors, assuring nations that wish to develop semiconductor industries dominance in their own markets, while allowing residual competition domestically and in third markets. But the semiconductor case presents yet another problem. Unlike steel and textiles, which are produced worldwide, there are only two major semiconductor producers-the U.S. and Japan-and an emerging third one in the EC. Therefore, most third country markets would be one hundred percent open to exports, even under a managed trade regime. However, if Japan has a fundamentally different long-term strategy than the U.S.—relentless price cutting in order to gain market share-then the Japanese will gradually capture the lion's share of these third country markets in ways the U.S. and perhaps the EC consider illegitimate. This gives the U.S. and the EC an effective choice either of ceding markets or fighting fire with fire, leading to the familiar pattern of subsidy wars, excess capacity, widespread dumping, and staggering losses.

The problems are surely more soluble if the management is explicit rather than covert and guilt-ridden.

As the frustration of the U.S.-Japan semiconductor deal illustrates, this is a problem whether the rules of the trading system are ostensibly liberal or managed; in fact, though the present "management" of semiconductor trade is incoherent and asymmetrical, the current semiconductor regime is plainly something other than liberal. Again, the problems are surely more soluble if the management is explicit rather than covert and guilt-ridden, since it is easier to enforce accountability with a system of explicit rules and in a multilateral context. A multilateral semiconductor accord would have to embody common rules for fair and unfair pricing and subsidy-something akin to a shared understanding of the principles of antitrust, which nations party to the semiconductor arrangement would have to abide by. The alternative is to cartelize semiconductor markets worldwide, which is surely a third best, if that. A managed trade regime in semiconductors, as in steel, might assure each major producing nation a share of its domestic market, allow free competition for the remainder, and require a common understanding of antitrust principles and of predatory pricing.

A managed trade regime in semiconductors … [would] require a common understanding of antitrust principles and predatory pricing.

Some Common Principles

This review of three industries suggests that if nations wish to retain domestic production capacity and not cede their entire market to foreign suppliers, it is possible to design relatively liberal and balanced managed trade regimes: not free trade, but freer trade. However, several caveats are in order.

Note first that there is not one template that fits all industries. In textiles and apparel, the “threat” to established producers is from low-wage countries; the problem of emerging worldwide excess capacity is tempered by the fact that “capacity” is rather less expensive and long lived than in steel. Moreover, there is plenty of competition among advanced nations to keep competitive pressure on each other, and no reason to cartelize that sphere of the industry A regime based on limiting the total rate of increase of imports has been moderately successful-though it produces far more leakage than the domestic industry wants.

It is possible to design relatively liberal and balanced managed trade regimes: not free trade, but freer trade.

In steel, on the other hand, the problem is worldwide subsidy and overcapacity, coupled with a near universal desire among nations to retain steelmaking facilities. In the steel case, the present nonregime is a series of purely tactical expedients. The necessary remedy may be a more explicit managed regime based on market shares. In semiconductors, though a reciprocal import share regime would solve the problem in the home economies of producer nations, it would require an entirely new set of negotiated common principles to establish norms of behavior in third country markets.

Secondly, the suitability of managed trade regimes in some products-steel, textiles, semiconductors, some farm products, among others-does not mean that we need or want a generic system of managed trade. Ideally, the norm should be roughly that of the GATT—relatively liberal trade, based on the familiar principles of multilateral MFN nondiscrimination, national treatment, with limited tolerance for market-distorting subsidies, quotas, and market closing devices. The reason that a GATT-like system should be the residual is that is relatively simpler and cleaner (though as the long complex history of dumping disputes attests, it is not nearly as simple and clean as its defenders claim).

The suitability of managed trade regimes in some products … does not mean that we need or want a generic system of managed trade.

However, even if a liberal trade regime is the residual, it is very clear that some key nations do not really wish such a regime in some key products. Nor is it clear that a departure from liberal norms in those product areas need result in net losses of allocative efficiency. Indeed, such a departure may bring net benefits, if the problems of overcapacity and glut can be frankly addressed, negotiated, and resolved (as they apparently have been in textiles).

