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BOOK REVIEW

IS FREE TRADE OBSOLETE?

MANAGING THE WORLD ECONOMY: THE CONSEQUENCES OF CORPORATE ALLIANCES, by Peter F. Cowhey and Jonathan D. Aronson. Published by the Counsel on Foreign Relations, Washington, D.C., 1993. $18.95.

Charles S. Kaufman†

In the 1990s a protectionist's job is not an easy one. Consider the U.S. senators who set out to boost the fortunes of a domestic television maker by creating a high-density television ("HDTV") consortium, only to find that European firms, Thomson and Philips, made more televisions in the United States than anybody else, and they did it in union shops. And what can protectors of the U.S. airframe industry do about incursions of that most notorious product of European subsidies and targeting, the Airbus, when it contains 30% U.S. content? Will it help for Japan to increase its imports of U.S.-made autos if those autos are Hondas?

The nations that came together after World War II to create the General Agreement on Tariffs and Trade ("GATT") had fresh memories of the trade war that exacerbated the Great Depression. They sought to fashion a world where trade restraints gradually disappeared, allowing a global economy to flourish and raise living standards in all nations. In their book, *Managing the World Economy: The Consequences of Corporate Alliances*, Peter F. Cowhey and Jonathan D. Aronson document the curious way things actually turned out fifty years later. Global trade indeed is flourishing and expanding, but despite ever-present protectionist barriers. This expanding trade moves less through conventional exports of national products, the authors tell us, and more through a byzantine network of international corporate alliances ("ICA"s) that exchange goods, investments, services, and complementary expertise in a way that transcends both cultural and protectionist barriers. They end by arguing for reforms in the GATT and, to a lesser extent, antitrust laws to conform with new economic realities.

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Cowhey, Professor of International Relations and Political Science at the University of California, San Diego, and Aronson, Professor of International Relations at the University of Southern California, explain just how far the world trading system remains from the ideal of free trade. The GATT, for example, does not cover petroleum, which constitutes about half of world trade. Exceptions, safeguards, and "VRA"s (so-called voluntary restraint agreements, which circumvent the GATT's prohibition on import quotas) affect agriculture, textiles, shoes, airplanes, automobiles, and semiconductors. In the end, only about 15% of all trade is truly free.

The authors, citing impressively broad-based research and abundant statistics, chiefly present the argument that the postwar international trading regime has evolved toward a "market access regime." The original GATT concept, they contend, presumed that every nation should follow the U.S. model, which featured large, centralized, self-sufficient corporations oriented to a domestic economy and a government that largely kept out of the private sector except for a role as an antitrust referee. Given a level playing field, nations would benefit by trading according to the classical economic principle of comparative advantage.

In reality, European and Japanese governments have departed from the U.S. model by employing far greater government intervention in their economies, setting national industrial policies to increase exports (and thwart imports), paying subsidies, sponsoring consortia, and allowing managed cooperation between competitors. Outside the United States, a permissive antitrust atmosphere has allowed the growth of strategic domestic corporate alliances ("DCA"s). DCAs, like the European Airbus consortium or Japan's *keiretsu*, can provide efficient vertical integration and a resulting export edge. (*Keiretsu* are Japanese trading conglomerates like Sumitomo and Mitsubishi, which typically include a bank, a trading company, and a host of manufacturers linked by cross-ownership of stock.) Horizontal DCAs, like Japan's government-sponsored semiconductor research consortia of the 1970s, can position a nation's manufacturers for export by pooling research and development, sharing the most promising technologies, and avoiding duplication of effort. Cowhey and Aronson refer to the European and Japanese systems as the "hybrid model for industrial development" and conclude that it has come to dominate world trade. As evidence, they note that the United States has tentatively relaxed antitrust laws to allow research consortia like the Sematech microchip consortium and joint efforts by the Big Three automobile makers to develop an improved battery for electric cars.

Meanwhile, rather than waiting for trade barriers to lessen, corporations have been leaping over the barriers by entering ICAs

with foreign partners. Professors Cowhey and Aronson argue that nations have begun to recognize and encourage this process, rather than pursue ideal, frictionless trade between economies modeled on the United States. Faced with political pressure from dissatisfied trading partners to open their markets, nations do not offer free trade by halting industrial policies that tilt the playing field toward domestic industries, but instead insure that the partners still have access to their imperfect markets.

One example of the authors' concept of market access is the U.S.-Japan semiconductor agreement. Instead of leveling the playing field by identifying and prohibiting Japanese government and business practices that disfavored U.S. microchips, and instead of slapping on duties to compensate for alleged export "targeting," the countries set a 20% goal for foreign (i.e., U.S.) semiconductor sales in Japan. Because Japanese electronics firms could only meet their targets by consulting more closely with U.S. chip makers, companies from the two nations formed long-term alliances, and the worldwide semiconductor industry has grown more integrated as a result.

