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US Trade Policy in an Unbalanced World Economy

by Georg Koopmann, Hamburg*

Both the national as well as the international debate on US trade policy are overshadowed, and strongly influenced, by the large external imbalances of major trading nations. What do these disequilibria mean for US trade policy? Moreover, is the USA losing comparative advantage in agriculture and high-technology manufacturing? Do industrial policies in other countries distort American trade?

US trade policy has come under fire in recent years, abroad as well as domestically. Foreign criticism ranges from accusations of power diplomacy in trade negotiations over complaints about US interference with the national sovereignty of trading partners to allegations of carving up world markets through cartel-like agreements such as the recently concluded chips accord with Japan. An example of tough treatment of trading partners by US authorities is Brazil which currently runs an annual trade surplus of more than \$ 4 bn with its northern neighbour. Under heavy US pressure, including the threat of tough retaliatory measures, the Brazilian government has already taken a number of steps, in particular giving full copyright protection to imported software, to defuse the long-running conflict over the country's – seemingly xenophobic and, in the final analysis, possibly self-defeating – market reserve policy in informatics.¹ Further accommodation of US complaints has been signalled.²

Domestically, trade policy is criticized, among other things, for lacking consistency, neglecting structural adjustment, promoting deindustrialization and supporting the inefficient instead of contributing to the creation of world-class industries.³ As David Stockman, the former Budget Director, puts it, the essence of the present government's trade policy is to "espouse free trade, but find an excuse on every occasion to embrace the opposite".⁴ Academic observers such as Robert Driscoll and Jack Behrman come to a similar conclusion stating that "the overriding principle is that of freedom of trade and payments – unless the freeing of trade hurts the interests of key sectors".⁵

Evidence on inconsistent trade policy is provided by the steel industry which has enjoyed growing protection since the late 1960s covering an ever-increasing

number of products and countries⁶ without any explicit quid-pro-quo demanded by the government (in fact, over the period of protection the US steel industry, more precisely, the integrated steelworks, has performed considerably worse, in terms of labour unit costs and technical progress, than competing steelworks in other industrial countries and lost its comparative advantage over a number of newly industrializing countries such as Brazil and South Korea), while smaller and less influential industries such as the shoe industry have been denied protection, in the latter case on the ground of allegedly proven inability to adjust to changed competitive conditions. At the same time, strangely enough, the motorcycles industry consisting of but one American firm (Harley-Davidson) along with two

¹ Under the Brazilian information law computers, computer software and all products with computer chips made by domestic companies are heavily protected from foreign competition until 1992. For example, the production of microcomputers is restricted to locally owned firms. Official sources in Washington estimate that the market reserve policy adopted in 1984 will have cost US based companies \$ 15 bn in lost sales to Brazil by 1992. Cf. *Information technology in Brazil – the national firms take the lead*, in: *EIU Multinational Business*, No. 3, 1986, p. 35.

² Cf. I. D a w n a y: Brazil cools conflict with US, in: *Financial Times*, 28. 10. 1986. An additional cause for US concern derives from the fear that the protection accorded to informatics may spread to other industries such as chemicals, precision engineering and aerospace.

³ L. T h u r o w: The need for industrial policies. The case of the USA, in: *Annalen der Gemeinschaft*, 1984/1, p. 8.

⁴ Cf. D. S t o c k m a n: The triumph of politics. Why the Reagan revolution failed, *New York etc.* 1986, p. 158.

⁵ Cf. R. D r i s c o l l, J. B e h r m a n (eds.): *National Industrial Policies*, Cambridge (Mass.) 1984, p. 21.

⁶ The office of the US Trade Representative has negotiated bilateral export restraint arrangements with 17 steel-exporting countries as well as an extension and expansion of the 1982 steel arrangements with the European Communities. The arrangements, which cover more than 80 percent of total US steel imports, will remain in effect through September 30, 1989. They aim at an import penetration level of 18.5 percent for finished steel plus a 1.7 million net ton annual level for semifinished steel. (Cf. G. K a p l a n: The President's steel program is working, in: *Business America*, March 31st, 1986, p. 11.) At the same time, however, efforts are under way to make the coverage even more comprehensive as countries not party to the arrangements, in particular Argentina, Canada, Sweden and Taiwan, have increased their steel exports to the USA considerably. (Cf. N. D u n n e: Tougher US action urged to curb steel imports, in: *Financial Times*, 16. 10. 1986.)

