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DOC NO	Doc Type	Document Description	No of Pages	Doc Date	Restrictions	
1	LETTER	TO PRESIDENT REAGAN RE. MISCONDUCT CHARGES (PARTIAL)	1	ND	B6	599
2	LETTER	TO DAVID P. BOBZIEN RE. MISCONDUCT CHARGES	2	1/11/1984	B6	600

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Message

Operator

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THE WHITE HOUSE
WASHINGTON

Date 1.27.84

Suspense Date _____

MEMORANDUM FOR: John

FROM: **DIANNA G. HOLLAND**

ACTION

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_____ Please handle/review

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_____ For your recommendation

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From: Ellen Strickert Room 93, Correspondence Section

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Ellen Cheney
with Counsel
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E.O. 13233

C. Closed in accordance with restrictions contained in donor's deed of gift.

Dear President Reagan:

I have written to you previously on this matter. Enclosed please find a copy of correspondence from my attorney, [redacted] to David Bobzien of the U.S. Department of Justice, Office of Professional Responsibility. b6

Over the past five months, I have been totally frustrated by the lack of action by your office and the Department of Justice on my charges. Even though all of the charges of misconduct have been substantiated and documented, the lack of response and concern is appalling. I have exhausted all of my appeals and I am awaiting execution of my sentence.

Justice department officials have warned [redacted] b6 [redacted] and myself against taking my story to the press because it would hinder their investigation. It now appears that this is my only recourse.

Although your public image is one of accessability and concern, I find that in reality this is not the case.

[redacted] b6

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THE WHITE HOUSE

WASHINGTON

January 31, 1984

MEMORANDUM FOR FRED F. FIELDING

FROM: JOHN G. ROBERTS

SUBJECT: Cerami Correspondence Transmitting Second Interim Report on Special Trade Study

Charles A. Cerami has written you, enclosing a copy of the second interim report on the Special Trade Study "that you helped to make possible." Cerami notes that a State Department working group will review the report, but asks for any comments you might have.

The report begins by noting that the current talk of a "world trade crisis" is exaggerated, as is the belief that the world is experiencing a "protectionist drift." Part I of the report outlines politically-based trade restrictions deliberately used by national governments (an example would be local content or "Buy American" legislation). The report concedes that such ingrained practices cannot easily be extirpated, and urges greater reporting about and communication concerning the practices, as a first step in educating governments and peoples about their counter-productive effects on the nation as a whole.

Part II of the report considers more narrowly-based restrictions, such as special protection for particular industries, usually represented by politically influential legislators. The report is more optimistic about resisting such restrictions, primarily because the injury to the nation as a whole is clearer when an isolated industry or region is protected.

Part III of the report discusses the north-south crisis and the need to facilitate the provision of credit to the less developed countries. The report's argument is that the world trading system desperately needs new markets, and that such markets cannot develop if the Third World has no means of paying for goods from the developed countries. This section of the report also emphasizes the deleterious effect on world trade of the over-valued U.S. dollar.

Since a State Department working group will be reviewing the report, it strikes me as somewhat inappropriate for you to offer substantive comments that may conflict with the

official views of the Government as presented by the working group. For the same reason I do not recommend a referral to those in the White House more involved with trade matters. Accordingly, the attached draft reply is innocuous and simply thanks Cerami for sharing the report with you.

Attachment

THE WHITE HOUSE

WASHINGTON

January 31, 1984

Dear Charles:

Thank you for your kind letter transmitting the second interim report on the Special Trade Study. I was pleased to read on the opening page of the report that talk of a "world trade crisis" is exaggerated, and that the common belief in a "protectionist drift" is unwarranted. At the same time, however, as the bulk of the report makes clear, there certainly are serious problems and troubling developments in this area that merit the most careful attention. For that reason, I was pleased to learn that your impressive work will be reviewed by a working group organized by the State Department.

The discussion on page 17 of the report concerning the counter-productive nature of some retaliatory trade measures called to mind a favorite analogy of the President's. As the President stated in his September 27, 1983 address before the Board of Governors of the World Bank and the International Monetary Fund:

> [W]e and our trading partners are in the same boat. If one partner shoots a hole in the bottom of the boat, does it make sense for the other partner to shoot another hole in the boat? Some people say yes and call it getting tough. I call it getting wet -- all over.

Once again, thank you for sharing this draft with me. I am certain that those reviewing it will find it a valuable contribution to a very important discourse.

With warmest personal regards,

Sincerely,

Orig. signed by FFF

Fred F. Fielding
Counsel to the President

Mr. Charles A. Cerami
The Atlantic Council of the
United States
1616 H Street, N.W.
Washington, D.C. 20006

FFF:JGR:aea 1/31/84

bcc: FFFielding/JGRoberts/Subj/Chron

THE WHITE HOUSE

WASHINGTON

January 31, 1984

Dear Charles:

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Sincerely,

Fred F. Fielding
Counsel to the President

Mr. Charles A. Cerami
The Atlantic Council of the
United States
1616 H Street, N.W.
Washington, D.C. 20006

FFF:JGR:aea 1/31/84

bcc: FFFielding/JGRoberts/Subj/Chron

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Name of Correspondent: Charles A. Cerami

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Subject: Provides a copy of the second interim report on Special World Trade Study

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Office/Agency (Staff Name)	Action Code	Tracking Date YY/MM/DD	Type of Response	Code	Completion Date YY/MM/DD
CWOLL	ORIGINATOR	83/12/21			/ /
	Referral Note:				
OVFTIB	D	83/12/21		S	84/01/05
	Referral Note:				
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ACTION CODES:
A - Appropriate Action
C - Comment/Recommendation
D - Draft Response
F - Furnish Fact Sheet to be used as Enclosure
I - Info Copy Only/No Action Necessary
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S - For Signature
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December 15, 1983

192696

Mr. Fred Fielding
Counsel to the President
The White House
Washington, D.C. 20500

Dear Fred:

Attached is a second interim report on the Special Trade Study that you helped to make possible. I understand that a working group organized by the State Department will review this. Meanwhile, however, I would greatly value any comments you may be able to give me.

