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The Robert E. Hudec Article on Global Trade

Trade and Tensions

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INTRODUCTION

International disputes and tensions arise in situations where one nation is seeking its own economic betterment in ways that diminish the economic welfare of other nations. Prior to World War II, most nations deployed systems of tariffs and import quotas in unveiled attempts to protect their domestic industries. Today, trading tensions are often generated by a range of government activities that limit imports or subsidize exports; yet the governments that impose these measures often rationalize them as policy measures that have no protectionist or other trading objective. The earlier trading model was a mercantilist one. Economic welfare was seen as a zero-sum game in which each nation bettered its position when it sold more than it purchased from abroad. Because all nations could not sell more than they purchased, some nations were necessarily winners and others were losers. Under the mercantilist view, the nation that obtained the greatest surplus of exports over imports was the greatest winner.

In the early nineteenth century, David Ricardo developed a theory of free trade.[1] Under Ricardo's approach, each nation

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1. DAVID RICARDO, ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION (3d ed. 1821), reprinted in THE WORKS AND CORRESPONDENCE OF DAVID RICARDO

gained by producing what it was best at producing, i.e., those goods or services in which it generated the greatest new value. Then if nations would trade freely, they would each maximize their own wealth. But Ricardo's theory went somewhat further. He showed that a nation would maximize its own welfare by eliminating its own trading barriers, regardless of what other nations did.

Great Britain followed Ricardo's advice throughout the last half of the nineteenth century.[2] Ricardian analysis, however, exerted only a limited impact on other nations. The Cobden-Chevalier Treaty of 1860 between Great Britain and France,[3] together with most-favored-nation clauses in French treaties with other nations, only temporarily lowered tariffs throughout much of Europe.[4] Germany opted for a protectionist policy in 1879.[5] France, where enthusiasm for free trade had declined substantially after the Franco-Prussian War, began its return to protectionism by sharply raising tariffs in 1881, imposing full agricultural protection by 1890, and completing that return in the 1892 Méline tariff.[6] The United States maintained substantial tariffs throughout the nineteenth century and into the twentieth century.

Although Ricardo provided a powerful analysis, substantial practical impediments block the path towards a goal of fully free trade. Ricardian analysis shows that aggregate free trade will maximize national wealth but will not evenly distribute new wealth. Indeed, free trade produces both winners and losers. Consumers, export industries, and industries that use foreign products as inputs into their production processes are likely to win. Industries that become subjected to intensified competition from producers from abroad are likely to become losers. Because business firms in adversely-affected industries are more likely to be organized than consumers, they are more likely to be

128–49 (Piero Sraffa ed., Cambridge 1951).

2. *See, e.g.*, Douglas A. Irwin, *The Political Economy of Free Trade: Voting in the British General Election of 1906*, 37 J.L. & ECON. 75, 78–79 (1994).

3. Treaty of Commerce Between Great Britain and France, Jan. 23, 1860, 50 British and Foreign State Papers 13.

4. Ronald A. Brand, *GATT and the Evolution of United States Trade Law*, 18 BROOK. J. INT'L L. 101, 109–10 (1992).

5. *Id.* at 110.

6. L.C.A. KNOWLES, ECONOMIC DEVELOPMENT IN THE NINETEENTH CENTURY: FRANCE, GERMANY, RUSSIA, AND THE UNITED STATES 252–53 (1932); GERARD CURZON, MULTILATERAL COMMERCIAL DIPLOMACY: THE GENERAL AGREEMENT ON TARIFFS AND TRADE AND ITS IMPACT ON NATIONAL COMMERCIAL POLICIES AND TECHNIQUES 18 (1965).

able to exert political pressures on government decision makers.[7] Moreover, because they have traditionally focused on marketing to the large domestic market, the economic interests of American producers have—at least until relatively recently—been weighted towards protectionism. Similarly, labor unions representing workers in these potentially affected industries are another source of protectionist pressure. These groups are likely to lobby against exposing their industries to foreign competition. In short, Ricardian analysis indicates that free trade maximizes national wealth, but in most nations that analysis becomes subordinated to the interests of those groups that exert the most effective political pressure. These groups are precisely the groups that would suffer under free trade.

In the United States, Alexander Hamilton's *Report on Manufactures*[8] urged protection for domestic manufacturing in order to foster its growth. Congress did not act upon Hamilton's *Report* as such, but it did follow his recommendation on protecting domestic industry. Throughout the nineteenth and much of the twentieth centuries, American industry developed and prospered behind the tariff laws' barriers. Indeed, except for three years during the Civil War, the tariff provided the principal source of revenue to the federal government throughout the nineteenth century.[9]

Prior to World War II, tariffs and other trading barriers plagued Europe. These barriers impeded European manufacturers from attaining the full benefits of scale economies because the barriers made it difficult for them to market their goods in neighboring countries. Further, because trading barriers limited the market in which goods could be sold, they were a principal cause of unemployment and consequent social unrest. In the pre-World War II period, nations jockeyed to advance their own industries at the expense of foreign industries. They erected trade barriers and often adjusted the exchange rates of their currencies in order to advantage their trading positions. The failed European experience with protectionism helped to motivate a number of European nations to create the European Common Market in 1957.[10] An earlier and more far-reaching at-

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7. MANCUR OLSON JR., THE LOGIC OF COLLECTIVE ACTION 143 (1965).

8. Alexander Hamilton, *Report on Manufactures* (Dec. 5, 1791), *in* THE REPORTS OF ALEXANDER HAMILTON (Jacob E. Cooke ed., 1964).

9. Brand, *supra* note 4, at 107–08.

10. Treaty Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 11; *see, e.g.*, John Pinder, *The Single Market: A Step Towards Union*, *in*

tack on protectionism, however, began with the creation by the world's major trading nations of the General Agreement on Tariffs and Trade (GATT) in 1947.[11]

The GATT was designed to foster trade over the long run. Under the GATT, member states agreed to eliminate non-tariff barriers and to gradually reduce tariffs through periodic rounds of negotiations. The GATT produced several rounds of negotiations that reduced tariffs substantially. In 1994, its Uruguay Round of negotiations produced the World Trade Organization (WTO),[12] a successor structure to the original GATT.

