Policy Analysis

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Executive Summary

From Capitol Hill, Wall Street, the Great Plains, and Silicon Valley have come proposals to abandon the multilateral trading system and begin managing trade from Washington.(1) A move toward managed trade--substituting government intervention and market-share goals for market forces and multilateral rules--would represent a change in policy for the United States, which since the end of World War II has been a leading advocate of liberalizing international trade.

Advocates of managed trade often refer to it as "strategic trade" and "industrial policy" in an attempt to create the impression that adopting such a policy would be wise. American public opinion is being swayed by that rhetoric. A survey by the American Insight Group found that well-educated, high-income Americans, who have traditionally been the most receptive to free trade and foreign investment, are beginning to favor an aggressive U.S. trade policy, especially toward Japan.(2)

Moreover, as Jeff Faux, president of the Economic Policy Institute, a liberal think tank, noted, the U.S. government's progression toward an industrial policy "is probably going at a faster pace than it would have had [Michael] Dukakis been elected."(3) The government has already approved subsidies for manufacturers of semiconductors and high-definition television, and Congress and the Commerce Department have forced renegotiation of the FSX fighter deal with Japan.

The argument that the United States should adopt managed trade always involves Japan and frequently boils down to no more than the following: Japan, which manages trade, is doing very well economically, so managed trade must work. The advocates of managed trade overlook Japan's high savings rate, long work week, low illiteracy rate, and relatively modest government spending. In addition, they ignore the many countries, including most of the Eastern bloc, whose economies have been strangled by central planning.

We should be wary of jumping to the conclusion that Japan's economic successes have been the result of managed trade and its powerful proponent, the Ministry of International Trade and Industry. Although some industries supported by MITI, such as semiconductors, have succeeded, other MITI projects have failed. For example, the aluminum-smelting industry, which MITI nurtured, has practically disappeared from Japan.(4) In addition, some of Japan's greatest commercial successes are firms that entered new markets even though MITI tried to hold them back.(5) Honda and Sony are good examples. It is therefore not clear whether Japan's economic miracle occurred as a result of MITI, as some in the United States believe, or in spite of MITI, as some in Japan believe.

Even if we concede that MITI has generally been successful in promoting Japanese industries, it does not follow that the United States should adopt similar policies. Only if we believe that such policies would promote our national interest should we adopt managed trade. If managed trade is to be an effective policy for the United States, it must not become another income-support program for politically well organized protection-seeking interests. In light of the debate surrounding extension of the voluntary restraint agreements on steel, which were more a matter of politics than of economics, it seems unlikely that the United States would avoid that trap. Managed trade, in whatever guise, would probably do more harm than good.

Trade Imbalances

Many of the calls for managed trade are motivated by concern with the U.S. trade deficit, which was $114.9 billion in 1989. The largest U.S. bilateral deficit in that year was $49.8 billion with Japan. Not surprisingly, Japan is the object of most proposals for managed trade.

Americans tend to associate bilateral trade deficits with unfair trade practices, but in a multilateral trading system, there is no reason for bilateral trade figures to zero out. Why should the United States' demand for imported automobiles and shoes exactly equal South Korea's demand for imported hides and aircraft?

The authors have run deficits with their local grocery store for many years. They have been able to maintain a trade relationship with Giant Food by paying their grocery bills with money, not legal services. Giant Food, in turn, runs much larger deficits in its trade relationships with its suppliers, such as Paul Newman and Frank Perdue. The same principle applies to countries; there is no reason for bilateral trade flows to be equal.

Another widespread belief--typically manifested in rhetoric about "level playing fields"--is that the United States is experiencing bilateral trade deficits because its markets are open to foreign competition whereas other countries' markets are closed to U.S. competition. However, the evidence of both the openness of our markets and the protection of foreign markets is ambiguous. For example, the average tariff rate on Japanese imports is comparable to the average tariff rate on U.S. imports.(6) Moreover, the value of U.S. exports to Japan increased rapidly in the 1980s. The growing bilateral trade deficit with Japan is a result of an even more rapid increase in the value of imports from Japan.(7)

A recent Federal Trade Commission study concludes that the United States has completely reversed the progress toward multilateral free trade that had been made since World War II. As a result of the proliferation of nontariff barriers to trade, which include quotas such as those on steel and textiles, the U.S. economy is less open today that it was in 1946.(8)

The U.S. trade deficit is the result of macroeconomic conditions and policies, not unfair trade practices. The low U.S. savings rate and America's recent tendency to spend more than it earns have produced a large influx of capital, a correspondingly large trade deficit, and a number of bilateral trade deficits.