As always, my thanks for your great support.

Kindest regards and best Holiday Wishes.

Sincerely,

Charles

Charles A. Cerami

Second Interim Report

on

Special World Trade Study

After eleven months of discussions with leading officials of 21 governments, 6 international organizations, and numerous major corporations, it is appropriate first to report two general observations.

o The common talk of a great "world trade crisis" is inaccurate. Overall, international commerce has fared better during the recent recession years than has the domestic trade within most nations. Well over 20% of the global product is traded across national borders.

o And the almost-universal belief that a "protectionist drift" is taking us far from the healthy trade trends of the 1960's in unwarranted. In the view of very realistic observers in the OECD and other vantage points, only a few lines have been harshly affected by any such movement. It is particularly unfortunate that this idea should have been allowed to flourish, for that can lend momentum to restrictive actions that might never be envisioned in a better climate.

But global generalizations can be misleading. By dividing trade into two quite separate areas, a discussion of its conditions can become much more meaningful and potentially useful:

-- Trade among the industrialized countries is amazingly healthy, hampered by many willful factors that need to be steadily resisted, but not at all blocked by any intractable problems. By this we mean that the production of most goods, the international demand for most goods, and the buying power to pay for most goods are in reasonably good balance among the OECD countries. That

these are not expanding at a rate sufficient to accomodate a growing work force is true, and that a nation like Japan seems to do too much of the producing and too little of the consuming of internationally-traded finished goods may also be true; but these are only evidence of the fact that assymetries are part of any dynamic system. A perfect balance and an ideal future projection would probably contain more hidden pitfalls than we have now.

The supposedly "healthy trends" of a few decades ago held much greater imbalances than we have today. The overwhelming U.S. post-war superiority led to such an over-creation of world facilities and buying power that it laid the groundwork for the almost-catastrophic inflation of later years. The 1960's era of tariff-cutting rounds was actually built atop the trembling foundation of a deteriorating American dollar. President Johnson signed one of these major agreements and then with hardly a pause, asked trading partners to allow deviations from it.

By contrast, the trade differences among OECD countries today are more-or-less elective. For reasons of combatting inflation, of holding down trade deficits and interest rates, and most of all for reasons of maintaining jobs and the political votes that go with them, governments quite naturally tug and haul at each other. But there is no constraint that would absolutely prevent the national leaders from compromising virtually every one of these problems. They are a matter of political choice.

-- Totally different and desperately sick is the north-south situation. There the problem is real and arithmetical. First high oil prices and then enormous interest charges have created a sheer lack of purchasing power that can make import buying literally impossible.

The LDC's, taken as a whole, were the most dynamic section of the world economy until a dozen years ago. They were clearly the very best hope of new markets for the products of the advanced countries. And the percentage gains in their trade were well above those of the already industrialized nations. Now the very countries that are so anxious to be their suppliers are urging -- indeed, insisting -- that they import less from us. Unless new forms of financing and new ways of scattering risk are devised and implemented, the potential of the Third World market will be lost. And the geopolitical consequences will be far more disturbing than the commercial ones.

In trying to find a usable pattern in the complex trade picture, this study is suggesting an arbitrary reduction to just three categories of problems. This is naturally an oversimplification, but it can nonetheless prove useful for determining which are the most manageable and setting up timetables for study and negotiation.

The three categories are very distinct, not only in their degree of urgency and seriousness, but also in the methods required for their solution. They are:

First, impediments to trade among advanced countries that are imposed by central governments as matters of national policy.

Second, obstacles to trade that are created by relatively narrow geographical or commercial segments within nations and that are not closely tied to a national policy.

Third, the bizarre new trade-reduction measures that have been forced on the debt-laden countries.

In order to get some idea of what is behind those three generalizations and to

determine what might be made of them, it will be helpful to examine some of the thinking -- by expert persons in the U.S. and abroad -- that has gone into the formation of this tentative three-part view.

I

Politically-important trade restrictions deliberately used by national governments

What were once thought to be "foreign trade devices," such as subsidization of exports, imposition of quotas on imports, or so-called voluntary export-limitation agreements, have now become routine tools to carry out job-creating activities that modern government sees as a prime responsibility.

A non-socialist Spanish official of definitely conservative leanings told this observer, "We all know that today a government is charged with keeping every worker on the payroll. Whether you subsidize a company, or lend it billions (as the U.S. did with Chrysler), or stop some competitive imports from coming in -- or just put the laid-off employees on a welfare list -- you are doing about the same thing. Some of your own citizens are bearing the burden to make sure that other citizens have some buying power. If you do it through welfare, they get the buying power for doing nothing -- which is probably the worst and most inflationary thing. To whatever extent you can have these people producing something and then hopefully move them toward better and more efficient production, you increase the chance that your efforts will eventually be more like the Chrysler experience and less like the old British experience under the Labor governments."

It is tempting to argue against this view, to insist that all subsidies are a slippery slope. But it is like talking into a high wind. Governments with

unemployment rates of 12% and above -- as so many of the Atlantic trading partners have -- will not soon risk ending subsidization of steel, or farm goods, or any other important sector. Several of the experts consulted repeatedly pointed to labor rigidities, especially in Europe, as the main problem. This in not, however, one of those problems that tends to fade when it is understood. The rigidities will be with us for a long time. The most productive efforts on the part of the whole trading community should be directed toward agreeing and acting as if the practices they give rise to are genuinely temporary. And also on insisting that they not be predatory.

In point of fact, as numerous persons consulted have pointed out, a subsidy is much harder on the exporting nation (as opposed to the companies or workers involved) than on the importing one. If it is substantial in size, it means that the more affluent industries, workers, or geographical areas of a country are being surreptitiously drained of wealth in order to support the less affluent. It also means that users in the importing country are receiving goods at discount prices. The real harm to the latter nation comes only if these low-priced imports seriously injure or even cripple a local industry. That obviously cannot be permitted. To bar products that are imported on that basis is elementary good sense, and it will have the respect of the international community. But to pretend that all subsidies are strongly opposed, at the very time when one's own country is engaging in practices with a similar end, tends to undermine such respect and to weaken the voice with which a government can speak on more pertinent subjects.

