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More Bilateral Trade Agreements Would be a Blunder: What the New President Should Do

Introduction

Bilateral trade agreements, unfortunately, are once more in vogue. Frustrated with protracted negotiations under the General Agreement on Tariffs and Trade ("GATT"),¹ the Reagan Administration proposed negotiating a series of bilateral trade agreements with major U.S. trading partners. Former U.S. Ambassador to Japan Mike Mansfield and former Senate Majority Leader Robert Byrd have both suggested that the U.S. and Japan should negotiate a bilateral trade treaty. Senator Baucus promotes the idea in an accompanying Article.² The recently concluded United States-Canada Free Trade Agreement³ has provided a major impetus to the advocacy of bilateral agreements, and is significant as a signal that trade liberalization is still possible and that international negotiations can still bear fruit.⁴

Proponents of bilateral accords fail to see, however, that such agreements could increase trade frictions and eventually fragment the world trade system. Beyond the unique case of Canada (and maybe Mexico sometime in the next century), further bilateral agreements are likely to produce the same disastrous effects on world trade as an overt policy of protectionism.

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1. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. (5), (6), T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT].

2. See Baucus, *A New Trade Strategy: The Case for Bilateral Agreements*, 22 CORNELL INT'L L.J. 1 (1989).

3. United States-Canada Free Trade Agreement Communication from the President, H.R. Doc. No. 100-216, 100th Cong., 2d Sess. (1988). For a comprehensive discussion of the agreement, see *International Trade—United States-Canada Free Trade Agreement*, Jan. 2, 1988, reprinted in 27 I.L.M. 293 (1988), and in 29 HARV. INT'L L.J. 572 (1988).

4. C. AHO & M. LEVINSON, *AFTER REAGAN: CONFRONTING THE CHANGED WORLD ECONOMY* 94 (1988).

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This Article advocates continued reliance on multilateralism in United States trade policy. Part I sets the political backdrop. Part II explores the key concepts of the GATT and their vital importance in world trade. Part III explains how a move toward a trade policy favoring bilateral agreements would be a deleterious move away from the GATT. Part IV explores and rejects the most talked about potential bilateral agreement—a United States-Japan accord. Finally, in Part V, this Article proposes a strategy for President Bush that includes a strong reliance on multilateralism as the cornerstone of U.S. trade policy. Such a policy should include U.S. pressure abroad to revamp and enforce the GATT and an active presidential role in forming trade policy at home.

I. The Political Backdrop

The impetus for bilateral trade agreements grows out of substantial congressional frustration with the Reagan Administration's trade policy and with its lack of progress in solving trade problems. Despite its free trade rhetoric, U.S. trade policy fundamentally changed under the Reagan Administration toward a more tit-for-tat, protectionist stance.⁵

Unprecedented trade deficits and private sector complaints spawned unprecedented administrative and legislative action on trade in the past four years. In September, 1985, after four years in which the Reagan Administration repeatedly labeled the trade deficit a sign of economic strength, the Administration changed course and began vigorous if not always effective action against allegedly unfair practices by foreign States and firms. It initiated over a dozen unfairness complaints under Section 301 of the Trade Act of 1974 against countries accused of maintaining barriers to U.S. exports.⁶ The Administration negotiated a cartel-like semiconductor agreement with Japan and then applied sanctions against Japan for allegedly violating the agreement.⁷ According to then Treasury Secretary James Baker III, the Reagan Administration has provided more import relief than any of its predecessors in the past fifty years.⁸ Meanwhile, the U.S. Congress passed (over initial objections from the Reagan Administration) a 1000-page trade reform bill,⁹ unprecedented in scope and scale.

5. *Id.* at 83-84.

6. Under the Trade Act of 1974, 19 U.S.C. § 2411 (1982), the President may respond to unfair trade practices by imposing import duties and restrictions. Under the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, the U.S. Trade Representative has the power to enforce this provision under presidential approval.

7. Semiconductor Agreement, Sept. 2, 1986, United States-Japan, — U.S.T. — T.I.A.S. No. — (numbers not yet assigned), reprinted in 25 I.L.M. 1409 (1986). See Hirsh, *International Trade Agreement Between the Government of Japan and the Government of the United States of America Concerning Trade in Semiconductor Patents*, 28 HARV. INT'L L.J. 175 (1987).

8. Address by James Baker III, Institute for International Economics (Sept. 14, 1987). C. AHO & M. LEVINSON, *supra* note 4, at 84.

9. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107.

Sentiment is growing for the United States to abandon its traditional multilateral approach to trade and to pursue a more active trade policy, simultaneously pursuing bilateral and regional agreements with like-minded countries.¹⁰ Others, like Congressman Gephardt, urge the United States to adopt unilaterally a tit-for-tat trade policy, retaliating against alleged unfair trade practices or against countries with persistent surpluses.¹¹ How Congress and the new Administration will implement the 1988 trade bill remains to be seen.

II. The Case for Multilateral Trade Policy

In the years following World War II, the GATT arose as the primary agreement regulating international trade.¹² The cornerstone supporting both political and economic arguments for the GATT is the most-favored-nation principle ("MFN").¹³ Unconditional MFN requires that one nation agree to "extend to another [nation] the most favorable trade concessions it [the former] has granted, or may grant, to any third country" in some other future or existing agreement, regardless of whether the latter nation is giving the former nation any future concessions in return.¹⁴ This principle was crucial to the GATT at its inception and remains compelling as a guiding concept today.

The arguments for unconditional MFN in the GATT fall into two categories, economic and political, with some overlap between the two.¹⁵ The economic arguments center on efficiency.¹⁶ States applying unconditional MFN do not discriminate among supply sources. This minimizes distortions in the market because imports come from the lowest-cost source. Unconditional MFN also promotes overall trade liberalization, since each party to the GATT opens its markets equally to all other member-States.¹⁷ Finally, unconditional MFN is simple to administer; transaction costs at the border are significantly reduced.¹⁸

The political arguments for unconditional MFN emphasize its ten-

10. See Baucus, *supra* note 2, at 7.

11. N.Y. Times, March 22, 1988, at A1, col. 4; N.Y. Times, March 15, 1988, at D2, col. 3.

12. The GATT was originally created as the international trade rules for the proposed International Trade Organization ("ITO"). The ITO, intended to complement the International Monetary Fund and the International Bank for Reconstruction, was never ratified. The GATT survived, however, and became the central international agreement pertaining to trade. J. JACKSON, *WORLD TRADE AND THE LAW OF GATT 2-3* (1969).

13. See generally R. SNYDER, *THE MOST-FAVORED-NATION CLAUSE* (1948); J. JACKSON, *supra* note 12, at 249-59.

14. Hufbauer, Shelton-Erb & Starr, *The GATT Codes and the Unconditional Most-Favored-Nation Principle*, 12 *LAW & POL'Y INT'L BUS.* 59 (1980).

15. Keohane, *Reciprocity in International Relations*, 40 *INT'L ORGANIZATION* 1 (1986).

16. Hufbauer, *Should Unconditional MFN Be Revived, Retired or Recast?*, in *GATT AT THE CROSSROADS—ISSUES IN WORLD TRADE POLICY* 36-38 (R. Snape ed. 1986).

17. C. AHO & J. ARONSON, *TRADE TALKS—AMERICA BETTER LISTEN!* 120 (1985).

18. Keohane, *supra* note 15, at 12.

dency to reduce tension among nations.¹⁹ From an international political viewpoint, MFN fosters sovereign equality among nations and guarantees newcomers access to international markets.²⁰ The automatic extension of trade-liberalizing measures to others reduces friction and disputes.²¹ In contrast, discriminatory arrangements can increase misunderstandings and disputes among different trade groupings or cause resentment on the part of outsiders.²² Discriminatory treatment also increases the probability that trade will be used as a weapon of foreign policy.²³

From a domestic political viewpoint, discriminatory restrictions are difficult to remove because they create vested interests in exporting as well as importing countries. For example, both protected domestic textile producers and supplying firms in other countries that hold quota licenses find discriminatory restrictions to their benefit.

Finally, MFN decreases the legal and legislative burdens of treating different countries unequally. Discrimination often results in domestic laws being applied differently to imports from various origins.²⁴ Separate national agreements increase the work of elected officials in nations, like the United States, where agreements have to be ratified by legislators. Legislative action on separate agreements also opens up the possibility of domestic political bargaining and log rolling which could undermine the original intentions of a given agreement.²⁵

Although unconditional MFN is theoretically the centerpiece of the GATT system, that system also includes agreements involving conditional MFN treatment. Conditional MFN requires a reciprocal agreement between two nations granting favorable trade treatment. For example, State A extends to State B the same trade concessions it granted State C only if State B reciprocates with concessions equivalent to those given by C to A.²⁶ Conditional MFN can be used to expand trade, but because only a limited number of countries may join restrictive agreements, conditional MFN is inferior to unconditional MFN as a trade policy.

