THE CONDUCT OF INTERNATIONAL ECONOMIC RELATIONS IN THE BUSH ADMINISTRATION

Bruce J. Heiman

The United States adopted the "open door" policy one hundred years ago. Today, the appointment of James Baker as secretary of state highlights this theme of diplomatic emphasis on trade negotiations. Bruce J. Heiman tells us what we might expect in the realm of international economic relations under the new administration, and why.

INTRODUCTION

Less than twelve hours after acknowledging his election as the forty-first president of the United States, George Bush selected his good friend and campaign chairman, former Secretary of the Treasury James Baker, to be his secretary of state.[1] No other action or statement could provide a better key to understanding how international economic relations — the sum total of trade, investment, and monetary negotiations — will be conducted in the Bush administration.

THE SUBSTANCE: A NON-DOCTRINAIRE FREE TRADE ORIENTATION

President Bush brings nearly two decades of foreign policy experience to his new job.[2] But none of his previous positions was concerned directly with formulating policy on international *economic* issues. Instead, his involvement over the years generally has been limited to expounding the official position of other administrations. Moreover, prior to the presidential campaign, he had neither written nor spoken about such issues.

Based on his campaign positions, however, we find that Bush believes in the importance and value of free trade, while showing a willingness to bow to politically important domestic demands for "fair trade" and protection.

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1 Close personal friends for thirty years, the two have been political comrades since Baker first ran Bush's Senate campaign in Harris County, Texas in the 1970 losing effort. He subsequently served as Bush's campaign manager in his unsuccessful race against President Reagan in 1980, and again as National Campaign Chairman last year.

2 Indeed, of those voting for him, "experience" was one of the most frequently cited reasons for the selection. In addition to his eight years as vice president, he also served as director of the CIA (1976-77), chief of the US Liaison Office to the Peoples Republic of China (1974-75), US ambassador to the United Nations (1971-72) and a representative from Texas (1967-71).

Thus, a Bush issues paper presented shortly after the Republican convention explains:

> Protectionism benefits some businesses at the expense of the rest of the economy and exposes us to retaliation and the prospect of an all-out trade war which no one would win. Such measures drive up the cost to consumers and misallocate our economic resources.
>
> Increased trade reduces international tensions and provides a better standard of living for everyone. But our commitment to free trade must be linked to a commitment to fair trade by our trading partners. They must respect our right to compete in their marketplace and they must compete fairly in ours.

During the campaign, Bush applied these "principles" to three major industrial sectors: textiles, agriculture, and steel. Bush promised support for each, but did so by calling for the end of market barriers to US exports and for full enforcement of negotiated bilateral import restraint agreements.[3]

It should surprise no one that these "free but fair" trade themes and positions generally mirror those of the Reagan administration — in its *second* term. Not coincidentally, it was at that juncture that White House Chief of Staff James Baker became secretary of the treasury, head of the Economic Policy Council, and the leading administration official on international economic issues.

During Reagan's first four years, the administration adhered to a doctrinaire laissez-faire approach. Even as the value of the dollar soared 85 percent, the administration refused to intervene in the currency markets.[4] Partly as a result

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3 *Textiles*: In March, he opposed the Textile, Apparel and Footwear Trade Act of 1987 passed by Congress which would have "frozen" imports at their 1986 levels, although he promised "vigorous enforcement" of bilateral agreements with the Big Four exporting countries to the United States (Taiwan, Korea, Hong Kong, and China), as well as efforts to ensure opportunities for US textile exports.

Agriculture: Bush pledged to "knock down trade barriers" to US exports of corn, beef, and other crops; but he said he would only act to "end subsidies that distort markets and restrict trade . . . in concert with our trading partners." In October, he urged Trade Representative Clayton Yeutter to initiate an investigation of Japan's barriers to US rice exports, a move sought by the domestic Rice Millers Association.

Steel: Less than a week before the election, he assured Pennsylvania Senator John Heinz, chairman of the Senate Steel Caucus, of his "intention to continue the voluntary restraint program after September 30, 1989" (when the existing "agreements" to limit steel exports to the United States are due to expire; the parties include nineteen countries plus the European Community [EC]). Bush pointed out that "a comprehensive VRA (voluntary restraint agreement) program has proven to be more effective in offsetting unfair trade practices than trying to counter these practices on a case-by-case basis." (In earlier statements on the steel industry, he had avoided making a commitment to extend the VRAs, arguing that while he believed "in vigorously enforcing our trade laws," he also believed in free trade and that "protectionism, in the end, costs American jobs.")