The inconsistencies can perhaps be reigned in, but not eliminated. One odd hybrid trade-restraining measure is exemplified by a complaint that a very high Chilean official voiced to this analyst: "Your Government quietly agrees with us that we really should be producing more copper and using all possible methods to

increase productivity. Yet, the U.S. has voted against us in Inter-American meetings -- voted that we should restrain our production. How can it expect us to pay our debts if we do not make and sell our main export product?" The answer, of course, is a domestic political one. With three senators from mining states facing elections soon -- and with world copper stocks bulging -- it is clear why the U.S. is under pressure to take part in this restraining attitude and try to save copper workers' jobs.

It should be added that at a subsequent meeting in Asunción in October, 1983, the U.S. made a promise to restudy the subject. The Chileans, while recognizing the friendly gesture, are still skeptical that the inconsistency will be resolved.

Another type of broad restrictive device, the "voluntary agreement" to curb exports in a certain line has even more long-run dangers. For one thing, as Australian Prime Minister Fraser says, everyone knows that is is not voluntary at all -- that it means giving up part of a market under threat of otherwise losing the entire market; and visible hypocrisy seldom has a happy result.

As an example, two persons who figured in these discussions feel that the U.S. insistence on "voluntary" Japanese restraints on automobile exports would have had better results for both nations if outright quotas had been established. "The Japanese would have understood the blunt setting of a certain volume of trade or a fixed share of the market," one said. "It would have been easier for their own government to explain at home. And it would have made planning easier for the automotive industry in both places." It should, of course, be recognized that such flat protection might encourage the U.S. domestic industry to relax and ignore improvements in productivity. But if the so-called voluntary device is really being used as a ruse to stimulate local producers, there is an extra reason

to question how long such devious measures can be effective.

More tangibly, the proliferation of these agreements is grabbing whole sectors of industry away from the authority of the tariff-cutting rounds that were carried out with so much effort and placing them under special umbrellas that gradually separate them from the world of free markets.

Exchange-rate manipulation is another obvious example of a practice that supposedly can tend to stimulate a nation's exports across the board or to inhibit imports across a similarly wide range. But while it was believed, at the start of the study, that this technique was a major factor in distorting trade, the information gathered so far points in the other direction. We have found no good evidence that even the widely-held belief that the Japanese yen was deliberately undervalued is true. Apart from the obvious fact that an undervalued yen would greatly increase the cost of all the raw materials and fuels on which Japan is so dependent, it is simply not apparent to some of the most knowledgeable monetary experts that a government can for long work against the enormity of the market forces. And if Japan can not manage this, how much less could it be manipulated by less wealthy and less adroit governments? The mere fact of substantial undervaluation would draw in so much speculative buying that a government would have to keep its exchange operations noticeably busy in order to hold its currency's value down.

But there is another form of broad restrictiveness that can and does have major effects. One of the most important forms of protectionism among developed countries is the unpublished and usually denied pressure which governments place on their larger companies to purchase supplies, components, and equipment from local firms in preference to imports. (It should be noted that this is a practice virtually unknown in U.S. trade policy -- as a counterweight to the many criticisms

that have been recorded on other points.) In many cases, even when a foreign company has set up a subsidiary within that nation, it is not treated as an equal. The pressures to avoid its products still continue.

The huge volume of business which this represents -- taken together with more apparent protectionism in government procurement practices -- is probably a bigger factor in the distortion of trade than any of the remaining old tariff barriers.

Clearly, there is no way to legislate or regulate this practice out of existence. An example of how subtle it can be is the following: In an important Asian nation, a manufacturing company purchased some speciality steels from the U.S., defying the usual practice of favoring local suppliers. As the shipments were unloaded, numerous "observers" stood by with pad and pencil, noting the articles and their destination. It was not done surreptitiously, but just the reverse. The message was not lost on the purchaser, and no further import orders of this kind were placed.

The ideal way to banish such a problem would rely on true good will among trading partners, whereby each nation uses the power of government to avoid rather than promote this kind of descrimination. Such a utopian solution is not in sight. Certainly not in an era when several participants in this study firmly assert that some major trading powers (including the U.S.) clearly have a policy of pressing for negotiations on any area of trade in which they are dissatisfied and bluntly refusing to negotiate on the areas they already dominate. But another approach presents itself: A vigorous system of recording, communicating, and if necessary retaliating against each incident that is brought to light. This might seem to exacerbate international trade tensions. But in reality, it might reduce them by bringing sneak barriers into the open.

It will now be necessary to study what system of policing and reporting might be set up. In the past, most advanced nations have been rather lax about guarding the interests of their would-be exporters, partly because government and business are not in close partnership and partly through disinterest. As a result, it is found that a good many companies consulted are distrustful of government. Perhaps wrongly, they conclude that their own government has political and defense interests which it places ahead of commerce and so it avoids wrangling over trade in order not to rock the boat. There is also a feeling among the businessmen of several advanced nations that their officials are far more interested in political affairs and rate commercial matters as second class issues.

It would be a positive step in the direction of more trade and freer trade if more governments, acting cooperatively, organized campaigns to get steady reports from their business communities on experiences encountered in trading with other nations.

To repeat what was touched on above, the trade restrictions that governments have formed the habit of using cannot quickly be rooted out. Unlike the narrow practices to be referred to in section II, which can be ended without affecting more than a few percent -- at the very most -- of a nation's population, these deeply-ingrained methods would be very disruptive to sweep away in short order. To expect that it be done during this kind of difficult economic period is unrealistic. This is one reason why a great world conference on trade was generally opposed by over 90% of persons consulted in this study.