How to choose which products are candidates for a managed trade regime? The most logical place to look is at those products where nations are currently restraining trade, and for one reason or another wish to retain or develop technological and production capacity. In that case, if there is widespread reluctance to observe the norms of liberal trade, a frankly acknowledged managed trade regime, with a balance-of-benefits as the core principle, is vastly preferable to the current patchwork of subterfuges and imbalanced concessions. If at some point, the members of the GATT wish to shift their managed trade regime, say in wheat, towards freer and freer trade, that is of course their prerogative.

A balance-of-benefits approach is also a better way of reconciling the reality of widespread domestic economic interventions with equity and comity in the trading system as a whole. Simply countervailing against other nations' subsidies or market-closing policies is no solution. In an emerging industry, such as high definition television, where each major region wishes to develop production capacity, a balance-of-benefits approach could attempt to calculate and negotiate limits on the total amount of subsidy. Nations which wanted their products to be freely traded would have to abide by those limits. Alternatively, a sector in which major nations had fairly mercantilist goals could follow the formula outlined above for steel, where a portion of each nation's domestic market could be reserved for domestic suppliers, and the rest could be available for imports, perhaps with auctioned quotas. If trading nations eventually grew weary of ruinous subsidy wars as the industry matured, reciprocal reductions in subsidies could be negotiated.

A balance-of-benefits approach is also a better way of reconciling the reality of widespread domestic economic interventions with equity ... in the trading system as a whole.

Though this paper has not treated agriculture, the recent U.S. position on farm trade is a splendid illustration of the best being the enemy of the good when it comes to reciprocal reduction of subsidy and oversupply. In the recent Montreal midterm review of the GATT round, the EC urged the U.S. to pursue a medium term program of reciprocal reduction of subsidies, with some tolerance for supply and price management and a mutual respect for historic regional export markets. The U.S. took the position that it would only agree to this interim approach if Europe joined the U.S. in a grandiose commitment to absolutely free trade in agriculture by the year 2000. The Europeans rightly saw that as a cynical maneuver which the U.S. delegation contrived in order to seem absolutely devoted to the freest possible trade while winking to assure domestic farm interests that no capitulation was genuinely contemplated. The diplomatic result, predictable, was impasse. Even the nations that are the lowest cost producers and the most committed to liberal trade in agriculture, such as Canada and Australia, shared the EC view that partially managed trade in farm products was the only conceivable route towards freer trade.

Free traders need to comprehend. .. that a regime of partially managed trade can be the route to relatively freer and more sustainable trade.

The point that free traders need to comprehend is that a regime of partially managed trade can be the route to relatively freer and more sustainable trade, as well as to a more balanced and sustainable role for the U.S. in the system. They should also note that this approach would inject a greater degree of multilateralism into the trading system. At present, in the mind of free traders, the ideal of "multilateralism" is irrevocably yoked to the ideal of "liberal," for both historical and ideological reasons. But these two ideals are logically separable. It is possible to have a trading regime that is slightly less liberal, in that it tolerates some explicitly managed trade, but is also more genuinely multilateral than the present system in which various subterfuges invariably involve bilateral side deals that do real harm both to the multilateral norms and to the flow of commerce.

There is also the question of overall balance in the trading system. Here, major nations with chronic trade surpluses need to be regarded as free riders. When a nation runs a chronic surplus, it produces more goods than it consumes. That allows the surplus nation to enjoy the benefits of a rather tight fiscal and monetary policy-low rates of interest and inflation-without suffering from a high unemployment rate, because that unemployment is exported. It means, in turn, that the surplus nation's domestic industry has lower capital costs than its competitors, which is likely to lead to a higher rate of productivity growth and hence to exacerbate the imbalance. Surplus nations are a source of exported austerity; they force other nations to depress demand to reduce their current account imbalances.

Major nations with chronic trade surpluses need to be regarded as free riders.

Keynes had the right answer. Incentives should be structured into the international monetary and trading systems to encourage surplus nations to expand both their economies and their markets for imports. One approach would be to "tax" nations with chronic surpluses, and to have the tax capitalize Third World development and refinancing funds. The Super-301 approach is another remedy. But skeptics are right to be somewhat wary of this remedy, because it makes the U.S. the aggrieved party, when in fact the aggrieved party ought to be the trading system as a whole.