Policy Proposals

In recent years there have been several proposals for cutting the trade deficit with Japan, all of which are based on the erroneous assumption that a bilateral trade deficit is a serious problem.

Advisory Committee Recommendation

The Advisory Committee for Trade Policy and Negotiations, originally established by the Trade Act of 1974, composed primarily of CEOs of large corporations, and chaired by James D. Robinson III of American Express, recognized the important role macroeconomic policies play in the U.S. trade deficit with Japan but nonetheless recommended a variation on the theme of managed trade.(9) The advisory committee recommended that U.S. negotiators calculate what U.S. market shares would be in competitive, barrier-free markets and then push the Japanese to implement policies that would produce those market shares. Although the advisory committee's recommendation is only for trade with Japan, it could be applied to other countries.

For the advisory committee's approach to work, the U.S. government would have to be able to estimate market shares with reasonable accuracy. Although it might be possible to compare the production costs of simple commodities, such as wheat, and then make intelligent estimates of market shares in competitive, barrier-free markets, conducting such an exercise for differentiated products and more complicated market structures would be far more difficult. No one knows how to estimate the competitive market shares for such industries as telecommunications and semiconductors. Given the inexactness of such estimates, substantial disagreement over "appropriate" market shares would probably arise.

Implementing the advisory committee's approach might well cause even more suspicion and hostility than we now face. That risk would be greatly increased by the possibility that the negotiating agencies would be captured by exporting firms seeking larger and larger foreign market shares, regardless of economic efficiency. If the advisory committee's recommendation were implemented, export firms would have the same strong incentives to spend time and money guaranteeing export shares that import competing firms already have to lobby the government to protect and expand their domestic market shares. Moreover, the United States would probably generate less hostility by limiting foreign exporters' U.S. market shares than it would by imposing U.S. exports on other countries. The latter policy would force them to confront the results of America's political bullying daily.

Enforcing market shares would also be a problem. Although MITI, for example, has a great deal of influence in Japan, it cannot force Japanese companies to buy U.S. semiconductors. To enforce a U.S. share in the Japanese semiconductor market of, say, 20 percent, without buying the semiconductors itself, MITI would have to be able to compel Japanese companies to buy U.S. semiconductors. The Japanese government could only accomplish that if the Japanese economy were centrally planned-- the same type of planning that ruined the economies of the Eastern bloc countries. Such a solution would certainly reduce Japan's trade surplus to the United States, but it would also have many undesirable consequences for Japan and the rest of the world.

Even if the market-share targets were met, they would not be met by expanding trade. Foreign countries, responding to U.S. pressure, would probably redirect their purchases from more efficient but politically less powerful suppliers to suppliers backed by the political clout of the U.S. government. In the words of Jagdish Bhagwati, a professor of economics at Columbia University, that would produce "a world economy in which the politically powerful nations would expand their exports to weaker nations at the expense of less powerful but more efficient rivals. The overwhelmingly likely outcome then would be a proliferation of voluntary import expansions-- discriminatory, quantitative commitments by specific countries to increase imports from the United States."(10) Such trade would be neither free nor fair.

The Kissinger/Vance Proposal

Another version of managed trade was proposed by former secretaries of state Henry Kissinger and Cyrus Vance. Their proposal, which, like the advisory committee's, was aimed at Japan but could be applied to other countries, calls for the United States and Japan to establish an overall trade balance with which both countries are comfortable. To achieve that balance, Japan would be permitted to choose which exports to reduce, which imports to increase, and the amount of reduction or increase.(11)

Just as war has been called too important to be left to generals, the Kissinger/Vance proposal suggests that trade is too important to be left to secretaries of state. The proposal is at first glance an appealing diplomatic solution because it allows maximum flexibility to be used to achieve a desired result. However, Japan would be very unlikely to open its market to U.S. exports. Instead, Japan would restrict exports, raise prices, and blame the United States for the results.

