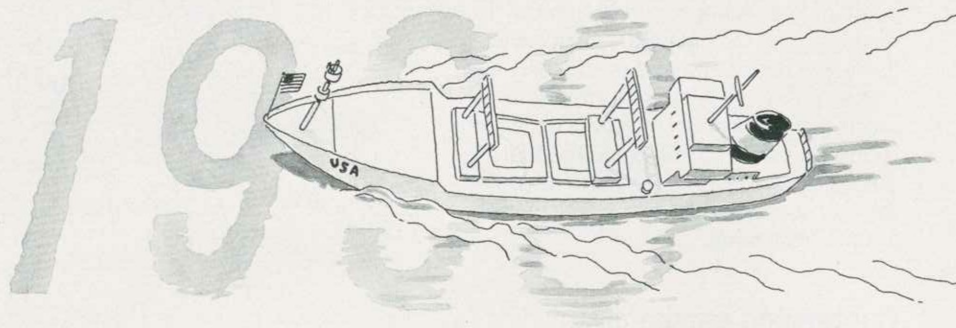
U.S. International Economic Strategy: Looking toward the 1990s

By John N. Yochelson



We live in a new technological era that is transforming the structure of the global economy faster than policymakers can respond. Technological change is internationalizing the marketplace, forcing adjustment in the workplace, buffeting the world trade and financial system, and redistributing economic power on a global scale.

The differential between the pace of change and the time for response makes it imperative to develop a long-term perspective. This concern prompted the Center for Strategic and International Studies (CSIS) to organize a bipartisan study group to assess U.S. international economic strategy for the 1990s. The Maekawa Report and the Ministry of International Trade and Industry (MITI)'s work on the future role of Japan in the international community both served as valuable models for the CSIS effort that brought together legislators, senior government officials, private sector leaders and academic experts.

Four main challenges

Our working group reached consensus on four challenges that must be met to sustain U.S. global economic leadership in the decade ahead:

First, the United States must come to grips with the extremely rapid internationalization of its own economy. The period during which the United States could exercise commanding influence while remaining invulnerable to external forces is over. An ever-expanding set of technology links is connecting the United States to the rest of the world.

Over the past two decades, the menu of international options for U.S. companies to invest, produce, outsource and sell abroad has been greatly widened. Meanwhile, with the growth of prosperity abroad, the U.S. market has become increasingly accessible to foreign goods and capital. Trade as a share of GNP has doubled since 1970 while foreign assets in the United States have increased from $107 billion to more than $1.5 trillion. These changes have blurred the distinction between domestic and international economic policy, and they have left the United States with less autonomy than it previously enjoyed.

Second, U.S. policymakers must shape an approach to the globalization of technology, whose worldwide development and diffusion has reduced longtime U.S. advantages. U.S. superiority, which fueled striking postwar gains in productivity and growth, has been narrowed by the transfer of know-how abroad through sales, licensing, joint ventures and access to research data. The shortening of product life cycles and the internationalization of R&D have cut sharply the monopoly advantage once enjoyed as a result of U.S. breakthroughs. At the same time, the deepening of technology bases outside the United States has multiplied sources of future innovation.

These far-reaching changes have created increasingly complex and difficult trade-offs for U.S. policymakers who have relied on U.S. technology to support national commercial interests, strengthen alliance ties, promote global economic development, and maintain a security edge vis-à-vis the Soviet bloc.

