

Lutz, Stefan H.

Working Paper

Trade Policy: 'Political' vs. 'Economic' Factors

ZEW Discussion Papers, No. 02-75

Provided in Cooperation with:

ZEW - Leibniz Centre for European Economic Research

Suggested Citation: Lutz, Stefan H. (2002) : Trade Policy: 'Political' vs. 'Economic' Factors, ZEW Discussion Papers, No. 02-75, Zentrum für Europäische Wirtschaftsforschung (ZEW), Mannheim

This Version is available at:

<https://hdl.handle.net/10419/24363>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Discussion Paper No. 02-75

**Trade Policy:
'Political' vs. 'Economic' Factors**

Stefan H. Lutz

ZEW

Zentrum für Europäische
Wirtschaftsforschung GmbH

Centre for European
Economic Research

Discussion Paper No. 02-75

**Trade Policy:
'Political' vs. 'Economic' Factors**

Stefan H. Lutz

Download this ZEW Discussion Paper from our ftp server:

<ftp://ftp.zew.de/pub/zew-docs/dp/dp0275.pdf>

Die Discussion Papers dienen einer möglichst schnellen Verbreitung von
neueren Forschungsarbeiten des ZEW. Die Beiträge liegen in alleiniger Verantwortung
der Autoren und stellen nicht notwendigerweise die Meinung des ZEW dar.

Discussion Papers are intended to make results of ZEW research promptly available to other
economists in order to encourage discussion and suggestions for revisions. The authors are solely
responsible for the contents which do not necessarily represent the opinion of the ZEW.

TRADE POLICY: 'POLITICAL' VS. 'ECONOMIC' FACTORS

Non-Technical Summary

Ongoing public discussions about international trade relations suggest that national institutional and cultural differences are relevant for assessing international trade policies. Yet economic trade theory mostly assumes countries to be organized around common notions of complete markets. This paper compares these two alternative modes of trade policy analysis by juxtaposing the “economic” view inherent in Gene Grossman’s work on “Japan’s Innovation and Trade” with the “political” view of “Japanese-American Relations” expressed by Chalmers Johnson. A synthesis is attempted with the help of some remarks on “New Trade Theory’s Implications for Policy Analysis” by John Pomery.

Joan Robinson stated in 1970 that "there is no branch in economics in which there is a wider gap between orthodox doctrine and actual problems than in the theory of international trade." Many contemporary economists would argue that this gap has been bridged. Gene Grossman, who could be characterized as such an economist, follows the "economic" view that holds that there is one common set of axiomatic elements with which to describe economic activity in different countries. Consequently, the direction of every economy is determined by independent actions of profit-maximizing individual agents. Critics from outside the profession, such as the political scientist Chalmers Johnson, urge their readers to ignore the opinion of mainstream economists. They explicitly reject the analytical approaches taken by economists and challenge the validity of economic assumptions used. This view holds that Japan's economy is not organized around classical notions of free markets.

John Pomery considers the choice of scientific method as part of the economist's problem, and therefore advocates merging elements of both the "economic" and "political" view. I argue that this merging can greatly reduce existing ambiguity of trade policy analysis, specifically because economists' knowledge of the international economy has improved. Therefore, I see clear reason for optimism. Phenomena such as intra-industry trade, scale economies, and imperfect competition are all better understood. This has led to changing perceptions of the international economy, since over time, quite some flow of information between the proponents of different views has taken place. Grossman's work shows that he has taken up the challenge to further dynamic descriptions of the economy. Other contributions have taken up aspects of "politics" in the shaping of trade policy. Finally, interdisciplinary work linking cultural and institutional environments to innovation has been developed.

TRADE POLICY: 'POLITICAL' VS. 'ECONOMIC' FACTORS

Stefan H Lutz*

18 November 2002

ABSTRACT

The ongoing discussion of U.S.-Japanese trade relations suggests that national differences such as in the institutional environment may be relevant for assessing international trade policies. However, economic trade theory often assumes countries to be organized around common notions of complete markets. This paper compares two alternative modes of trade policy analysis by juxtaposing the “economic” view inherent in Gene Grossman’s work on “Japan’s Innovation and Trade” with the “political” view of “Japanese-American Relations” expressed by Chalmers Johnson. A synthesis is attempted with the help of some remarks on “New Trade Theory’s Implications for Policy Analysis” by John Pomery.

