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PER SPECTIVES ON
GLOBAL POWER
AND WEALTH

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Beyond Laissez Faire

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This reading disputes the traditional laissez-faire approach to economic policy making in the United States. The author argues that this approach leaves America disadvantaged in international economic competition with the newly industrializing countries of East Asia and, especially, Japan. Breaking with the central tenets of neoclassical economics, Clyde Prestowitz insists that maintaining a strong industrial base in the United States is important to the country's economic future. The United States must abandon laissez-faire rationalizations for inaction and develop a proactive policy that targets high-growth and high-wage industries. The country must also reform the rules of international trade and monetary relations, he concludes, in order to facilitate and reinforce this proactive strategy.

Markets, open to trade, and minds, open to ideas, will become the sole battlefields.

—Victor Hugo

We did the opposite of what the American economists said. We broke all the rules.

—Naohiro Amaya, MITI vice minister

Europe's choice is between survival and decline.

—Jacques Delors, president of the Commission of the European Communities

As the end of the Cold War opens the door on the new era once envisioned by Victor Hugo, Americans are coming to realize what the Japanese and Europeans have long understood: that economics will be the key to world affairs. That realization—along with growing suspicions that fundamental American premises about the nature of economic competition are wrong—has brought to a boil a great debate over U.S. economic policy that has simmered during the past decade as trade friction increased and American industry lost out in one technology after another.

At the heart of that debate is the question of whether what a country makes—the structure of its economy—matters. The conventional wisdom, captured in a quip that Bush administration economic advisers deny having made, is that it does not matter: "Potato chips, computer chips, what's the difference? They're all chips. A hundred dollars of one or a hundred dollars of the other is still a hundred dollars."

For most of the past 45 years, U.S. policy has been based on such logic. Partly because they believed it and partly to avoid the kind of economic conflict that helped cause World War II, postwar U.S. leaders fostered a doctrine of laissez faire that separated economic interests from others. The exception was, of course, policy toward the communist world, in which the United States implemented an economic strategy as part of its general policy of containment. Toward all others, though, U.S. economic doctrine was best expressed by Herbert Stein, chairman of the Council of Economic Advisers during the Nixon and Ford administrations:

The world economic order was to be universalist and private. We were floaters and free traders. In a strict sense, there would be no economic relations between countries. There would be economic relations between individuals who happened to live in different countries but who operated in a world market that didn't distinguish between friend and foe.

That view, based on the classical Ricardian concept of comparative advantage, holds that countries do best when they concentrate on producing those goods naturally favored by their resources, climate, or location, and then trade for other goods. Thus, the United States does well to trade wheat from its temperate Midwest for coffee from tropical Brazil. National policy should not, goes the argument, encourage the production of any particular items such as airplanes or supercomputers. Indeed, such policies are seen as counterproductive. Trade is always envisioned as a positive sum game; one country cannot gain at the expense of another. If the United States fails to commercialize an important technology or loses a large industry, there is no cause for alarm as long as the work is being done by a noncommunist state.

That kind of thinking was evident at a high-level 1985 White House meeting about foreign firms that were illegally dumping semiconductors on the U.S. market and damaging American producers. As a high-ranking Reagan administration official put it: "Why do we want a semiconductor industry? We don't want an industrial policy in this country. We don't want to pick winners and losers. If our guys can't hack it, let them go."

In effect, the economic orthodoxy defined U.S. welfare as being identical to
that of the entire world economy. The terms "globalization," "mutual interdependence," and "borderless world" became popular, rationalizing a lack of concern for the structure and nature of interdependence. Because the international economy was thought to be freely floating, the key to prosperity was not U.S. policy so much as the strengthening of international rules, procedures, and institutions. The International Monetary Fund (IMF), the World Bank, and the General Agreement on Tariffs and Trade (GATT) became the trinity for spreading and maintaining the orthodox gospel, a task initially facilitated by their apparent success. Indeed, the birth of those institutions was followed by unprecedented worldwide economic growth, and the first rounds of GATT tariff-cutting negotiations coincided with an impressive increase in world trade, reinforcing the conviction that the main task before U.S. leaders was the expansion of international rules and institutions without regard for their impact on the U.S. economy.