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Japanese-owned producers (Honda and Kawasaki) has been granted massive tariff protection in 1983,⁷ but on what reasoning? Is motorcycles a vital industry? Can a process of constant shrinking – approximately 150 producers of motorcycles have disappeared from the market since the first motorcycle was manufactured commercially in the United States in 1901 – be reversed within a few years? In fact, aggressive foreign competition was not the main source of the problems facing in particular the American producer, but mismanagement and the general economic recession, and Harley-Davidson has quickly recovered in an improved overall economic climate and with a new management.⁸ What remains is a questionable precedent. The same is true for the automobile industry which still enjoys tacit protection from Japanese competitors, after the more formal self-restraint arrangement expired in early 1985. Finally, the textile industry, which can look back on a tradition of uninterrupted import protection beginning in the mid-fifties, has performed remarkably well in terms of productivity, product quality and specialisation behind the tariff and, most important, the non-tariff walls erected under the aegis of the multi-fibre arrangement. Despite this good performance, however, import restrictions persist and are even growing, even though President Reagan has vetoed highly protectionist textile legislation in Congress.

External Disequilibria

Both the national as well as the international debate on US trade policy are overshadowed, and strongly influenced, by the large external imbalances of major trading nations. As regards the US economy, its trade position began to worsen in 1980, when the external value of the dollar started rising. Under a macroeconomic regime of tight monetary and loose fiscal policies the process of external deterioration rapidly gained momentum. After a long surplus period lasting from 1883 to 1970 and a short period of unstable development during the seventies the US trade account jumped from a \$ 32.1 bn deficit in 1980 to a \$ 148.5 bn shortfall in 1985, i.e. 3.7% of GNP (as compared to 1.2% in 1980). In 1986, the trade gap widened even more: the annual deficit may well exceed \$ 160 bn, as the figures in Table 1 suggest.

⁷ Ad valorem tariffs on heavyweight motorcycles, i.e. motorcycles having a total piston displacement over 700 cc, have been increased by 45 percentage points on top of the existing 4.4 % rate, decreasing over a five year period to pre-relief levels. For details cf. J. H a t c h - I l l: The Harley-Davidson case: escaping the escape clause, in: *Law and Policy in International Business*, Vol. 16, No. 1, 1984, pp. 325 ff.

⁸ For details cf. *Lektion für Amerika*, in: *Wirtschaftswoche*, No. 37, 5. 9. 1986, pp. 52 ff.

During the same period, the two other leading trading nations, Japan and the Federal Republic of Germany, sharply improved their trade balance. Table 1 shows a Japanese swing from \$ –11.5 bn in 1980 to +45.6 bn in 1985. Meanwhile the German trade surplus which in 1980 had reached its lowest level since 1972 with merely \$ 5.8 bn surged to an all-time high of \$ 24.9 bn in 1985. In relation to GNP Japanese net exports increased from –1.1 % to 3.4 % while the German ratio grew from 0.6 % to 4.0 %. Estimates for the current year even suggest considerably higher trade surpluses for both countries, in absolute as well as in relative terms.

Table 1 also shows that Japan and the Federal Republic which are by far the most important trading partners of the USA outside North America together account directly for 42 % of the global US trade gap in 1985. However, the same ratio holds for 1980 which indicates that these countries did not benefit overproportionately from mounting US deficits.

What do the striking external disequilibria shown above mean for US trade policy? First of all, rising trade deficits are not necessarily associated with the erosion of a country's industrial base. Empirical evidence for the USA tends to indicate the contrary. During the recent economic expansion, i.e. the three years ending in the final quarter of 1985, US manufacturing production increased by 28.2 %. This compares to an average of merely 24.2 % in earlier expansions.⁹ Moreover, since 1980 when the US manufacturing trade balance started to swing from a \$ 17.0 bn surplus to a \$ 107.4 bn shortfall in 1985 (cf. Table 2), manufacturing production has risen at more or less the same rate as GNP; accordingly, its share in total output remained stable at about 22 %. It has also been shown, for a sample of 73 US industries, that there is no statistically significant relationship between changes in net exports (i.e. exports less competing imports) and employment over the period 1980-1984. For example, the electronic components industry enjoyed the greatest percentage growth in employment of all the 73 industries reviewed even though the industry's net export ratio (net exports as a percent of shipments) declined by nearly 9 percentage points. At the other extreme, the railroad equipment industry suffered the greatest loss of employment but at the same time increased the net export ratio by 5 percentage points.¹⁰ Last but not least, increased competition from abroad has contributed significantly to

⁹ Earlier expansions include those beginning after 1954 Q2, 1958 Q2, 1961 Q1, 1970 Q4, and 1975 Q1. For details, in particular regarding the performance of individual industries cf. R. O r t n e r (in collaboration with H. K. S t o k e s Jr.): Domestic demand spurs factory output, offsets rise in trade deficit, in: *Business America*, May 26th, 1986, pp. 10 f.

improving manufacturing efficiency and product quality in the United States, which can be viewed as an asset for the future competitiveness of American industry.