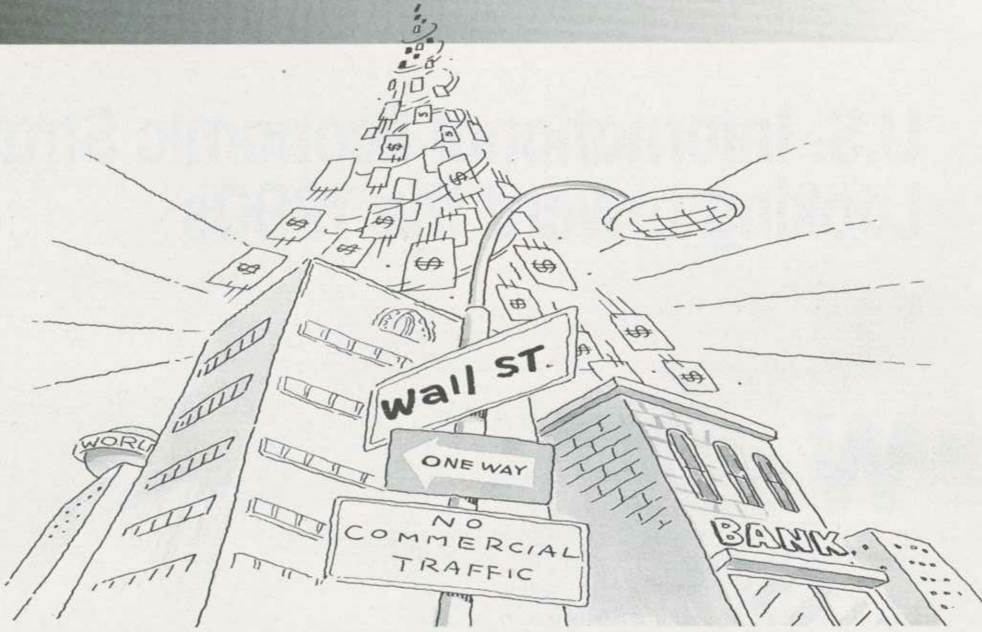
Third, the global economic imbalances that threaten both the United States and its trading partners must be redressed: the U.S. trade deficit and corresponding surpluses overseas, the rapid accumulation of U.S. foreign indebtedness and the LDC debt overhang. The imbalances being accumulated cannot last without putting the international trade and financial systems at risk. Looking ahead, the central issue is not whether but how and when they are corrected. Export-led growth in the United States and global economic expansion provide the basis for a preferred outcome. Some progress along these lines has been made since the fall of the dollar that began in 1985, but progress has fallen well short of expectations.

Stronger foundations

Fourth, the United States must cope with sharpening tension between its economic interests and security burdens. The relative shift in the U.S. economic position has made the long-term affordability of the nation's defense establishment a major issue. Beyond this issue of resources, the growing overlap of commercial and defense technologies—and their widening dissemination—have made their restriction from the Soviet bloc not only more costly to the United States in commercial terms but more problematic as a practical matter. A new balance must be struck.

Members of the CSIS working group agreed in their discussions that an effective response to these challenges must begin at home by strengthening the foundation of the U.S. economy.

A vital first step must be to improve the capital position of the United States. The weakening of this position, as reflected in the budget deficit, the growth of foreign indebtedness, and the interna-



tional exposure of U.S. commercial banks to the indebted countries, is the clearest point of U.S. economic vulnerability. In response, the United States must reduce its budget deficit and restrike the balance between savings and consumption. A macroeconomic policy framework that increases savings will deepen the pool of domestic resources for investment, lower the cost of capital, and reduce reliance on foreign borrowing.

Contrasting perspectives

Further, a broad-based program for improving the productivity and flexibility of the nation's human resources is crucial to the future performance of the U.S. economy. Upgrading education at all levels, with greater emphasis on mathematics and science and on the economically disadvantaged, is essential. Worker retraining and adjustment programs can also make decisive contributions to the capacity to shift resources into growth sectors of the economy.

Finally, the United States must build further its capacity to develop, apply and market leading-edge technologies. At a minimum this requires more generous tax incentives to promote research and development, an adjustment of antitrust barriers to R&D collaboration, a program to facilitate commercialization of government-sponsored research and a focused effort to expand the availability and use of information relating to foreign science and technology.

Awareness of this priority national agenda is growing. Progress can be expected, regardless of the outcome of the 1988 presidential election.

Beyond these elements of consensus, two contrasting perspectives emerged within the CSIS study group with respect to the way the United States defines and pursues its interests in the international economic arena.

Most participants felt that U.S. international economic strategy should continue to link national interests with a vibrant, open global economy. The United States is bound to become increasingly enmeshed in the world economy as a result of the technological forces at work. U.S. economic strength and national influence in this new era will hinge on receptivity to global economic change. The United States must use its negotiating assets to adjust the multilateral system and make it work.