The Kissinger/Vance proposal would be a reprise, on a broader scale, of Japan's voluntary export restraints on automobiles. As a result of those restraints, which were implemented in the spring of 1981 in response to U.S. pressure, Japan sold fewer cars in the United States, but the cars it did sell were generally more luxurious models, loaded with options, that carried substantially greater markups.(12) Export restraints can cost U.S. consumers plenty.(13)

The Kissinger/Vance proposal would permit Japan to limit exports to the United States in precisely those areas in which Japanese firms can earn the greatest monopoly profits and thus harm U.S. consumers the most. The Federal Trade Commission, the Department of Justice, and a number of state agencies enforce antitrust laws. They devote substantial resources to detecting domestic monopolies and cartels and preventing their formation. Yet the Kissinger/Vance proposal would encourage foreign producers to act as monopolists in the U.S. market.

The Baucus Proposal

Sen. Max Baucus (D-Mont.) introduced a bill (S. 292) in January 1989 that called for the president to negotiate sectoral agreements, similar to the 1986 Semiconductor Arrangement with Japan. The Semiconductor Arrangement has resulted in higher U.S. prices for semiconductors and increased U.S. employment in their production, as its proponents hoped it would. However, an unintended but foreseeable result of raising the U.S. price of semiconductors was to reduce employment in the larger computer and computer workstation industry.(14)

The Semiconductor Arrangement has also hurt U.S. competitiveness in the computer industry. Many Japanese semiconductor producers also make computers; the Semiconductor Arrangement did not force those integrated producers to raise their internal prices for semiconductors. Because many Japanese computer manufacturers were able to buy semiconductors for less than their U.S. competitors could, the Semiconductor Arrangement made it possible for Japan to compete more effectively in the computer market, which had traditionally been dominated by U.S. firms.(15) The Semiconductor Arrangement is hardly a model for U.S. trade policy.

The Key Sectors Approach

Another argument for managed trade is based on the assumption that there are "key sectors" of the economy that are supposed to have linkages with other sectors. Loss of key sectors is supposed to produce a ripple effect, as related sectors contract and shrivel up. Conversely, when key sectors are nurtured and permitted to grow, they allegedly create benefits throughout the economy, as related sectors grow. The decline of certain elements of the U.S. electronics industry, especially televisions, VCRs, and semiconductors, is usually cited in support of the key sectors theory.(16)

Perhaps the best known argument for the existence of key sectors comes from the "deindustrialization" or "manufacturing matters" school of thought once made popular in Great Britain by the economist Nicholas Kaldor and now espoused by two modern Americans, Stephen Cohen and John Zysman of the Berkeley Roundtable on International Economy. As the title of their book, Manufacturing Matters: The Myth of the Post-Industrial Economy,(17) suggests, Cohen and Zysman consider manufacturing a key sector.

The basis for their argument is that there are linkages between manufacturing and the rest of the economy. According to Cohen and Zysman, because of those linkages, it is unlikely that the United States can move from a manufacturing to a service economy, as some have argued.(18) They believe the United States needs to maintain a strong manufacturing sector if it is going to develop a strong services sector. Cohen and Zysman argue that the United States is deindustrializing, which they claim presents a serious threat to our economic well-being. They recommend that the United States adopt a policy of managed trade to foster reindustrialization.

There are two major problems with Cohen and Zysman's argument. First, it is not clear that U.S. manufacturing is in trouble. Productivity growth in manufacturing was very high in the 1980s,(19) and as Robert Lawrence has shown, manufacturing's share of the U.S. gross national product has remained roughly constant for several decades.(20) Faced with those conclusions, Cohen and Zysman look for other evidence to support their case that manufacturing is declining.(21) Their reluctance to support their assertions with statistical tests and consistent economic analysis led Bhagwati to conclude that "manufacturing may indeed be in trouble in the U.S.; but the authors do not provide a plausible analysis as to how and why."(22)

Second, the existence of linkages between various sectors does not imply the existence of external benefits to other industries, which economists call externalities. As noted below, the existence of externalities provides at least a theoretical basis for managed trade. The existence of linkages that are not externalities does not.