JEL classification: A12, B41, F10

Keywords: trade theory, policy, institutional factors

*Stefan H. Lutz, PhD, ZEW – Centre for European Economic Research, Department of Industrial Economics and International Management, L7, 1, D-68161 Mannheim, Germany, Tel.: (49)(621)1235-295, FAX: (49)(621)1235-170, E-mail: lutz@pool.uni-mannheim.de. I would like to thank Myron Hale, John Pomery and Mark Tilton for helpful comments on an earlier version of this paper.

TRADE POLICY: "POLITICAL" VS. "ECONOMIC" FACTORS

1. The Topic

The ongoing discussion of U.S.-Japanese trade relations suggests that national differences such as in the institutional environment may be relevant for assessing international trade policies. However, economic trade theory often assumes countries to be organized around common notions of complete markets. In contrast, political scientists often concentrate on national differences without taking the results of economic trade theory into account. This paper compares these two alternative modes of trade policy analysis by juxtaposing the “economic” view inherent in Gene Grossman’s work on “Japan’s Innovation and Trade” with the “political” view of “Japanese-American Relations” expressed by Chalmers Johnson. A synthesis is attempted with the help of some remarks on “New Trade Theory’s Implications for Policy Analysis” by John Pomery.

According to Joan Robinson, "there is no branch in economics in which there is a wider gap between orthodox doctrine and actual problems than in the theory of international trade."¹ Robinson made her statement in 1970, based on the trade theory then practiced. Today, as then, many of her colleagues would doubt that such a gap exists. Many contemporary economists, while admitting the validity of her complaint back then, would argue that this gap has largely been bridged by advancements in exactly that type of economics that she criticizes. As we shall see later, Gene Grossman could be characterized as such an economist. Other critics of economic trade theory come from outside the profession. Chalmers Johnson, for example, excuses his attacks on economists' analyses with being a political scientist himself, but proceeds to urge his readers to discount or ignore the opinion of mainstream economists.²

The non-academic discussion of trade relations has also been rather heated. A selective overview of the non-academic discussion of U. S. - Japanese trade relations will give some

impressions of the variety of public opinions. This also constitutes evidence typically taken more into account by political scientists than by economists.

2. An Overview

Trade imbalances between the U.S. and Japan have been repeatedly the focus of public and academic discussion in the U.S. The analyses obtained and resulting policy prescriptions range from Japan as an economic role model for the U.S. to demands to "get tough" on Japan for "not abiding by the rules". Not surprisingly, most commentators on U.S.-Japanese economic relations do not differ much in their assessment of the economic facts of trade imbalances, but on the underlying causes. These differences, in turn, lead to different assessments of the reality observed and to different policy prescriptions.

A selective sample gives some hints of the diversity in opinion. Lee Iacocca implicitly describes Japan as Neo-Mercantilists, though without using this term³, by stating:

"The Japanese game plan is simple: take in American raw materials but not finished goods, because that would cost them jobs."

He offers the following solution:

"We have to freeze our deficit with Japan in place, and tell the Japanese to take it down by a good amount, such as 20 percent per year, until we balance it."⁴

The President of the German Congress of Industry and Trade, Hans Peter Stihl⁵, however, opposes the opinion that Japan closes her markets for imports:

"Of course, there will always be specific problems but open access to Japanese markets is [already] largely achieved."⁶

The Wall Street Journal's Alan Murray differentiates between U.S. and Japanese Industry by stating:

"... Japanese multinational companies don't act like other multinational companies when they go overseas. ... they are far more likely to give most of their business to other Japanese companies."

Murray also concludes:

"Together, the evidence shows clearly that the behavior of Japanese multinationals is an exception in world commerce. And if the world's trading system is going to stay together, that behavior must change."

According to Murray's colleague Michael Granfield, even the IRS thinks along these lines and, consequently, "takes up protectionism." Granfield alleges that the IRS operates under the assumption that Japanese multinationals operating in the U. S. move an unfair share of profits to their home country to avoid U. S. taxation. Hence, regulation was proposed to establish a minimum tax, based on average revenues of U. S. firms, that all foreign multinationals will pay. Still these differences in assessing underlying causes are not the root cause of disagreements. These disagreements possibly stem from a combination of normative conceptions of what "fair trade should be" and awareness of "who gains and loses" under alternative arrangements. According to Murray, the former U.S. administration was in principle a proponent of free trade. He states:

"[P]resident [Bush] doesn't like to talk about managed trade for ideological reasons. It suggests that the government has a role in determining trade flows."

Still, he identifies the U. S. - Japanese auto parts agreement from January 1992 as a clear example of managed trade:

"Make no mistake about it: The Trade agreements that President Bush brought home from his ill-fated trip to Japan are a clear example of 'managed trade'. The President and his people don't like to admit that."

