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Preface

Prior to joining Florida International University in January 1993, J. Antonio Villamil spent four years in Washington, DC, serving first as chief economist of the US Department of Commerce and then as undersecretary for economic affairs. He has more than 20 years of experience as an economist in both the private and public sectors, specializing in international trade issues and economic development. He was senior vice president and chief economist of Southeast Banking Corporation in Miami. He has also served as senior economist of the Crocker National Bank, the Continental Illinois National Bank of Chicago, and the US Treasury Department.

Dr. Villamil has published articles in the *Journal of Inter-American Studies and World Affairs*, the *Review of Research in Banking and Finance*, *Euromoney*, *Hemisphere*, *Florida Trend*, and the *Banker*. He has also written a chapter on country risk assessment in the *International Banking Handbook*.

He is a member of the policy panel of the National Association of Business Economists and of the board of directors of the Dade County Economic Forum. He also serves as outside director of Republic National Bank of Miami.

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Issues in the Formulation of US Trade Policy in the 1990s

by J. Antonio Villamil

The purpose of this lecture is to identify and provide an overview of principal issues in the formulation of US trade policy in the 1990s. Subsequent lectures will amplify each of these issues through more rigorous research.

Background: US Trade Policy in a State of Flux

Since the end of World War II, the United States has been a leading force in liberalizing world trade and investment through successful rounds of the General Agreement on Tariff and Trade (GATT). US trade policy objectives have been both political and economic.

Political objectives, such as increased world trade and prosperity to "contain" Soviet expansionism and to promote political pluralism in developing nations, have been key factors in the formulation of US trade policy.[1] To a significant extent, therefore, US trade policy formulation has been an integral part of broader US foreign policy objectives. It is no coincidence, for example, that the Foreign Commercial Service of the United States was an organizational unit of the State Department until the 1980s. While it has now been transferred to the Commerce Department, the State Department continues to play a principal role in the formulation of US trade policy through the Office of the Undersecretary for Economic Affairs.

Economic objectives in trade policy formulation slowly gained ascendancy in the past decade as the United States became increasingly integrated into the world economy. US

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[1]See, for example, the Twentieth Century Task Force, *The Free Trade Debate* (New York: Priority Press, 1989).

statistics (adjusted for price changes) show that during the 1980s, while the Gross National Product (GNP) rose 30 percent, total trade in goods and services increased 72 percent and total foreign capital flows rose 60 percent.[2]

The growing interdependence of US economic activity with the rest of the world presents a significant challenge to the formulation of US trade policy. Macroeconomic disturbances, market and trade distortions in main trading partners, and the internationalization of production due to the growth of transnational enterprises have an increasing impact on US economic activity through the functioning of efficient global capital markets and growing international trade flows.

In addition, the birth of political pluralism in the former Soviet Union, and in most of Central and Eastern Europe, has reinforced the importance of economic factors in the formulation of US trade policy. According to the International Monetary Fund, the principal objectives of US trade policy in recent years have been the following:[3]

- to strengthen the multilateral trade system by completing the Uruguay Round of the GATT;
- to open foreign markets to US goods, services, and investment; and
- to promote free and "fair" trade.

While these objectives, if achieved, would clearly improve the efficiency of world markets, they lack a clearly defined goal that links the formulation of trade policy to improvements in the nation's standard of living. There is also an absence of a systemic approach to the formulation of US trade policy that would combine macroeconomic policy, competition policy, and international market opening measures in a cohesive framework.

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[2]National Research Council, *Behind the Numbers: U.S. Trade in the World Economy* (Washington, DC: National Academy of Sciences Press, 1992), 21.

[3]International Monetary Fund, *Issues and Developments in U.S. Trade Policy* (Washington, DC: IMF Press), 21.

Another key issue is the increasing fractionalization of the institutional process for formulating trade policy among principal actors such as the executive branch, Congress, states, and localities.

An assessment of these issues will be presented in this paper with the aim of providing fertile ground for dialogue and additional research. The following quotations provide a brief example of the confused nature of the current US trade policy debate:

- "We should aim by 1995 to eliminate the deficit in our global trade in goods and services and hence halt the need to borrow abroad with consequent further buildup in the nation's foreign debt."[4]
- "The members of the Task Force who have signed this report believe that the United States should adopt the goal of attaining a trade surplus by 1993."[5]
- "The ultimate objectives of monetary and fiscal policy are economic growth and raising living standards, not exchange rate stability or current account balance per se."[6]
- "US and Japanese officials meet to discuss trade issues...Japan's trade surplus with the United States has soared to about $44 billion, creating pressure on Washington to take a tougher stand toward Tokyo."[7]

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[4]Competitiveness Policy Council, *First Annual Report to Congress* (Washington, DC: International Economics Institute, March 1992), 25.