As economist Robert Kuttner and foreign policy analyst Alan Tonelson have noted, laissez-faire doctrine was the perfect philosophy to rationalize American hegemony. Political leaders felt no qualms about granting economic concessions in exchange for votes in the United Nations or military basing rights. And since it did not matter what was produced in the United States, damage to major U.S. industries resulting from U.S. allies' trade and industrial policies was not a cause for great concern. The laissez-faire consensus was also domestically convenient, defining out of existence any need to think about the structure of the American economy—or how various policies, domestic or foreign, were fundamentally changing it.

Having long denied the approach of the new era, the orthodox have recently begun to respond to it with concern and calls for more of the same. They see great potential danger in any weakening of the old regime or of the U.S. world role that has underpinned it. In the words of a leading economist, there is real danger of "a nationalist upsurge triggering new trade controls, restrictions on foreign investment and a generalized withdrawal from international economic cooperation" in the United States. Abroad, there is risk of "a breakdown of economic cooperation" that could "produce new global divisions that would be profoundly destabilizing." To avoid these threats, the orthodox call for maintaining U.S. hegemony, and they argue that this can only be done by shoring up the old system. They propose a new monetary conference to replace the old Bretton Woods system with a new construct of reference ranges, as well as close monetary and exchange rate policy coordination, with the IMF providing forecasts. Not only do they see successful completion of the Uruguay Round of GATT as essential, but they also call for the exhausted negotiators to go on to strengthen GATT's power to police the international trading system, create a GATT for investment, and eliminate all tariffs and quantitative trade barriers by the end of the century. The orthodox goal is global trade and investment essentially free of government intervention by the end of the century. This consolidation of the "free floaters" system is to be presided over by a smoothly cooperating troika of the European Community, Japan, and the United States. But as Yogi Berra would say: "It's déjà vu all over again." It will not work.

POTATO CHIPS VS. COMPUTER CHIPS

The orthodox doctrine is elegant in its design and even noble in its thrust. It can be quantified and modeled, and its vision of international consensus and cooperation is idealistic. Unfortunately, it is based on false premises, the first and foremost of which is that what we make does not matter. It does matter—profoundly.

First, some industries experience very rapid growth, increases in productivity, and reductions in cost, and have a major impact on many other sectors. Such industries contribute more to economic welfare than others. The semiconductor business has grown exponentially over the past 20 years, sparked development of large new industries such as personal computers, increased productivity and Quality in many industries (such as aircraft design and supercomputer), and brought millions of workers to a higher than average level of skills and wages. While most of us love potato chips, they have not had the same dynamic impact on our economy. This is not to say that the United States should stop making potato chips, but if it substituted potato chips for computer chips, its long-term ability to create wealth would be diminished.

Moreover, domination by national producers of an imperfectly competitive industry may result in extra profits and wages for the domestic economy. Long disputed by orthodox economists, the validity of the concept of economically strategic industries has been confirmed by the recent work of James Brander, Paul Krugman, and Barbara Spencer. They point out that dominating a technology or an industry in which there are only a few players, such as aircraft, enables producers to obtain supernormal profits. Since the location of such industries is not dependent on the weather or special natural resources, it can be influenced by policy so that a clever country could raise its living standards by capturing a preponderance of these industries. For example, American domination of the aircraft industry is a great plus for the U.S. economy and is largely the result of U.S. policy decisions dating back to creation of the National Advisory Commission on Aeronautics in 1915.

Second, some industries bring greater training and wages to workers. Unique or highly differentiated complex production of goods such as 747 aircraft or microprocessors requires training and skills that bending hula hoops does not. Because they do not compete primarily on price as commodities do, such products typically yield higher than normal wages. By the same token, high growth often means rapid productivity gains, and industries with high productivity usually pay high wages. This cycle is self-reinforcing because such industries invest more in research and development and training to assure the high skills that yield higher wages.

Third, it will be easier for the United States to expand into new high-growth, high-wage industries if it has not entirely abandoned important older industries. Many industries are closely linked. A major reason why no VCRs are made in America is that most U.S. producers were forced out of the TV industry. The loss of world market share by the U.S. semiconductor industry over the past 12 years
has been matched by a similar loss of position by the U.S. semiconductor equipment industry. The U.S. auto industry is the largest customer of the U.S. semiconductor industry. The decline of the U.S. auto industry has hurt the U.S. semiconductor industry because foreign-based auto producers often do not buy semiconductors from U.S. manufacturers.