Some of the Tokyo Round non-tariff-barrier codes contain conditional features.²⁷ For example, only firms from countries that are signatories of the government procurement code may bid on the government

19. *Id.* at 27. Hufbauer, *supra* note 16, at 36.

20. Keohane, *supra* note 15, at 23.

21. *Id.*

22. See generally G. PATTERSON, *DISCRIMINATION IN INTERNATIONAL TRADE—THE POLICY ISSUES 1945-66* (1966).

23. C. AHO & J. ARONSON, *supra* note 17, at 120. See also G. PATTERSON, *supra* note 22, at 271-317.

24. See OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, *NATIONAL TRADE ESTIMATE: 1986 REPORT ON FOREIGN TRADE BARRIERS* (1986).

25. C. AHO & J. ARONSON, *supra* note 17, at 120.

26. Keohane, *supra* note 15, at 4. For a discussion of exceptions to unconditional MFN under the GATT, see J. JACKSON, *supra* note 12, at 264-72.

27. Hufbauer, Shelton-Erb & Starr, *supra* note 14, at 61.

projects that are open to foreign bids.²⁸ Under U.S. law, only GATT members that are signatories of the subsidies code are entitled to the injury test on subsidized exports to the United States.²⁹ These departures from unconditional MFN were designed to enhance discipline and thereby promote trade. They provided a mechanism for pressuring free riders and foot draggers that sought to lower standards.³⁰

Other departures from unconditional MFN do not necessarily promote trade or enhance discipline. Regional groupings such as free trade areas and customs unions divert trade as well as create it. GATT members often abuse Article XXIV, which permits regional groupings.³¹ Article XXIV lays out specific requirements which members seldom meet in practice, although the recent U.S.-Canadian agreement may be an exception.³² A further proliferation of regional groupings would set precedents for more special deals, fragment the trading system, and damage the interest of non-participants.

Some scholars have suggested that the increasing number and types of exceptions to unconditional MFN have weakened, perhaps irreparably, the role of the GATT and the very model of liberal world trade.³³ However, these fears need not lead to scrapping the GATT or multilateral trade policy. While the GATT undoubtedly needs reform,³⁴ the overall multilateral structure survives despite its current limitations. The GATT also provides a conceptual starting point for any trade negotiations incorporating multilateralism and MFN. A policy of pursuing bilateral agreements may shift that presumption with potentially disastrous effects on the world economy and political cooperation.

28. Keohane, *supra* note 15, at 19. See G. HUFBAUER & J. SHELTON-ERB, *SUBSIDIES IN INTERNATIONAL TRADE* 120-23 (1984). See also JONES, *The GATT-MFN System and the European Community as International Frameworks for the Regulation of Economic Activity: The Removal of Barriers to Trade in Government Procurement*, 8 MD. J. INT'L L. & TRADE 53, 63 (1984).

29. Trade Agreements Act of 1979, 19 U.S.C. § 2503 (1982).

30. Keohane, *supra* note 15, at 12-13.

31. GATT, *supra* note 1, at art. XXIV. For a discussion of article XXIV and the difficulties it creates for the GATT multilateral framework, see J. JACKSON, *supra* note 12, at 575-623. See also K. DAM, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 274-96 (1970); Baucus, *supra* note 2, at 19-21.

32. For an historical analysis of the relationship between limited agreements and multilateral agreements see Diebold, *The History and the Issues*, in *BILATERALISM, MULTILATERALISM AND CANADA IN U.S. TRADE POLICY* (W. Diebold ed. 1988).

33. Hufbauer, Shelton-Erb & Starr, *supra* note 14, at 91-93. Jackson has termed the weakening of unconditional MFN a "crisis of confidence in the international trade system." Jackson, *The Crumbling Institutions of the Liberal Trade System*, 12 J. WORLD TRADE L. 93 (1978).

34. See *infra* notes 66-72 and accompanying text.

III. Generic Problems with Bilateral Free Trade Agreements³⁵

Bilateral free trade agreements are justified only in special cases. For example, the U.S.-Israeli free trade agreement has outstanding political implications.³⁶ The U.S.-Canadian free trade agreement and the European Community may be special cases in light of the proximity and interdependence of the member-States.³⁷ In his 1988 State of the Union address, President Reagan spoke of including Mexico in a North American trade accord.³⁸ Beyond these examples, further bilaterals would seriously undermine the world trading system.