The New International Economics

Avinash Dixit, Jonathan Eaton, Gene Grossman, and Paul Krugman are among the economists who have begun to integrate the fields of international economics and industrial organization. They start not from the pure competition view of markets found in classical economic theory but from the imperfect competition models of modern industrial organization. Under such market conditions, managed trade can be justified as an instrument of national policy because of "profit shifting." Managed trade allows a nation to increase its national income by shifting profits, or in economic jargon "rents,"(23) from the oligopolistic industries of other countries to itself through the use of such instruments of managed-trade policy as government subsidies.

There is, however, a big step between theory and policy. It is one thing to conclude in theory that a policy of managed trade could benefit the nation. It is a very different thing to conclude that a particular policy for a particular industry would benefit the nation. Krugman has identified four major questions that must be satisfactorily answered in order to justify the use of managed trade in any particular instance.(24)

Can Key Sectors Be Identified?

The first question is whether key sectors can be identified. That would be a difficult enough question to answer ex post; given the current state of knowledge, it may be impossible to answer ex ante. Economists have suggested two criteria for determining whether a sector is key: the existence of rents, which are likely to take the form of unusually high returns on capital or labor, and the existence of positive externalities. Both criteria are related to raising national income, or increasing the size of the "economic pie."(25) A sector that meets either of those criteria is a key sector.

Rents. In testing for the existence of rents, one cannot simply look for high wages. Wage differences in an industry can reflect a host of factors unrelated to rents. Workers who are paid more because they are highly skilled or endure harsh working conditions, for example, are not earning rents.(26)

One cannot concentrate on the winners and ignore the losers when testing for the existence of rents. What appears to be an exceptionally high profit from an earlier investment in research and development might well be a normal rate of return on a risky investment. Although some investments in R&D produce tremendous returns, many large investments yield nothing. Firms will invest in R&D only if the returns on products that succeed are large enough to cover the losses on products that fail. Therefore returns to an industry from R&D can be assessed only by considering the failures as well as the successes. Only industries that are earning abnormally high profits after the risk of failure is taken into account are earning rents.(27)

Simple luck is a related problem. Because of shifting demand, technological developments, or political events, the capital and workers that are already in certain industries may earn unusually high rates of return. Such windfalls, however, do not accrue to new entrants. There is thus no reason to use government policy to encourage entry into such sectors.(28)

Even if industries in which capital and labor have historically earned abnormally high returns could be identified, a policy of managed trade would not necessarily be warranted. If a policy is to encourage R&D in certain sectors, the sectors must be identified in time for effective government action to be taken, usually before their products reach the market. That is likely to be more complicated than identifying such sectors after the fact.

Externalities. Not all linkages imply positive externalities. Externalities are found only in linkages in which there are no established property rights and thus no market prices. It is frequently argued that much technological and business information is an externality because firms in one industry benefit from knowledge generated in other industries without paying for it.(29)

For example, advocates of federal support for high-definition television assert that subsidizing development of a domestic HDTV industry would have large spillover effects on the domestic electronics industry, especially on semiconductor and computer producers. However, determining whether such effects are externalities is difficult because externalities, by their nature, do not produce a paper trail for economic investigators. There have been a few historical studies of externalities, but predictive studies are needed to inform trade policy.

Is There a Policy Instrument?

The second question that policymakers should address when deciding whether to adopt a policy of managed trade is whether there is a policy instrument that could promote the desired goals. The real problem here is insufficient knowledge. For policymakers to encourage key sectors, they must be able to predict the results of their policies, which often depend on the nature of competition within an industry. For most industries for which managed-trade policies have been recommended, the relevant markets cannot be characterized as "perfectly competitive." Those industries do not operate with many small producers who make identical products. Product differentiation and learning curve effects complicate matters, and of course, the effects of government intervention are much more difficult to predict with complex market structures than with simple ones. Many economists find making such predictions so daunting that they are unwilling to experiment, at least for the present.(30)

Would Decisions Be Made Properly?