Table 3 compares the performance of US manufacturing industries with that of the manufacturing sector and subsectors in Japan, the Federal Republic of Germany and the OECD as a whole for the period 1980-1985. It shows that manufacturing in the USA has expanded considerably faster than in Germany and the OECD as a whole, remaining only slightly behind Japan. Total US manufacturing output was 17 % higher in 1985 than in 1980, as compared to 10 % for the OECD as a whole and a meagre 4 % for the FRG. During the same period manufacturing employment declined by 8 % in the USA. This compares with 6 % in the average OECD country while the Federal Republic records a 12 % decline and Japan a 5 % increase. It indicates a substantial rise of labour productivity in US manufacturing in recent years, well above the OECD average. Given that overall US employment has increased by 10 million since 1980, with unemployment largely unchanged, the decline in manufacturing employment appears undramatic.¹¹

If the figures are broken down by subsectors, it can be seen that only one US industry (basic metals) shows a decline in production during the period under review. All the remaining industries expanded, and did so at a higher rate than their counterparts in competing OECD countries.

Protectionist Pressures

All this is just to show that the United States is not being "deindustrialized" by foreign trade, as is frequently asserted. It is not to say that the large trade

gap is not a matter of concern. It certainly is. It places a heavy burden on future generations as foreign debt accumulates and "evidence suggests that most of the funds available from abroad have indirectly supported consumption rather than adding much to our productivity or productive capacity".¹² Moreover, market shares which have been lost abroad may be difficult to regain. Last but not least, mounting trade deficits have contributed considerably to the strong protectionist sentiment in both Houses of the US Congress as well as among business associations and labour unions. Some 300 trade bills were introduced in the 99th US Congress which call for import restrictions of one sort or another. (With both Houses of the new Congress now being dominated by the Democrats, the protectionist pressures will even increase.) More often than not the bills have been justified by their sponsors on the ground that they will help reduce the trade deficit, either globally or on a bilateral basis. The Omnibus Trade Bill which the House of Representatives passed on May 22nd 1986, by a vote of 295 to 115 with one abstention typifies the proposed legislation. Among other things the bill requires an annual 10 percent reduction in the US bilateral trade deficit with Japan, Taiwan and the Federal Republic of Germany through unilateral tariffs and quotas if negotiations fail to produce the same result.

However, discriminatory trade restrictions as recommended by the Omnibus Trade Bill as well as

¹⁰ Cf. N. Fiecke: The foreign trade deficit and American industry, in: *Economic Impact*, 1986/1, pp. 51 f.

¹¹ In percentage terms, total employment in the United States was 8 % higher in 1985 than in 1980. By contrast, for the OECD as a whole it was merely 3 % above the 1980 level. In Germany, employment even declined by 3 % during the period under review, whereas Japan also lagged behind the United States but recorded a 5 % employment increase. For details cf. OECD: *Main economic indicators*.

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REPORT

Table 1
Global and Bilateral Trade Balances of the United States, Japan and Germany, 1980-1986^a
 (billions of dollars)

	1980	1981	1982	1983	1984	1985	Jan.-June 1985	1986
USA	-32.1	-39.7	-42.6	-69.4	-123.3	-148.5	-69.3	-83.9
Japan	-11.5	9.1	7.1	20.6	34.0	45.6	20.1	36.9
Germany	5.8	12.6	21.1	16.5	19.0	24.9	10.8	22.6
USA-Japan	-12.2	-18.1	-18.9	-21.7	-36.8	-49.7	-24.2	-28.7
USA-Germany	-1.3	-1.6	-3.2	-4.5	-8.7	-12.2	-5.8	-7.7

^a Exports f.a.s., imports c.i.f.

Sources: OECD: Main economic indicators, various issues; U.S. Department of Commerce: Highlights of U.S. Export and Import Trade, various issues; idem: United States Foreign Trade, Monthly Report, August 1986.

global import-restricting action as proposed in other trade bills are unlikely to have a lasting impact on the trade balance. Instead, they would invite retaliatory actions by trading partners, help import-competing industries at the expense of export sectors and redistribute trade flows among countries. If the trade balance is to be changed, capital flows must be altered as the capital balance ultimately "governs" the trade account. Capital flows, however, are determined by macro-economic conditions, in particular the incentives to save, invest and consume which cannot be influenced by trade policy measures in a predictable way.

Since 1976, consumption and investment expenditures have consistently, and at an increasing rate, exceeded the income which US residents have earned. Net inflows of financial and real resources from abroad, attracted by rising interest rates and a growing confidence of foreign investors in the US economy, have closed the gap. However, an increasing share of foreign resource inflows has been claimed by the government (largely for public consumption), all the more so as private investment, after an investment-led recovery, has receded to a low level. Hence, the government must substantially cut the budget deficit in order to restore external balance. This is the more important as otherwise the government or the Federal Reserve Board, in a climate of growing uncertainty and decreasing confidence, could be forced to raise interest rates in order to attract needed foreign capital and

thereby run the risk of driving the economy into a deep recession.

