America's Lost Leverage[*]

by Alan Wm. Wolff and John R. Magnus

August 1998 finds U.S. trade officials at a new and unexpected crossroads. At stake is the effectiveness of one half of what has hitherto been known as U.S. trade policy.

Trade policy consists, in large measure, of negotiating and living under trade agreements. Since 1934, the Trade Agreements Program has provided a framework under which Republican and Democratic administrations have pursued, with varying degrees of success, U.S. trade policy goals.

Since World War II and until quite recently, there have been two key components of that program. One featured broad, cross-sectoral agreements, with lengthy rules, such as the North American Free Trade Agreement (NAFTA) concluded with Canada and Mexico as well as the 1947 General Agreement on Tariffs and Trade and its progeny. The other component involved country- and sector-specific agreements aimed at resolving particular market access problems with particular trade partners. Examples include a 1986 semiconductor agreement with Japan (updated in 1991 and 1996) and a 1992 U.S.-China pact over enforcement of intellectual property rights.

Significantly, neither half of this program could have survived for long without the other. Narrow market access initiatives aimed at eliminating specific barriers would have had very little chance of success without the backdrop of broader efforts to craft and update generally applicable trading rules. At the same time, in multilateral talks, it was widely understood that the rules under consideration would not address many of the most deeply rooted and problematic barriers in particular other countries, and that it would accordingly be necessary to maintain a very healthy bilateral component in U.S. trade policy. Without that understanding, the 1994 World Trade Organization (WTO) agreements could never have attracted public and congressional support in the United States.

This is not a criticism of WTO- and NAFTA-type agreements themselves, which are generally well-designed and solidly in the U.S. interest. But are they only a partial solution to our trade problems? One cause is the very nature of the international system. Trade agreements are reached among sovereign states, and whatever these states do not specifically agree to refrain from doing is, by definition, permitted. As anyone who has spent time in the trade policy world knows, attempting to list the things a government may not do to influence commercial opportunities in favor of its own nationals, and failing to agree on some aspects, merely creates a roadmap for governments determined to afford protection to domestic industry, agriculture or services.

A second, related cause is the "least common denominator" approach that sometimes prevails in international talks. The WTO agreements, for example, have been

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signed by more than 130 countries with widely varying degrees of commitment to actually opening their markets.

A third reason is the inability, so far, to fashion generally applicable rules that respond to the role that private businesses, and public-private combinations, play in keeping imports out of some of United States' key export markets.

The lesson is that these broad agreements are good but not perfect. As one element in a wider trade strategy, the use of WTO- and NAFTA-type agreements makes good sense. As the only element, it would be grossly inadequate.

Regrettably, we now have, or at least are on the verge of having, just such a one-dimensional trade policy.

What has undermined the bilateral component? The Dispute Settlement Understanding (DSU) of the WTO, coupled with a lack of resolve on the part of the United States.

The U.S. approach to lowering foreign trade barriers not effectively reachable under multilateral rules had consisted of applying pressure bilaterally, backed by the threat of sanctions under §301 of the Trade Act of 1974. Section 301 confers broad authority on the president to threaten (and where necessary impose) economic penalties in order to secure the removal of "unjustifiable" or "unreasonable" foreign government practices that "burden or restrict" U.S. commerce.

Many, if not most, of the actions authorized by §301 -- such as punitive tariffs on goods from the offending country -- are actions that, since the Uruguay Round, would violate the United States international commitments. But §301 has always represented a recognition that some foreign trade practices are sufficiently offensive to merit such a unilateral step – especially if it appears to be the best or only way to end those practices.

The §301 approach launched in 1974 worked reasonably well for 20 years, undergirding the negotiation and enforcement of bilateral agreements seeking to open, for example, Japanese markets for semiconductors, telecommunications equipment, insurance, flat glass, and various other goods and services. While sometimes less than pleasant for the foreign countries involved, the §301 process led to substantial benefits for the United States, and also, ultimately, for the countries whose trade barriers periodically came under scrutiny, as market forces came to play an increasing role in their economies.