The current administration under President Clinton is also partial towards managing trade with Japan.⁷ Lee Iacocca expresses an opinion similar to Murray's about Congress when stating that legislators would rather be regarded as "perverts than as protectionists."⁸ Hans Peter Stihl also addresses free trade. However, he is strictly opposed to the U. S. - Japanese auto parts agreement. He calls it:

"... a violation of the regulations of GATT and a discrimination against other countries. This is not acceptable for German industry and [therefore] needs political clarification."

However, in comparing the positions of American and German proponents of free trade, some additional facts merit consideration. The U. S. has a chronic trade deficit with Japan⁹, roughly 4-5 times the size of the trade deficit with the European Community as a whole. A major part of this deficit is due to trade in automobiles. Germany has an overall trade surplus, but a small trade deficit in automobile trade with Japan of approximately \$1 billion¹⁰. Mr. Stihl's own business belongs to the market leaders for power saws in Japan.

Notwithstanding different direct interests in a specific trade issue, the question about whether Japanese firms (and consumers) "act differently" seems to lead to a core aspect of the problem. Powell (1992) offers the opinion that not only Japanese firms, but also Japanese private investors and consumers act inherently different from their American counterparts. However, he predicts a movement toward more "American" behavior patterns in Japan. He lists as some of the "cornerstones of the country's economic miracle" that might now be endangered:

"stable shareholding arrangements that secure 'patient' capital for companies to invest; strategic emphasis on market share and not profits; lifetime employment for employees, and complete disdain for 'shareholder rights.'"

He also argues that the Japanese work culture is presently in a state of transformation, and that Japanese shareholders have begun to change their expectations with respect to dividend payouts. Until recently, institutional, interlocking share ownerships (keiretsu) have provided for stable, inexpensive capital. For Powell, these cornerstones, and especially the ability to secure long-term capital with low dividend payments, made the basis for Japan's relative success in world markets. He states, for example:

"One result [of keiretsu] was that Japanese managers were spared the pressure to earn the high returns on invested equity required of their American counterparts."

Powell's bottom line conclusion is that changed shareholder, worker and consumer awareness will force Japanese industry to act more like their American counterparts. In a sense, the "solution" being that Japan, after all, will become more American, will be forced to "play by the rules."

What appears above as the question whether "Japanese are different or not" constitutes a question about adequate analysis for the trade theorist. The remainder of the paper will take a look at two different types of analysis, labeled as "economic" and as "political." This is concluded by an attempt to point the direction toward a possible reconciliation of these two views. The following discussion will also be exemplary with respect to the theoretical view points and the literature covered. The focus will be on Grossman (1990) and Grossman and Helpman (1990) who apply contemporary mainstream economic theory to the case of Japan, on Johnson (1991) who proposes political-historical determinants of Japanese economic development and policies, and on Pomery (1990) who considers the choice of scientific method as part of the economist's problem.

3. An "Economic" View

The notion, that there is one common set of axiomatic elements with which to describe economic activity in different countries and that eventually every region must follow the rules of a free market in which the "direction of the economy is determined by the independent actions of consumers and corporations all operating to maximize their profits and income"¹¹ is widespread among the economic profession. It is also taught to students of economics from the very beginning. For example, Ethier (1988) states in an introductory text on international economics¹²:

"The basic pattern of Japanese trade in manufactured goods seems mostly determined by economic fundamentals, not by Japanese trade policies."

In a sense, this is of course correct, since short-term trade policies do not normally exert the main influence on long-term developments. However, the so called "economic fundamentals" merit additional attention, since they may very well be the outcome of specific policies themselves. We will continue the discussion of economic fundamentals below, following a short introduction into contemporary economic theory.