[5]Twentieth Century Task Force, 34.

[6]Council of Economic Advisers, *1990 Economic Report of the President* (Washington, DC: US Government Printing Office, 1990), 97.

[7]*The Miami Herald*, Business Section, 13 February 1993, 3C.

Recent US Trade Policies and the Nation's Standard of Living

The recent trade policy debate in Washington has been overly concentrated on the need to promote exports and decrease the trade deficit on goods and services as a sine qua non for improving the nation's economic performance. A recent White House brief on US trade policy and international competitiveness states that:

> The strong increase in merchandise exports between 1983 and 1990 contributed to a steadily rising proportion of US economic growth. Indeed, from 1986 to 1990, US merchandise exports accounted for 41 percent of the rise in real GDP, with their contribution reaching 88 percent of real GDP growth in 1990 alone.[8]

This thinking also permeates the US Congress and the general debate on the formulation and objectives of US trade policy. Numerous bills were introduced over the past years in Congress to "force" other nations to reduce their bilateral trade surplus with the United States, while many outside commentators have hailed the recent reductions in the US trade deficit as a sign of economic progress and growing US "competitiveness."

Absent from this growing debate on the aims of US trade policy is an assessment of the causal factors that determine US trade performance. These fundamental factors, such as macroeconomic policies, are the main determinants of US trade performance over time. More importantly, these factors determine changes in the nation's standard of living.

The table in the appendix entitled "Net Exports and Indicators of Standard of Living" illustrates the danger to the nation's standard of living of concentrating solely on policy measures that increase exports and decrease the trade deficit. There appears to be little statistical relationship between improvements in our trade deficit and objective indicators of the standard of living such as economic growth, the unemployment rate, and price adjusted changes in total weekly earnings in the private economy. In fact, since 1988 the US trade

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[8]The White House, *Briefing Book on U.S. Trade Policy and International Competitiveness* (Washington, DC: The White House, mimeographed, unclassified, 18 March 1992), 5.

deficit in goods and services has significantly declined while the nation's standard of living has deteriorated.

Therefore, there is an urgent need to change the trade policy debate away from "neo-mercantilistic" thinking, which overly concentrates on increasing exports and decreasing the trade deficit as the principal goals of US trade policy. Trade policy outcomes should be judged on a set of objective indicators related to the nation's standard of living. Trade policy formulation should be systematically developed with this aim, incorporating macroeconomic and competition policies to the current approach that aims solely at lowering trade distorting practices.

This aim is not only based on sound economic theory, but is a necessary condition for developing a national consensus on the importance of trade policy outcomes on the nation's standard of living. According to the report of proceedings from the US Foreign Policy Conference of the Stanley Foundation:

> Today the goal must be to develop ways to define objectives that will be widely supported. As long as this critical shift in the problem set is not noted, institutional reforms will have only marginal effects on the ability of the United States to play a leading role in the birth of a secure and prosperous global system.[9]

The formulation of US trade policy with the stated goal of improving the nation's standard of living is not a *sufficient* condition for successful policy outcomes. Current US trade policy suffers from an incoherent approach to policy formulation. The problem is both conceptual and institutional in nature. I will amplify on these two issues in the following sections of the lecture.

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[9]The Stanley Foundation, *Global Changes and Institutional Transformation: Restructuring the Foreign Policymaking Process* (Muscatine, Iowa: The Stanley Foundation, October 1992), 12.

A Systems Approach to the Formulation of US Trade Policy

A systems approach to the formulation of US trade policy would incorporate international trade and investment issues as an integral part of the nation's overall economic policymaking process. Under this approach, the formulation of US trade policy would be linked with macroeconomic policies and competition policies with the goal of maximizing the growth potential of the economy. The objectives of international trade liberalization through multilateral, regional, and bilateral agreements would in effect become a subset of the economic policy goal of the nation to improve living standards.

At present, trade policy formulation is institutionally de-linked from the broader economic policy process. The results are, in many occasions, conflicting policies that foster efficiency through trade liberalization agreements, and macroeconomic policies that negate efficiency gains through fiscal policies that stimulate consumption while providing disincentives to save and invest. Trade policy liberalization is also conducted without an institutional framework that links the market behavior of industrial firms across national boundaries. In essence, trade liberalization agreements lack a competition policy approach that would provide consultative mechanisms to improve the competitive behavior of firms across national entities.[10]

The following diagram illustrates the various components for a systems approach to the formulation of US trade policy.