For others, a more restrictive, territorial definition of U.S. interests is long overdue. The United States should not allow its systemic commitments to stand in the way of more immediate priorities: improving the U.S. trade position, rebuilding U.S. manufacturing capability, bolstering national technological strengths, and optimizing both the quality and level of U.S. employment. The United States must make full use of its leverage—including access to its domestic market—to advance these priorities in an increasingly mercantilistic world economy.

Loss of autonomy

These contrasting perspectives led to very different responses to the four global economic leadership challenges that are outlined above:

1) From a territorial standpoint, the pace of internationalization of the U.S. economy must be slowed. Loss of autonomy threatens the United States both politically and economically. The domestic market should be shielded in key sectors, foreign direct investment should be contained, and incentives should be created to retain high value-added manufacturing employment within national boundaries.

In contrast, a global view of U.S. interests gives priority to accelerating the pace of adjustment to internationalization. Tightening the access of foreign goods, services, capital and know-how to the U.S. market will weaken the U.S. economy. The global perspective puts a premium on a competitive environment that maximizes the benefits of internationalization.

2) A territorial view regards diffusion of technology as weakening both the U.S. competitive and security positions. Technology must be treated as a national commercial and strategic asset. Foreign access to the U.S. technology base should be limited through restrictions on investment, joint ventures and participation in R&D. The United States should create incentives to promote and retain leading-edge technologies in such bedrock sectors as semiconductors.

The global view, however, regards unilateral U.S. efforts to limit the diffusion of technology as self-defeating. The efficient development of the U.S. technology base requires openness, and the restriction of sensitive technology from entering the Soviet bloc requires cooperation. By promoting foreign investment, joint ventures and systematic monitoring of overseas developments, the United States can expand its access to foreign technology.

3) The territorial view targets reduction of the U.S. trade deficit on a country-by-country, sector-by-sector basis. Its premise is that the multilateral framework has weakened to the point that the United States must actively pursue second-best alternatives. These include unilateral restrictions on imports and heavy emphasis on bilateral negotiations to

open markets overseas. The territorial perspective favors a case-by-case approach to the management of Third World debt that could combine finance and trade concessions.

The global view of U.S. interests argues for greater emphasis on multilateralism. None of the pressing objectives on the U.S. international agenda—from reducing the trade deficit, to stabilizing exchange rates, to managing the global debt problem—can be positively achieved without multilateral cooperation. The United States should concentrate on adjustment of the multilateral system.

4) The territorial view of U.S. interests gives priority to forcing a redistribution of alliance burdens and to strengthening the U.S. defense technology base for both commercial and security reasons. Selective retrenchment of U.S. overseas commitments will relieve pressures on U.S. resources and prompt allies to do more. The territorial perspective argues for a "buy America" approach to defense procurement, an enhanced national R&D effort and a restrictive posture toward technology sharing.

A global view gives priority to more efficient use of alliance defense resources through tighter collaboration. Unilateral U.S. defense cutbacks would undermine allied incentives to share the security burden more equitably. The global perspective argues for achieving economies through weapons standardization, joint procurement programs and the pooling of R&D efforts.

On balance, the CSIS study group advocates a global approach to the challenges of the 1990s that would throw the full weight of the United States behind an effort to make the multilateral framework function more effectively. A solution would require progress along three fronts:

—Revision of the multilateral trading system to extend GATT coverage beyond goods in the Uruguay Round, define new responsibilities for the newly industrialized countries, and deal systematically with nonmarket economies.

—Tightening of institutional linkages between global finance and trade through closer collaboration between GATT, the IMF and the World Bank as well as between trade and finance decision makers within national governments.

—Enhancement of Western collaboration to redress current global economic imbalances, achieve institutional reform and lighten the U.S. security burden.

The U.S. commitment to multilateralism is not a commitment to the status quo. It faces rising pressures to define U.S. international economic interests more narrowly. The debate is far from settled, and U.S. trading partners all have a vital stake in its outcome.

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