A. Historical Antecedents

Advocates of more bilaterals in the Administration and on Capitol Hill would do well to remember the lessons of the 1930s. When the GATT was signed, the world had barely receded from the dire consequences of trade discrimination. In the wake of the Smoot-Hawley Tariff³⁹ and subsequent retaliation,⁴⁰ many countries tried to protect their own economies by establishing bilateral or regional agreements.⁴¹ Such "beggary-neighbor" strategies spread, deepening the world's economic decline.⁴² The lessons of the 1930s teach that bilateral agreements fail as mechanisms of international economic regulation,⁴³ impoverishing the international community for the short term benefit of a few States.⁴⁴

35. The treatment of bilateral agreements in this section focuses solely on bilateral free trade agreements and not on bilateral negotiations generally. For a more general discussion, see Diebold, *supra* note 32.

36. C. AHO & M. LEVINSON, *supra* note 4, at 94.

37. See M. SCHNIZNER, M. LIEBREZ & K. KUBIN, *INTERNATIONAL BUSINESS* 389 (1985).

38. See Diebold, *supra* note 32, at 160. See also Baucus, *supra* note 2, at 17-18.

39. Signed in 1930, the Smoot-Hawley Tariff contributed significantly to the Great Depression. See Cooper, *Trade Policy and Foreign Policy*, in UNIVERSITY OF MICHIGAN CONFERENCE ON U.S. TRADE POLICIES IN A CHANGING WORLD ECONOMY 2 (Mar. 28-29 1985).

40. In the months following the passage of the Smoot-Hawley Tariff, twenty-five countries retaliated with higher tariffs. C. AHO & J. ARONSON, *supra* note 17, at 16.

41. John Maynard Keynes described the situation for the United States as a period requiring a policy "to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbor which is worsted in the struggle." J. M. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY* 382-83 (1936), quoted in G. CURZON, *MULTILATERAL COMMERCIAL DIPLOMACY* 28 (1965).

42. C. AHO & J. ARONSON, *supra* note 17, at 16. See also Robinson, *Beggar-Thy-Neighbor Remedies for Unemployment*, in *READINGS IN THE THEORY OF INTERNATIONAL TRADE* 393-407 (1949) (offering a justification for such trade behavior).

43. See H.W. ARUNDT, *THE ECONOMIC LESSONS OF THE NINETEEN-THIRTIES* 17 (1944).

44. C. AHO & J. ARONSON, *supra* note 17, at 16. See LEAGUE OF NATIONS, *COMMERCIAL POLICY IN THE INTERWAR PERIOD: INTERNATIONAL PROPOSALS AND NATIONAL POLICIES* 70-71 (1942).

B. Economic Considerations

The arguments against bilateralism are both economic and political. In short, a succession of bilateral trade agreements will create resentment and inefficiency, increase bureaucracy, and send unwise signals to other nations.⁴⁵

From an economic perspective, bilateralism places obstacles in the path of free movement of goods and capital.⁴⁶ The desire to strike political balance between nations takes precedence over consideration of comparative resource endowments. Therefore, a bilateral system of trade prevents the efficient use of the world's resources.⁴⁷

Trade policy founded on a series of bilateral agreements creates an environment of unpredictability and discourages trade-related business investment. The perception that bilaterals expand markets for businesses in the participating States is often illusory or at best short term; the conclusion of a second or third discriminatory bilateral agreement necessarily disappoints expectations and opportunities created by the first.⁴⁸ If other nations follow the U.S. lead and negotiate bilateral agreements offering mutually incompatible privileges, predictability and stability would be destroyed for all States.

The experience of the 1930s shows how difficult it becomes for businesses to bear the risks of trade-related investment when changes in trade protection become less predictable. Heavy losses in output and employment occur when investment is reduced and directed into less rewarding projects. Moreover, trade policy conflicts resulting in a decline in trade and world output can provide fertile ground for political radicals to seize the reins of government.⁴⁹

C. Political Considerations

Inextricably linked to the economic concerns are political factors which argue against a bilateral approach to international trade. Friction may develop between parties to a bilateral agreement,⁵⁰ especially when a party to a bilateral decides to open up trade with a third State.