The government has responded to the protectionist pressures which it has considerably helped to create through its fiscal policies by rejecting sharply protectionist Congressional proposals while at the same time using them as a weapon in international negotiations. For example, the government dismissed the Omnibus Trade Bill mentioned above as "pure protectionism" and "trade-destroying, not trade-creating". President Reagan himself called it an "anti-trade bill".¹³ As an alternative to defensive import protectionism and an attempt to calm the protectionist mood the government has propagated an offensive trade strategy aimed at eliminating and, if necessary, retaliating against unfair trading practices abroad which allegedly deny American firms equal business opportunities on international markets. To create a level playing field is the essence of the trade policy action programme which President Reagan announced on September 23rd, 1985.¹⁴ The programme is intended both to help reduce the trade deficit and to increase the gains from trade for the United States. However, on the same reasoning that holds against import protection as a means of improving the trade balance, fighting against trade-distorting policies in other countries, even if it is successful, can do little, if anything, to help the trade account, as these measures have no permanent effect on macroeconomic variables such as aggregate savings, investment and consumption. They merely raise expectations which if disappointed, as appears almost inevitable, may even intensify protectionist pressures and ultimately force the government to adopt trade policies which do considerable harm to the USA as well as to the world economy without helping to solve the problem of external imbalances.

¹² Cf. The state of the world economy and the US trade position. Statement by chairman Volcker, in: Deutsche Bundesbank: Auszüge aus Presseartikeln, No. 69, October 10th, 1986.

¹³ Cf. President Reagan reiterates commitment to free trade, in: Business America, August 4th, 1986.

¹⁴ Cf. The President's trade policy action plan, in: Business America, September 30th, 1985.

REPORT

Table 2
US Trade by Major Sector, 1980-1985^a
(billions of dollars)

	1980	1981	1982	1983	1984	1985	Jan.-June 1985	1986
Exports								
Agriculture	41.3	43.3	36.6	36.1	37.8	29.6	16.0	13.3
Manufacturing	155.8	166.8	151.3	143.5	158.4	162.0	84.2	84.6
High-tech	54.7	60.4	58.1	60.2	65.5	68.4	35.7	35.2
Other	101.1	106.4	93.2	83.3	92.9	93.6	48.5	49.4
Services	118.7	137.2	148.0	146.4	158.6	150.2	75.3	77.6
Factor income	74.5	86.5	91.6	88.7	100.6	91.2	45.8	46.8
Other	44.2	50.7	56.3	57.7	58.0	58.9	29.5	30.8
Imports								
Agriculture	18.8	18.6	17.0	18.1	21.6	22.0	11.6	12.1
Manufacturing	138.8	156.4	158.1	178.5	241.8	269.4	133.6	150.7
High-tech	28.0	33.8	34.5	41.4	59.5	64.8	32.7	36.5
Other	110.8	122.6	123.6	137.1	182.3	204.6	100.9	114.2
Services	70.6	80.8	86.1	87.3	107.0	106.9	52.8	54.8
Factor income	29.2	36.2	40.5	38.9	53.1	50.1	24.9	25.9
Other	41.4	44.6	45.7	48.5	53.9	56.9	27.9	28.9
Balance								
Agriculture	22.5	24.7	19.6	18.0	16.2	7.6	4.4	1.2
Manufacturing	17.0	10.4	-6.8	-35.0	-83.4	-107.4	-49.4	-66.1
High-tech	26.7	26.6	23.6	18.8	6.0	3.6	3.1	-1.3
Other	-9.7	-16.2	-30.4	-53.8	-89.4	-111.0	52.5	64.8
Services	48.1	56.4	61.9	59.1	51.6	43.3	22.5	22.8
Factor income	45.3	50.3	51.1	49.8	47.5	41.1	20.9	20.9
Other	2.8	6.1	10.8	9.3	4.1	2.2	1.6	1.9

^a Exports f.a.s., imports c.i.f.

Sources: U.S. Department of Commerce: Highlights of U.S. Export and Import Trade, various issues; idem: Survey of Current Business, various issues; data submitted by the U.S. Department of Commerce.

Table 3
Production and Employment in OECD manufacturing 1985
(Index numbers with 1980 = 100)

	ISIC	Production				Employment			
		USA	Japan	Germany	OECD	USA	Japan	Germany	OECD
Food, beverages, tobacco	31	116	102	105	108	95	117	89	98
Textiles, clothing, ¹ leather	32	101	98	88	98	84	91	75	83
Wood and wood products	33	125	79	79	98	103	77	78	89
Paper and paper products	34	127	113	104	116	107	97	86	98
Chemicals	35	119	113	102	112	99	120	95	98
Non-metallic mineral products	36	112	96	84	95	88	84	82	84
Basic metals	37	89	100	97	96	70	90	63	73
Metal products, machinery and equipment	38	121	114	112	112	92	111	98	94
Total manufacturing	3	117	122	104	110	92	105	88	94

¹ Including footwear.