Daniel Fusfeld describes contemporary economic thought as being dominated by the New Neoclassical doctrine. He characterizes New Neoclassics as the economic dimension of a newly emerged conservatism, which returned to "the conceptual framework of Adam Smith and the economic liberals of the eighteenth century: the market is self-adjusting, leads to socially desirable outcomes, and could benefit from substantial returns to laissez-faire."¹³ He continues by stating that "[o]ne underpinning of the [New Neoclassical] theory is the idea of 'rational expectations.'" The reference to Adam Smith allows for directly attributing some well-known properties to the New Neoclassical model. Its philosophy is one of a naturally occurring harmonic (good, desirable) equilibrium. Sociologically, it is characterized by independently acting, individual competitors and consumers. The driving psychological force behind economic actors is egotism, possibly softened by compassion or sympathy for others. "Rational expectations" serve to further back up the confidence in the emergence of a philosophically desirable outcome, while further defining sociological and psychological characteristics. In its political dimension, New Neoclassical theory is firmly rooted in parliamentary democracy as the guarantor of social consensus on private property rights and capitalism. Its policy prescriptions are either laissez-faire or supply-side oriented (pro-business). Put in other terms, New Neoclassical theory can also be characterized on the macroeconomic level. Felderer and Homburg state that "New Classical economists perceive the business cycle as an equilibrium phenomenon: as a process in which markets are cleared at any instant and expectations are Rational."¹⁴ Again, this definition implies the political advocacy of laissez-faire. However, a survey of current research indicates that contemporary economics cannot consist alone of the type of New Neoclassical economics described above. A substantial part of that research could be characterized as Neokeynesian in that it does not "insist on permanent market clearance" while still being "based on individual optimization behaviour."¹⁵ But this division into only two distinct schools of thought leaves the attentive student of economics in a dilemma. The question remains how to classify those authors that are New Neoclassical in the choice of their model design (including guaranteed market clearing) but produce results that are largely incompatible with a laissez-faire policy prescription. In my opinion, this kind of research provides for potential candidates for a place

at the nexus of the current economics debate. Therefore, we may choose research of this kind for exemplifying the "economic view" of U. S. - Japanese trade relations and the role of "economic fundamentals" therein.

One example of an economic analysis including the description of some Japanese "economic fundamentals" is Grossman's (1990) paper. Grossman set out to "explain Japan's innovation and trade [through] a model of quality competition and dynamic comparative advantage." From the outset, Grossman discounts other "non-economic" explanations of Japan's economic development and follows instead Saxonhouse's (1986) arguments of factor endowments as basic determinants of trade. However, he takes the argument serious that Japan's performance cannot be understood with reference to static notions of comparative advantage alone, and quotes Freeman (1987) as a proponent of an important role of a broadly defined concept of "technology."¹⁶ He then goes along to integrate technological research and development (R&D) into an analytical framework leaving the relative endowments of skilled labor as economic fundamentals that remain largely unexplained. His analytical model is basically Neoclassical, especially with respect to postulated market clearing in the markets for labor and other resources. It deviates from (or advances the) Neoclassical framework with respect to incorporating dynamically changing comparative advantages in high-technology industries. This is done by introducing an imperfectly competitive high-technology sector and the possibility to increase the quality of its products through research and development (R&D), which requires skilled labor. The policy results derived are driven by the tradeoff between labor use for R&D and labor use for the production of goods, given initial endowments. Grossman comes to conclusions including, for example, that Japan, "as the country with the greater relative endowments of skilled labor compared to natural resources[,] will develop over time a comparative advantage in the high-technology sector."¹⁷ The question arises, of course, where the historically grown relative abundance of skilled labor in Japan comes from. On first blush, it seems that an answer would require an inquiry into social dynamics of the Japanese society. I will introduce such an inquiry below when discussing Johnson's work. Given a general notion of the complexity of an economy actually situated in a real society, one might surmise that Grossman's work could not only be unraveled by

questioning assumptions about initial endowments, but also by questioning the accuracy of the model design. This line of critique is exemplified in what follows.

In another paper on dynamic comparative advantage, Grossman together with Helpman (1990) set out again to model growth within a dynamic trade model driven by endogenous technological progress resulting from entrepreneurs' profit-maximizing behavior. This model was based on a framework developed earlier by Romer (1986) and makes reference to Grossman's (1990) work introduced above. The resulting presentation included the consequences on growth and R&D into a trade model examining tariffs and subsidies on final goods and subsidies on R&D in a two-country environment. In particular, technological growth was modeled endogenously, the effects of different factor endowments have been explored, and the significance of the degree of knowledge spillovers between countries has been demonstrated. In doing this, the model continues along the lines of building a synthesis of growth and (static) trade issues. The results derived from this synthesis build an attempt to formally link (short-run) trade policies, such as tariffs and subsidies, to long-run world-growth issues. However, even when staying within the economics paradigm, this assessment would have to be qualified with regard to both the model specifications used and the results derived. As usual, the authors sought their analysis clear and tractable by exercising prudence in model design. But some of the (simplifying) assumptions may affect the results derived in a crucial way. These assumptions are: 1) identical, homothetic preferences across countries; 2) innovations are not tradable between countries; 3) markets for final goods are competitive; 4) No "overlapping research" or patent races - each country develops only new goods that are not available in the other country; 5) governments collect and redistribute tariff revenues by use of lump-sum taxes and subsidies. All of these assumptions have the potential to greatly restrict the range of possible analytical results. But one assumption that stands out in this regard is nontradability of innovation between countries. Centrally based on this assumption is the authors' conclusion that stronger relative demand for final goods in the country with the comparative advantage in R&D slows long-run growth of the world economy by lowering this country's share in the development of new products. If this assumption is abandoned, quite different results may emerge. In particular, firms will emerge producing goods that have been