It also is worth noting Vice President-elect Dan Quayle's well- scripted answer during his debate with Senator Lloyd Bentsen on the question of the United States owing foreigners hundreds of billions of dollars. Quayle said he "would rather have people coming over here and make investments in this country rather than going elsewhere because, by coming over here and making investments in this country, we are seeing jobs."

4 Between January 6, 1981 (its low for the year) and February 25, 1985 (its peak), the value of the dollar increased 85 percent as measured by the Federal Reserve Board against a basket of currencies of ten major US trading partners. Yet throughout this time the administration adhered to its "clean float" policy, first articulated on May 4, 1981, by Beryl Sprinkel, acting undersecretary of the treasury for monetary affairs.

of the extraordinary rise in the dollar, the trade deficit skyrocketed from $36.4 billion in 1980 to $123.3 billion in 1984. Yet the administration refused to take action to slow the flood of imports.[5]

When Baker assumed the treasury post in 1985, he clearly faced a crisis. Baker firmly believed that maintaining open trade and investment was essential to avoiding a worldwide depression. But the business community and Congress were clamoring for action and relief.[6] Baker responded as a practical politician: he moderated the administration's laissez-faire approach and at the same time attempted to preempt more extreme reactions.

First, and most importantly, Baker orchestrated a new Group of Five (G-5) policy of coordinated intervention in currency markets, revealed in the "Plaza Agreement" on September 22.[7] At the same time, Baker convinced the Economic Policy Council to agree that Trade Representative Clayton Yeutter would announce a series of unfair trade practice actions and investigations designed to preempt congressional action.[8] The following month, at an international conference in Seoul, he revealed his plan for addressing the LDC debt problem.[9]

Baker continued to work on international economic problems in 1986 and 1987. He concluded, with Volcker, that a cheap dollar alone would not suffice to correct the trade problem. Therefore, he worked to persuade countries running trade surpluses (specifically, Japan and West Germany) to grow faster by lowering interests rates in order to absorb more imports from the United States. The administration also highlighted trade negotiations (bilaterally with Canada and multilaterally through the initiation of the new Uruguay Round) as an additional means of reducing trade barriers worldwide. Finally, begin-

5 Even the significant restraints on auto and steel imports — notable exceptions to the general laissez-faire approach — formally were accomplished by convincing foreign countries to "voluntarily" restrict their exports to the United States.

6 The chairmen of the House Ways and Means Committee and the Senate Finance Committee and Representative Gephardt supported legislation to levy a 20 percent surcharge on all imports. Other legislation to roll back significantly textile and apparel imports was cosponsored by a majority of each house that year. Even such Democratic "internationalist" stalwarts as Senators Moynihan and Bradley demanded that the Federal Reserve intervene in the currency markets and mocked the president's claim that a "strong dollar means a strong America." Senate Majority Leader Robert Dole, returning from a summer visit to Hong Kong, Korea, and Taiwan, demanded that the United States cease providing unilateral tariff benefits to those countries.

7 With Federal Reserve Board Chairman Paul Volcker's assent, during the spring and summer of 1985, treasury officials conducted secret discussions with representatives of the G-5 countries (the United States, Great Britain, France, West Germany and Japan). These talks culminated at a meeting of the finance ministers and central bankers of the five countries at New York's Plaza Hotel in late September. There they agreed the value of the dollar was too high and suggested intervention in foreign exchange markets on a coordinated basis in order to reduce the exchange rate of the dollar. While the dollar had already declined 18 percent from its peak in February, the "Plaza Agreement" accelerated this trend.

8 Thus, on September 7, the president directed the USTR to recommend retaliation against Japanese restrictions on US leather exports and EC production subsidies on canned fruit; on September 16, USTR self-initiated section 301 investigations of Brazil's policies and practices protecting their informatics industry [Editor's Note: See "Software Development in Brazil and Singapore," this issue], Japan's barriers to US tobacco exports, and South Korean restrictions on the ability of US firms to provide insurance services.