Finally, there is the obvious question of defense production and its increasing dependence on commercial technology. We are now in the age of spin-on rather than of spin-off. In the past, military technology was often commercialized for civilian use (e.g. 707 aircraft). Today the opposite is the case (e.g. flat-panel displays).

Not only does it matter what Americans make, but the Europeans and Asians alike pursue policies designed to foster a favorable mix of industries. It is foolish to pretend they do not. All of them, particularly the East Asians, have a producer rather than a consumer mentality; all take a relaxed attitude toward antitrust principles (indeed, the Japanese and Koreans foster huge keiretsu and chaebol arrangements); and all see trade issues in strategic terms.

If America’s economic partners do not view interdependence with indifference, neither should America. Of course, interdependence will inevitably increase. The trends of technology and the scale of production needed for global markets guarantee it. But in a world in which what is made matters, the precise terms of interdependence are very important. Boeing needs foreign airlines as customers, and together they are interdependent. For the United States, though, the fact that Boeing is the producer and exporter rather than the reverse is advantageous. Even among allies, national interests do not always intersect. A healthy desire to maintain enough freedom of action to defend one’s interests argues for care in the matter of globalization.

The truth is that there are different forms of capitalism, each deeply rooted and in competition with the others. Indeed, a 1991 book by a top Japanese Ministry of Finance official, Eisuke Sakakibara, titled The Japan That Has Surpassed Capitalism, argues that Japan is a noncapitalist market economy, far superior to the garden-variety capitalist type. The competition between these systems need not be hostile, but neither should it be ignored.

Just as the orthodox underestimate the important differences between the U.S. economy and those of its trading partners, so too do they overestimate the role of GATT (and other institutions) in the postwar international economic boom. There is no doubt that GATT made positive contributions. But it is unrealistic to ignore the impact of the Marshall Plan, the role of a long overvalued dollar, the impact of the Common Market, and the influence of a technological revolution that has vastly improved communication and transportation networks. Certainly, GATT tariff cutting has stimulated trade, but in many areas outside of GATT—such as services and agriculture—trade has actually grown faster than trade in general. Indeed, renewed growth may originally have made postwar trade liberalization possible (by creating a more benign environment)—not the other way around.

The true force behind the success of the international economic regime was the power of the United States and its ability and willingness to open its markets unilaterally while providing liquidity and technology to others. As American power has waned, the system has run into increasing difficulty. Calls for renewed coordination and cooperation will not repair it. Although America’s partners are often cooperative in times of crisis, their fundamental differences with conventional U.S. economic wisdom make attempts to revitalize the old system futile and even dangerous. The philosophical consensus required to make the old structures work is missing, and U.S. efforts amount to trying to persuade others to be like the United States. If the United States could not do that when it had overwhelming power, how can it possibly persuade others while it is in a state of relative decline? It cannot, of course, and its attempt to do so will only anger its partners and neglect the factors behind the continuing erosion of its economic power.

The United States is facing an era of unprecedented economic competition without the benefit of its past superiority in industry, technology, and finance. It is not possible to speak of an international economic policy without addressing the domestic basis of such a policy. In the past, others deferred to U.S. military and economic power. Today, Americans cannot expect to have influence or even minimal cooperation so long as they continue to pile up debt, fail to develop and maintain key technologies, and lose positions in major industries. Some reports from Japan, for example, tell of a growing contempt for the United States. Countries do not long listen to those they do not respect. It will not suffice to recast U.S. international economic policy; the United States must develop a wholly new economic strategy in which international competitiveness is a natural extension of the revitalization of the domestic economy.

The heart of the new strategy must be a recognition that what America makes matters and an explicit, high-priority commitment to American leadership in important industries and technologies. The United States must abandon its laissez-faire rationalizations for inaction and develop a proactive and comprehensive program.

It must be understood at the outset that the tired debate over “picking winners and losers” is beside the point. The United States has a large government that determines the shape of its economy through the tax, regulatory, and spending decisions it makes every day: The savings and loans bailout, the Pentagon’s research and development spending, NASA’s space shuttle, the breakup of AT&T, the investment decisions of the Defense Advanced Research Projects Agency (DARPA), and the U.S. Trade Representative’s recent emphasis on agriculture and services rather than on manufacturing—all affect the structure of the U.S. economy. As a complex country with a diversified economy and an unavoidably large government, the United States cannot shun policy choices that influence its economic structure.