developed by the other country. One country's R&D will not solely be determined by the same country's profitability of producing goods. Hence, this country's share in developing products may not decline, and world economic growth may not slow down. But this example is just one example of an assertion about a state of affairs that could be regarded as highly dependent on social and institutional factors. Consequently, I will continue with exploring the "Political view."

4. A "Political" View

Johnson¹⁸ explicitly rejects the analytical approaches taken by economists. He frankly states:¹⁹

"In talking about economic issues in the Asia-Pacific region, one must begin by largely discounting or ignoring the opinions of economics professors in English-speaking countries."

Even though admitting that he, of course, is arguing against economists because he is a political scientist of trade, he largely continues along the stated lines of argument by noting that U. S. - Japanese trade is a managed, bilateral game where the two players are inherently different.²⁰ Consequently, he challenges the validity of economic axioms and assumptions used in the U. S. for the case of Japan. This view, called "revisionism", holds that "Japan's economy and society are not organized around classical notions of free markets, in which the direction of the economy is determined by the independent actions of consumers and corporations all operating to maximize their profits and incomes."²¹

Hence, from the point of view of an economist, the first distinctive impression of Johnson's theory of state and economy is one that is defined negatively - his is not the theory of an economics professor. He clarifies this point by asserting that:

"[economists] are today concerned more with defending their arcane theories than with studying the nature and potentialities of Asian capitalism."

Directly following these statements, however, Johnson allows, if only hypothetically, for the possibility that these "arcane theories of English-speaking professors" are valid. He confirms that:

"... at the heart of the various economic disputes between Japan and the United States is what theory applies and whether the East Asian and North American capitalist economies even belong to the same species. The answer has direct implications for policy. If the two economies belong to the same species of capitalism, then there is every reason to suppose that problems might be solved ... through such measures as macroeconomic coordination, ..."

But he immediately expresses his doubts about this possibility by suggesting that economic coordination attempts since the Plaza Accord in 1985 made things worse rather than better, implying that the two forms of capitalism are indeed different. Where the economic point of view presents one, universally valid characterization of economic structures, Johnson assumes there are two, presumably equally valid. This implies differences in the philosophical foundations of the two views, since Johnson's view suggests that there can be a rightful place for two fundamentally different economic systems. It also opens up the possibility to consider a different set of behavioral assumptions about individuals (psychological) and about the interaction between individuals (sociological) that are the micro units of this economic system. Whereas the "economic" view insists on one philosophical foundation, a natural equilibrium outcome in a largely homogeneous world with similar economic, sociological and psychological underpinnings, Johnson philosophy affirms the validity of two conflicting value systems leading to awareness of two fundamentally different socio-economic systems, where a harmonic equilibrium situation does not necessarily arise. Similarly, his political theory is based on the awareness of conflict through otherness, rather than identical goals in relative harmony. From the "economic" point of view, conflict is possible about a material outcome, but it will have to be resolved by using strategies defined within the Western economic paradigm.

At the onset of his presentation, Johnson started out with a direct reference to the mode of economic analysis. However, in his paper, he first lays a historical foundation before

covering economic matters. He starts with the observation, that the end of the Cold War has enabled Japan to reevaluate her position towards the alliance with the United States. The same possibility, or rather necessity, arose for the United States. Johnson refers to Francis Fukuyama (1989) and Alan Tonelson (1991) as proponents of two conflicting views concerning the U. S. - Japanese alliance. In Johnson's opinion, Fukuyama comes close to the official American position in stressing Japan's similarities and common interests with the United States. On the other hand, Tonelson, whom Johnson calls a "neorealist", is closer to the official Japanese position that the present alliance was largely based on necessity and convenience when counteracting the "common Soviet threat." In the course of pursuing such policies, the U. S. had "smothered" Japan's foreign policy and her independence. Consequently, Tonelson holds a drift toward more regionalism likely, rather than continued U. S. - Japanese ties on old terms. Johnson sees in these differences of the official positions in Washington and Tokyo a major potential for conflict. In his words:

"... it is reasonable to conclude that during the 1990s Japan and the U. S. are on a collision course."²²

He concludes that in order to avoid a "collision", both countries will have to initiate reform. His following analysis concentrates on three key points. Namely, the New World Order, the movement from GATT toward economic regionalism, and the problem of "emotional friction" (kanjo no atsureki) between Americans and Japanese.