The essence of bilaterals is that a State plays favorites. Tensions with third parties are bound to develop because of the discriminatory treatment,⁵¹ producing resentment and distrust in the excluded

45. C. AHO & M. LEVINSON, *supra* note 4, at 94.

46. See R. GARDNER, *STERLING-DOLLAR DIPLOMACY* 13 (1956).

47. *Id.*

48. *Id.*; Ellis, *Bilateralism and the Future of International Trade*, in *READINGS IN THE THEORY OF INTERNATIONAL TRADE*, *supra* note 42, at 415-47.

49. For a detailed analysis together with a dramatic chart of the downward spiral of trade, see C. KINDLEBERGER, *THE WORLD IN DEPRESSION 171-72* (1973).

50. See Diebold, *supra* note 32, at 87.

51. In 1919, the Tariff Commission concluded that:

a policy of special arrangements . . . leads to troublesome complications. Whether as regards our reciprocity treaties or as regards our interpretation of the most-favored-nation clause, the separate and individual treatment of

nations.⁵² The effect on developing nations could be particularly acute. For left-of-center politicians in many third world States, discriminatory bilateral arrangements may well smack of colonialism.⁵³ The development of a globally consistent, stable system of trade requires effective equality of rights and obligations among States, which can be ensured only by general acceptance of the principle of nondiscrimination, otherwise known as most-favored-nation treatment. This principle mobilizes large nations to support the aspirations of small nations to be treated equally. In no other way can the sovereign equality of nations which differ enormously in size and power be realized, or even approximated.

The United States, Japan and the European Community—the major pillars of the trading system—cannot afford to be in rival blocs. Although the United States has expressed some frustration with the European Community for slowing the multilateral process and with Japan over market access, Western cooperation remains important for strategic and security reasons and must not be undermined. The best message of alliance cohesion the Western nations can send to Eastern bloc nations is a flourishing, unified and nondiscriminatory trading system. A fragmented trading system with friction and discrimination would send precisely the wrong signal.

Aside from international politics, domestic political considerations also argue against a policy of bilateralism. A strategy of bilateralism would necessarily require that Congress play a major role in formulating trade policy. Consider how members of Congress will be whipsawed by short term national interest as well as sectoral interests. Legislative action on separate agreements opens up the possibility that trade will be used as a weapon of foreign policy against countries failing to follow U.S. foreign policy initiatives. Some legislators, pressured by special interest groups, may seek to discriminate in the application of domestic law. In sum, a bilateral strategy would raise trade policy from “low level” to “high level” foreign policy. The new Secretary of State, James A. Baker III, would end up spending more time on the balance of trade, leaving him less time to spend on the balance of terror. That would be a gross misallocation of resources.

Regardless of the perspective, bilaterals or like-minded groupings are an inferior alternative when compared with multilateral liberalization on a nondiscriminatory basis.⁵⁴ Politically, bilaterals discriminate and create foreign policy problems. Economically, bilaterals fragment the international trading system. The United States needs to generate trade surpluses of up to \$50 billion to service its trillion dollar foreign

each case tends to create misunderstanding and friction with countries which, though supposed to be not concerned, yet are in reality much concerned.

Quoted in W. Diebold, *supra* note 32, at 3.

52. C. AHO & M. LEVINSON, *supra* note 4, at 94.

53. For an extended discussion of the drawbacks, see C. AHO & J. ARONSON, *supra* note 17, at ch. 7.

54. See C. AHO & J. ARONSON, *supra* note 17, at 17.

debt in the 1990s.⁵⁵ Without an open multilateral trading system, that will be next to impossible.

IV. Drawbacks of a Bilateral with Japan

Despite the arguments against negotiating a series of bilateral agreements, policy-makers persist in proposing an accord with Japan.⁵⁶ They base these proposals either on false premises or a misreading of the potential gains by paying insufficient attention to the negative consequences.

A. Tactical Considerations

Proponents of a bilateral trade agreement with Japan cite the corrosive effect that bilateral disputes have had on the U.S.-Japanese relationship and the ineffectiveness of the piecemeal approach to solving these disputes.⁵⁷ There are, however, several barriers to a U.S.-Japan accord. Before such an agreement can be effectuated, the trade policy process in the United States must be internally reformed to establish and highlight trade priorities. Otherwise, the U.S. will not overcome the disputes with Japan through a bilateral agreement. Moreover, the U.S. should not assume—even if it did change its policy—that Japan would be any more able or willing to accede to U.S. demands on contentious issues, such as agriculture and construction policy.⁵⁸ Multilateral, rather than bilateral, pressure would be more effective and more palatable politically within Japan.