Here again, if the U.S. can let go of the twin ideas that the trading system is its special responsibility and that the only defensible set of rules for that system are Ricardian ones, then the US., paradoxically, will be in a better position to bargain for system wide reciprocity, based on the principles of roughly balanced benefits and roughly balanced trading accounts. The European Community proposed something like this standard for the Uruguay round, but it was rejected by the U.S. as smacking too much of managed trade.

Surplus nations are a source of exported austerity; they force other nations to depress demand to reduce their current account imbalances.

With a balance-of-benefits approach, there are several tests of whether a particular nation is playing fair. Over time, it must have overall rough balance in its trade accounts. If it is a party to one of the specific managed trade arrangements outlined above, it must honor them. And its overall pattern of departures from free trade-market closings, subsidies, cartels, etc.-must not exceed some negotiated norm. The scheme for holding nations accountable must be elevated to system-wide accountability rather than nation-by-nation retaliation; that would be a real gain for multilateralism. If, for example, Japan is party to a steel arrangement that requires her to open 2 5 percent of her markets to steel imports and she fails to comply, there should be some automatic consequence imposed by the GATT and not by the U.S. government (which is worried about military bases). A logical consequence would be that other nations close their 25 percent import markets to Japanese steel.

This paper has necessarily treated the subject partly from a systemic perspective-how a managed trade system could work, while still providing the benefits of relatively open commerce and competition. It is also worth dwelling on the U.S. national interest in such a system. Because of its devotion to the GATT, the US. typically regards all departures from liberal trade as short-term tactical expedients, to be unilaterally given up as soon as possible. By recognizing that managed trade is sometimes the best available option, the United States will be more able to differentiate short-term tactical maneuvers from long-term strategic economic goals.

If managed trade in key industries is legitimate, the U.S. becomes much freer to press its trading partners-not simply to practice *laissez faire* in their own economies (the traditional U.S. diplomatic goal), but to bring a balance of obligations and benefits to the trading system. The U.S. is also freed to define industrial goals for its own domestic economy, and strategies for carrying them out. Such strategies might or might not require targeted industrial policies in any given sector. Under a managed trade regime for semiconductors, the U.S. might choose to subsidize semiconductor R&D via a Sematech consortium. In the case of steel, the U.S. might decide that holding foreign subsidized steel to a 25 percent market share is sufficient to allow a renaissance in American steel through free market principles, with only a reinvestment *quidpro quo* and some retraining aid as minimalist industrial policies.

By recognizing that managed trade is sometimes the best available option, the United States will be more able to differentiate short-term tactical maneuvers from long-term strategic economic goals.

Some Americans willing to embrace a modest dose of planning but skeptical of mercantilism have posed the choice as "protectionism" versus "adjustment."[30] Supposedly, protection means keeping other people's products out, while adjustment means temporary restraints while labor and capital are redirected to "higher value added" sectors, using the policy tools of reskilling workers and perhaps discreetly allocating some capital or subsidizing research. The trouble with this high sounding middle ground is twofold. First, it doesn't tell us what to do when other nations' mercantilism pushes the U.S. out of industries where we'd like to maintain some self sufficiency (steel happens to be a very high value added industry) and where U.S. industry is actually or potentially very competitive. Second, while professing to reject *laissez faire* purism, in fact it embraces most of the Ricardian shibboleths about trade.

Pluralism and the American National Interest

By adjusting its hegemonic ambitions to its economic capacity, … the U.S. will be in a better position both to work towards a sustainable, multilateral trading regime and to define and advance its own national interests.