It is often argued that given the U.S. political system, any conscious effort to affect the structure of the U.S. economy would inevitably become hopelessly politicized and result in large subsidies for politically powerful sectors. In fact, the opposite is true. At the moment, in lieu of any overall guiding criteria, the choices are inevitably the victim of politics or happenstance. The space station and supercollider, for instance, will be of very questionable benefit to the U.S. economy for
many years, if ever. Yet with no way to evaluate them in regard to other possible choices, they have proceeded because they happen to enjoy political support. We see the same dynamics at play with U.S. trade policy. Why has rice been such an important part of our agenda with Japan? Certainly not because analysis shows major economic gains from opening Japan's rice market.

Thus, a comprehensive policy would be based on the development of productivity and growth criteria to guide choices affecting the structure of the economy so that politicians will be forced to cease the present practice of rewarding favored groups. For instance, should DARPA focus its limited resources on strictly military technology or on dual-use technology? Should NASA be pouring money into the space station or into refurbishing the wind tunnels that underpin commercial aircraft research? It is often said that the government cannot pick winners, but we should not forget that some of the strongest U.S. industries—such as agriculture, aircraft, telecommunications, supercomputing, and networking—were the result of cooperative ventures between industry and government. None of these involved large subsidies; all involved a careful evaluation of global technology and market trends as well as the development of public policies that allowed U.S. industry to capitalize on those trends.

Several groups, including the U.S. Commerce Department, the Japanese Ministry of International Trade and Industry (MITI), the European Commission, and the private-sector U.S. Council on Competitiveness, have compiled lists of key industries and technologies for the twenty-first century. All the lists are essentially the same: Biotechnology, advanced materials such as industrial ceramics and engineered plastics, broad-band communication, and microelectronics clearly will be important in the future. It is desirable that those technologies and industries be realized here. A high-wage, high-growth economy will be far more likely with healthy performers in those sectors than it will be without them.

Americans must also understand that an optimal economic structure involves not only high technology, but the supporting and customer industries that inspire further innovation as well. For example, the auto industry is not only one of the largest customers of the semiconductor industry, but it demands chips of the highest quality and performance. Thus, to assure a healthy computer chip industry, thought must be given to how to maintain a competitive auto industry, particularly in view of the fact that many large foreign auto producers use virtually no U.S. semiconductors.

To ensure that the United States has a leading presence in the new industries—and the necessary strength in the industries that support them—it is imperative that Americans create a governmental mechanism to guide public policy choices in the direction of high growth, high value added, high productivity, and high technology. Congress could charge the General Accounting Office with developing criteria to evaluate the structural impact of legislation, and the Joint Economic Committee could act as the overall coordinator and evaluator of economic bills. In the executive branch, the present economic policy council could develop criteria to guide policy development while evaluating all new proposals with regard to their overall competitive and structural effect. Of course, other organizational struc-
tures are possible. The key is not bureaucratic forms. It is recognizing that what we make matters. Such a philosophy and such a mechanism would be the basis both for revitalizing the domestic economy and for developing an effective international economic policy to confront the new era of geo-economics.

In looking at the economic challenges before the United States, there is broad agreement among economists on several key points. Most agree that the world economy is moving inexorably toward greater integration; few see any salvation in isolation and protection. In the future, most see some kind of world trade organization, the continued removal of barriers to trade and investment, the development of a more predictable exchange rate system, and greater funding of development for Eastern Europe and the underdeveloped world. But the key for U.S. policy over the next several years is not so much the goal as how to get there.

The classic U.S. approach has been to maintain dollar dominance despite monetary instability, while proceeding with a trade policy based on the principle of laissez faire. Deviations from this line, such as suggestions to pursue a conscious industrial policy, have been condemned as unfair, and enormous efforts have been exerted in talks like the Structural Impediments Initiative with Japan that seek to bring foreign economic structures into accordance with American ones. The result has been little concrete success and growing resentment of U.S. demands at the bilateral level, and stubborn deadlock of GATT's Uruguay Round at the multilateral level.