Source: OECD: Indicators of industrial activity 1986-III.

The question, then, remains whether current US trade policies are appropriate to increase the benefits which the United States derives from participating in the international division of labour. Trade policy activities concentrate on areas where the United States presumably has comparative advantages. Essentially, these are agriculture, the high-technology sector, and services. The following observations and considerations will be limited to the first two areas.

Agricultural Crisis

Agriculture is widely viewed as an American success story. As Lester Thurow emphatically states, "in agriculture what started out a desperate effort to prop up a very large, very sick industry in the 1930s ended up with an industry which is the world's most efficient. . . America did not inherit its comparative advantage in farming – it created it."¹⁵ This observation contrasts sharply with the current reality of rural America which shows a picture of distress: overindebtedness, bankruptcies, personal tragedies and, increasingly, violence. The farm sector's contribution to total GDP declined from \$ 80.8 bn in 1981 to \$ 75.5 bn in 1985, i.e. by 6.6 %. During the same period (nominal) GDP rose by 36.1 %.¹⁶ This poor performance has its main root in foreign trade, which has become a major source of farm income since the second world war. After an uninterrupted increase from \$ 5.9 bn in 1969 to \$ 43.3 bn in 1981 agricultural exports have fallen below \$ 30 bn in 1985 (cf. Table 2). Their share of total exports, which had risen from 16 to 19 %, declined to a mere 14 %; in the first half of 1986 it even fell to 12 %. Agricultural imports, on the other hand, continued to increase after 1981, largely in tune with total imports (their share of total imports declined from 7 to 6 %). Hence, the agricultural trade surplus, which during the seventies had increasingly served to offset trade deficits in other sectors of the economy, dwindled from \$ 24.7 bn in 1981 to a mere \$ 7.6 bn in 1985. In 1986 the situation deteriorated

further; for the first six months a tiny surplus of just \$ 1.2 bn was recorded, as compared to \$ 4.4 bn for the same period of 1985 (cf. Table 2).

The crisis of US farm trade has a variety of causes, among them the sluggish world demand for farm products, the emergence of new competitors, aggressive EEC farm export policies and, most important, the steep revaluation of the dollar up to February 1985. But the crisis is also a consequence of farm policies in the US itself which have been characterized by a mixture of surplus-generating domestic policies¹⁷ on the one hand and export-market development measures on the other. Following a recommendation by the Williams Commission set up by President Nixon in 1970 to search for remedies for the worsening general export performance of the US economy, agriculture was singled out in the early seventies as an area where exports could be substantially expanded. In the years to follow, the increasing of export earnings became the overriding goal of US farm policy supported by a multitude of export promotion activities.¹⁸ All went well as long as the dollar was weak on international markets. The 1970's were an unprecedented boom period for US agricultural exporters. US agriculture became the dominant supplier and price leader on world markets, in particular in world grain trade. Here the US share increased from 34 % in 1968-70 to 71 % in 1979-80.¹⁹ However, prices have been kept at artificially high levels through domestic price support programmes in the United States, in particular through the fixing of loan rates.²⁰ High loan rates were maintained during the strong dollar period which began in late 1980. They caused US farmers to sell their crops to the government instead of defending export markets which in the face of a rising dollar would have required price-cutting action. Loan rates worked like an umbrella over the market while at the same time providing a strong incentive for foreign producers to increase their production and making it easy for them to undersell US suppliers. In the words of Edward Schuh, "It would be difficult to find a better means of shooting oneself in the foot!"²¹

¹⁵ Cf. L. Thurow, *op. cit.*, p. 9.

¹⁶ For the data base cf. US Department of Commerce: Survey of Current Business, various issues.

¹⁷ Surplus production follows from a dramatic increase of agricultural productivity in the USA since the second world war. A major factor behind this development has been the generous funding of agricultural R&D (including extension services) based on the rationale that the social returns in this field by far exceed the private ones.

¹⁸ Export-promotion activities include, but are not limited to, (1) a highly efficient Foreign Agricultural Service providing the US farm business with information about foreign trade opportunities as well as promoting trade in a more direct way, in particular through partly government-funded market development programmes; (2) export financing through the Commodity Credit Corporation; (3) direct export subsidies, and (4) government-to-government agreements such as the grain agreement with the Soviet Union.

¹⁹ Cf. J. Cathie: US and EEC agricultural trade policies: a long-run view of the present conflict, in: Food policy, Vol. 10, No. 1, February 1985, p. 22.

²⁰ Loan rates are reference prices on which official lending to US farmers is based. They have a strong influence on market prices as farmers may turn their commodities to the government should the market price fall below the loan rate. This mechanism effectively puts a floor under market prices.