The third question is whether policymakers would be able to make the correct and sometimes tough decisions by acting on the basis of economic evidence, not politics. As the above discussion indicates, identifying key sectors is difficult. In part, the difficulty reflects the current state of economic knowledge, both theoretical and empirical. Although further research is likely to increase our understanding of complex international market structures, identifying key sectors and formulating appropriate polices are likely to be extremely difficult tasks for a very long time. Whether the federal government could perform those tasks competently is therefore an important consideration.

Industries that stand to benefit directly from managed-trade policies, which usually entail protection from imports or government subsidies, are likely to advocate them even if they would not benefit the nation as a whole. Policymakers would have to be on the lookout for industries that invoked the economists' argument that a policy of managed trade can have legitimate uses in an attempt to justify income-support policies for their own benefit. Robert Lawrence of the Brookings Institution described the possibility of political considerations swamping economic ones:

> Managed trade is simply a bad idea. It replaces competition among firms with competition among bureaucrats. The division of powers in the U.S. political system is particularly ill-suited to managing the details of the economy. In the United States any attempt to divide up the pie would not be based on strategic economic and trade criteria. Rather, it would be based on political trade-offs that would reflect lobbying skills and masquerade under the rubric of fair shares.(31)

How Would Other Countries Respond?

The fourth question that must be asked is how other governments would respond if the United States adopted managed trade. Some believe that the adoption of an aggressive and across-the-board policy of managed trade would increase our nation's credibility in trade negotiations. Others believe that retaliation and a breakdown of the multilateral trading system would result.

More narrowly, before the government embraces any particular managed-trade policy it must consider the response of its trading partners. The mere existence of a policy instrument that could promote the desired economic goal of capturing rents or overcoming market failure from positive externalities does not mean that the policy would be effective if our trading partners responded by adopting a policy of managed trade in favor of their domestic producers. Those possible responses have to be considered even if we are indifferent to the effect of any initiative on our trading partners. Depending on the response, we may be worse off if we engage in managed trade than if we refrain from doing so. The possibility that other countries will react to any managed-trade policy we adopt complicates the task of assessing the impact of such a policy.

Difficulties

The difficulties associated with a policy of managed trade have been illustrated by the current debate over the government's role in the development of HDTV. HDTV is the term for a broad range of computer and television technologies that will produce sharper pictures on a wider-than-normal television screen.(32) Supporters of government intervention argue that there would be substantial spillovers (externalities) to other parts of the electronics industry, especially to the semiconductor and computer industries, from the development of HDTV. The proponents of that view include the U.S. Department of Commerce and the American Electronics Association, which has proposed a $1.35 billion program of federal support for HDTV.

Advocates of supporting HDTV argue that it will be a technology driver. Although it is easy to assert that there will be all kinds of benefits from the development of HDTV, it is more difficult to support those assertions. As a recent draft report of the Congressional Budget Office makes clear, there are some good reasons to doubt the claims that have been made.

HDTV is unlikely to constitute a very large part of the electronics industry, which makes it doubtful that its spill-overs will be large in comparison with those of other parts of the electronics industry. In addition, although HDTV would contain many high-technology components, those technologies have other uses, so it is unclear what role consumer electronics would play in their development. Moreover, given the globalization of manufacturing, it is far from certain that domestic production of HDTV would substantially increase the demand for domestic semiconductor production. U.S. firms could dominate the HDTV market and still buy their semiconductors abroad.(33) The Congressional Budget Office concludes that "it is unlikely that HDTV will play a pivotal role in the competitiveness and technology development of the [electronics] sector as a whole."(34)

Thomas Gale Moore, a senior fellow at the Hoover Institution and a former member of the President's Council of Economic Advisers, pointed out that because HDTV receivers will be large, they almost certainly will be assembled in the United States. However, regardless of the nationality of the owner of the U.S. assembler, whether U.S. or foreign semiconductors will be used will depend on the price and quality of the chips. Moore also warned that artificially fostering the HDTV industry would divert scarce and valuable engineering resources from the computer industry, in which U.S. firms are dominant.(35)

Thus, a convincing case for an interventionist trade policy has yet to be made; advocates of such a policy have yet to address the many difficulties it would entail.