In short, the Japanese position on the New World Order is that a) the U. S. has lost a lot of its economic influence and strength, b) the nations of the world are becoming more dependent on each other, c) the U. S. still acts as if they were in an unchallenged leadership role. The last point has special importance with respect to U. S. attempts to claim moral leadership and exert "foreign pressure" (gaiatsu) on Japan. The rationale for a movement from GATT to economic regionalism could stem from these considerations alone²³, even without taking into account any frictions evolving from a continued clash of cultures. Animosity towards the U. S. arises from the notion that the American domestic demise does not put the U. S. into the position of a strong role model fit for moral leadership. Johnson states, that Japanese opinion tends overwhelmingly toward viewing the U. S. as a nation in gradual

decline. In light of this, American demands on Japan, such as during the Gulf Crisis, are not well taken. On the contrary, they are viewed as unwelcome and unjustified *gaiatsu*.

Japan now tries to redefine her role according to her own terms. This is especially true for the realm of economics, where many Japanese writers now begin to acknowledge major structural differences between the United States and Japan. An often discussed example of these differences is, of course, *keiretsu*, but there are also others such as administrative guidance or structural corruption. Johnson forwards the opinion that structural economic differences need not in themselves be an obstacle to economic exchange, as long as they are recognized. The acknowledgment of such differences, however, puts the Japanese - American relationship on "a new ideological footing, one that in [Johnson's] opinion is more realistic than the old one and that will have to abandon the condescending efforts of American *gaiatsu* to force the Japanese to reform their economy using the American economy as a model."²⁴

As a bottom line, it may be concluded that the "political" view explicitly acknowledges the existence of two fundamentally different socio-economic systems, whereas the "economic" mode of analysis bases a detailed economic theory on the assumption of a basically identical socio-economic system. A more detailed discussion of the relation between the two views follows in the next, and final, chapter.

5. An "Economic and Political" Mode of Analysis

The need for a reconsideration of economic theory has been repeatedly advocated over time both by economists and non-economists. The reasons given range from economists' changing perceptions of the international economy that challenge their previous assumptions about self-adjusting perfect markets over the accusation that traditional trade theory was built with a pre-conceived result in mind to the need to a radical change in paradigm. The criticisms on economic theory can be described as having two major concerns. One is the lack of elements that explain evolutionary change, and the other is the notion that the economic discipline concentrates in a myopic fashion on the economic subsystem taking the social value

system and institutional environment as given. Fritjof Capra, physicist and philosopher, has expressed both concerns very pointedly:²⁵

" An economy is a continually changing and evolving system, dependent on the changing ecological and social systems in which it is embedded. To understand it we need a conceptual framework that is also capable of change and continual adaption to new situations. Such a framework is sadly lacking in the work of most contemporary economists, who ... are increasingly out of touch with current economic reality."

And:

"The evolution of a society, including the evolution of its economic system, is closely linked to changes in the value system that underlies all its manifestations. The values a society lives by will determine its world view and religious institutions, its scientific enterprise and technology, and its political and economic arrangements. ... The study of values is thus of paramount importance for all social sciences; there can be no such thing as a 'value-free' social science. ... Any 'value-free' analysis of social phenomena is based on the tacit assumption of an existing value system that is implicit in the selection and interpretation of data. ..."

Capra hints already at another major complication introduced by considering value and belief systems as fundamentally shaping the analysis. In a different context²⁶, Catherine MacKinnon has identified this problem area as the need for questioning the way we acquire and process knowledge. If Capra would have been using her terminology, he may very well have stated that it is necessary to engage economics and economic policy on the level of epistemology. Pomery states that the way we describe the current situation in trade theory depends on the type of philosophy of science that we espouse."²⁷ Pomery continues by discussing philosophy as science in terms of "Foundationalism" versus "Non-Foundationalism:"

"In its crudest form, the problem of Foundationalism can be summarized as follows:
(a) as practical beings, we need to make decisions (about beliefs, actions, values, et cetera); (b) we do not know how to make decisions without introducing 'foundational' beliefs to underpin those decisions; (c) all attempts to build a credible position to justify those foundations, whether in Mathematics, Analytical Philosophy, or Science,

appear to be seriously inadequate; (d) yet we can make no sense of a pure 'anti-foundationalist' world."