Probably the most progress, grudging as it will be, can be hoped for from a steady pressure on the countries that use these restraints most. Just as in the case of petty practices, these more serious forms of underground protectionism

should be documented whenever the business community makes them known to government. The more fully and in detail this is done, the more effective will be the exposure of the facts.

It will require a policy decision, but I see no reason why even a government publication -- such as "Business America" in the case of the U.S. and similar official trade reviews in other countries -- should not regularly report on significant instances of such protectionist practices. The fact must be faced that there might be printed retaliation from the country that is exposed in this way. But if the goal is really to increase trade, that price has to be paid. In the end, the detailing of so much of the truth will harm a protected sector here and there. It will probably affect no more than a small fraction of a nation's total foreign trade, and of that, the negative effect would be even less. At the same time, the positive effects should be larger, and the great gain will be that overall trade total will be considerably augmented. Today, as was the case many years past, the need is to increase the size of the pie. There can be no other way in a highly competitive era for any nation to make gains nearly great enough to satisfy the need for domestic growth.

II

Narrowly-based trade restrictions that require separate approaches

As one talks with the policymaking officials of each nation about international trade, it becomes apparent that no other subject arouses so much mutual recrimination. On security and other political issues, the feelings are stronger, more profound; but there opinions are grouped, so that several, or even scores of countries all hold one view, while another large number of capitals share a contrary opinion. Only in the matter of trade does each and every nation feel

that virtually all others are guilty of some reprehensible practices.

It will require more extensive talks among the expanded group of persons who have expressed interest in this study to gauge the full effect of these impediments. But it is clearly a broad and debilitating one.

As a huge market -- and a nation whose pleas of internal economic problems are generally derided -- the U.S. comes in for a major share of criticism. Most American officials sincerely feel that their country is the world leader in the fight for trade liberalization. But nearly all the U.S trading partners see the No. 1 nation in a very different light. This analyst encountered strong emotions and literally some bursts of profanity from persons in high places when he referred to the free-trade goals of the U.S.

The chief complaint is simply that the U.S. is very protectionist in practice, even while preaching liberalization in principle. The number of U.S. non-tariff barriers was invariably cited. So was the U.S. reluctance to buy defense equipment from abroad. But most of the complaints were in even narrower lines -- items that are of special interest to only one company or small industry that succeeds in gaining the support of just a few legislators.

A number of small nations that are either allied with or very friendly to the U.S. feel that they are especially mistreated for the very reason that their markets and retaliatory ability are small:

New Zealanders, for instance, believe that their attempts to be good partners often have negative results. They have reduced their protection of many industries and strictly avoided import-substitution approaches; but on the selling side, they find their few major export products stiff-armed by others. They understand why the size and complexity of the U.S. butter surplus caused Washington virtually to

bar any imports from the world's most efficient producer. And they appreciate the U.S. awareness of the effect that extensive disposal of its own butter would have on the limited international market. But they are affronted that it takes a steady effort on their part to keep from losing their sales of casein to the U.S. The U.S., they say, has no casein production of its own to protect; but a single senator and a small group of congressmen have made it a point to try to block the New Zealand product, because dairy interests maintain that the use of casein in certain food products may prevent the development of new uses for U.S. dairy items.

Austria, as another example, finds that it is forced to underbid U.S. competitors by at least 50% on machinery for the U.S. Corps of Engineers, even though Austria has been buying U.S. defense products for two decades with no offset whatever. The Austrians also regret that they are repeatedly mentioned in congressional hearings as having taken part in "technology transfer to the East," when the items involved contained not U.S. parts or technology whatever and had been freely offered to all potential buyers. In one instance, in fact, certain high-quality forging machinery was actually sold to the U.S. first; but critcism nevertheless arose when similar equipment later went to East Europe.

Most of all, the Austrians complain that their pleas for U.S. information that might help to control Austrian companies on technology transfer are never heeded. "On most things, we get fine cooperation from the U.S.," they say. "But when it comes to technical sales, there is simply no response - until the time when critcism builds up in Congress again."

The ambassador of another European country tells of a factory that was built there for the purpose of supplying components under contract to several U.S. firms. Then opposition in Congress mounted to the point where the start of production

kept being delayed. Not only did the entrepreneurs suffer almost disastrous losses; local persons soon became deeply resentful that the promised jobs were being denied them by the U.S.A.

"What is especially serious about repeated incidents like these", says the top trade official of a nation that complains of similar experiences, "is that it begins to give a taint of hypocrisy to the image of the U.S. The world has been critical at times, as it usually is of the big and powerful. But always the image of America was of remarkable frankness, even about your failures and shortcomings. You were too great to be devious. Now with this talk of free trade and this opposite behavior, you too often seem evasive and tricky."

Deeper examination shows that most of these complaints actually involve actions of the Legislative branch, rather than the Executive. When the discussion is sufficiently in depth, most critics agree that the State Department's claim of free-trade-mindedness is sincere, and that the STR's office has balanced views. What they are usually resenting turns out to be the intrusion of congressmen and senators which, even when it does not permanently block a certain type of trade, creates such uncertainty that the foreign producer either abandons or greatly limits his expansion.

This is far from being peculiar to the U.S. legislature. It is apparent that a similar kind of regionalism plays a large part in the trade realities of other representative democracies. This observer was in Canada, for example, at the time of a long series of cabinet committee meetings aimed at revising foreign trade policy. While the external appearance of unity was preserved, it was learned privately that hardly a single proposal was put forward -- even including some that had been thought to be innocuous -- without arousing the sharp objection of a minister whose home area had a special interest. When

it is, indeed, a massive difference between Ontario's manufacturing interests, Alberta's energy dominance, and the agricultural pre-eminence of other Western provinces, it has to be counted as an endemic fact and considered as part of our First Category of entrenched problems. But all too often, a handful of Canadian deputies stand stubbornly in the way of trade that 95% of the population would accept or even applaud.