9 He called for making available $9 billion in international agency credits and $20 billion in commercial bank loans over the next three years to debt-strapped countries that adopted free-market economic reforms and private-enterprise policies to spur economic growth.

ning in 1987, the administration began to work with Congress on trade legislation.[10]

As secretary of state in the Bush administration, Baker can be expected to continue to pursue the middle-of-the-road policies of the last four years.[11] Key areas to watch include:

• Exchange Rates and International Coordination:
After the election, currency traders around the world seemed to question the Bush/Baker premise that the United States could grow out of its budget deficits and began to sell dollars. As the dollar's value declined, Bush and Baker felt compelled to assert that they would follow Reagan administration policy and strongly suggested that they would intervene, if necessary, to prevent the dollar from falling too far. They believed the "markets" were overreacting — and continue to believe that if some progress is made toward reducing the budget deficit, then foreign investors will continue to provide the funds necessary to finance the deficit.[12]

• Economic Growth:
Bush and Baker believe the deficit can be steadily reduced by holding the line on spending and letting economic growth generate additional revenues with existing taxes. Similarly, Bush said during the campaign that the United States needs "to continue to encourage our trading partners to increase their economic growth. As their growth increases, we can reduce our trade deficit without slowing our economic engine."

10 With the decline of the dollar, a stabilization of the trade deficit, and the administration's use of existing authority to address unfair trade practices, protectionist pressures abated to the point where Baker (and Yeutter) believed an acceptable final bill could emerge. Importantly, the Democrats regained control of the Senate (November 1986) placing the Democratic Congress in a position to pass the bill.

11 Baker will take leadership on international economic issues with him to the State Department for several reasons (regardless of any formal organizational responsibilities). First, he has the closest relationship to the president, a first among equals in the cabinet. Second, he will have more experience than anyone else at the top level of the Bush administration. Third, his potential rivals in key economic decision-making roles are actually his allies: Nicholas Brady, secretary of treasury and his former deputy and alter ego, and Richard Darman, the director of Office of Management and Budget. Fourth, USTR's influence, already waning under Reagan (although still more significant than the Department of Commerce), will be further weakened by the departure of the current Trade Representative Yeutter after three-and-a-half years, and departure of the agency's most experienced trade negotiator, Michael Smith, after thirteen years.

12 Of course, the ultimate judge of whether sufficient progress is being made to reduce the deficit lies with those abroad: if they should decide to reduce their lending to the United States, then the exchange rate of the dollar would fall, confronting the Bush administration with the Hobson's choice of increased inflation or higher interest rates (in an attempt to attract back enough foreign capital). But this is the same tightrope which Baker has walked during the last several years and little suggests that he would approach the task differently.

By the same token, Bush and Baker can be expected to oppose vigorously any legislative proposals that would discourage foreign investment. Baker was quite serious about insisting that the recently enacted trade bill be vetoed if it included proposals to institute government screening of foreign investments that affected "essential commerce," or language that would impose burdensome and discriminatory registration and reporting requirements on foreign investors (the "Bryant Amendment"). He was successful in having these provisions stripped from the bill — but undoubtedly will have to face the problem again as the next Congress is tempted to impose such economically irrational, but politically attractive, restrictions on foreign investment.

• Addressing Foreign Trade Barriers:
There has been a continued emphasis on the Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations.[13] Key US objectives have been to build more discipline into the multilateral system and to expand coverage of GATT rules and principles to agriculture, services, intellectual property, and investment.[14] In addition, the Trade and Competitiveness Act of 1988 ensures that the Bush administration will take some aggressive, unilateral moves against unfair trade practices.[15] Although the Act does preserve some administration discretion with respect to identifying unfair practices, initiating trade actions, and retaliating, Congress will be overseeing implementation of this section of the Act closely.

• LDC Debt:
A Bush administration is unlikely to depart from the Baker Plan and "country-by-country" approach for dealing with this problem.[16] In the waning days of the Reagan administration, Baker showed a willingness to orchestrate greater financial assistance when necessary to debt-ridden countries (such as Argentina and Mexico) to bolster democratic political developments — a trend he could continue in his new position.

The Style: Reactive, Selective, Incremental, and Quiet

Baker is deliberate, careful, and pragmatic by temperament and legal background. He deals with issues as they arise on a case-by-case basis, with little attempt to relate individual solutions to a larger theoretical view. Moreover, given a general belief that the current state of affairs is desirable (or at least, acceptable) there is little reason to propose changes.

He also is acutely aware of limitations on time and resources which preclude addressing more than a few problems at once; he knows that priorities must

13 President Reagan signalled as much in his last major trade speech, to the Chamber of Commerce in Washington, D.C., on November 17.

14 Even before taking office, Bush faced a key GATT meeting in December. The United States was instrumental in pushing for a Uruguay Round "mid-term" ministerial review meeting in Montreal, and has worked hard to persuade the contracting parties to reach preliminary substantive agreements rather than simply to "review" the activities to date. Such agreements, argued the US representives, are important to ensure that meaningful final accords are reached by the targeted end of the Uruguay Round, at the end of 1990. At the time this article was written (three weeks before the meeting), the prospects for a successful meeting were uncertain. The United States had begun to scale back its demands in order to avoid an embarrassment that could undermine further negotiations.