We now have come full circle to the aspirations of the early post-war regime: the ceding of some national economic sovereignty to supranational public authority, the better to permit individual nations to operate mixed economies at home. In the late 1940s, this vision stalled, because the real supranational authority was the hegemonic supremacy of the United States. But in the 1970s and 1980s, as national sovereignty has been ceded to global private capital and the hegemonic position of the U.S. has weakened, the American protectorate is in many respects no longer viable. And the fact that the two emerging rival centers of economic power-the EC and Japan-are both more comfortable with a mix of mercantilism and liberalism makes it that much more likely that a mixed trading system is the only durable alternative and that the rules should acknowledge the reality. I have suggested in this paper that, by adjusting its hegemonic ambitions to its economic capacity, and by modifying its concomitant devotion to *laissez faire as* a standard for itself and others, the U.S. will be in a better position both to work towards a sustainable, multilateral trading regime and to define and advance its own national interests. But obviously, ceasing to play the hegemonic role will involve not only a change of habits; it will involve a loss of perquisites.

Readers should not mistake this observation for the wish that the U.S. play a less influential global role. There was a time when the United States loomed so large that it could play the role of hegemon and serve its national economic interests as well as its goals for the trading system and for the western alliance. And for the most part, the U.S. threw its economic weight around in a remarkably enlightened fashion. The issue is not whether it would be nice to maintain that role; the relative shrinkage of the U.S. economy makes such a role unsustainable. The issue is how best to adjust to the new realities.

Clinging to the illusion of American hegemony in a laissez faire world will only weaken the U.S. economy and the global economic order.

Playing a different role will require a drastic revision of some foreign policy fundamentals. If the U.S. ceases to function as hegemon, it will no longer be able to confer economic benefit in exchange for geopolitical foreign policy goals. It will be more subject to the discipline of membership in a global system. It may have to defer more to European and Japanese wishes with regard to East-West issues, Third World debt, arms control, the environment, and other policy areas where the U.S. has generally expected that if its views do not always carry the day at least they frame the agenda. It may have to defer more to Third World interests, too. All of this might even be salutary Fortuitously, these shifts are also happening just as the Soviet Union is becoming more respectful of pluralism.

The scholars who investigate the logic of hegemony and global economic stability are divided on the question of whether a stable global order is possible in the absence of a hegemonic nation. The interwar period is a chilling precedent. But clinging to the illusion of

American hegemony in a *laissez faire* world will only weaken the U.S. economy and the global economic order. The United States is no longer preeminent, and most other nations favor a mixed form of capitalism rather than *laissez faire.* We had better work towards the goal of a stable, pluralist system because all the economic indicators suggest that a pluralist world is what we now have.

We had better work towards the goal of a stable, pluralist system because … a pluralist world is what we now have.

Endnotes

1. Katzenstein (1985), chapters 1 and 2; Gourevitch (1986), chapters 5 and 6.

2. Choate and Linger (1988), p. 91.

3. Defense Science Board Report, 1988.

4. Bhagwati (1988), p. 1.

5. *Economic Report of the President, 1988*, Table B-96.

6. Ruggie (1983), p. 209.

7. Quoted in Bhagwati (1988), p. 29.

8. This argument is made by Ruggie (1983).

9. Kindleberger (1973), esp. chapter 14.

10. See Keohane (1984); Krasner (1983); and Gilpin (1987).

11. See Kennedy (1986).

12. After Triffin (1960).

13. Keohane (1984); Krasner (1983); Gilpin (1987).

14. See Ricardo (1951).

15. Paraphrased in Krugman and Obstfeld (1988), p. 258.

16. See Krugman (1984; 1986; 1987); Dixit (1988); and Dixit and Grossman (1984). A nontechnical summary of this New View is given in the textbook by Krugman and Obstfeld (1988), chapter 6.

17. See Heckscher (1919) and Ohlin (1933).

18. See Samuelson (1949).

19. See Stegemann (1989), pp. 75-76.

20. See Brander (1986) and Spencer (1986), and the discussion of their work in Stegemann (1989), p. 75.

21. See Katz and Summers (1988).

[22] See Roth (1989).

[23] Krugman (1987), p. 143.

[24] Cline (1987), p. 46.

[25] Rothstein (1989).

[26] See Cline (1987).

[27] Howell, *et al.* (1988), p. 51.

[28] Howell, *et al.* (1988).

[29] Howell, *et al.* (1988), p. 496.

[30] Reich (1983), pp. 774ff; Hufbauer and Rosen (1986).

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