²¹ Cf. G. E. Schuh: International agriculture and trade policies: implications for the United States in: B. Gardner (ed.): US agricultural policy: the 1985 farm legislation, Washington, D.C., 1985, p. 72.

Table 4
Commodity Pattern of US Net Exports,¹ 1930-1985

	1930	1937	1947	1960	1970	1973	1981	1985
Agricultural goods	15	-459	1,604	857	558	8,055	23,909	7,918
Industrial supplies and materials	165	233	2,456	-837	-2,331	-6,948	-66,890	-39,173
Fuels & lubricants	433	395	1,013	-739	-1,384	-6,369	-71,333	-45,021
Chemicals	3	22	553	1,128	2,216	3,138	11,996	9,429
Other	-271	-184	890	-1,226	-3,163	-3,717	-7,553	-3,581
Capital goods	518	486	3,144	4,949	10,557	13,928	45,680	8,795
Consumer goods	-92	-38	958	-505	-4,834	-8,481	-22,864	-55,682
Automotive products	282	353	1,147	633	-2,242	-4,543	-11,750	-45,879
Military goods	7	22	174	804	1,230	1,386	3,581	4,290
Other	-113	-332	47	-373	365	-1,534	768	-12,399
Total	782	265	9,530	5,528	3,303	1,863	-27,566	-132,130

¹ Net exports in millions of dollars, including exports on f.a.s. (free alongside ship) value basis, imports on customs value basis.

Sources: US Department of Commerce: Highlights of U.S. Export and Import Trade, various issues; William H. Branson: Adjusting to Global Competition, in: Economic Impact, 1984/2, p. 15.

Recognizing the self-defeating nature of its agricultural policies, the government undertook a major policy shift in 1985. Loan rates were sharply cut in order to restore international price competitiveness, while the resulting income loss for farmers would be, at least partly, compensated for by increased direct income support through higher target prices.²² At the same time, the government adopted an aggressive export strategy comprising countervailing export subsidies for sales on third markets as well as retaliatory import restrictions against countries closing their home markets for US agricultural commodities or treating them in a discriminatory way. Action in the trade field is directed mainly against the EEC and, to a lesser degree, Japan. This is because the EEC not only protects major domestic markets from US competitors, as does Japan, but also acts as an agricultural exporter on an increasing scale through its export restitution mechanism. For example, export subsidies have turned the EEC from a net importer to a net exporter of grain, and during the first half of the eighties, the EEC's share of world wheat exports increased from 12 to 17%, whereas the US share declined from 50 to 25%.

Change in Policy

One finds it hard to criticise the US government for taking aim at the agricultural trade policies of other countries, in particular the EEC, which highly distort competition. American policy in this field does, however, have its own shortcomings. To begin with, the virtual exclusion of agricultural trade from the overall trading system goes back to the waiver which the US received for its agricultural policies under Article 25 of the GATT

as early as 1955. The waiver gives the US government the right to impose unilaterally import quotas for all price-supported crops. As a consequence, important parts of US agriculture, e.g. sugar, dairy products and cotton, are still heavily protected from foreign competition. Secondly, as the conflict over the consequences for US farm exports of Spain's and Portugal's accession to the EEC has shown, the USA prefers a narrow, market-for-market concept of reciprocity detrimental to the overall trading order. In the third place, aggressive export policies may do more harm to fair-trading than to unfair-trading nations. Ironically, among the affected trading partners are those Third World countries whose agricultural sector has been supported by US development aid ("green revolution"). Finally, as a growing number of countries can underprice large sectors of the US farm economy, without any subsidies, the question may be raised how long the USA would truly respect the *laissez-faire* régime in farm trade which it is now so urgently demanding.

High Technology

Contrary to agriculture, high technology and innovative activities have for more than a century been an area of comparative US strength: "Since 1880, U.S. manufacturing exports have been largely concentrated in new products that other countries either could not yet produce or had not yet begun to produce in quantity."²³

²² Target prices are artificial prices set above market prices to provide the basis for "deficiency payments" to farmers.

²³ Cf. H. Brooks: Technology as a factor in U.S. competitiveness, in: B. Scott, G. Lodge (eds.): U.S. competitiveness in the world economy, Boston 1985, p. 328.

Table 4 gives an account of US net exports by broad economic categories for the period 1930-1985. It shows a remarkably stable pattern of surpluses and deficits. With the exception of agriculture, all the surplus sectors of today, i.e. chemicals, capital goods and military goods, already produced surpluses in the pre-war period. Apart from the oil industry, only one product group – automotive products – has changed from a surplus to a deficit category. The table also shows a rapid post-war expansion of surpluses in the strong sectors (which largely compensated for growing deficits in the weak sectors) coming to an abrupt halt in the early eighties. This is most distinct for capital goods where a drastic fall of surpluses is recorded for the period 1981-85.