New Argument against Managed Trade

The new international economics has produced not only a new argument for managed trade but a new counterargument as well. The premise of both arguments is that many markets are characterized by imperfectly competitive behavior. Imperfectly competitive behavior implies that there are new gains, above and beyond the normal ones found in perfectly competitive markets, that can be realized from freer trade. Those gains are of three kinds.

Freer trade can reduce price distortions faced by consumers by increasing the overall level of competition in a domestic economy. Oligopolistic firms (firms operating in industries with only a handful of competitors) may limit their output in an effort to raise prices artificially and increase their profits. Such practices obviously reduce the well-being of consumers and the nation as a whole.(36) The most powerful antidote to undesirable oligopolistic behavior is the entry or potential entry of additional competitors, and foreign competition benefits U.S. consumers just as surely as new domestic competition would.

Freer trade can also eliminate the wasteful duplication of firms' producing on too small a scale, which because of fixed costs have inefficiently high average costs. The anti-competitive pricing of oligopolistic domestic firms encourages new entry. If foreign competition is restricted, the new entrants will be domestic firms. Devoting the economy's resources to such high-cost production is inefficient. To the extent that new entry imposes otherwise avoidable production costs, there is a loss to the domestic economy. By reducing the market price, freer trade can discourage inefficient entry by domestic firms.

Finally, freer trade can reduce the rents realized by foreign firms.(37) Restricting trade can lead to foreign producers' forming cartels that charge oligopolistic prices in the United States. Because profits, or rents, are transferred outside the United States, foreign cartels are even worse than domestic ones. Freer trade in the form of increased foreign competition can reduce the rents that accrue to foreign firms.

The additional benefits from free trade are not just theoretical; they have empirical support. A recent survey of the empirical literature by J. David Richardson of the University of Wisconsin concludes that freer trade creates sizable increases in an economy's real income. According to Richardson, trade liberalization produces substantial gains in real income because it rationalizes industrial structure and reduces noncompetitive pricing. Cases in which trade liberalization reduces national income appear to be rare. It thus appears that the gains to be derived from trade liberalization are even greater in the new environment than they were in the classic environment.(38)

It is commonly thought that the existence of imperfectly competitive markets strengthens the case for intervention and weakens the case for free trade. As the new counterargument demonstrates, the benefits from free trade are even larger with imperfectly competitive markets. Thus, although a theoretical argument for a managed-trade policy can still be made, the practical argument for free trade is stronger.

Conclusion

In theory, managed trade would entail government intervention only when it would be beneficial. In practice, however, policymakers would find it difficult to remain independent and base their decisions on economic considerations alone. They would also find it difficult, if not impossible, to know when federal government intervention was in the interest of the nation, not just the affected industry, and what form intervention should take. Krugman summarizes the argument for rejecting managed trade:

> If the potential gains from interventionist trade policies were large, it would be hard to argue against making some effort to realize these gains. The thrust of the critique offered above, however, is that the gains from intervention are limited by uncertainty about appropriate policies, by entry that dissipates the gains, and by the general equilibrium effects that insure that promoting one sector diverts resources from others. The combination of these factors limits the potential benefits of sophisticated interventionism. Once the expected gains from intervention have been whittled down sufficiently, political economy can be invoked as a reason to forgo intervention altogether. Free trade can serve as a focal point on which countries can agree to avoid trade wars. It can also serve as a simple principle with which to resist pressures of special-interest politics. To abandon the free-trade principle in pursuit of the gains from sophisticated intervention could therefore 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 nevertheless the right policy. In fact, this is the position taken by most of the new trade theorists themselves. So free trade is not passe--but it is not what it once was.(39)

Even the most well intentioned government intervention can wreak havoc on downstream industries and consumers, as illustrated by the parable of the skunks and the snapping turtles.(40) The story chronicles New Hampshire's efforts to "assist" tourism and fishing, two of the state's largest industries. When local merchants complained that tourists and fishermen were traveling to Maine and Vermont to avoid New Hampshire's skunks, the state government undertook an aggressive skunk eradication program. An increasing number of fishermen and tourists visited the fragrant shores of New Hampshire's many lakes and rivers, and local merchants were delighted.