[10] I would recommend that the current discussions under the Structural Impediments Initiative with Japan be incorporated as part of the formal process for trade liberalization treaties.

A Systems Approach to US Trade Policy Formulation

Goal: Maximize societal welfare through the formulation of coherent trade policies that are linked to macroeconomic and competition policies.

Macroeconomic Policies ↔	*Competition Policies* ↔	*Trade and Investment Liberalization*
US fiscal policy	Industrial organization	Multilateral agreements
US monetary policy	International rules and laws covering competitive behavior among firms	Regional agreements
International macroeconomic policy coordination	International consultative mechanisms	Bilateral agreements
		Sector specific agreements

→ *US Standard of Living** ←

*Changes in US standard of living would be measured through a set of objective indicators such as economic growth, changes in real personal income, consumer price inflation, changes in real average weekly earnings, the civilian unemployment rate, and other indicators of economic well-being.

A systems approach to the formulation of US trade policy would lead to a shift away from consideration of the trade balance as the main objective measure of trade policy.

The following table illustrates what every rigorously trained economist fully understands--that the behavior of the trade balance over time primarily depends on the gap between the desired rate of investment and saving. Microeconomic factors, such as tariff and non-tariff barriers, play a relatively minor role in the determination of the trade balance. A reduction in trade distortions are important, however, from the perspective of the standard of living by fostering efficiency gains in the allocation of scarce resources on a worldwide basis.

The statistical simulation by Hufbauer illustrates that out of the *net* $101 billion deterioration in our merchandise trade deficit between 1980 and 1988, macroeconomic explanations more than accounted for the change. Microeconomic explanations--popular with the Congress, the media, and the general public--had little impact on the rise in the trade deficit.

While the author warns that cause-effect relationships are difficult to segment in the categories presented, the exercise does have general policy implications for US trade policy. Among these implications are the following:

- Policies that would foster increases in the rate of private saving relative to desired investment is the major factor in improving the trade balance over time.
- Improvements in trade performance over time requires linking macroeconomic and microeconomic factors in the formulation of US trade policy.
- Improvements in the trade balance, per se, have little to do with changes in the standard of living. For example, according to the simulation, new Non-Tariff Measures (NTMs) by the United States against US imports had a *positive* effect on the trade balance of roughly $20 billion. The losses in consumer welfare resulting from the new NTMs, as well as the losses in productive efficiency, are not discounted from the positive figure. This is an important reason for *not* relying on the trade balance as an objective measure of the nation's standard of living.

Causes of the Worsening Merchandise Trade Deficit, 1980-88 ($ Billions)[11]

Microeconomic explanations	-$20
(1) Unfair trade practices:	
New NTMs by industrial countries against US exports	6
New NTMs by the United States against US imports	-17
(2) Lagging US technology	20
(3) Poor US product quality	6
(4) Lower petroleum prices	-35
Macroeconomic explanations	$114
(1) Dollar exchange rate:	
Rise of 40 index points between 1980 and 1985	120
Fall of 43 index points between 1985 and 1988	-110
(2) Government deficit:	
Increase in unified federal budget deficit from average of $57 billion (2.2 percent of GNP) in FY 1979 and FY 1980 to average of $153 billion (3.2 percent of GNP) in FY 1987 and FY 1988	25
(3) Private savings:	
Decrease in personal savings from 4.9 percent of GNP in 1979 and 1980 to 2.6 percent of GNP in 1987 and 1988	58
(4) Growth gap:	
Lag in ROECD growth of 1 percent per year	9
Decline in US exports to Western Hemisphere developing countries	12
Unexplained residual	$7
Actual deterioration in merchandise trade deficit between 1980 and 1988	$101

Implementation of a systems approach to the formulation of US trade policy also requires reforms in the institutional process for developing such policies. This issue will be developed in the next section.

[11]Gary Clyde Hufbauer, Background Paper in the Twentieth Century Task Force, *The Free Trade Debate*, ibid., 174.

The Current Institutional Process for Formulating US Trade Policy

The United States faces significant challenges in the institutional process for formulating US trade policy in the 1990s. At a time when major world competitors are increasingly centralizing the formulation of trade policies on a cross-country basis, the institutional process in the United States has become increasingly fractionalized.[12]

Increasing systemic tensions exist between the State Department, the Treasury, Commerce, and the White House Office of the US Trade Representative (USTR). These tensions arise not only from a narrow perspective on the constituencies that the various organizations represent, but also from the lack of an institutionalized mechanism to formulate US trade policy.