The GATT and its WTO successor have been enormously successful. However, the issues that continue to generate trading friction are, not surprisingly, variations of the issues that have accompanied the debate over free trade since the early nineteenth century. Governments sometimes distort trade flows in order to advance their own national interests at the expense of global welfare. Although the Ricardian paradigm suggests that it is impossible to advance national welfare in this way, governments sometimes behave as if this were possible. Indeed, as discussed below, recent scholarship has shown that—contrary to the Ricardian paradigm—there are limited possibilities for governments to distort trade to their national advantage. Some governments, therefore, may exploit this new learning. We have also learned that markets do not always operate perfectly. As a result, governments properly intervene in domestic markets to generate positive externalities, to reduce or eliminate negative externalities, and to correct other market malfunctions. The line between some of these interventions that are widely recognized as proper functions of government and the government market interventions that improperly distort international trade flows is sometimes blurry or unclear. For example, government actions designed to generate positive externalities by encouraging the concentration of a new industry in a particular geographic location (thus enabling firms to participate in the same highly skilled labor pool) may extend to government subsidization that advantages the domestic industry in competition with its rivals from abroad.

THE EUROPEAN COMMUNITY AND THE CHALLENGE OF THE FUTURE 51–52 (Juliet Lodge ed., 2d ed. 1993).

11. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187 [hereinafter GATT].

12. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1125 (1994).

Some of the most important issues that give rise to international tensions are clouded in rhetoric, misunderstanding, or disagreements about the role of economics. Governments frequently impede trade through regulations or other measures that are ostensibly keyed to non-trade objectives. Sometimes it is unclear whether the asserted rationale is intended to obscure protectionist intent. Sometimes a trading impediment will generate tensions, regardless of its rationale. Yet in both circumstances, rhetoric in which one jurisdiction justifies a trade barrier on policy grounds that are superficially unrelated to trade and in which another jurisdiction employs free (or freer) trade rhetoric to criticize that barrier will characterize the trading tensions that arise. Many of these issues are related to one or more of these overlapping areas: (1) traditional concern with import penetration; (2) industrial policy; (3) competition policy; (4) intellectual property; (5) strategic trade policy; (6) interactions between industrial, competition, and trade policies; and (7) disagreements about the role of economics.

I. IMPORT PENETRATION ISSUES

The paradigm situation giving rise to trade disputes occurs when an increased volume of imports impinges on the market shares of the domestic producers of the same product. If the imports are sold in the domestic market for less than in their home market (or for less than cost), this situation may trigger the application of anti-dumping laws.[13] Assume, however, that the imports are sold at or above their home-market price and above their cost of production and transport. The next question is whether the import surge is a temporary phenomenon or whether its continuance over the long term appears likely.

Temporary import surges are less likely to cause, or to threaten to cause, the serious injury that both international law and U.S. law require as a condition for providing import relief.[14] Resort to protectionist measures in such circumstances would overstep the narrow authority to limit imports that the Agreement on Safeguards recognizes.[15] For example, the WTO Appel-

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13. 19 U.S.C. §§ 1673–1677k (2000).

14. *See infra* notes 18–40 and accompanying text.

15. Agreement on Safeguards, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1, Legal Instruments—Results of the Uruguay Round, 33 I.L.M. 1125 (1994) [hereinafter Agreement on Safeguards].

late Body ruled illegal[16] the duties that President Bush placed on steel imports in 2002,[17] and the duties were probably illegal under U.S. law as well.

If the import surge appears likely to continue indefinitely, the reason is probably related to the relative cost efficiencies of the foreign producers vis-à-vis the affected domestic producers. In such a case, the domestic industry has two options: (1) exit the market or (2) take steps to increase its efficiency, bringing itself up to international standards of competitiveness. Article XIX of GATT 1947 and the Uruguay Round Agreement on Safeguards govern the steps that an affected nation may take.[18] The Agreement on Safeguards provides that nations may take action when a product "is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products."[19] In such a case, the affected nation may limit imports for an initial period of four years, which the nation may extend to a total of eight years.[20] In general, the limitation (if it takes the form of a quota) may not reduce imports below the average of the last three representative years for which statistics are available.[21] U.S. law includes a safeguards provision which is cast in language close to that of the Agreement on Safeguards.[22] Upon the U.S. International Trade Commission finding that an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury (or threat of serious injury) to a domestic industry, the President may (within broad parameters) impose additional duties or quantitative restrictions on the importation of that article.[23]

The key question underlying protection when the viability

16. Appellate Body Report, *United States—Definitive Safeguard Measures on Imports of Certain Steel Products*, WT/DS248–54, 258–59AB/R (Nov. 10, 2003).

17. *See* Proclamation 7529, 67 Fed. Reg. 10,553 (Mar. 7, 2002); Action Under Section 203 of the Trade Act of 1974 Concerning Steel Products, 67 Fed. Reg. 10,593 (Mar. 7, 2002).

18. GATT, *supra* note 11, art. XIX; Agreement on Safeguards, *supra* note 15, art. 2.

19. Agreement on Safeguards, *supra* note 15, art 2.

20. *Id.* art. 7.

21. *Id.* art. 5.

22. 19 U.S.C. § 2251 (2000).

23. 19 U.S.C. §§ 2253(a)(3)(A)–(C). Broad limitations upon the President's power to increase duties or impose quantitative limits are contained in 19 U.S.C. § 2253(e). *See also* 19 U.S.C. §§ 2253(e)(1)(B)(2)–(4).

of the domestic industry is threatened is whether it can ultimately be restored to competitiveness or whether it will be forced to exit the market. The scenario that takes place when a flood of imports threatens local industry with extinction tends to take the following path: The imports are likely taking a growing share of the domestic market from the local producers. The influx of imports may be driving domestic prices below unit production costs. This is especially likely in an industry with heavy capital costs. Indeed, in such an industry, this effect is exacerbated as local producers reduce their production in response to an excess of goods in relation to demand. In such circumstances, their unit costs are pressured upwards as they reduce production. Revitalizing the industry may require domestic producers to invest in new plants, but they may be reluctant to do this at a time when there is overcapacity, output from existing plant is selling at below-average-cost prices, and they are losing market share or incurring losses.[24]

One device that other nations employ in the above circumstances is a form of industry-run or government-run cartel. Under this response, the domestic producers work out a plan among themselves governing the reinvestment that is required for the recovery of the industry. Alternatively, they accept a government-designed plan for reinvestment, or a plan devised with heavy input from that industry. All of these approaches require domestic producers to follow a plan that guides them on how much of existing plant to scrap and how much new plant to acquire.[25] By formulating such a plan, industry overcapacity can be eliminated and production can be consolidated in efficiency-enhancing ways. In addition, the risks associated with new investment are reduced, easing the transition from an industry based on outmoded plant to one based on state-of-the-art plant. The European Synthetic Fiber Agreement[26] and an agreement restructuring the Dutch brick industry[27] take this approach. Japan also takes this approach when its domestic in-

24. *See* Harry First, *Structural Antitrust Rules and International Competition: The Case of Distressed Industries*, 62 N.Y.U. L. REV. 1054, 1069 (1987) (discussing timing of capacity reduction and reinvestment).