Another example of the market access regime is foreign direct investment in the European Community ("EC"). EC members have established local content rules and subsidies for domestic industries that serve as formidable barriers to the international flow of manufactured goods. Yet the EC's relative openness to foreign direct investment has enabled foreign firms to make their products on European soil with relative ease and gain a substantial share of the European market.

Traditionally, analysts have viewed corporate arrangements designed to skirt trade barriers as simply inefficient alternatives to obstructed direct trade. For example, Mitsubishi Motors cannot import any more cars into the United States than its allocated share under a U.S.-Japan automobile VRA. But it can enjoy unlimited imports of Mitsubishi-engineered automobiles made in Korea by Hyundai under an ICA. Pent-up demand for Japanese cars thus flows around the trade barrier and creates a niche for Korean automobiles.

Observing that such arrangements produce absolute increases in world trade flows even in the face of intractable trade restraints, Cowhey and Aronson see international strategic alliances as signs of an emerging regime where nations look more to improved market access than to progress toward an idealized free market. The authors even endorse a different method of accounting world commerce, adopted from the writings of economist DeAnne Julius. Julius does not classify commerce on the basis of where goods are made and where they are shipped; rather, she looks to the nationality of purchasers and sellers. So, for example, a sale by a U.S. firm

to its U.S. subsidiary abroad would not count as an export. But a sale by a U.S. firm to a U.S.-based subsidiary of a Japanese firm would be an export, and a purchase by the U.S. firm from a Japanese subsidiary would be an import. By this accounting, not only does the world economy appear far more internationalized, but the United States appears to be keeping even rather than suffering a massive trade deficit. (The authors concede that the balance-of-payments deficit remains a serious U.S. liability.) Also, under Julius's accounting, the tendency of Japanese firms, wherever they are located, to be "import averse" stands out starkly.

Cowhey and Aronson are at their best in the central section of their book, when they demonstrate the shift to the market access regime by closely analyzing trends in the automobile, semiconductor and telecommunications sectors. Even readers who remain unconvinced by the conclusions of Cowhey and Aronson should find their detailed examination of trade in these three essential and dynamic industries enlightening. U.S. readers troubled about economic decline might find the telecommunication services chapter good bedtime reading, since U.S. firms lead as providers of global telecommunications services—followed by England. On the other hand, the authors' study of the automobile sector reveals new U.S. weaknesses. The major U.S. automakers have entered DCAs with auto rental companies, and much of reported U.S. automobile sales volume goes to those captive markets. If one discounts rental fleet purchases, U.S. and Japanese firms each take about 50% of the U.S. automobile market. The study of the automobile sector also reveals the complex array of ICAs linking the U.S., European, and Japanese industries.

Unfortunately, the chapters preceding the trade sector studies bog down in an excessively abstract and schematized explanation of the argued transition from the post-war free trade regime to the current market access regime. The authors describe general trends as two sets of six "pillars" that support the respective systems. For example, Pillar One of the old system is the U.S. model of industrial organization; in the new system it is the hybrid model of industrial development. Pillar Two used to be "separate systems of governance" and now is "internationalization of domestic policies," and so on. The reader may find the authors' meaning quite obscure until the later illustrations from automobiles, microchips, and telecommunications breathe life into their elaborate theoretical structure.

The authors' first set of pillars involves the change from the U.S. model of industrial organization to the hybrid model of industrial organization. Because of this shift, according to the authors, bilateral or "plurilateral" negotiations will replace multilateral ones. Observing the stalled Uruguay round of the GATT, the authors point out that bilateral talks have been more successful than

multilateral talks, particularly between Japan and the United States. The semiconductor agreement and the opening of Japanese government contracting to foreign bidders are examples cited by the authors of bilateral talks which either secured implementation of existing GATT principles or laid the groundwork for later multilateral negotiating. The North American Free Trade Agreement ("NAFTA") exemplifies a plurilateral negotiation that may lead to a regional improvement in market access. The authors endorse this increasing use of bilateral trade agreements, as long as the parties conform to multilateral trading norms and seek to "multilateralize" their agreements; the result, they argue, will be bottom-up management of international trade.

However, Cowhey and Aronson glide over the fact that bilateral negotiations often mingle political and economic goals. That should naturally worry weak bargaining partners like Taiwan or Mexico, but even between strong nations political considerations can overwhelm economic factors. For example, the need to keep Japan as a cold war ally at least partly explains why for so long the United States tolerated economically mighty Japan's retention of protectionist measures designed for its postwar reconstruction. The current tough trade stance of the United States may spring in part from a realization that Japan's geopolitical capital as an "unsinkable aircraft carrier," in East-West military conflict has declined in value. The world economy would be more stable, and more healthy, if international trade norms controlled instead of relative power.