A bilateral trade agreement with Japan would be a mistaken strategic move in U.S. trade policy. Foremost, it would tie the hands of American trade negotiators. The launch of the Uruguay Round at Punta del Este demonstrated the importance of coalition building in future trade negotiations. Since coalitions shift from issue to issue, it is better to retain the flexibility to form different coalitions than to limit options by joining a bilateral with another major pillar of the trading system. For example, the United States might someday wish to join forces with the European Community in a multilateral forum on the issue of market access to Japan, but may later have to join with Japan to ensure that the European Community does not use the 1992 effort as a means to discriminate against outside interests.

Furthermore, if the United States does enter into a bilateral trade agreement, it is not at all obvious that Japan is the most appropriate partner. Senator Baucus prefers a bilateral with Japan,⁵⁹ while Congressman Gephardt has proposed that the European Community should

55. For references and an extended discussion of the problems of servicing U.S. foreign debt, see C. AHO & M. LEVINSON, *supra* note 4, at ch. 2.

56. See, e.g., Baucus, *supra* note 2, at 8-17; *Groping for a Practical New Order in World Trade*, N.Y. Times, Aug. 30, 1987, at 30.

57. See Baucus, *supra* note 2, at 12.

58. See C. AHO & M. LEVINSON, *supra* note 4, at 85.

59. See Baucus, *supra* note 2, at 8-17.

be the object of U.S. bilateral initiatives.⁶⁰ Senator Bradley favors a plurilateral trade agreement with the Pacific Rim nations.⁶¹ Who is going to decide and on what basis?

Granted, new approaches to trade policy in a highly pluralistic world may bring needed pressure on free riders and foot draggers. The preferred approach, however, is to remain within the GATT and develop the conditional MFN approach as was done with the Tokyo Round, where only signatories to the new codes received the benefits of abiding by the additional discipline.⁶² Since the free riders and foot draggers will vary from issue to issue, conditional MFN allows for greater flexibility.

B. Practical Considerations

Beyond these tactical issues, there are several practical reasons to reject a bilateral trade accord with Japan. The drawbacks are manifold. First, negotiation of a traditional free trade agreement is too modest a goal. Even if the agreement covered tariffs and non-tariff barriers or included such new issues as trade in services, intellectual property and foreign investment, the two nations would have failed to address significant problems. The most difficult problems the United States has with Japan, including the distribution system and cultural preferences, are not susceptible to negotiation by formula or by drafting new trade rules.

Second, the concessionary nature of negotiations requires that the United States "give up" something in order to receive something out of an agreement. This may mean dismantling import restraints on steel, autos, semiconductors, machine tools, textiles and the other barriers that remain to Japanese exports to the United States. The U.S. Congress might have to construct an institutional apparatus for dispute settlement that would allow frictions with Japan to skirt U.S. trade remedy laws. Particular interest groups and members of Congress are likely to think that this would give up too much control.

Third, while the new U.S.-Canadian bilateral is a good agreement, it still failed to address many of the central difficulties of trade between the two countries. The accord does not address subsidies, trade remedy actions, government procurement, or intellectual property.⁶³ This agreement took almost two years to negotiate, and the talks came perilously close to collapse on several occasions. Moreover, even after Canada and the United States reached an agreement and the U.S. Congress ratified the accord, the Canadian public nearly rejected the agreement by coming close to voting out the conservative Mulrooney government responsible for its negotiation. Indeed, the agreement became the cen-

60. Address by Representative Richard Gephardt, "United States Trade Policy for the 1990s," George Washington University Law Society (Oct. 12, 1988).

61. Address by Senator Bill Bradley, New York Economic Club (Dec. 8, 1988).

62. See Hufbauer, Shelton-Erb & Starr, *supra* note 14, at 61.

63. For an assessment of unfinished business and for an analysis of how the bilateral agreement might blend with the multilateral talks, see Diebold, *supra* note 32.

tral issue of Canada's national campaign.⁶⁴ Before launching another bilateral, it would be wise to wait and see how the agreement with Canada works out.