Two years went by, and a rumor began to spread: the fish had stopped biting in New Hampshire. The next summer was a disaster for the fishing industry; the fish population was badly depleted. Once again fishermen and tourists took their gear and their business to neighboring states.

What had gone wrong was that there were fewer skunks, the natural enemy of snapping turtles, to eat snapping turtle eggs. The snapping turtle population had surged, and the turtles were busily eating fish eggs. To make a long story short, New Hampshire had to import a large number of skunks. For several years New Hampshire imported and exported both skunks and snapping turtles in an attempt to find the optimal mix.

Managing trade is at least as difficult as managing wildlife. Tinkering with either will always have unintended consequences. Policymakers would thus be wise to recognize that Mother Nature and the Invisible Hand make better managers than do government officials.

Notes

(1) For a short but convincing defense of the multilateral trading system, known as the General Agreement on Tariffs

and Trade (GATT), from which the United States has benefited greatly, see Jagdish Bhagwati, "Let GATT Live," Wall Street Journal, July 28, 1989, p. A10.

(2) American Insight Group, Survey and Report 1989, no. 1 (Cambridge, Mass.: AIG, 1989), p. ii.

(3) Quoted in Paul Blustein and Evelyn Richards, "If It Looks Like a Duck and Walks Like a Duck," Washington Post, May 7, 1989, p. A1.

(4) Carla Rapoport, "Great Japanese Mistakes," Fortune, February 13, 1989, p. 108.

(5) See George Melloan, "Big Business Sometimes Needs a Compass Adjustment," Wall Street Journal, April 11, 1989, p. A23, and Katsuro Sokoh, "Japanese Economic Success: Industrial Policy or Free Market?" Cato Journal 4 (Fall 1984): 521-43.

(6) C. Fred Bergsken and William R. Cline, The United States- Japan Economic Problem (Washington, D.C.: Institute for International Economics, 1987), pp. 54-56.

(7) Between 1980 and 1987 U.S. exports to Japan increased by 33 percent, from $21 billion to $28 billion, and total U.S. exports grew by less than 12 percent. Over the same period, U.S. imports from Japan jumped more than 170 percent. See Economic Report of the President, 1989, Table B-104.

(8) David Tarr, "A General Equilibrium Analysis of the Welfare and Employment Effects of U.S. Quotas on Textiles, Autos, and Steel," Bureau of Economics staff report to the Federal Trade Commission, February 1989.

(9) Advisory Committee for Trade Policy and Negotiation, Analysis of the U.S.-Japan Trade Problem, February 1989.

(10) Jagdish Bhagwati, Protectionism (Cambridge, Mass.: MIT Press, 1988), p. 125. This tiny book is crammed with common sense about international trade.

(11) Henry Kissinger and Cyrus Vance, "Bipartisan Objectives for American Foreign Policy," Foreign Affairs 66, no. 5 (Summer 1988):899-921. The Kissinger/Vance proposal was advocated by the labor representatives on the advisory committee in their dissenting opinion. Advisory committee report, pp. xxii-xxiii.

(12) Arthur Denzau, "Made in America: The 1981 Japanese Automobile Cartel," Center for the Study of American Business formal publication no. 76, August 1986, p. 10.

(13) Robert Crandall, "Import Quotas and the Automobile Industry: The Cost of Protectionism," Brookings Review (Summer 1984): 13.

(14) Arthur Denzau, "Trade Protection Comes to Silicon Valley," Center for the Study of American Business formal publication no. 86, August 1988, pp. 3-6.

(15) Ibid., pp. 6-7.

(16) See, for example, Labor-Industry Coalition for International Trade, White Paper on International Trade, June 1986, p. 10. Television is frequently included on the list of declining elements of the U.S. electronics industry because there is only one U.S.-owned television maker, Zenith. However, 20 companies manufacture color television receivers in the United States. Thomas Gale Moore, "The Promise of High-Definition Television: The Hype and the Reality," Cato Institute Policy Analysis no. 123, August 30, 1989, pp. 8-9.