25. Efficiencies of scale and/or scope might accompany consolidation in some industries. Consolidation carries the potential for faster learning curve advances. Consolidation could potentially also generate a variety of efficiencies in administration. *See, e.g.*, First, *supra* note 24, at 1069.

26. Commission Decision 84/380, 1984 O.J. (L 207) 17 (EC).

27. Commission Decision 94/296/EC of 29 April 1994 Relating to a Proceeding Under Article 85 of the EC Treaty, 1994 O.J. (L 131) 15, 16.

dustries require revitalization.[28] In the following discussion, this approach to industry restructuring will be referred to as a "crisis cartel approach."

The crisis cartel approach to industry restructuring appears to be unavailable to U.S. industries afflicted by an avalanche of imports. Because the prevailing ideology within the United States is one of unfettered competition, widespread public disapproval would meet any suggestion that a cartel-like process should oversee restructuring.[29] The law, in any event, would bar any such mechanism. Industry-wide agreements on investment would be condemned as per se illegal under the Sherman Act.[30]

Although the United States has incorporated a safeguards provision into its domestic law, it has handicapped itself in using it. On the one hand, the safeguards provision permits the U.S. government to provide temporary relief from imports.[31] On the other hand, it is far from clear how the domestic industry can restore itself to world-class competitiveness during this temporary period in the absence of a collective plan, which the antitrust laws forbid. The U.S. safeguards provisions themselves require assessments of the industry's progress in modernization.[32] Yet a collective action problem may block the crucial steps. Reinvestment—and the modernization that it makes possible—may appear to each domestic producer as both futile and unprofitable in the absence of assurance that the remainder of the industry is reducing aggregate capacity. The Agreement on Safeguards imposes time constraints on protection that sometimes may be too short for the market to generate capacity reductions through individual decisions not to reinvest. The crisis cartel approach described above may provide an answer to this collective action problem in other jurisdictions.

Is there an inherent contradiction built into the U.S. safe-

28. MITSUO MATSUSHITA, INTERNATIONAL TRADE AND COMPETITION LAW IN JAPAN 280–85 (1993) (relief for depressed industries); TAKATOSHI ITO, THE JAPANESE ECONOMY 204–05 (1992) (depression cartels).

29. *See generally* Daniel J. Gifford, *Antitrust and Trade Issues: Similarities, Differences, and Relationships*, 44 DEPAUL L. REV. 1049 (1995). The crisis cartel approach is discussed in Gifford, *supra*; First, *supra* note 24; and Benjamin A. Tisdell, *"Steeling" the World: Economic and Antitrust Implications of Steel Industry Cartels as Alternatives to Trade Protectionism*, 97 NW. U. L. REV. 473 (2002)

30. Sherman Act, 15 U.S.C. § 1 (2000). Agreements among competitors restricting output are generally treated as per se illegal. Federal Trade Comm'n v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 423 (1990); Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85, 99 (1984).

31. 19 U.S.C. § 2251 (2000).

32. 19 U.S.C. § 2254 (2000).

guards law? The Agreement on Safeguards shapes the U.S. safeguards provisions. That Agreement may reflect an international consensus about how an industry that becomes vulnerable to increased import penetration may restructure itself to regain a state of international competitiveness. Other nations may understand the crisis cartel mechanism as a tool for overcoming what they may see as collective action problems that would impede the regeneration of an afflicted industry in this kind of situation. The United States, however, adheres to the Agreement on Safeguards but avoids the crisis cartel mechanism that other nations may see as implicit in its use. Is the United States waiting for a market solution that the market (constrained by the time limitations of the safeguards provisions) is impeded from supplying?

For relief against import surges, in past years the United States has tended to rely upon voluntary export restraints and upon anti-dumping proceedings.[33] During the surge of Japanese automobile imports in the 1980s, the Reagan administration happily let the Japanese government pressure its auto manufacturers into export restraints.[34] The U.S. government avoided proposing any agreement with the Japanese government and thus maintained its theoretical free trade stance while obtaining the import relief that it desired.[35] Anti-dumping proceedings depend on the fiction that the foreign producers in question are selling in the U.S. market below "fair value."[36] This characterization enables U.S. officials and domestic business lobbies to portray the proceedings as consistent with a "fair" version of free trade. Yet the statute defines "fair value," inter alia, as a price below cost and includes within the definition of "cost" elements that business persons and economists do not generally consider to be components of cost.[37] The traditional avoidance of safeguards proceedings has enabled officials and interest groups to publicly maintain their adherence to a free trade ideology while they simultaneously seek import relief. Now that the

33. 19 U.S.C. §§ 1673–1677k (2000).

34. See CLYDE V. PRESTOWITZ, JR., TRADING PLACES: HOW WE ALLOWED JAPAN TO TAKE THE LEAD 422–23 (1988) (describing the erection of the voluntary restraint with the active participation of the U.S. government but without its formal adherence).

35. *Id.*

36. 19 U.S.C. § 1673 (2000). Whether a product is being sold at less than fair value is determined by comparing the export price with "normal value." 19 U.S.C. § 1677b (2000).

37. 19 U.S.C. §§ 1677b(b), (e) (2000).

Agreement on Safeguards prohibits voluntary export restraints,[38] that strategy must rely more heavily upon anti-dumping proceedings to achieve the desired protection while ostensibly eschewing protectionism.

This apparent avoidance of dealing with collective action problems in safeguards situations is a puzzle. In a variety of other circumstances, U.S. law recognizes market failures and takes corrective action. For example, intellectual property laws are responses to market failures. Environmental regulation is premised upon market failure. A forthright attempt to address the economic and social issues surrounding import-penetration issues would hold the anti-dumping laws up to the scrutiny they deserve. At present their application is hidden in a jungle of administrative obscurantism that treats commonly-used phrases such as "fair value" and "cost" as terms of art.[39] The U.S. government would better serve the public if greater resort were made to safeguards procedures where protection stands fully revealed. If safeguards proceedings became the common method for seeking import relief, the issues underlying industry restructuring (including collective action problems) would ultimately be recognized and publicly debated. Whether or not industry restructuring would be welfare enhancing in any given case, the public would be served by greater transparency in the policy debate. Moreover, an allowance of collective action to foster restructuring would likely be less welfare-reducing than our apparent present national policy of providing protection to inefficient industries with no plans for their rejuvenation.[40]

In situations in which imports surge and erode the market shares of competing domestic producers, pressures mount for relief. Nations experiencing such situations take a variety of courses. The United States has tended to rely upon anti-dumping proceedings and voluntary export restraints. Other nations, at least at times, have taken different routes, including the use of so-called crisis cartels. The heavy U.S. reliance on anti-dumping proceedings has generated and fostered widespread distrust and cynical views of those proceedings, especially among affected foreign nations. In the eyes of U.S. ob-

38. Agreement on Safeguards, *supra* note 15, art. 11(1)(b).

39. *See supra* note 37 and accompanying text.