Fourth, since both the U.S. and Japan have substantial trade interests and business investments in other countries, establishment of a new bilateral would divert trade and investment. This would result in economic inefficiency, raising consumer costs and altering sourcing patterns for firms with subsidiary operations in other countries. The extent of the net inefficiencies created would depend upon the balance between trade creation and trade diversion.⁶⁵ Nonetheless, some consumers, affected multinational corporations, and third-country business interests would have cause to complain.

Fifth, even the onset of negotiations between the U.S. and Japan would cause other countries to change their behavior—and not necessarily in ways conducive to reaching a multilateral agreement. Other Asian countries, for example, would likely clamor for similar negotiations with either Japan or the United States (Asia's major trading partners), or both. The United States lacks the capability to conduct a series of bilaterals simultaneously, but could not afford to defer resolution of these requests until the U.S.-Japanese negotiations were completed.

Finally, the U.S. must carefully compare the costs of failure with the likely gains from any agreement. As any negotiations of this type proceed, the negotiators must realize that if they fail it is often impossible to return to the *status quo ante*. Under such circumstances, negotiators are hard pressed to come up with an agreement, no matter how bad or how unworkable. The gains of a bilateral accord with Japan are unlikely to be so great as to warrant risking the trading system as it now stands.

V. A Strategy for the New President

A. Reform the GATT

A great deal needs to be done to reform the international trading system. The GATT is one of the three major international institutions originally designed to help stabilize the world economy in the post-World War II environment. The GATT, however, does not have the authority in trade that the International Monetary Fund has in finance or the World Bank has in development.⁶⁶ The GATT is an administrative agency with a professional staff of fewer than 200 people (compared with 1700 for the IMF and over 6000 at the World Bank).⁶⁷ The deficiencies of the GATT, or more accurately of the GATT system, have

64. N.Y. Times, Oct. 2, 1988, at A5, col. 1.

65. For the classic statement of the concepts of trade diversion and trade creation, see J. VINER, *THE CUSTOMS UNION ISSUE* (1950).

66. C. AHO & M. LEVINSON, *supra* note 4, at 87.

67. *Id.*

become apparent in recent years.⁶⁸

The GATT needs several institutional reforms. The adjudication of disputes and enforcement of rules needs strengthening,⁶⁹ and rules on subsidies and unfair trade need revamping.⁷⁰ The GATT must become more of a forum for the mediation and reconciliation of trade disputes not explicitly covered by existing rules.⁷¹ The GATT should aim at responding to problems as they emerge. These reforms share the common goal of heightening the respect and authority of the GATT in the international community. International policy makers can make and implement the changes detailed above through multilateral negotiations already in progress. The Uruguay Round is currently addressing many of these issues.

Beyond institutional reforms, the GATT mirrors the cooperation that its members invest. Unfortunately, international cooperation on trade may be at its lowest level since World War II. Political will is a necessity in all countries—but especially in the United States. Ensuring success of the Uruguay Round, therefore, should be the first trade priority of the new President. Although working for change will be arduous, the stakes are too high not to continue trying.⁷²

B. Opening Markets and Deterring Barriers Through Retaliation

U.S. trade policy should emphasize the opening of foreign markets over the protection of domestic industries. The United States should pursue an aggressive policy of deterrence and retaliation toward the end of strengthening adherence to internationally established rules of trade.⁷³

Discussions of international trade invariably underestimate the importance of deterrence, although it is elemental in understanding strategic relations among nations. Some advocates of free trade mistakenly believe that tolerating offensive behavior without retaliation is an admirable form of self-restraint. Though tolerance may signal U.S. commitment to a liberal trading order, it also allows other countries to infringe upon trading rules without prosecution. Yet, reluctance to retaliate is enshrined in American trade law. Where the U.S. does impose sanctions, the intent is protectionist rather than market-opening. Retaliation, however, far from being something to avoid at all costs, is a necessary part of a self-regulating world system of free trade. Unfortunately, under current GATT procedures, the probability that a country illegally interfering with trade will suffer major economic harm from retaliatory actions is extremely low. The deterrent effect is negligible.

68. For an excellent treatment of the deficiencies of the GATT system, see M. CAMPS & W. DIEBOLD, *THE NEW MULTILATERALISM* 37-72 (1986).

69. *Id.* at 43-44.

70. *Id.* at 40.

71. *Id.* at 49-55.