(17) Stephen Cohen and John Zysman, Manufacturing Matters: The Myth of the Post-Industrial Economy (New York: Basic Books, 1987).

(18) That view was taken in a 1984 report by the New York Stock Exchange, "U.S. International Competitiveness: Perception and Reality," cited in Cohen and Zysman, p. 5.

(19) Value added per hour paid, a measure of productivity, grew at 4.7 percent a year from 1981 through 1987, roughly one and one-half times the postwar average and more than three times the rate from 1973 through 1981. For comparison, private business sector productivity grew at an annual rate of 1.7 percent from 1981 through 1987. Economic Report of the President, 1989, p. 57.

(20) Robert Lawrence, Can America Compete? (Washington, D.C.: Brookings Institution, 1984), pp. 18-20.

(21) Cohen and Zysman, pp. 59-76.

(22) Jagdish Bhagwati, "Review of Cohen and Zysman, Manufacturing Matters," Journal of Economic Literature 27, no. 1 (March 1989): 122.

(23) Rent is a wage received by workers or a return on capital above the resource's opportunity cost in other pursuits. Rents are beneficial to the domestic economy because they increase the nation's control over goods and services.

(24) Paul Krugman, "Introduction: New Thinking about Trade Policy," in Strategic Trade Policy and the New International Economics, ed. Paul Krugman (Cambridge, Mass.: MIT Press, 1986), pp. 1-22.

(25) If the purpose of a policy is to redistribute income or accomplish some other end, such as promoting national security or prestige, even at the cost of reducing income, its justification is entirely different and noneconomic.

(26) It should be noted that the FTC staff report found no support for the argument that protection of high-wage industries increases the average wage in the economy. In fact, the report found a small decrease in the average wage. Tarr, p. 4.

(27) Gene Grossman, "Strategic Export Promotion," in Strategic Trade Policy, pp. 47-68.

(28) For example, the owners of oil reserves experience a windfall when the price of oil rises. New entrants who choose to search for oil in response to higher prices, however, will earn, on average, only a competitive rate of return. In general, because the price mechanism signals additional competitors to enter an industry when prices rise, there is no need for the government to encourage even more entry.

(29) Simple linkages, such as the use of semiconductors to build computers, do not imply externalities. Because a supplying industry can capture in profits the benefits of its production to downstream users, there is no reason to expect underinvestment in the upstream industry. See Lawrence, Can America Compete? p. 99.

(30) Bhagwati, Protectionism, pp. 105-10.

(31) Robert Lawrence, "Lure of Trade Management," Financial Times, March 9, 1989, p. 22. Anyone who believes the United States should follow a managed-trade policy should ask if there is a consensus in the United States in favor of sacrificing self-interest to strategic considerations, or if the more likely result is that the politically powerful will get the benefits of managed trade, regardless of the merits.

(32) The current U.S. television technology uses 525 lines and has a 4:3 ratio of width to height. HDTV generally refers to any television technology with over 1,000 lines and at least a 5:3 ratio of width to height. According to some estimates, an HDTV receiver will require a memory with associated semiconductors 30 times more powerful than that found in today's personal computers. Moore, p. 1.

(33) Congressional Budget Office, "The Scope of the High- Definition Television Market and Its Implications for Competitiveness," staff working paper, July 1989.

(34) Congressional Budget Office, p. 1.

(35) Moore, p. 12.

(36) The injury to the nation is measured by the standard dead weight loss, which is directly proportional to the degree

that market price exceeds marginal cost.

(37) J. David Richardson, "Empirical Research on Trade Liberalization with Imperfect Competition: A Survey," OECD Economic Studies no. 12 (Spring 1989): 11-15.

(38) Richardson, p. 18.

(39) Paul Krugman, "Is Free Trade Passe?" Journal of Economic Perspectives 1, no. 2 (Fall 1987): 131-44.

(40) Susan Liebeler, "Trade with Pacific Rim Nations: What to Expect in 1989," Foreign Trade Association of Southern California, April 20, 1989, reprinted in "Notable and Quotable," Wall Street Journal, May 2, 1989, p. A14.