Such impediments, which probably exist in nearly all countries, in direct proportion to the degree of decentralization of the national government, are created by remarkably small groups of individuals, rather than the makers of foreign policy. It does not require any "free trade bias" to question them. Since they exist for only a very narrow interest, rather than for a national one, they are often more of a disservice to the home country than to the trading partners who feel affronted by them. Many of the experts who figure in this study believe that these restraints have almost entirely negative results with scarcely any redeeming benefits for any nation or substantial group of workers. If they favor and assist an individual company, they say, it is only for a limited time and at the price of penalizing an entire society.

What is now needed is a more specific analysis of the non-national trade barriers of <u>other</u> nations. We have so far heard mostly the complaints about U.S. practices and there has not been time to look at the other side of the coin. A humorous recent report from Japan highlights how many restrictive ways are at work abroad: A young politician who is a U.S. college graduate with a background of defending free trade is running for the Japanese Diet in Wakayama Prefecture on the promise that he will vigorously protect that district's "Mikan" citrus fruit against the inroads of imported U.S. oranges. It may well be that many of the restrictions against U.S. exports we hear about actually

originate in this narrow way, rather than as the policy of a central government. Pinpointing that fact could make a major difference in the ways and the effectiveness of negotiating on such problems.

The hierarchy of relative degrees of protectionism in the major nations is often confused by the fact that practices of a national and non-national nature are lumped together indiscriminately. That may be why several of the persons consulted say we believe misguidedly that in the final analysis they see little or no difference between the North Americans and such countries as, say, France or Japan, which have the strongest protectionist reputations. They cite the French remark, "You Americans talk and talk about free trade principles until it comes time to reach a real agreement; and then it turns out that your political realities do not permit you either to agree or to keep your promises. We take the trouble to consider our political realities first. We don't sound quite so liberal, but what we say we'll do, we do."

French officials, in turn, express their bitterness over Germany's system of industrial norms -- product standards that have been commonly accepted in Germany for over a century, Germany's ancient law about beer content that bars most French beers from selling there, and Italy's insistence that all pasta sold there be made from durum wheat. To the Germans and Italians, these are normal requirements. To the French, they are blatant NTB's.

Despite this, the present study has so far had to conclude that France and Japan do inhibit imports much more seriously than the U.S. and most other OECD countries do. They make it very much harder and costlier for a foreign producer to get his products inspected and passed for entry. Their most important behavior, however, reinforces points made in the first section of this report. It is interference with trade at a high level and in a big way, particularly in pressuring

companies to buy locally, that earns those two countries the greater part of their protectionist standing.

It is now appropriate to set out briefly some of the questions regarding narrowly-based trade restraints that can be explored further - questions that would hopefully evoke means by which a great deal of new business and new jobs could be stimulated:

First, should there be more public knowledge of attempts made to bar imports and of the pro-and-con reasoning? Should friendly trading partners come together through their trade representatives and devise ways to educate their publics on the relative merits of restrictions that benefit very small groups? (Trade has become a subject which, like inflation and taxation, is now of real public interest. The old fear that people will be bored by it is no longer valid.)

Second, even before or in the absence of any such international effort, should the U.S. or any other single trading nation take this same educational step unilaterally -- not as a "favor" to trading partners or as a gesture of magnanimity, but as a duty to its own people?

Third, consider whether a similar attitude should be applied to most other aspects of trade. Persons from several nations cooperating in this study have urged a 180-degree turn to make clear to businessmen, labor groups and consumers that imports are not "concessions" to a foreign power, but rights that should not lightly be taken away from a free people. Some of them emphasized that this is by no means a new activism by government; rather it is government's new wish <u>not</u> to be drawn into what should usually be private business.

Fourth, on the other hand, how can the entire business community be given more and repeated assurance that its government stands ready to help overcome

analyst only by a minority of persons who like to call themselves dedicated free traders. They feel that protesting unfair actions by others should not involve retaliatory measures. The old reciprocal thinking has stressed free trade as long as others also liberalize. Otherwise, retaliate in kind. So if country A discriminates against exports from Country B, then B does likewise against goods from A. True, Country B should protest, even retaliate by some means -- political, financial, or commercial. But not by barring the products of Country A. If it is recognized that such merchandise is good for the importing country, barring it only means that B is hurt twice.

This argument goes on to quote Adam Smith : "The country supplies the town with the means of subsistence and the materials of manufacture. The town repays this supply by sending back a part of the manufactured produce to the inhabitants of the country . . . Among all the absurd speculations that have been propagated concerning the balance of trade, it has never been pretended that either the country loses by its commerce with the town, or the town by that with the country which maintains it."

Today, say the purest free-trade advocates, this sentence might be appended: Nor should it ever be pretended that either the country or the town can gain by cutting off a part of this commerce in order to punish the other.

If this thought appears to run counter to the revered principle of reciprocity, then so be it, say its proponents. There are numerous ways that one nation can pressure and induce another to behave fairly in commercial matters. Counter-productive, self-injuring measures need not be counted among them.

III

Blending the Interests of North and South

This analyst began with a personal belief that the Third World had been unrealistic in its development aspirations, far too aggressive in trying to cartelize and raise its raw material prices, and should be dealt with rather firmly by the advanced nations that largely control its destiny. But a deeper look has altered that view. At this point in the talks with officials of the major countries, with those of several Newly-Industrialized Countries, and with some of the Group of 77 leadership, it appears that the latter have made a distinct move toward realism and cooperativeness, while the NIC's tend to want the best of both worlds; the advanced countries, meanwhile, are highly practical about short-run handling of the Third World but woefully unimaginative about where our longer-run interests lie.

The monetary and financial disruption between north and south could easily condemn both areas to a bleak future. But there is one very bright aspect, if one considers deeply enough: The identity of interest between the two areas. The north, for the sake of present banking stability and future market expansion, needs the south more than it once imagined. And the Third World, for its part, is even more desperately reliant on us -- if it hopes to remain part of the organized and progressing world at all.