40. Thus if a collective action problem prevents an industry from restructuring itself into profitability, the invocation of safeguards accompanied by a resolution of the collective action problem may be more welfare-enhancing (or less welfare-reducing) than invoking safeguards without such a resolution.

servers, the use of crisis cartels in Europe and Japan is likely to reinforce beliefs that those jurisdictions are not fully committed to open markets and free trade goals. These differences of view, however, reflect only a small part of the potential misunderstandings that underlie today's trade tensions.

II. INDUSTRIAL POLICY

The role that government should play in the economy is the subject of both widespread agreement and significant disagreement. There is agreement that government has a proper role to play in economic affairs and that neglect of that role detracts from welfare. Thus, government carries a responsibility to provide the infrastructure, such as effective means of communication and transportation, on which the rest of the economy depends.[41] That responsibility also extends to the fostering of an educated workforce. Much of this infrastructure consists of so-called "public goods," i.e., goods that because they are non-appropriable (a lighthouse is the classic example),[42] will therefore not be generated by the market. Government responsibilities also include action to reduce or eliminate negative externalities, such as pollutants which cause social harm but which do not show up on the books of the firm producing them. Accordingly, because they do not constitute costs to the firm, that firm has no incentive to control them.

The extent to which governments possess capabilities for fostering economic growth beyond the type of actions described above is a matter of controversy, both in the United States and abroad. Although there is widespread agreement about the government's role in providing infrastructure, the bounds of that infrastructural involvement have always been the subject of debate. Just what is the extent of the government's responsibility for educating the workforce? To what extent does this responsibility extend to higher education? Does the provision of infrastructure extend to the support of basic research? American responses to these questions are not necessarily replicated in other nations.[43] The proper scope for these particular govern-

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41. Brett M. Frischmann, *An Economic Theory of Infrastructure and Commons Management*, 89 MINN. L. REV. 917, 924–25 (2005).

42. *But see* Ronald H. Coase, *The Lighthouse in Economics*, 17 J.L. & ECON. 357 (1974) (showing the inadequacies of lighthouses as premises for public-goods analyses).

43. *See, e.g.*, Thomas J. Siepmann, *The Global Exportation of the U.S. Bayh-*

mental activities are sometimes the subject of national political debate, but they are generally not controversial from an international perspective. Rather, the response of a government to internal pressures to provide differential support for particular industries or firms can generate international controversy. The U.S. debates over domestic policy during the 1980s and 1990s focused on exactly this issue.

In the United States, the edge of the internal industrial policy debates lay in the extent to which government should intervene on behalf of specific industries or even of specific business firms.[44] The policy debate reached a peak during the 1980s when Japanese imports were seen as posing significant threats to many U.S. manufacturing industries, such as automobiles, machine tools, and semiconductor chips.[45] The debate reemerged in the early 1990s with the Clinton administration. The Clinton administration was widely seen as more interventionist in the economy than its predecessors.[46] Moreover, many officials in that administration had participated in the debates of the 1980s as advocates of interventionist policies.[47]

These debates, however, appear to have generated a consensus that the government's role should be the traditional one: it can promote national welfare by contributing to the infrastructure, but it is generally incapable of advancing aggregate welfare by supporting particular industries or business firms. This consensus recognizes that government lacks the informational resources of the market and so cannot identify growth industries as well as the market can. In addition, the government decision making apparatus is handicapped by its vulnerability to political pressures that seek to skew government decision making towards private lobbying interests.

Dole Act, 30 U. DAYTON L. REV. 209, 239–40 (2004) (describing funding for higher education and research in the United States and abroad as well as the decision of many European nations to follow the United States' lead in expanding the availability of patent rights to university scientists).

44. *See generally* William E. Hudson, *The Feasibility of a Comprehensive U.S. Industrial Policy*, 100 POL. SCI. Q. 461 (1985); Stuart E. Eizenstat, *Reindustrialization Through Coordination or Chaos?*, 2 YALE J. ON REG. 39 (1984); Roger Pilon, *On the Folly and Illegitimacy of Industrial Policy*, 5 STAN. L. & POL'Y REV. 103 (1993).

45. *See, e.g.*, Gifford, *supra* note 29, at 1074.

46. *See, e.g.*, Michael L. Doane, *Green Light Subsidies: Technology Policy in International Trade*, 21 SYRACUSE J. INT'L L. & COM. 155, 157, 162–65 (1995) (describing Clinton interventionist programs).

47. *See* ROBERT B. REICH, THE NEXT AMERICAN FRONTIER (1983); Steve Charnovitz, *Designing American Industrial Policy: General Versus Sectoral Approaches*, 5 STAN. L. & POL'Y REV. 78 (1993); Eizenstat, *supra* note 44.

Other nations have not reached that consensus. Governments sometimes cannot or will not limit their pursuit of industrial policies to domestic applications. The use of crisis cartels in some other jurisdictions as a means for rejuvenating inefficient industries was discussed above. Now consider government use of a special form of industrial policy: The employment of trading policies designed to alter the terms of trade. Those policies also carry the potential for generating barriers to trade. Government support for particular industries can affect the way it administers both its competition policies and its trade policies. It can affect the way that it subsidizes particular industries or industrial ventures. For example, the European Union (EU), in the eyes of many American observers, may be supporting the Airbus venture in an effort to generate economic rents, to foster high-tech industry as an aid to growth, and to foster the development of a highly skilled employment base. The discussion of strategic trade policy below suggests that government support for the Airbus venture may well generate economic rents.[48] Additionally, the Japanese government has a long history of government-industry cooperation under which local industries have been protected from foreign competition and in which Japan has virtually guaranteed markets for high-tech components through the vertical relationships inherent in Japanese industrial organization. These matters are discussed below.

When governments pursue industrial policies—especially those designed to promote more rapid development of particular sectors of their economies—they are necessarily seeking to alter the current distribution of comparative advantage. Because the Ricardian theory of comparative advantage has been widely understood to have served as the premise for the original GATT and the subsequent rounds of negotiations that have culminated in the WTO, some proponents of free trade have seen a tension between industrial policy and free trade goals. Moreover, proponents of free trade within the United States have based their positions upon Ricardian theory. Accordingly, the United States is likely to be especially critical of trade impediments raised by other nations on an industrial policy rationale. Trade tensions are likely to be exacerbated if and when the jurisdiction employing an industrial policy approach to economic development denies that it is practicing protection.[49]

48. *See infra* notes 92–103.