72. For an analysis of the difficulties, see C. AHO & J. ARONSON, *supra* note 17.

73. See generally I. DESTLER, *AMERICAN TRADE POLITICS: SYSTEM UNDER STRESS* (1986).

The new President should retaliate against foreign barriers that clearly violate internationally defined rules of the world trading system. In each instance of retaliation, the United States should define clearly and state publicly what actions on the offending nation's part will cause the U.S. to lift the retaliatory measures. In addition, retaliation should occur only within the realm of international trade, to make it clear that the United States has no desire to allow trade disputes to poison other aspects of international relations. Ideally, trading partners would be confident that eliminating the objectionable practice would end U.S. interference with their exports.

Unfortunately, current U.S. laws cloud the potential clarity of a trade policy employing retaliation. Individual companies and industries may file for import relief with little cost and no risk, giving them an inordinate influence in setting U.S. trade policy and stripping American diplomats of much of their bargaining leverage. A trading partner has little incentive to compromise to avert retaliation when it knows that any individual American company can still obtain sanctions against it. The deterrent effect of calibrated, government-initiated retaliation is lost. Some of the current U.S. laws allowing private actions should be traded away at the Uruguay Round and replaced by a specific policy of retaliation, granting the President the flexibility to impose and withdraw retaliatory penalties.

The 1988 trade bill has already taken some steps in reforming U.S. law and policy, emphasizing market-opening retaliation over market-closing protection. The publication of foreign trade barriers to U.S. exports, as required by law, and the occasional public disclosure of lists of retaliation targets may also deter the further spread of barriers. If new barriers are erected, the United States could publicly identify some of the items on the list of retaliatory targets in order to mobilize the public sector in the offending country.⁷⁴

Applying deterrence to trade policy does carry with it the risks of escalation, retaliation, and counter-retaliation. Careful selection of targets for retaliation can reduce some of these risks. Such targeting requires a competence and an objectivity on the part of officials in the executive branch, both in choosing barriers to retaliate against and in selecting the targets of retaliation. Although it offers one possible means of maintaining a self-enforcing system of international trading rules, this approach requires the adoption of well defined rules. The ongoing multilateral talks under the auspices of the GATT provide the best opportunity to improve the rules that govern trade.

Opening new markets, as the supporters of bilateral agreements suggest, is a crucial step, but it is a step best taken within the multilateral trade framework. President Bush should initiate reforms of the GATT

74. M. Levinson, *Trade Policy or Trade Strategy* (Working Paper for a Council on Foreign Relations study group on the Economic Choices Confronting the Next President, New York (May 10, 1988) (unpublished manuscript).

through the Uruguay Round and promote a strong policy of retaliation against GATT violators. These efforts risk failure, however, unless he also can successfully manage domestic trade politics.

C. Managing the Domestic Trade Front

A major lesson of the past decade is that it is not enough for the President to negotiate freer trade with other countries. He must also attend to the domestic front on trade matters. He must do more to involve the private sector and Congress in making trade policy. He must mobilize private sector support and keep Congress constantly apprised of the negotiations. He must convince Congress and the public that he is according trade matters their due priority and is protecting American interests.

A frank policy of retaliation against foreign barriers would provide visible evidence to the domestic political arena that the U.S. government is vigorously asserting the country's interest in trade matters. This will help establish presidential credibility on trade, greatly diminishing protectionist pressures on the domestic front.

The new administration must continue to push hard for visible signs of progress. Unless a new multilateral accord resolves basic issues of disagreement, trade frictions with Japan and the European Community are likely to escalate in the decade ahead. Yet the United States should not succumb to pressures to resolve trade frustrations through numerous bilateral accords. The break-up of the world trading system into regional blocs, each based upon separate bilateral agreements, is directly contrary to the long-established U.S. goal of liberalizing the international flow of goods and services.

Perhaps most importantly, the new President must lead the formulation of American trade policy. The political structure for handling trade issues requires that the President take the lead in order to protect members of Congress from intense pressure to save local factories and mines from import competition. When the chief executive fails to assume the role of advocate and lightning rod on trade matters, as was the case throughout the Reagan years, the protectionist pressures may be impossible for Congress to withstand.

Conclusion

As the new U.S. administration struggles to find its way on trade policy, the world will await nervously. George Bush will face enormous pressure to abandon the United States' traditional commitment to the multilateral process and instead to cut bilateral deals. The President must stand firm, supporting the multilateral process and retaliating against those States that break internationally accepted rules. Trade can no longer be treated as a stepchild of domestic economic policy at home and of foreign policy abroad. It must be a continuing priority.