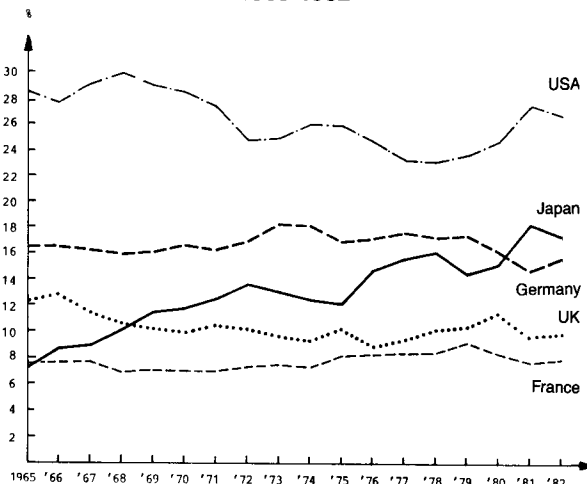
The trends shown in Table 4 are consistent with more precisely defined figures on high-technology trade provided by the U.S. Department of Commerce (DoC) for the period from 1965 on.²⁴ Until 1981 high-technology manufactures generally recorded growing surpluses, often large enough to offset growing deficits in other manufactures trade. High-technology surpluses grew from \$ 3.1 bn in 1965 to \$ 23.6 bn in 1985.²⁵ However, after 1981 they fell drastically amounting to a mere \$ 3.6 bn in 1985 and even turning to a deficit (\$ -1.3 bn) in the first half of 1986 (cf. Table 2).

The sharp deterioration of the high-technology trade balance has given rise to the question whether the competitive problems apparently facing the US high-technology industry are just a short-term transitory phenomenon or whether more fundamental long-run forces are at work. There is an optimist as well as a pessimist school on this issue in the United States. For the optimists, among them Fred Bergsten, William Branson and Robert Lawrence, the worsening trade account on high-technology goods is a mere reflection of misaligned exchange rates and misguided macroeconomic policies.²⁶ The pessimist school, on the other hand, points to an underlying erosion of high-technology competitiveness long before the dollar appreciated in real terms.²⁷ This view is somewhat

²⁴ High-technology goods are defined as manufactured products that have an embodied R&D spending (including both the funds directly spent by the final producers as well as the funds spent by producers of intermediate products used in the final product) relative to the value of shipments which is significantly above the R&D content of lower technology goods. On this basis, the U.S. Department of Commerce has singled out 10 product groups as high-technology goods, the most important of which (combining around 75 percent of total U.S. high-technology exports) include (1) aircraft and parts, (2) office, computing, and accounting machines, (3) communications equipment and electronic components, and (4) professional and scientific instruments. For details cf. U.S. Department of Commerce: U.S. high technology trade and competitiveness, Washington, D.C., February 1985.

²⁵ Ibid., p. 5.

Figure 1
Export Market Shares of Major Industrial Countries in High-Technology Manufactures, 1965-1982^a



^a Share of total major industrial country exports of high-technology manufactures.

Source: U.S. Department of Commerce: U.S. high technology trade and competitiveness, Washington, D.C., February 1985.

supported by DoC data showing a long-term decline of export market shares for US suppliers of high-technology goods until the late 1970's, largely to the advantage of Japanese competitors (cf. Figures 1 and 2).²⁸

Declining market shares in areas of traditional US strength are consistent with long-term trends in factor endowment. International data on various basic factors of production for a sample of six industrial countries and six NICs²⁹ show that

□ the USA still enjoys a comparative advantage in goods and services that require more scientific know-how and more physical capital than the average good or service;

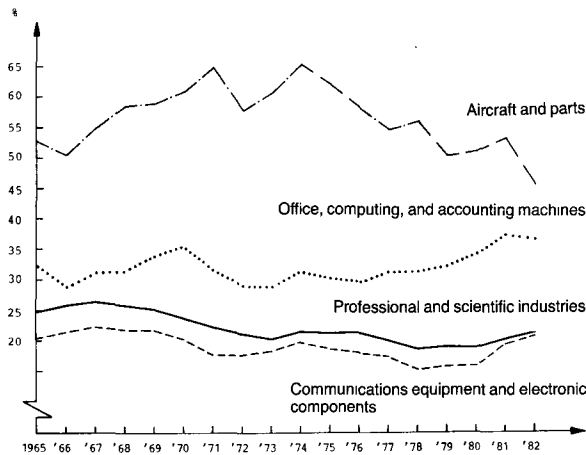
²⁶ Cf. C. F. Bergsten: Gearing up world growth, in: Challenge, May/June 1986, pp. 35 ff.; W. Branson: Adjusting to global competition, in: Economic impact, 1984/2, pp. 14 ff.; R. Lawrence: Can America compete?, Washington, D.C., 1984.