It has become quite trite to dwell on our need for enlarged markets. Yet scarcely anyone in the industrialized world behaves as though there is any truth in it. So it must be said again and again: We <u>need</u> new markets. We will need them rather desperately in a few decades, and they take more than just years to create. We can eke out enough enlargement in our own markets to grub along;

but we cannot go back to living with the old vitality unless we make use of more of this planet as a place to sell.

Nearly all the officials of advanced countries whose views were solicited have been rather disdainful of the so-called "Lima Target", whereby, the Group of 77 asks that 25% of the entire world's industrial capacity be in the Third World by the year 2000. If the comments made to this analyst by the Group of 77 officials are accurate, they no longer see this as a firm demand, if indeed they ever did, but merely, as an indication of the direction they hope world development will take. Persons of great sophistication have remarked that even this would overwhelm the OECD nations with a flood of low-cost imports. They appear to overlook the fact that those upgrading nations would not only be selling products, but buying them as well. Supplying the needs of that developing world -- food, components, services, technical products -- would be a major way to give the already industrialized countries a revived future.

The Third World, for its part, must face the fact that it has no alternative but to cooperate with the advanced Free World nations. The pretense of turning to the socialist bloc for assistance is futile. The examples of impoverishment that such moves have brought to Cuba, Angola, Mozambique, and others make it plain that a nation as unevenly developed as the Soviet Union is no place to go for development aid. The U.S. and its allies should be able to convey this message to the Third World; but only if the message is coupled with enough tangible offers from our side to forestall desperate moves by radically-led groups in countries without hope.

The cash plight of the LDC's is too well known to need restatement here. What is less recognized is that the advanced world is suffering greatly from the very measures of austerity that it has been counseling to the debt-ridden. It is

not the function of this study to judge existing monetary or demand-management policies, but it does seem imperative to point out that still-excessive interest rates are now a greater menace to the world economic system than inflation is.

Apart from the fact that such rates are, in themselves, a likely cause of renewed high inflation later on because of the costs they add to everything produced and the pressure they create for more inflationary international lending practices, they are severely damaging the industries of the U.S. and other OECD nations by distorting exchange rates. Unless the overvaluation of the U.S. dollar is brought to a rapid end -- virtually at any cost -- the damage to America's industries will be irreparable. And most other countries freely recognize that the health of U.S. industry is vital to all.

The eight highest-debt Latin American countries bought $9 billion less from the U.S. in the first half of 1983 than they had in the first half of 1982 -- a 37% drop.

Exports of metals, machinery and transport equipment were down 47% in that period. Exports of textiles were off 40%. Exports of wood and paper were off 32%. And so on.

Trade with Latin America has been placed on virtually a cash basis. As U.S. Commerce Undersecretary Lionel Olmer has pointed out, even many first-class U.S. companies would find it difficult to prepay suppliers if suddenly deprived of all credit. We cannot expect our former Latin customers to perform such a feat.

The distorted dollar rate also makes a mockery of attempts by U.S. international firms to compete normally. Ingersoll-Rand, a leading maker of heavy equipment, has pointed out that declines of 22% to 37% by some European currencies

relative to the dollar since 1980 (after adjusting for relative inflation rates) can result in a disadvantage of as much as 58% for U.S. products trying to compete in third markets. These recent public bid results are examples:

(1) At a recent bid for a large number of compactors in Indonesia, the following prices per unit were bid:

Italian made	$24,473
Japanese made	26,154
Made in Malaysia or Indonesia	26,330
Swedish made	28,601
Made in the U.S. by Ingersoll-Rand	35,298

(2) A similar public bid took place in Korea, for a large number of portable compressors, and here is the line-up per unit:

Made in Belgium	$ 7,569
Made in Japan	9,159
Ingersoll-Rand made in the U.S.	10,269

(3) The following compactor bids were made recently in Guatemala (per unit):

Made in Mexico	3,195
Made in UK	4,928
Made in France	5,275
Made in the U.S.	6,376
Made in the U.S.	$ 7,999

And it should be added that some of the U.S. bids were made almost at cost, simply in an attempt to stay in the market.

Since almost all the authorities contacted to date in this study fear that the major nations will not soon achieve the 3%/4% real growth without inflation that they believe would be needed to overcome the debt problem, new financing devices are clearly vital.

One area that needs more study is an expansion of export credits to the LDC's. The idea of creating an international clearing house for coordinating such credits

would also get more attention. Anything that helps to enlarge credits without making them a means of predatory competition is desirable.

Even more basic is to move away from the mistake of too much borrowing by means of bank credits, rather than by means of securities that have a secondary market and can automatically stabilize themselves. One thing to be studied urgently is creation of a special international discounting mechanism. It should be able to discount bank debt and other public or private debts of developing nations at free-market rates; and it should issue certificates that could be presented to central banks. By buying or selling debt instruments, such a system would introduce new vitality and stability to international credit.

While working in these ways to assist Third World liquidity, the advanced nations should be making sure that the present anti-import requirements of the debtor nations do not harden into fixed habits.

It has been suggested by several of the experts contacted that present attempts to make the LDC's rationalize their economies might include taking advantage of our leverage as creditors to get firm promises from them that protectionist devices will be rolled back at certain fixed times. And parallel with that, advanced countries whose banks are owed large sums could be urged to reduce their own restrictions on imports from Brazil, Mexico, etc. By doing this, they help their own banks. It would seem profitable, and appropriate for this study to pursue talks with policymakers who would be involved in such decisions, and especially to see whether cuts made for that reason could then be multilateralized via MFN.

In the way that adversity can sometimes be used for constructive purposes, the moves that must be made just to tread water and keep the system going can also be adapted to positioning ourselves for genuine progress in the longer run.

Appendices:

The following are appended either because they will help to give a sense of the type of discussions from which many of the conclusions come or because they contain points of special interest that do not fit the context of the report at this stage.

Appendix 1

This is a summary of remarks made to the analyst by a very high-level U.S. official:

Use of Japan as a scapegoat should end. He is bearish about Japan's economic position. Not bad, but a slowing rate of growth and profitability. For the U.S. to base so many of its problems on a complaint about one efficient rival is wrong and dangerous.