15 The Act "strengthens" in two ways the ability of the US government to address unjustifiable, unreasonable, and discriminatory foreign practices which burden or restrict US commerce under section 301 of the Trade Act of 1974, as amended. First, it expands the number of actionable unfair trade practices. Second, it increases American leverage by making retaliation more probable. In addition, the Act requires the government each year to identify and take action against the most onerous "priority" trade barriers in "priority" foreign countries.

16 In one respect, the plan clearly failed: it failed to spur economic growth in debtor countries through market reforms and additional capital infusions. On the other hand, it did help stall any massive defaults. (During the last three years, banks committed $17 billion, primarily by extending existing debt repayments. Moreover, during this time US banks have been able to replenish and expand their capital reserves by $27 billion in order to buffer any future default and permit writedowns of debt.)

be set and followed. Moreover, in choosing which issues to try to address, he believes it makes little sense to engage in futile exercises; there should at least be a significant chance of succeeding. At times this approach requires waiting until there is a sufficient interest in the problem and a consensus on a general solution among the public, organized lobbies, and Congress.

Of course, it is easier to succeed if a specific, limited (but not overly defined) objective is set. A series of small successes generates momentum for additional efforts and the reputation for succeeding actually makes it more probable in the future.[17] Don't look for any grand strategy from Foggy Bottom.

The 1988 Trade Act embodies a strong congressional consensus (and considerable national sentiment) to elevate international trade and economic concerns to the same level as foreign policy and national defense interests. One important way in which the Act does so is to strengthen the trade representative's formal authority and bureaucratic presence in national trade and economic matters. Essentially, Congress adopted a "balance of power," separate-but-equal model in which USTR joins the Departments of State and Defense as key policy decisionmakers.

This model is highly unlikely to be utilized by the Bush administration. International economic issues will receive greater attention — but attention from the secretary of *state*. Moreover, as secretary of state, Baker naturally will demonstrate increased sensitivity to other foreign policy concerns. In short, Baker is likely to think about international economic issues as only part — though an extremely important part — of US larger international relations.

Public discussion of the administration's negotiations on international economic issues will be kept to a minimum. Baker's approach is cautious, consensual, and non-confrontational. Indeed, by severely limiting the number of people who know his strategy, Baker believes he maximizes his freedom of action. In fact, until a "deal" is in hand, he often sees little reason to confirm even that negotiations are taking place.

Baker believes this style of operation is particularly well-suited to the resolution of international economic issues. His legacy at Treasury is the understanding that: (1) the United States can no longer dictate economic policy to the industrialized countries; (2) no other country can do so, either; therefore (3) the United States still can exercise economic leadership by defining problems, negotiating, and building consensus for desired solutions. Baker demonstrated the efficacy of this approach with respect to obtaining exchange rate cooperation and international interest rate coordination.[18]

17 Recall Baker's successes at Treasury (exchange rate realignment and interest rate coordination; tax reform) as well as those issues he chose not to address (the deficit, at least until the October 19 crash brought everyone willingly to the negotiating table for a short-run solution; and the debate over whether to give domestic banks new securities powers).

18 If he is tempted to deviate from his usual *modus operandi*, no doubt he will recall quite vividly his public lambasting of the West German government on October 16, 1987 for raising their interest rates (he had been urging them to keep them down to spur economic growth) and the stock market crash three days later.

THE DIFFERENCE: TWO POSSIBLE INNOVATIONS

Even as the United States presses ahead with a multilateral approach to trade, interest is increasing in a bilateral or plurilateral trade agreement approach as a complement or alternative to exclusive reliance on the GATT.[19]

The United States and Canada, and Australia and New Zealand, recently have concluded such agreements. The European Community is well on its way toward its 1992 market integration plans. The United States and Mexico began discussion on a framework agreement last year.[20] Studies examining possible agreements between the United States and Japan, Taiwan, South Korea, and ASEAN currently are underway.

As secretary of the treasury, Baker repeatedly suggested that if sufficient trade liberalization did not occur through multilateral trade negotiations, then the United States should be willing "to explore a 'market-liberalization club' approach, through minilateral arrangements or a series of bilateral agreements."[21] Indeed, it was Baker who undertook to resurrect the US-Canada Free Trade Agreement negotiations when they had broken down and who took the lead in concluding and subsequently selling the agreement to Congress.