²⁷ Cf. for example B. Scott: U.S. competitiveness: concepts, performance, and implications, in: B. Scott, G. Lodge (eds.), op. cit.

²⁸ As Figure 1 shows, since 1979 the US share has risen again. But this largely reflects a mere arithmetic effect of the revaluation of the dollar. Cf. U.S. Department of Commerce, op. cit., p. 9.

²⁹ Cf. J. Mutti, P. Morici: Changing patterns of U.S. industrial activity and comparative advantage, Washington, D.C., 1983, p. 8. Factors of production include physical capital, R&D capital (represented by the number of R&D scientists), arable land and various types of labour (skilled, semi-skilled and unskilled). The geographical coverage is as follows: United States, Canada, France, Federal Republic of Germany, Japan, United Kingdom, Argentina, Brazil, Hongkong, India, Mexico, and South Korea.

Figure 2
Export Market Shares of Leading US
High-Technology Industries,
1965-1982^a



^a Definition of export market shares as in Figure 1.

Source: See Figure 1.

□ however, the US share of those resources has dropped particularly rapidly: between 1963 and 1980, the US share of physical capital fell from 42 to 34 %, while its share of R&D scientists declined from 63 to 51 %.

More specific analyses show a growing shortage of certain scientific and engineering skills in the United States, in particular computer-related skills, which are critical to the expansion of high-technology industries.³⁰ Moreover, numerous studies point to microeconomic factors such as management failures, poor management-labour relations, a growing tendency of US manufacturers to move production facilities abroad, and a rapid transborder transmission of technology within the domains of multinational corporations weakening the domestic base of US high-technology industries.³¹ Finally, government policies, in particular the concentration of public R&D spending on a narrow range of sophisticated technologies for defence and space, are held responsible for the declining US technological lead in the civilian area.³²

Significance of Foreign Industrial Policies

The conclusion may be drawn from the foregoing that if there really is a fundamental competitive problem for the American high-technology sector this should be largely traced to domestic causes. However, public discussion in the United States tends to put the blame on industrial policies in other countries, which are held to create artificial comparative advantages in precisely

those areas where the US has traditionally displayed a strong export performance. The US government has responded by intensified efforts, preferably on a bilateral basis, to remove trade-distorting industrial policies abroad in general and in the high technology area in particular.³³

It is true that industrial policies have proliferated in the past and increasingly concentrated on the creation of sophisticated "winner" industries. A recent review of structural policies in major industrial countries³⁴ has shown a broad range of measures and devices by which governments support industries based on high technology. But the study also points to the crisis of selective industrial policies as government intervention is not based on superior knowledge and quickly becomes dominated by equity considerations at the expense of efficiency.

It is difficult to assess the real significance of foreign industrial policies for US trade. It is even more difficult to show that industrial policies of other countries work to the *disadvantage* of the United States. A broad examination of foreign practices has led Paul Krugman to the conclusion that "the industrial policies of foreign governments have not been a serious problem for the United States".³⁵ Against this background, US efforts to "break" industrial policies abroad generally appear to be a search for a scapegoat for domestic failures rather than a strategy based on sound empirical evidence as to the true impact of the incriminated practices on the US economy. Moreover, if enforced through retaliatory trade policy which will inevitably provoke counter-retaliation, what started as a market-opening effort may end up with even higher barriers to trade.

³⁰ Cf. for example U.S. Department of Commerce: An assessment of U.S. competitiveness in high technology industries, Washington, D.C., February 1983, p. 25.

³¹ Cf. for example E. Buffa: Making American manufacturing competitive, in: California Management Review, Vol. 26, No. 3, Spring 1984, pp. 29-49; and L. Thunow: Revitalizing American industry: Managing in a competitive world economy, in: California Management Review, Vol. 27, No. 1, Fall 1984, pp. 9-41.

³² As a consequence of the strong defence bias of public R&D funding and the strain which this places on R&D resources available for non-defence purposes, the USA has fallen behind Japan and the Federal Republic of Germany in civilian R&D expenditure as a percentage of national income although it is still ahead of its main economic rivals in terms of overall R&D. Since President Reagan took office in 1981 the defence share of public R&D spending has dramatically risen from around 45 % to nearly 75 %. Cf. P. Stephens: When the Pentagon turns consumer, in: Financial Times, August 14th, 1986.

³³ For an official account of trade policy actions cf. Business America, Vol. 9, 1986, No. 19, pp. 2 ff.

³⁴ Cf. H.-H. Härtel et al.: Neue Industriepolitik oder Stärkung der Marktkräfte? Strukturpolitische Konzeptionen im internationalen Vergleich, Hamburg 1986.

³⁵ Cf. P. Krugman: The U.S. response to foreign industrial targeting, in: Brookings Papers on Economic Activity, 1/1984, p. 115.