The State Department's principal mission is to further the foreign policy agenda of the United States. The Treasury's principal objective is the efficient conduct of fiscal and domestic economic policy. Commerce's mission is to stimulate the growth of US industry. The USTR, which would be an excellent mechanism for coordinating US trade policy, has become essentially a negotiating arm for US market opening initiatives. If we add the trade policy views of the Council of Economic Advisers, the Defense and Agricultural Departments, and the US Congress, an atomized and suboptimal process clearly emerges.[13] This fractionalization is likely to increase in the 1990s due to the growing role that the Environmental Protection Agency and the Labor Department are playing in trade policy. According to Stephen D. Cohen:

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[12]For example, the rise of the European Commission in Brussels where EC trade directives are formulated and the increasing coordination of policies in Asia under the ASEAN framework.

[13]For an in-depth discussion on these issues, see Stephen D. Cohen, *The Making of United States International Economic Policy* (Second Edition, Praeger Publishers, 1981).

> Organizational variants and bureaucratic behavior patterns are important, if not critical, variables in determining policy substance. US international economic policy is frequently a reflection of organizational dynamics, namely the procedures for reconciling values and goals. Individuals articulate and defend these values and goals, but there is a high correlation between the positions taken by individuals and their bureaucratic affiliation.[14]

The growing fractionalization of US trade policy is not only an issue of federal organization. States and localities are also playing an increasing role in trade promotion, in laws and regulations that impact international commerce and investment, and in the development of agendas that directly influence US foreign policy.[15] Nonetheless, this might be a positive development for legitimizing federal policies as long as mechanisms are developed for integrating state and local initiatives in the process for formulating US trade policy. Such institutionalized mechanisms are lacking at present since there is no cohesive and institutionalized framework for conducting US trade policy at the federal level.

Concluding Observations: An Agenda for Further Research

Throughout this lecture, I have presented an overview of principal issues in the formulation of US trade policy in the 1990s. A satisfactory resolution of these issues is necessary for increasing the effectiveness and legitimacy of US trade policy. I have argued that the optimal formulation of US trade policy requires:

- an overriding goal that measures successful trade policy outcomes from the perspective of improvements in the nation's standard of living;
- a cohesive framework that incorporates trade policy formulation into overall macroeconomic and microeconomic policies; and

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[14]Cohen, op. cit., 352.

[15]See, for example, an excellent article on this issue by Michael H. Shuman, "Dateline Main Street: Local Foreign Policies," *Foreign Policy* (Winter 1986-1987).

- an institutional process conducive to the efficient development and implementation of US trade policy.

Each of the three main issues discussed will form the basis for additional research. The North American Free Trade Agreement, the Uruguay Round of the GATT, and the Structural Impediments Initiative with Japan will be researched to determine if they meet the criteria we have presented. The impact of these initiatives on the State of Florida will also be assessed.

Appendix

NET EXPORTS & INDICATORS OF STANDARD OF LIVING

YEAR	Net Exports of Goods & Services[1]	SELECTED INDICATOR OF STANDARD OF LIVING: G D P Growth[2]	Change Average Weekly Earning[3] (%)	Unemployment Rate[4]
1972	- 56.5	5.1	4.1	5.6
73	- 34.1	5.2	- .0	4.9
74	- 4.1	- .6	-4.2	5.6
75	23.1	- .8	-3.0	8.5
76	- 6.4	4.9	1.5	7.7
77	- 27.8	4.5	1.2	7.1
78	- 29.9	4.8	- .0	6.1
79	- 10.6	2.5	-3.1	5.8
80	30.7	- .5	-5.8	7.1
81	22.0	1.8	-1.5	7.6
82	- 7.4	- 2.2	-1.2	9.7
83	- 56.1	3.9	2.0	9.6
84	-122.0	6.2	.8	7.5
85	-145.3	3.2	-1.3	7.2
86	-155.1	2.9	.3	7.0
87	-143.1	3.1	-1.0	6.2
88	-104.0	3.9	- .9	5.5
89	- 73.7	2.5	-1.0	5.3
90	- 51.8	.8	-1.8	5.5
91	- 21.8	-1.2	-1.5	6.7

1/ NIPA Basis, billions of 1987 dollars
2/ Percent change from preceding period, 1987 dollars
3/ Percent change from preceding period. 1982 dollars (private)
4/ Civilian rate average for the period.