Sneering at the Lima target is wrong. It probably won't be met, but the more progress we make along that route, the better it will be for us, for the growth of our markets.

The U.S. industrial pattern will change greatly -- as it must. Autos and many other products that were once the advanced items will gradually become only semi-sophisticated articles. Our imports of cars may go from 25% to 75%. OK with him as long as we have plenty of other things to make. There will not only be adequate markets for U.S. computers, but young and just-starting markets. Plenty of need for them in Biafra. But these new markets have to be making and selling something beyond just raw materials. For if not, those raw materials would have to be priced so exorbitantly as to be a real threat to world economic stability.

Subsidies are bad -- but worse for the country that uses them than for the recipient nation.

Notes from a conversation in London with a leading official of the Foreign Office:

Britain's Philosophy -- basically liberal, free trade. It has always been and it makes sense because 30% of Britain's GNP is exports -- the highest percentage in the world.

Britain's Posture -- liberal because of the present personalities involved -- Thatcher, Parkinson, and Howe. This administration is more liberal than the past several were because it was less linked to Labor. But there are pockets of opposition within the government. Mrs. Thatcher speaks of "free and fair trade," which is admittedly a contradiction in terms. But she does mean that if others trade fairly, Britain will trade freely.

Britain's role in the Community -- on international trade the EEC is supposed to speak as one. And the commission speaks for the EEC. That means it is always a compromise, and a poor one because it must be in accordance with the weakest position. France is the most protectionist. Germany is the least.* Britain is about in the middle. It wants to see the development of full community-wide freedom in all things. Trade, money, services, and labor (although Mrs. Thatcher is not really inclined to pull out of the EC. But she would not mind weakening it to the point where Britain could ultimately hold more sway there.

Community role in the World -- Britain also wants the EEC to be open to the outside and eventually to get to global free trade. But realistically, there will have to be exceptions, such as steel and especially agriculture where every country is protectionist.

On France's proposal for regionalism in high technology, there is no British policy yet. But they do welcome France's step away from strict nationalism.

*Observer's note: This comment is stated as it was said, but does not agree with information from other sources.

Notes excerpted from talk with a very high official of Britain's Ministry of Trade. London, September 19, 1983.

Britain's chief trade worries are: 1) Japan. The Japanese keep promising to ease their restrictions but nothing happens. 2) The United States. It talks of liberalizing trade, but nothing happens.

"All of us over here are very angry over Reagan's specialty steel decisions. We want to see the Williamsburg commitments implemented. If you say you're going to hold fast on protectionism, then do it. If you say you will roll back protectionism as the recession ebbs, then do it.

Britain will take part in any liberalizing move as long as it is comprehensive and reciprocal. Mrs. Thatcher has said that and she means exactly that.

Special Canadian Points of View gathered in confidential talks with leading trade officials in Ottawa

Because trade is 30% of Canada's GNP Canadians attach greater importance to a multilateral trading system. But it is clear according to leading policy makers that Canada must find new ways to operate.

The GATT Ministerial meeting agreed on a fairly comprehensive work program which could lead to changes in the GATT in about two years. But these would be changes of detail and not in the basic contract itself. As Canadians see it, the important thing is how seriously last November's agreement is taken. They appear to be skeptical. More than anything else they think the need for more frequent meetings has been demonstrated. The last gathering had been in 1973 in Toyko, leading to the Toyko round of negotiations. Canada is giving much thought to how to involve ministers more effectively in the GATT. The consultative group of 18 (which involves some 40 powers) has overall management of policy direction, although not decision-making powers. It is the body that might serve this purpose.

On export credits, OECD disciplines are more important than those of GATT. Canada cannot afford a credit war with Japan, the US and the EEC.

Getting internal agreement is more difficult in Canada than just about anywhere else. Each point raised brings sharply opposed views of the Ministers from farming and energy producing areas and those from industrial areas.

One high and particularly outspoken official expressed doubt about whether there is a real trade crisis in the world. He is not sure that the unemployment and debt problems may not also be exaggerated. This person is very much against New Zealand Prime Minister Muldoon's idea of a big new global meeting or trade round. Any tariff-cutting session could be a disaster, with all Ministers

having such problems at home. And any big meeting would give the impression that there is a crisis that the IMF can't cope with. We should try to ease, not heighten the tension. Another strong feeling of this same official is that the administrative weakness of GATT is very serious. He feels that any new proposals to strengthen the organization should emphasize smaller leadership in order to make things go.

This is one of the persons who feels most strongly that the Japanese threat has been greatly exaggerated. "Canada is paranoid about the Japanese, and Washington is much more so". This is one of the worst dangers we face. Looking for scapegoats is the worst basis for decision making, and it is a way of not confronting our own deficiencies.

A number of Canadian officials expressed little enthusiasm for a realigning of exchange rates, but all came around to agreeing that they would go along if many trading partners felt that the move was needed.

A sharply dissenting view about GATT changes was given to me by one person in a very sensitive position who is present at <u>every</u> foreign trade discussion. He believes that Canada will only pay lip service to the idea of strengthening GATT, but will be happy to see it stay weak. The reason is that after years of obeying the GATT rules and feeling that hardly anyone else does, Canada has begun to side-step those rules (for example, in giving special low-cost loans to Third World customers). This kind of easy going approach is beginning to appeal more than Canada's old puritanism.

One of Canada's most respected think-tanks is developing a totally new approach to world trade rules. While agreeing that a single big umbrella is required to recognize that we are all part of one world, this organization

stresses the important differences in trade relations between various nations. For example, trade with the U.S. is 70% of Canada's foreign trade. It is artifical and irrational to try to subject this to the same rules as trade with Indonesia or Bangladesh. So an idea titled "Differentiated Universality" is being proposed as a way to get regional or sectoral rules within the overall GATT system.

This same research organization agrees with the need for administrative changes in GATT, and sees more prior consultation among Ministers as the principal need.