Thus, the most important development on the international economic scene is not the Uruguay Round but EC '92. The Europeans have understood that to have truly free trade and deeply integrated national economies, a high degree of homogenization is necessary; otherwise, adjustment costs resulting from structural disparities will undermine the effort. Thus the harmonization of regulatory, labor, social, and technical standards, judicial and corporate governance, and monetary and other regimes has gone hand in hand with freer trade. Even in the context of moving toward integration, no European country is prepared to accept damage to its major industries as a result of structural asymmetries or the industrial policies of its trading partners. The Europeans have recognized that the only way to truly free trade is to integrate.

This should be the model to guide future U.S. policy globally. The United States must move toward ever greater liberalization and world economic integration. Americans must always be prepared to negotiate and ready to take the initiative. But negotiations must be based on the principle that the United States will not allow important segments of its economy to be damaged as a result of structural asymmetries with other countries, foreign industrial policies, or international monetary instability.

The United States must reorient its trade strategy. If what a country makes matters, then what it trades also matters. Trade frictions among the EC, Japan, and the United States have been generated more by the composition of trade deficits than by their size. It is often said that the major problem between Japan and the United States is the large bilateral trade deficit, yet the United States also has a large trade deficit with Saudi Arabia but very few trade frictions. Theoretically, Americans
could ship enough logs, scrap metal, and waste paper to Japan to balance the value of all the VCRs, semiconductors, and autos that they import, but such a balance would probably not resolve the trade frictions. The real problem is that major U.S. industries are being displaced by Japanese competitors.

The Uruguay Round and the GATT are foundering because their two core principles—national treatment and unconditional most favored nation (MFN) status—ignore the importance of the composition of trade, thus avoiding the most difficult and important issues. Under the national treatment standard, countries reciprocate in applying the same laws and regulations to the goods and firms of other countries as they do to their own. Under unconditional MFN, countries that extend special favors to one of their trading partners must extend the same favors to all.

That system is based on the premise that its members pursue similar objectives in a similar way. But what if one country has an open and transparent legal and political system as well as an immigrant tradition of welcoming newcomers, while another country has a history of exclusivity and a tradition of granting preferences to insiders? What if one enforces strict antitrust laws and eschews industrial policy, while another allows or even encourages quas cartels and embraces industry targeting? Over time, the industries that the latter country targets will predominate.

That is precisely what is happening. When Amaya said Japan broke all the rules, he meant that it ignored the comparative advantage concepts of the GATT and actively targeted industries such as steel, machine tools, and semiconductors. When Delors spoke of survival or decline he meant that being present in key industries is a matter of life or death: That is why Europe has resisted U.S. efforts to persuade it to reduce Airbus subsidies. That these views and policies are at odds with conventional U.S. concepts does not necessarily make them unfair. Nevertheless, they may put important U.S. industries at a disadvantage.

Beyond industrial targeting is the issue of structural asymmetries, which also give economic advantages to some countries under the GATT system. Take the auto industry, for example. To sell autos, a manufacturer must have dealers. In the United States, the same dealer may sell Ford and Nissan or Chevrolet and Toyota. In Japan that is rarely the case, meaning that to sell in Japan a U.S. company must set up an entirely new dealership network, a time-consuming and costly proposition. Because markets with such closed dealer systems are more difficult to penetrate than the U.S. market, the American auto industry is at a long-term disadvantage. Even if its quality and productivity are perfect, it will be less able to sell in the world's major markets than its Japanese competitors. In view of the importance of economies of scale, this is a major disadvantage.

Finally, there is the free-rider problem. The MFN system allows countries to pocket the concessions made by others without reciprocating. As long as a country's trade barriers are nondiscriminatory, its barriers may be as high as it likes. South Korea, for example, has relatively high tariffs. They are considered fair, however, because they are high for everyone, even though South Korea enjoys the benefit of low U.S. tariffs.

Because the current international institutions do not address the problems of industrial targeting, structural asymmetries, and free riding, they effectively discriminate against the most open societies, which—ironically—have been the most fervent supporters of these institutions. Eventually, however, ardent cools in the face of rejection. The tragedy of the Uruguay Round is that it has left unresolved most of the really difficult trade issues of the past decade—structural issues in industries like steel, semiconductors, and aircraft—and that it is providing no way to address them in the future. . . .