He understands the move toward foundationalism up to the 1920s as the natural climax of Enlightenment, and observes that the past sixty years have seen a continual weakening of the foundationalist position. The positive-normative theory distinction together with strong emphasis on empirical testing is one major offshoot of the foundationalist position.

In my opinion, Pomery addresses a key point underlying the divergence of the presented "economic" and "political" views. Expressed simply, this point lies in comparing a "foundationalist" position and an "anti-foundationalist" position by describing them as subscribing to a two-step scientific procedure and a four-step scientific procedure, respectively.²⁸ The two-step procedure involves first, to describe the world in a neutral, value-free manner, followed by the second step of a value judgment or choice of "how the world should be." The four-step procedure involves the steps: a) choice of perspective, b) choice of description, c) value judgment or choice of "how the world should be," and d) policy prescription or assertion of "how the world could be."

On first impression, the two-step procedure seems to resemble the mode of analysis of the "economic" view, and the four-step procedure seems to resemble the model of analysis of the "political" view. But even though the "political" view looks broader to someone critical of the "economic" view since it complements the latter in many ways, it still is based on somewhat arbitrarily chosen foundations based on an incomplete view of the world. It also may lack the depth of technical analysis of economic mechanisms often provided by the "economic" view. Hence, the "economic" view may complement the "political." The difference in focus and methodological rigor of the two views is due to the fundamentally different nature of the respective problems addressed. The "economic" aspects of a particular trade policy issue are often much more clearly defined and well-structured than the "political" aspects. Yet all have to be considered in order to reach policy-relevant conclusions.

Does Pomery think, there is a possible reconciliation for these two views? He doesn't give a clear answer to that question, but he declares that there is certainly no obvious way to reach such a reconciliation. He states:²⁹

"It would be nice to unveil a bottom line to the discussion. However there should be enough evidence so far to suggest that the cost of achieving any bottom line is to ignore some potentially-important aspects of the situation. The view here is that there is no unambiguous trade policy, and there are good reasons to expect failure of closure in such a debate."

The debate Pomery refers to is about finding unambiguous foundations for trade theory. With respect to less fundamental goals, I would argue that there is clear reason for optimism. Integrating both views wherever practicable may greatly reduce existing ambiguity of trade policy. Pomery observes that "[e]conomists' knowledge of the international economy has increased"³⁰ and that phenomena such as intra-industry trade, scale economies, and imperfect competition are all better understood. This has led to changing perceptions of the international economy. Many of the factors now understood had been mentioned in the past by critics, such as Capra or Robinson, as elements lacking from economic analysis. Obviously, some flow of information between the proponents of different views takes place. Grossman's work shows, after all, that he has taken up the challenge to further a dynamic description of the economy. Moreover, other contributions such as Baldwin (1994) or Grossman and Helpman (1994) have taken up aspects of "politics" in the shaping of trade policy. Interdisciplinary work linking different cultural and institutional environments to innovation has been forwarded, for example, by Albach (1994).

References

- Albach, H. (1994). Culture and Technical Innovation. A Cross-Cultural Analysis and Policy Recommendations (W. de Gruyter, Berlin/New York).
- Baldwin, R. E. (1994). "The Eastern Enlargement of the European Union," Paper prepared for the Ninth Annual Congress of the European Economic Association (University of Limburg, Maastricht, 3-5 September 1994).
- Capra, F. (1982). The Turning Point: Science, Society, and the Rising Culture (Bantam Books, Toronto).
- Ethier, W. J. (1988). Modern International Economics, Second Edition (W. W. Norton & Co. Inc., New York).
- Felderer, B. and S. Homburg (1987). Macroeconomics and New Macroeconomics (Springer Verlag, Berlin).
- Freeman, C. (1987). Technology Policy and Economic Performance: Lessons from Japan (Pinter Publishers for the Science Policy Research Unit, University of Sussex).
- Fukuyama, F. (1989). "The End of History?," The National Interest, Vol. 16, pp. 3-18.
- Fusfeld, D. R. (1990). The Age of the Economist, Sixth Edition (Scott, Foresman and Company, Glenview, Illinois).
- German Information Center (1992). "DIHT-Präsident kritisch zu US-japanischem Kompromiß," Deutschland Nachrichten, January 24, 1992, p. 6.
- Granfield, M. E. (1992). "The IRS Takes Up Protectionism," The Wall Street Journal, April 3, 1992, p. A12.
- Grossman, G. and E. Helpman (1994). Protection for Sale," American Economic Review, Vol. 84(4), pp. 833-850.
- _. (1990). Comparative Advantage and Long-Run Growth," American Economic Review, Vol. 80(4), pp. 796-815.
- Grossman, G. (1990). "Explaining Japan's Innovation and Trade: A Model of Quality Competition and Dynamic Comparative Advantage," BOJ Monetary and Economic Studies, Vol. 8 (2), pp. 75-100.