An overall judgment about Canada's foreign trade attitude might be summed up in this way: After a period of looking outward for its growth and prosperity, Canada became inward looking for a period of years, more taken up with the politics of social programs than with the economics of trade. Now the slowdown in growth and employment is prompting national politicians to turn outward again. Canadians talk more about facing up to their international responsibilities and they can be expected to take a greater role in the world.

Talks at the U.N. with officials of a UNIDO office (late July and August 3, 1983).

The UNIDO office in New York exists partly to train persons from member nations how to run programs to attract foreign investors. In theory, any nation can send officials to train in New York, but it is significant that there is a regional tendency which makes mainly Western Hemisphere nations turn to New York while other UNIDO offices in Vienna and Tokyo get people from their areas. This evidence of regionalism may tie in with Canada's new thoughts about different trading rules for different partners.

The investment promotion programs of the various nations are highly competitive among themselves. A few officials may realize that the world either will or will not move toward development and that no single nation is likely to buck an adverse trend. But most investment officers feel that they will be quickly judged on the basis of immediate performance. Unfortunately they are right. Some countries, such as Singapore, strictly monitor how much a promotion officer spends on each prospective investor and what the results are. If they are not quickly successful, back home the officer goes.

It is important to note that the officials who direct this office find investment promotion very hard to sell in the U.S. The U.S. government gives only a few percent of the total cost of running the New York office, while other countries who are host to such offices pay 100% of their cost. This means that Americans are failing to understand how many jobs and profits can be created by investing overseas.

Excerpts from notes made after a talk with a member of the U.S. delegation to the United Nations (July 21, 1983).

The idea of developing nations creating a "hospitable climate" for business investment has been exaggerated. Some of the poorest nations have tried hardest to make the climate attractive. But business doesn't go there because the market is not apparent. Some nations with a big market potential do attract companies, even when they are less hospitable.

The following are edited remarks made at a recent CSIS Conference, (October 24-26, 1983) by Australian Prime Minister Malcolm Fraser. These are cited as an example of how political leaders at the top levels are beginning to talk bluntly about trade. The inference is that there will probably be more such initiatives, often directed toward the public and therefore involving the people of most advanced nations much more actively in trade issues than they have been.

Speaking to representatives of 15 Pacific region countries, Prime Minister Fraser said:

> At this stage we need a framework that would not commit Pacific region governments to directions that they might find unwelcome but that would enable them, nevertheless, to join in a closer relationship with each other.
>
> I would suggest a development toward something like the OECD, beginning perhaps with an arrangement similar to the OECD's Economic and Development Review Committee where an impartial analysis of each country's economy is undertaken. Such a process would help to define areas for increased cooperation and would draw out the effects of one country's policies on its neighbors. Participation would not have to be compulsory -- only open to the free decision of member governments.
>
> The trade negotiations of the last 20 years, indeed since the foundation of the General Agreement on Trade and Tariffs (GATT), have been bedeviled by the attitudes of the most protectionist European powers.
>
> The GATT has become a pale shadow of what was originally once hoped, and the "Most Favored Nation" principle -- which I believe is utterly important

in trade matters if goodwill is to be maintained between nations -- was destroyed by the decisions of major states at the last multilateral trade meeting in 1982.

In addition, since the last trade round, governments around the world have made a whole raft of decisions that have added to protection. Voluntary restraint agreements abound and we know there is nothing voluntary about them at all. They are exacted under threat of losing the whole market.

I propose that nations prepare a new code on protection to cover industrial goods, agricultural goods, and services.

The first element in the code would be a total and absolute commitment on the part of any signatory not to raise protection in any form -- direct, indirect, legal, or "illegal" -- against any other signatory.

Negotiations would no longer be inhibited by the most protective major powers. Those powers could continue to be as protective as they wanted to be and would not have to sign. It is probable, however, that major industrial states, including those of Europe, would before long join such a code once it was proclaimed and once a major economic group has endorsed it.

The easiest way for such a proposal to be put into place would be for the president of the United States to become committed to it -- for two reasons.

First, this nation has the economic weight to make the proposal workable. Second, trade represents such a small part of the U.S. gross national product that the proposal could be put in place with less immediate impact on the United States than on any other nation.

Many states would applaud the United States for being the first of all industrial nations to give the developing world an old-fashioned "Fair Go." I am certain that as other states and nations signed such a code, trade flows between them would grow enormously and thus others would be dragged or cajoled into participating in a better world -- almost whether they wanted to or not.

I know that the U.S. president is in his mind and heart firmly committed to the principles of free trade. I am certain that it is within the power of the Pacific nations to advance this concept greatly. I am equally certain it is within the power of the United States to bring it to effect -- and if there is any leader in this nation with the courage to do so he would go down in history as the president who saved the twentieth century from disaster.

These little-noted facts about U.S. trade patterns have emerged in the course of discussions:

-- A general drop in relative international transportation costs is a big factor in changing the trade picture -- and particularly in putting the U.S. at a disadvantage. An ITC study shows that freight rates as a percentage of the value of manufactured imports have fallen nearly 25% in the past 6 years. Bulk ocean carriers and wide-bodied planes are thought to be a principle reason. It is estimated that from 1976 to 1981 declining transport costs accounted for 27% of the total real growth in imports. They are undoubtedly a factor in the surge of foreign autos and steel into the U.S.

It would appear that this change in the former "protection" which distance lent to the U.S. should be taken into account in future negotiations.

-- In exporting more raw materials and importing more manufactured goods, the U.S. is showing the pattern usually associated with a less-developed country. For example, the leading U.S. exports to Japan are grains, cotton, and coal. The main U.S. imports from Japan are autos, trucks, video equipment, and motorcycles. As Chairman, Alfred E. Eckes, of the International Trade Commission, has said, this is a reminder of the colonial trade pattern which the U.S. had with Great Britain in the 18th Century. And the U.S. is now falling into the same pattern in its trade with Taiwan and Korea.