While working toward an integrated world economy, we must deal with a world of industrial policies and structural asymmetries. With respect to goods like sugar, which can be produced in several countries but for which some have a clear natural cost advantage, the United States should strive to open its own—and international—markets. Developing countries typically need open markets for their primary exports in order to build their economies. The United States should provide them with this opportunity, but with three conditions. First, the costs of adjustment must not fall entirely on low-wage workers: Those affected should be assisted in finding new positions. Second, U.S. markets should only be opened to those that meet minimal levels of social and environmental performance. The United States should not open its markets to the products of slave labor or give free run to products from nonmarket economies. Finally, market opening must be reciprocal. If Americans open their market to countries that sell low-cost apparel, then those countries must be prepared to open their markets to American low-cost fabrics and fibers, rather than using apparel sales in the United States to subsidize development of their own fabric and textile industries behind high trade barriers.

The most important exports are those industrial and advanced technology goods that a number of countries are more or less equally capable of producing. Those industries are the primary object of industrial and structural policies, and a strong U.S. position in many of those areas is important. Here U.S. policy must offset or eliminate artificial, policy-based advantages to its industry. That should not be done in a moralistic way. It is not unfair for other countries to have a different view of industrial or antitrust policy than the United States. If the Europeans want to subsidize Airbus, and if the Japanese want to target supercomputers, that is their business. Lambasting them as unfair will only poison relations. The United States should, however, be prepared to offset the negative effects of their policies on its own industry. Americans should always be willing to negotiate, but they must be prepared to act unilaterally with countervailing subsidies or other measures, not out of moral outrage, but for self-preservation. Surely Delors and Amaya would understand.

The same holds for structural asymmetries. That the Japanese, for example, have a different market structure is not wrong; Americans should not blame them or insist that they become more like Americans. At the same time, the way the Japanese (and others) do business does sometimes put important U.S. industries at an unacceptable disadvantage. The long-term solution to this problem is, of course, structural convergence. Since it will not come quickly, however, Americans must reconcile themselves to a certain amount of trade management with Japan.
That does not mean negotiating strict bilateral, sector-by-sector market shares. A model for trade management might be the deregulation of telecommunications. In America, because of the past history of the industry and its consequent structure, it was clear that one could not simply remove regulations and tell AT&T's challengers that they could compete: AT&T would have crushed any newcomer. Certain restrictions were therefore put on AT&T in order to give a degree of affirmative action and a significant market share to MCI, Sprint, and others. By managing competition in telecommunications for a time, the government hoped to change the market's structure and make it more competitive. If the United States recognizes that simple commitments to "free trade" or "open markets" do not always bring healthy—or even fair—results domestically, it should also be able to have a more sophisticated approach internationally. To break old structures and overcome the effects of industrial policies it may be necessary to negotiate affirmative action for imports and foreign investment.

Beyond the need to reorient its trade strategy, the United States should help build a more stable international monetary system that shares the burdens equally among the major economies. The current instability arising from a weakened U.S. position causes conflict and protectionism while undermining long-term investment planning.

Even after the 1971–73 collapse of the Bretton Woods system—under which the dollar was used to back up fixed exchange rates—the United States has continued to bear the brunt of the costs of maintaining the world's monetary system. Without a strong replacement for Bretton Woods (the current non-system of loose G-7 coordination hardly qualifies), the dollar has remained the major reserve currency.

Being the printer of the world's money does have it attractions. Americans can borrow in their own currency and thereby escape the disciplines normally applied to debtors. They can pay debts by simply printing more dollars. They can partially export the consequences (like inflation) of poor domestic economic policy, and they have financial leverage that others do not.

But there are costs as well. Capital tends to flow abroad more readily because there are fewer transaction costs and risks. Underinvestment at home may be the result. Other countries tend to undervalue their currencies with regard to the dollar, thereby giving them an advantage in trade. Also, dollar dominance tends to encourage bad economic habits by releasing the United States from normal financial discipline; such habits, in turn, slowly undermine the whole U.S. economy. Costs, along with the burden of providing liquidity to an expanding world economy from a relatively declining economic base, led the United States to sink Bretton Woods. Unfortunately, the floating exchange rate system that replaced it from 1973 to 1985 was marked by speculative overshooting that again made the costs unbearable for the United States and resulted in the Plaza and Louvre Accords of 1985 and 1987. In the context of substantial philosophical differences among the major industrialized countries, however, the weak coordinating institutions of the current G-7 process have not been particularly successful. The United States continues to bear the costs of overdependence on the dollar, and the international system continues to bear the costs of inadequate coordination and the resulting monetary instability.