49. Thus, for example, in the 1980s, the Japanese government had both abolished formal barriers to the importation of semiconductor chips and taken an array

III. INCONSISTENT COMPETITION POLICIES

On the surface, competition policy appears to be highly congruent with free trade objectives. Fully free trade would allocate the world's resources in accordance with their highest valued uses, and nations that have enacted competition laws ensure that their national resources will be allocated according to their highest valued uses. Yet appearances are sometimes misleading. Competition policies differ and some competition policies are less focused upon fostering an efficient allocation of goods and services than are others.[50] Competition policies that incorporate significant distributional goals may be capable of impeding trade. Thus, for example, competition policies that are administered to shield producers from intensive competition can exert a protectionist effect when more efficient foreign rivals challenge those producers.[51] Even the competition policies of two or more jurisdictions that purport to embrace the same abstract goals may be interpreted differently at implementation levels.[52] As a result, competition policies—which ideally ought to reinforce freer trade—sometimes generate trading tensions.

Relations between the United States and the EU were strained when the European Commission initially disapproved the Boeing/McDonnell-Douglas merger.[53] After the U.S. government exerted considerable diplomatic pressure, the Commission approved the merger only on condition that Boeing surrender three exclusive supply contracts that it had negotiated with three large U.S. carriers (American, Continental, and Delta).[54]

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of measures designed to prevent any "adverse effect on domestic firms which might produce confusion in the market," thus effectively protecting its developing semiconductor industry. PRESTOWITZ, *supra* note 34, at 134; *see also* LAURA D'ANDREA TYSON, WHO'S BASHING WHOM?: TRADE CONFLICT IN HIGH-TECHNOLOGY INDUSTRIES 95–96 (1992).

50. *See generally* Daniel J. Gifford & Robert T. Kudrle, *Rhetoric and Reality in the Merger Standards of the United States, Canada, and the European Union*, 72 ANTITRUST L.J. 423 (2005).

51. *See* Jeffrey M. Peterson, Comment, *Unrest in the European Commission: The Changing Landscape and Politics of International Mergers for United States Companies*, 24 HOUS. J. INT'L L. 377, 390–91 (2002).

52. *See* Gifford & Kurdrle, *supra* note 50, at 424–25.

53. *See* H.R. Con. Res. 117, 105th Cong. (1997) ("[e]xpressing the sense of the Congress regarding the interference of the European Commission in the merger of the Boeing Company and McDonnell-Douglas").

54. Commission Decision, Case IV/M.877, Boeing/McDonnell-Douglas, 1997 O.J. (L 336) 16, 46, 68–71, 116 (EC); *see* Daniel J. Gifford & E. Thomas Sullivan, *Can International Antitrust Be Saved for the Post-Boeing Merger World?: A Proposal to Minimize International Conflict and to Rescue Antitrust from Misuse*, 44 ANTITRUST BULL. 55 (2000) (discussing the Commission's decision).

It is unclear why the merger would violate the European Merger Regulation[55] with the contracts but would not violate the regulation without the contracts. Some observers construed the Commission action as designed to advantage the European aircraft manufacturer Airbus in its competition with Boeing, its U.S. rival.[56]

Boeing's acquisition of McDonnell-Douglas eliminated the third ranking manufacturer of large commercial aircraft, leaving in the field only itself and Airbus. The U.S. antitrust authorities nonetheless cleared the merger on the ground that McDonnell-Douglas—although it continued to manufacturer its current line of aircraft—had ceased to be a developer of new aircraft models.[57] The Supreme Court formulated this type of antitrust analysis in 1974 when it decided the *General Dynamics* case.[58] In that case, the Court viewed a coal mining company (United Electric) as no longer a player in the market for long-term supply contracts for coal because the company had already committed most of its reserves to buyers.[59] As a result, its merger with a second coal mining company (Material Service Corp. and its successor General Dynamics) did not significantly affect competition in the market for long-term supply contracts for coal.[60] The European Commission, however, evaluated the merger differently. It viewed the merger as strengthening Boeing and thus advantaging Boeing in its competition with Airbus. In the language of the European Merger Regulation, the merger strengthened Boeing's "dominant position."[61] Somewhat ironi-

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55. The Merger Regulation in effect at the time of the Boeing decision was Council Regulation 4064/89, 1990 O.J. (L 257) 13 (EC). That Regulation has since been revised and is now Council Regulation 139/2004, 2004 O.J. (L.24) 1 (EC).

56. Paul B. Stephan, *Global Governance, Antitrust, and the Limits of International Cooperation*, 38 CORNELL INT'L L.J. 173, 192 (2005); Harry First, *The Intersection of Trade and Antitrust Remedies*, 12 ANTITRUST 16, 18–19 (1997); Thomas E. Kauper, *Merger Control in the United States and the European Union: Some Observations*, 74 ST. JOHN'S L. REV. 305, 319 (2000) ("[T]he criticism of the [European] Commission's approach to the Boeing-McDonnell Douglas case as trade policy oriented or, more pejoratively, protectionist, has at least the ring of plausibility.").

57. Boeing Co., 5 Trade Reg. Rep. (CCH) ¶ 24,295 (July 1, 1997) (closing investigation of proposed merger of Boeing Corp. and McDonnell-Douglas Corp.).

58. United States v. General Dynamics Corp., 415 U.S. 486 (1974).

59. *Id.* at 499–504.

60. *Id.* at 506.

61. The Merger Regulation in effect at the time of the European Commission's Boeing decision had been adopted in 1989 and became effective in 1990. Council Regulation 4064/89, *supra* note 55. That Regulation was revised in 2004. Council Regulation 139/2004, *supra* note 55. Both versions of the Merger Regulations prohibit mergers that create or strengthen a "dominant position" because such mergers

cally, in the years following the Commission's conditional approval of the merger, Airbus has outsold Boeing, thereby replacing Boeing as the "dominant" manufacturer of commercial aircraft.[62]

A similar conflict in antitrust law occurred a few years later in connection with the proposed merger between General Electric and Honeywell.[63] Although the U.S. antitrust enforcement authorities cleared the merger, the European Commission prohibited the merger largely on the ground that the merged company could bundle products at a package price that none of its European competitors could meet.[64] Although the European Court of First Instance has recently affirmed the Commission's decision, it distanced itself from the Commission's bundling analysis in so doing.[65]

Even more recently, the European Commission ruled that the Microsoft Corporation's bundling of its Media Player with its Windows operating system was an abuse of dominant position under the European competition law.[66] That case is also under appeal. The Korean Fair Trade Commission issued a similar ruling.[67] These decisions appear to conflict directly with the approach taken by the U.S. Court of Appeals for the D.C. Circuit towards technological tying.[68] That court ruled that because the incorporation of new functionalities into the operating system is the way that much innovation proceeds in the software industry, the law should create an exception for platform software to

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would impede effective competition in a substantial part of the common market. Council Regulation 4064/89, *supra* note 55, at 16; Council Regulation 139/2004, *supra* note 55, at 7.