Cowhey and Aronson argue that the negative products of bilateral negotiations, like VRAs, result from the current regime's failure to give bilateral negotiations a proper role and its relegating them to "the twilight zone of trade relations." But the current trade regime generally disapproves only the bilateral trade initiatives sponsored by powerful, protection-seeking industries like textiles, steel and footwear. In fact, the GATT, under Article XXIV, embraces in concept bilateral and plurilateral organizations like NAFTA and the EC that advance regional free trade.

One interesting suggestion of the authors is a change in GATT Article XXIV, which approves regional trade blocks (in the form of a customs union) only if they have no internal barriers and keep their unitary tariffs against the rest of the world lower than the average tariff before formation. The authors endorse a change to requiring only that the block's volume of trade with the rest of the world maintain its pre-formation level. In other words, a block should qualify if it has no net protectionist effect. The change would most likely make it easier for regional organizations to qualify under Article XXIV. However, since the GATT Contracting Parties have generally waived most favored nations ("MFN") treat-

ment and other obligations for regional trade organizations even if they do not strictly fulfill Article XXIV, the proposed change might yield little practical effect. In addition, Cowhey and Aronson do not discuss whether a trading block would have to maintain equal trade volume in each industrial sector or in the aggregate.

Cowhey and Aronson also emphasize the role of investment as a surrogate to trade, and the importance of trade in services, particularly in telecommunications. They urge changes in GATT to foster free trade in those areas, a position already promoted (without much success) by U.S. negotiators throughout the Uruguay Round. While the authors' position on this issue is far from controversial, they do add some valuable facts to the debate. For example, industry by industry, they show how U.S. direct investment in Europe has more than offset protectionist economic policies and allowed U.S. firms to participate in the European economy; in Japan, however, the combination of trade barriers and barriers to investment has closed off U.S. market participation and exacerbated trade imbalances.

Another trend traced by the authors is the use of industrial policies to shape national comparative advantage and improve a nation's stance in international trade. A growing number of economists agree with Cowhey and Aronson that government policies which promote export-based industries, like the Japanese semiconductor consortia in the 1970s that eliminated duplicative research and "rationalized" markets, can increase a nation's comparative advantage and enhance its exporting position. Conservative economists, however, have viewed national comparative advantage as an immutable characteristic. Adopting this view, the U.S. government has in the recent past rejected domestic industrial policies and labeled other nations' industrial policies as unfair "targeting" deserving of trade sanctions or retaliation. Cowhey and Aronson predict that as the U.S. model of industrial organization fades, the United States will emulate other nations' industrial policies rather than seek to eliminate them as unfair.

Among the authors' other suggestions for changes in the GATT is a proposal that VRAs be banned and a proposal that GATT have as a goal the conversion of all trade barriers to defined tariffs. These are hardly changes; in fact the authors restate two of the hoariest principles of the GATT. Under the GATT, importing nations may not impose quotas or quantitative restraints. A VRA, voluntary in name only, circumvents the GATT's ban on numerical import quotas by restraining exports within the exporting country and not at the border. It violates the spirit, if not the letter, of the GATT. The GATT is unlikely ever to have the status of an international trade regulating body necessary to make VRAs illegal; the notion of such an organization fizzled in the 1940s when the GATT

Contracting Parties failed to create a proposed International Trade Organization ("ITO").

By the same token, no institution exists to implement what the authors call "Global Antitrust." While the authors suggest that international alliances that pool research or collude to allocate markets might ultimately restrain competition, they do not fully explain the sort of antitrust system that could address the problem. One solution they discuss, extraterritorial application of U.S. antitrust laws, does not reconcile well with the authors' earlier account of the waning U.S. model of industrial development. In addition, other nations may well object to a world order where the U.S. military might polices global military conflict and U.S. trade organizations police trading behavior. An ITO-type organization could provide an alternative source of global antitrust, but it would require nations to surrender a discomforting amount of economic sovereignty.

Missing from the authors' analysis is a single important question—why? Why have world trade at all? The goal of the old regime, unrestricted world trade, may have been unrealistic but at least it had a purpose: maximum economic efficiency and maximum wealth for trading nations. The market access regime described by the authors lacks such a goal and suggests a worldwide patchwork of mutual concessions where countries manage trade by deciding ad hoc how much market access is enough. If trade will proceed under agreements that promise not general openness but managed slices of market access, who will say how much trade access is enough? Open investment policies advocated by the authors may indeed provide a surrogate for direct trade, but investment cannot substitute for all trade, particularly in a country like Japan where foreign investment is expensive and faces cultural obstacles.

A managed trading system lacks guarantees that consumers will get the benefits they need and that promising enterprises in politically less powerful nations will achieve a proper niche. If the goal of free trade actually is unreachable, *some* multinational set of trading standards must prevail, or the expanding network of international trading relationships described by Cowhey and Aronson will never deliver the full benefits of a global economy.