- Huntington, S. P. (1996). The Clash of Civilizations (Simon & Schuster, New York).
- Iacocca, L. (1988). Lee Iacocca's Talking Straight (Bantam Books, New York).
- Johnson, C. (1995). "History Restarted: Japanese-American Relations at the End of the Century," in: C. Johnson, Japan: Who Governs? The Rise of the Developmental State (W. W. Norton, New York).
- MacKinnon, C. A. (1989). Toward a Feminist Theory of the State (Harvard University Press, Cambridge, Massachusetts).
- Murray, A. (1992). "The Outlook: Managed Trade May Serve a Purpose," The Wall Street Journal, Vol. 73 (68), January 20, 1992, p. A1.
- Nakamoto, M. and N. Dunne (1994). "Japan and US edge towards agreement on trade," Financial Times, May 24, 1994, p. 16.
- Pomery, J. (1991). "The New Trade Theory: Implications for Policy Analysis," in: D. L. Weimer (ed.), Policy Analysis and Economics: Developments, Tensions, Prospects (Kluwer Academic Publishers, Boston).
- Powell, B. (1992). "And After the Fall?," Newsweek, April 20, 1992, pp. 53-55.
- Robinson, J. (1978). Contributions to Modern Economics (Basil Blackwell, Oxford).
- Romer, P. M. (1986). "Increasing Returns and Long-Run Growth," Journal of Political Economy, Vol. 94, pp. 1002-1037.
- Saxonhouse, G. R. (1986). "What is Wrong with the Japanese Trade Structure?," Pacific Economic Papers, No. 137.
- Tonelson, A. (1991). "What is the National Interest?," The Atlantic Monthly, July 1991, pp.35-52.

Notes

¹Robinson (1978), p. 213. Originally written in 1970.

²At least as far as economic issues in the Asia-Pacific region are concerned. See Johnson (1991), p. 17.

³Johnson (1991, p. 25) explicitly labels Japanese trade policies neo-mercantilist.

⁴Iacocca (1988), pp. 188, 202.

⁵Reported in German Information Center (1992).

⁶Author's translation from German.

⁷See, for example, Nakamoto and Dunne (1994).

⁸Iacocca (1988), pp. 191, 192.

⁹In 1988, this was approximately \$50 billion.

¹⁰Statistics for 1990. The overall trade surplus was approximately \$60 billion.

¹¹I have borrowed this formulation from Peter Ennis as quoted in Johnson (1991).

¹²In a case study: "Does Japan Play Fair?," p. 241.

¹³Fusfeld (1990), pp. 179, 180.

¹⁴Felderer and Homburg (1987), pp. 196, 197. Footnotes are omitted. From a comparison of the main characteristics described, it seems clear that "New Neoclassical" and "New Classical" theories are the same.

¹⁵Felderer and Homburg (1987), p. 209.

¹⁶Grossman (1990) notes that frequent criticism on previous economic analyses centered around the static nature of the (Heckscher-Ohlin) theory of trade which was by design not capable of explaining the growth performance of a country like Japan. Japan's growth would be more adequately described by a Schumpeterian process.

¹⁷Grossman (1990), p. 98.

¹⁸In a speech delivered on November 5, 1991 at Purdue University.

¹⁹Johnson (1991), pp. 17, 18.

²⁰Johnson's argument is a specific case as a much larger discussion about the role and differences in institutions and even cultures, represented foremost by Huntington (1996).

²¹Johnson took this definition from Peter Ennis.

²²Johnson (1991), Footnote omitted.

²³A corollary to this is Japan's concern to become disadvantaged through provisions of future bilateral trade agreements such as that between U. S. and Mexico. It is understood, that the weaker U. S. position makes the emergence of such agreements more likely.

²⁴Johnson (1991), p. 22.

²⁵Capra (1982), p. 190. Footnote omitted.

²⁶MacKinnon (1989), pp. ix and 106, in an attempt to lay the foundations of a feminist theory of the state.

²⁷Pomery (1990), pp. 20, 21. Footnotes omitted.

²⁸Pomery (1990), pp. 22-25.

²⁹Pomery (1990), p. 40.

³⁰Pomery (1990), p. 16.