In terms of economic gains, the idea is that rather than appeal to the lowest common denominator in multilateral negotiations, a series of sequential bilateral agreements (in the nature of free trade pacts) could build on each other to achieve higher levels of trade liberalization. Thus, the potential economic benefits of increased trade achieved through liberalization on a piecemeal basis might be worth the risk of fragmentation and disruption to the world trading system as a whole.[22]

Politically, the "threat" of a series of bilateral agreements could maintain pressure on the GATT negotiators. It also serves as a useful counterweight to those (e.g., Representative Gephardt) who would impose country-specific import restrictions. Finally, even if a multilateral system is preferred, a "second best" solution of entering into bilateral or plurilateral agreements (regional blocs) might be necessary in order to maintain negotiating leverage with participants in other trade agreements (e.g., Europe 1992).

Interestingly, Baker may find another compelling political reason for supporting bilateral agreements. As secretary of state, he is likely to become increasingly sensitive to foreign policy concerns and objectives such as fostering democratic trends around the world. Yet one of the traditional tools, foreign

19 Baker understands that the ability of the United States tq act unilaterally in international economic issues is quite circumscribed. But that does not mean that the United States must act multilaterally, either. The Baker style is to reach agreement, "cut the deal," with the key players.

20 Indeed, during the campaign Bush said the United States "should build on the achievement of our free trade zone with Canada — a $130 billion agreement — and work with our other neighbor, Mexico, to create a free trade zone of unprecedented size, a new North American compact."

21 On July 11, 1988, in Jakarta, Secretary of State Shultz voiced support for a related idea by calling for greater regional economic cooperation in the Pacific basin.

22 Clearly the European Community thinks so, as the desire to achieve greater efficiencies is one of the powerful forces behind its plan to integrate markets by 1992.

aid, will not be available in a significantly increased amount due to continuing budget deficit pressures. Bilateral trade agreements permit Baker to offer preferential access — or at least special recognition — to certain countries.

The US approach to international trade problems — under President Reagan as well as earlier administrations — has been characterized by product or issue-specific negotiations which often end in a process-oriented solution (a "leveling of the playing field"). The approach is extraordinarily time and resource intensive, all too often, US officials and businesses complain, without any real results. Time and time again, for example, the Japanese have agreed to open up a particular market only to see imports from South Korea and Taiwan increase.[23]

Increasingly during the last few years, commentators (e.g., Pat Choate, vice president and policy analyst at TRW, Inc.; Clyde Prestowitz, Carnegie Endowment), business leaders, and members of Congress have called for the negotiation of a results-oriented aggregate trade accord with foreign countries.

The well-known "Gephardt Amendment" to the recent omnibus trade bill was just such an approach. The amendment would have required that countries with large worldwide and bilateral trade surpluses with the United States reduce those bilateral surpluses by a set amount each year or face mandatory retaliation. While Representative Gephardt argued that such an approach would lead to increased US exports, most commentators correctly noted it would, in all probability, lead to reduced imports from Japan and thus was simply an elaborate form of protectionism.

At about the same time, other Senators developed bilateral approaches to trade designed to ensure that US exports would increase (even if a foreign country's exports continued to rise as well so that the bilateral US deficit with that country was not reduced).

More recently, Senator Max Baucus introduced legislation calling for the negotiation of a comprehensive accord with Japan covering trade, and coordination of economic and monetary matters, as well. In October, in a speech to the International Law Society at George Washington University, Representative Gephardt urged as a priority matter the beginning of negotiations with the EC to construct "an economic NATO to coordinate economic policies in pursuit of mutual growth and freer trade in order to ensure that the United States is not locked out by EC '92."

Insofar as Secretary of State Baker considers national economic matters in a broader foreign policy context, broad bilateral agreements could facilitate tradeoffs and resolutions of other issues as well. They also could establish a framework and procedures for more amicably resolving disputes, thereby improving relations generally. Finally, simply the act of negotiating such broad accords — even if it took five or seven years to do so — would positively influence bilateral relations during the interim.

23 Indeed, Governor Dukakis criticized Vice President Bush for leading a market access trade negotiating team to Japan in 1984. Bush declared the negotiations a success, but three years later US exports had increased only 19 percent. (It would be 1988 before US exports would increase significantly.)

Clearly, the international business community need fear no sudden, dramatic changes in US economic policy. Nonetheless, Baker's substantive knowledge of world trade markets and international monetary systems presage an evolution in American trade negotiations. Global economic conditions, especially the "twin deficits" of the United States, favor the usage of sequential bilateral agreements and aggregate trade accords. Further, the presidential favor Baker enjoys as secretary of state encourages an increased emphasis on the linkage between economic relations and diplomacy.