62. *See, e.g.*, Stanley Holmes & Carol Matlack, *Boeing is Choking on Airbus' Fumes*, BUS. WEEK, June 30, 2003, at 50, 50 (noting that 2003 could mark "the third year in a row Airbus won not only more orders [for commercial aircraft], but also more of the lucrative widebody variety").

63. Commission Decision, Case COMP/M.2220, General Electric/Honeywell, 2004 O.J. (L 48) 1 (EU).

64. *Id.* ¶¶ 353, 378. See discussion in Gifford & Kudrle, *supra* note 50, at 459 (2005).

65. Case T-209/01, Honeywell Int'l Inc. v. Comm'n of the European Communities, 2005, http://www.curia.eu.int/en/content/juris/index.htm (click on T-209/01 Judgement of 14/12/2005, Honeywell/Commission). See *id.*, at ¶¶ 36, 78, 86, 102, 121, 122, 126.

66. Case T-201/04R2, Microsoft v. Comm'n of the European Communities, 2004, http://www.curia.eu.int/en/content/juris/index.htm (click on T-201/04 Order of 22/12/2004, Microsoft/Commission). Microsoft's interim appeal was denied. *Id.*

67. *See generally KFTC Condemns Microsoft for Bundling Applications with Windows Operating System*, 89 ANTITRUST & TRADE REG. 626 (2005).

68. United States v. Microsoft Corp., 253 F.3d 34, 84–95 (D.C. Cir. 2001).

the otherwise applicable per se rule governing tying arrangements.[69]

All of these decisions either have generated significant international tension or have carried the potential for doing so. The widely held American view was that industrial policy concerns skewed the European Commission's *Boeing* decision.[70] Many U.S. observers view the *GE/Honeywell* decision as keyed to the protection of European firms from the competition of a more efficient foreign rival.[71] The *Microsoft* decision appears to have ramifications for that company's operations and its relationships with rivals and customers on a world-wide scale—effects that the easy transmission of digital programming aggravates. The *Boeing* and *GE/Honeywell* decisions also have global consequences. These decisions have affected global competition and trade flows. Moreover, in the *Microsoft* case, Sun Microsystems, one of Microsoft's U.S. competitors, lobbied the Commission to reach a result that had been rejected in the U.S. courts, thus emphasizing—from a U.S. perspective—the European Commission's actual and potential impingement on U.S. economic policy.[72]

Competition policy ostensibly is directed towards the furtherance of allocative efficiency—i.e., the goal of directing society's resources towards their highest valued uses. Free trade fosters an analogous result: under a free trade regime, the world directs its resources toward their highest valued uses. When competition policy is administered in ways that detract from allocative efficiency, it generates the appearance of pursuing goals that are less compatible with those of free trade. When competition policy produces results that effectively protect domestic industry, that perception is likely to be reinforced. In the latter case, the administration of competition policy is open to interpretation as a tool of protectionism. It is thus a double-edged sword: as world markets become increasingly global, competi-

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69. *Id.*

70. Lisa M. Renzi, Comment, *The GE/Honeywell Merger: Catalyst in the Transnational Conglomerate Merger Debate*, 37 NEW ENG. L. REV. 109, 139 n.249 (2002) ("Boeing's major competitor, Airbus Industries, was the primary objector to the merger, and the Commission was widely regarded as molding European competition policy to fit Airbus' interests.").

71. *See* Eric S. Hochstat, Note, *The Brown Shoe of European Union Competition Law*, 24 CARDOZO L. REV. 287, 291 n.19 (2002) (reporting contentions of protectionism by Senators Trent Lott and Mike DeWine).

72. Amanda Cohen, *Surveying the Microsoft Antitrust Universe*, 19 BERKELEY TECH. L.J. 333, 355 (2004).

tion policy can become increasingly important as an adjunct to trade, as it fosters free entry and subjects all business firms to competition from their global rivals. Yet in those instances when major jurisdictions take different approaches to the administration of competition law as it affects global competitors, competition law itself can be a significant source of tension.

IV. POTENTIAL TROUBLES AT THE INTERSECTION OF COMPETITION POLICY AND INTELLECTUAL PROPERTY LAW

The interface between intellectual property law and antitrust (or competition) law is another area where the European competition law authorities appear to have departed from the route taken in the United States. These differences carry the potential for generating trade conflict if and when the European rules compel a U.S. multinational firm to choose between doing business in Europe and sharing its intellectual property with European rivals.

In *Magill*,[73] the European Court of Justice ruled that television stations could not enforce the copyright protection which Irish law extends to their program schedules in order to prevent an independent company (Magill) from publishing a combined guide to all television programming.[74] The court ruled that ownership of the copyright conferred a "dominant position" on the companies, requiring them to license the schedules to Magill.[75] Otherwise the companies would abuse their dominant positions within the meaning of Article 82 of the Treaty.[76] *Magill* thus raised the issue as to whether intellectual property rights in a patent or copyright conferred on the holder a "dominant position" within the meaning of Article 82 and, if so, whether a refusal to license those rights would constitute an "abuse" of that dominant position. The *Magill* issue has reappeared in various forms in European case law, most recently in *IMS Health*.[77] The latter case involved a copyrighted structure

73. Joined Cases C-241 & C-242/91 P, Radio Telefis Eireann & Indep. Television Pub. Ltd. v. Comm'n, 1995 E.C.R. I-0743.

74. *Id.* ¶ 47.

75. *Id.* ¶ 54.

76. *Id.* ¶¶ 54–58. The Treaty provision prohibiting an abuse of a dominant position is currently article 82. At the time of the decision in *Magill*, it was numbered as article 86.

77. *See generally* Council Decision 2001/165, 2002 O.J. (L 59) (EC); *see also* Case C-418/01, IMS Health GmbH & Co. v. NDC Health GmbH & Co., 2004 E.C.R.

employed by IMS to report usage of pharmaceuticals to their manufacturers. This structure divided Germany into discrete geographical locations for the purpose of identifying sales volumes (and thus usage) of different pharmaceuticals by location. The European Commission took the view that IMS was required to license its copyrighted structure to rival data collectors and that its failure to do so constituted an abuse of dominant position.[78] In its decision on appeal, the European Court of Justice drew up guidelines for requiring compulsory licensing by holders of intellectual property rights.[79] These guidelines appear to give some comfort to IMS, although they are open to an expansion (in subsequent caselaw) of the obligation of a rights holder to license.