In the long run, the only solution will be some kind of world central bank. Our objective might be a modified version of John Maynard Keynes's original vision of the IMF: With the creation of a world currency, all countries could borrow up to specified limits without bank review, and all would be subject to a mechanism that would force countries with chronic trade surpluses as well as those with deficits toward balance. Obviously, such an ambitious plan would have to include an intermediate stage marked by the shared hegemony of the dollar, yen, and European currency (ECU), as well as an expanded role for the IMF.

To get things moving in that direction, the United States should begin unilaterally to reduce the dollar's international role. U.S. leaders should not block expanded IMF funding and should press for greater use of the IMF's special drawing rights in international dealings. America should encourage European monetary union and the establishment of the ECU as the single European currency. At the same time, the United States should press for greater use of the yen, deutsche mark, and eventually the ECU in international transactions. The Japanese trading companies, for example, might be persuaded to bill in yen instead of dollars, and the Organization of Petroleum Exporting Countries might consider at least partial settlement in currencies other than the dollar.

Finally, as the world's monetary system has outrun the ability of the United States to underpin it, so have the demands for development capital outrun the ability of the United States to meet them. To meet the enormous need for development capital—in the former USSR, in Eastern Europe, and throughout the Third World—capital-rich countries such as Germany and Japan must pick up the burden. From the U.S. viewpoint it is desirable that they do so through international institutions rather than by expanding the reach of their global enterprises, which could put U.S. industry at a further disadvantage. Keynes's concept of an IMF surcharge on chronic surplus countries should also be revisited. Not only would it create greater pressure toward trade balance, but it could also be an important source of development capital. The United States should do its best to increase its own contributions to the IMF and the development bank system. Rather than blocking others from raising their contributions because of concerns over voting weights, America should press them to do so. All of this must, of course, be coupled with meaningful debt relief, which would entail a reduction of interest rates on accumulated Third World debts, proportional sharing of the losses among all creditors, and the introduction of new funds from international lending institutions to ensure the flow of new resources to poor countries.

In the end, the United States cannot hope to confront the new era of geo-economics successfully if as a matter of highest priority it does not revitalize its domestic economy. It must concentrate on building broad leadership in industry and technology through a comprehensive economic strategy. U.S. international economic policy must be an extension and integral part of that strategy; that policy
should focus on stimulating world economic integration on the basis of a de-emphasis of the dollar, a favorable trade composition, broad reciprocity and affirmative action in key trading relations, and a commonsense foreign investment policy. But to do so, Americans will have to abandon much of the conventional wisdom of economics that has misguided U.S. policy for years.

33
Toward a Mosaic Economy: Economic Relations in the Post–Cold War Era
BENJAMIN J. COHEN

In this essay, Benjamin J. Cohen discusses the future of the international economic order. Pointing to forces that both reinforce and undermine the existing system, he concludes that there is no predictable pattern for future international economic relationships. The end of the Cold War and the decline of the United States have reduced the interest of all countries in cooperative arrangements. At the same time, the persistence of international economic regimes, domestic groups with vested interests in the current system, and prevailing social values reinforces cooperation. In opposition to Prestowitz (Reading 32), Cohen argues that the United States should work to strengthen the existing order with multilateral policies whenever possible but be prepared to accept regional solutions when necessary.

At the outset of the final decade of the twentieth century, the world economy has entered a critical period of transition. Change, as usual, is driven primarily by developments in the advanced industrial nations—the countries that for decades have dominated every aspect of international economic relations. Recent developments in the industrial world have been momentous: the emergence of Japan as a financial and commercial superpower, the revived pace of regional integration in Europe, the continued erosion of America’s industrial competitiveness, not to mention the end of the cold war. Taken together, these developments suggest that fundamental changes may now be anticipated in the design and management of the global economic system.

Despite emerging strains, it will be possible to preserve the essential elements of the open, multilateral order erected after World War II. Tensions and friction will undoubtedly be amplified across a broad range of issues, but resistance to