In 1994, however, the DSU entered into force, creating a "binding" dispute mechanism under which a country targeted by §301 sanctions could automatically prevail in a WTO panel procedure focused narrowly on the United States' response – rather than on the other country's protectionist conduct. That country could then counter-retaliate against the United States, *with the full authority and blessing* of the international trading community as embodied by the WTO.

It is perhaps logical that this would make the United States hesitant in its use of §301. But the degree of hesitation so far has been noteworthy. When members of Congress, before voting on the WTO agreements, raised concerns in 1994 about the potential impairment of §301, the Administration assured Congress that it would not be one iota less aggressive in using section 301 sanctions to secure the removal of foreign barriers falling outside WTO rules. Congress approved the DSU, and the other WTO agreements, based on this and other similar commitments. Yet, in practice, the standard for §301-based retaliation appears to have risen impossibly high.

MOZENBARAI

Japan and other countries have noticed, accurately concluding that the U.S. government is no longer capable of using §301. Tired of outside pressure to open its markets in a manner befitting a leading economic power, Japan has taken to answering U.S. bilateral trade complaints with *mozenbarai* – a term that translates roughly into "rudely rejecting outsiders at the gate." In one recent case, the U.S. government determined that Japan was restricting access to its market for consumer photographic film and paper products, yet Japanese officials refused for more than a year even to hold a serious discussion with their U.S. counterparts about the complaint and the evidence on which it was based.

Japan's new position is that U.S. complaints must be handled under the WTO agreements or not at all – even though the WTO agreements do not even begin to address the key forms of Japan's subtle methods of protectionism. Apparently, with the entry into force of the WTO agreements, the United States has lost most of its ability to approach Japan about barriers and practices not covered by WTO rules. Our government has had very limited success in forging new bilateral market access pacts with Japan and has had difficulty in securing compliance with, or renewal of, existing bilateral agreements.

Meanwhile, as the recent photographic film case made clear, the WTO itself is, at least at this time, unsuited to helping to address the complex methods of protectionism practiced by Japan and some of its emulators. The current system is thus structurally biased in favor of countries that maintain opaque barriers, and against transparent trade regimes like our own.

In short, the constraints on the use of §301 that the United States accepted in return for a strengthened WTO dispute system have created a dangerous imbalance in U.S. trade relations with key trading partners. The problem is a serious one, and – especially in light of the desperate need to motivate economic reform in Asia -- Congress has every reason to do something about it.

What can Congress do? First, lawmakers can give the president forms of leverage that can be used without creating an opportunity for the foreign government to block the U.S. initiative in Geneva. This new authority should allow the president or a Cabinet-level trade official to impose fines on foreign enterprises that participate in, or are the chief beneficiaries of, foreign government actions that close key markets to U.S. goods or services.

Second, §301's definitions for "unjustifiable" and "unreasonable" foreign government practices need to be modernized for an era in which governments are collaborating with private enterprises in ways that WTO- and NAFTA-type rules and dispute panels cannot reach. Collaboration in a foreign government's protectionist scheme should be actionable.

Third, Congress should monitor the course of U.S. efforts to open foreign markets, with regular oversight hearings, and assessments of the successes and failures. A central question should be whether the United States, with the world's largest and most open market, is exercising its considerable leverage to achieve reciprocity abroad.

The DSU that appears to have so sapped the vitality of our bilateral trade diplomacy is up for reconsideration in 1998. After a four-year trial period, it is clear that whatever benefits the United States may have derived from the switch to binding WTO dispute settlement, there have been major costs as well. Because backing away from binding dispute settlement now may not be a realistic option, other reforms (including the changes to §301 suggested above) are all the more important. Unfortunately, there has been no indication so far that the U.S. government is prepared to recognize the extent to which the DSU has impaired its bilateral trade diplomacy, much less concede the need to repair the breach.

When trade and economic circumstances turn, as they always do, members of Congress will have reason to examine the status of America's bilateral trade diplomacy for the first time since the WTO vote in 1994. There are serious trade problems falling wholly or partly outside the limited remedial scope of WTO- and NAFTA-type rules. It is wholly unacceptable for the U.S. government to find itself unable to obtain even negotiations, much less satisfactory resolutions. Pursuing the reform of §301 today would start the rebuilding a structure that would make finding solutions possible once again.

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