Translated into the terms of U.S. law, *Magill* and *IMS Health* raise the question of whether a patent or copyright might be construed as an "essential facility." Under U.S. law, the courts have deemed the essential facility doctrine to require the owner of a facility to make it available to rivals when certain conditions are met: (1) one firm controls a facility; (2) competitors cannot practically duplicate the facility; (3) the firm has denied competitors use of the facility; and (4) it is feasible to provide the needed access and there is no business justification for refusing to do so.[80] By common consensus, the doctrine originated early in the twentieth century in the *St. Louis Terminal Railway* case,[81] where a consortium of railroads under the leadership of Jay Gould obtained control over the two bridges and ferry line that provided the only means for railway traffic to cross the Mississippi River at St. Louis.[82] In that case, the U.S. Supreme Court effectively ruled that the facilities had to be made available to all of the railroads that wished to use them.[83] The doctrine has been used throughout antitrust history but not expansively. Indeed, it has come under increasing criticism in recent decades.[84] Moreover, the U.S. Supreme Court, in its re-

I-5039.

78. *IMS Health* Case C-418/01 ¶ 52.

79. *Id.*

80. City of Anaheim v. S. Cal. Edison Co., 955 F.2d 1373, 1380 (9th Cir. 1992); MCI Comm'ns Co. v. Am. Tel. & Tel. Co., 708 F.2d 1101, 1132–33 (7th Cir. 1983); *see* Robert Pitofsky, Donna Patterson & Jonathan Hooks, *The Essential Facilities Doctrine Under U.S. Antitrust Law*, 70 ANTITRUST L.J. 443 (2002).

81. United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912).

82. *Id.* at 397.

83. *Id.* at 411–13.

84. *See, e.g.*, Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841 (1989).

cent *Trinko* decision,[85] referred to that doctrine as a creature of the lower courts (rather than its own creation in *Terminal Railway*) and even refused to say whether the doctrine has a place in the antitrust laws.[86] In light of *Trinko*, it appears unlikely that U.S. courts would require access to patented or copyrighted material under an essential facilities rationale. Thus, the stage is set for this jurisdictional conflict over the scope for the compulsory licensing of intellectual property to generate trade tensions if and when the more stringent European law is applied to a non-European multinational business firm. When this event occurs, the rhetoric employed will, as in the other issues so far discussed, resemble ships passing in the night. One side will speak in the language of competition law while the other side will respond in the language of trade and obligations under TRIPS.[87]

Although patents and copyrights might not be construed as essential facilities, their presence may carry consequences in the realm of tying and bundling. As observed above, the European Commission has already faulted Microsoft for packaging its Windows Media Player with its Windows operating system. Microsoft allegedly abused its dominant position in violation of Article 82. Because Microsoft produces an overwhelming share of personal computer operating systems, it was apparent that Microsoft possessed a dominant position. Microsoft's integration of Media Player into the operating system (in effect, a technological tie) constituted the forbidden "abuse." As observed above, the European treatment of this tie departs from the U.S. law because the U.S. law accords special treatment to the integration of new functionalities into a software platform. A different but related potential for conflict will now be examined.

The *Magill* line of cases appears to treat the possession of intellectual property rights as potentially conferring a dominant position upon their holders. This line of cases concerns itself with whether an intellectual property rights holder must license those rights to competitors. But there is potential for expansion. If the possession of intellectual property rights is deemed to con-

85. Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko L.L.P., 540 U.S. 398 (2004).

86. *Id.* at 410–11.

87. Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments—Results of the Uruguay Round vol. 31, 33 I.L.M. 81 (1994) [hereinafter TRIPs].

fer a dominant position, then perhaps under the approach exemplified in *Microsoft* the European Commission will forbid any intellectual property rights holder from packaging a second product with the license. Should EU law develop in this way, it would appear to be following a route different from the one that U.S. law is presently taking.

U.S. law—in a manner not unlike EU law—treats tying arrangements imposed by a firm possessing market power as per se illegal.[88] In the past, the antitrust case law has vacillated on whether the existence of a patent—or even a copyright—generates a presumption of market power sufficient to trigger application of this per se rule.[89] Congress, however, has indicated that in the related patent law doctrine of misuse, actual market power must be established before a commonplace tie (i.e., the tie of a staple product) to a patent becomes unenforceable.[90] By contrast, in the antitrust context the issue of whether a patent generates a presumption of market power—and whether that presumption is rebuttable—has been a troublesome one for at least fifty years. In March 2006, however, the Supreme Court revisited the issue of whether the mere existence of a patent raises a presumption of market power for antitrust purposes. In *Illinois Tool Works Inc. v. Independent Ink, Inc.*,[91] the Court ruled that it would not, thus clarifying an issue that has unsettled antitrust law for half a century.

Under the *Independent Ink* ruling abolishing the presumption of market power, U.S. antitrust law will conform more closely to the current state of the patent misuse doctrine. A plaintiff seeking to establish a tying violation will have to prove market power; it will no longer be able to rely on a presumption arising from the possession of a patent. But if the European authorities infer a dominant position from the existence of a pat-

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88. *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 15–16 (1984) (holding tying arrangements as per se illegal when the firm employing them possesses power in the market for the tying product and the arrangement involves a substantial amount of commerce in the market for the tied product).

89. *See* Daniel J. Gifford, *The Antitrust/Intellectual Property Interface: An Emerging Solution to an Intractable Problem*, 31 HOFSTRA L. REV. 363, 369–70 (2002).

90. 35 U.S.C. § 271(d)(5) (2000).

91. 126 S.Ct. 1281 (2006). This ruling was not unexpected. *See, e.g.*, Jonathan H. Adler, *Looking Ahead to the 2005-2006 Term*, 2005 CATO SUP. CT. REV. 321, 345 ("The American Bar Association, among others, filed briefs supporting Illinois Tool Works' petition for certiorari so that *Loew's* could be overruled. A decision overturning *Loew's* seems likely. The question is whether the existence of a patent will be entitled to any weight at all in a market power determination.").

ent or a copyright and consider that tying constitutes an abuse of that dominant position, then the European and U.S. laws will conflict in yet another area. In such an event, the European law—because it would contain the most extensive prohibition—would act like a trade barrier, possibly prohibiting a wide range of marketing activities. In some instances, such a prohibition could bring to the fore as yet unresolved issues over the extent and scope of international obligations to accord respect to intellectual property rights.

V. STRATEGIC TRADE POLICY ISSUES

Although Ricardo's free trade analysis continues to generate a powerful influence and nudge nations ever closer towards an ultimate objective of global free trade, more recent scholarship has identified circumstances in which one country may advance its national interest by taking actions that promote its own trading interests at the expense of others. Developed largely in the last quarter of the twentieth century, students of strategic trade policy have noted that industries characterized by continuously declining costs carry the potential for generating exports that return supracompetitive profits to the exporting nation.[92] By nurturing such industries, therefore, a nation could generate favorable terms of trade, thereby augmenting its aggregate national wealth with the economic rents generated by those industries.[93]

Early in the twentieth century, economists developed the theory of the optimal tariff.[94] Under this theory, a large importing nation that imposes a small tariff on imports may affect the price of a good produced abroad for the export market.[95] To the extent that the domestic market of the importing nation is large in relation to the supply available for export, a tariff can exert downward pressure on the export price.[96] For the importing nation, the results of the tariff then are (1) the creation of a small deadweight loss; (2) the imposition of higher prices on domestic

92. *See, e.g.*, TYSON, *supra* note 49, at 3–4; Paul R. Krugman, *Is Free Trade Passé?*, 1 ECON. PERSP. 131, 134–38 (1987).

93. *See* TYSON, *supra* note 49, at 3–4; Krugman, *supra* note 92 at 134–38.

94. *See* C. F. Bickerdike, *The Theory of Incipient Taxes*, 16 ECON. J. 529 (1906); *see also* ELHANAN HELPMAN & PAUL R. KRUGMAN, TRADE POLICY AND MARKET STRUCTURE 17–19 (MIT Press 1989).

95. HELPMAN & KRUGMAN, *supra* note 94, at 12–13.

96. *Id.* at 13.

consumers; (3) a reduced foreign supply price; and (4) customs revenues generated by the tariff.[97] The latter are equal to the amount of the tariff multiplied by the volume of imports. The part of customs that reflects the reduced foreign supply price will exceed the deadweight loss associated with the tariff so long as the tariff is kept relatively small in amount.[98] This tariff, therefore, increases aggregate national welfare.

In the late twentieth century, economists developed strategic trade theory, a set of analytical approaches that identify policies capable of enlarging national wealth by altering the terms of trade.[99] Consider industries that experience continually falling unit costs. These falling costs may be due to scale and/or scope economies or to learning-curve effects or both. In those industries, a firm that is further along on its unit cost or learning curve possesses an advantage over its rivals. As long as it maintains its lead, it maintains a cost advantage. The industry characteristic of falling unit costs ensures that the industry structure is not one of perfect competition and thus that supracompetitive profits are available and cannot be competed away. These profits will return to the exporting nation, advancing its aggregate welfare. In the early 1980s, economists used game theory to show how a government might confer a trading advantage on a domestic industry. Thus, as Barbara Spencer, James Brander, and others have pointed out, the subsidization of research and development can operate as a trade weapon. Subsidization of a new Airbus model by European governments might effectively preempt the field, making entry by Boeing (its U.S. competitor) economically infeasible.[100] Another such industrial strategy involves the exercise of protectionism as a step in generating economic rents from exports in imperfectly competitive industries. Thus in the 1980s Japanese barriers to the importation of semiconductor chips enabled its domestic producers to proceed further on their learning curves than would have been the case if its domestic market had been open.[101] Then, having acquired this advantage from a protected domestic mar-

97. *Id.*

98. *See id.* This assumes that the tariff is set at an optimal amount and that the import supply curve is rising.

99. Krugman, *supra* note 92.

100. *See generally* Barbara J. Spencer & James A. Brander, *International R&D Rivalry and Industrial Strategy*, 50 REV. ECON. STUDIES 707 (1983); Avinash Dixit & Albert S. Kyle, *The Use of Protection and Subsidies to Entry Promotion and Deterrence*, 75 AM. ECON. REV. 139 (1985).

101. TYSON, *supra* note 49, at 98.

ket provided by their government, the Japanese semiconductor firms entered the international marketplace at a higher level of efficiency than they would otherwise have attained.[102] Paul Krugman, however, calculated that although the Japanese strategy generated a domestic semiconductor industry that would not have existed in a free trade context, the Japanese strategy nonetheless appears to have reduced its own aggregate welfare.[103]

Strategic trade theory thus provides yet another basis for the generation of tensions over trade. The Ricardian paradigm rested upon the theory of comparative advantage. Strategic trade theory now tells us how governments may artificially construct comparative advantage. When nations exploit this possibility, they are apt to generate tensions over trading issues. The trade disputes generated by the Japanese government's fostering of its domestic semiconductor industry and European governments' support for a wide-body commercial aircraft industry are the classic examples.

VI. THE INTERACTIONS AMONG INDUSTRIAL POLICY, COMPETITION POLICY, AND TRADING POLICY

Although on the surface industrial policy, competition policy, and trade policy sometimes appear to be addressing different concerns, these policies interact in a variety of ways. A government premises its support and encouragement for particular industries (or even firms) that are the traditional core of industrial policy upon insulating that industry (or those firms) from intensive competition. Thus government administrators may believe that a successful industrial policy entails an exemption from competition policy. The Japanese Anti-Monopoly Law, for example, contains explicit provisions designed to prevent the competition policy embodied in that law from interfering with that nation's industrial policies.[104] The European industrial policy aimed at the rehabilitation of the synthetic fiber industry specifically authorized an industry cartel charged with oversee-

102. *Id.*

103. HELPMAN & KRUGMAN, *supra* note 94, at 174.

104. The Japanese Anti-Monopoly Law contains a range of exemptions in sections 21–24, including exemptions for depression cartels and rationalization cartels. *See* MATSUSHITA, *supra* note 28, at 311–15.

ing investment in new plant,[105] a cartel that otherwise would have been illegal under Article 81 of the Treaty.[106] Besides impinging on competition policy, industrial policy can skew trade policy. The Japanese Anti-Monopoly Law's exemption for industrial policy will be unavailing unless the target industry is also freed from foreign competition. Thus the successful implementation of industrial policy must contemplate the erection (or maintenance) of the trade barriers necessary to provide this relief. Similarly, the cartel authorized by the European Commission to oversee investment in the synthetic fiber industry would be extremely handicapped in carrying out its task unless import barriers protected the cartel members from foreign competition.

As discussed above,[107] the rehabilitation of an industry negatively impacted by a surge of imports can take place behind the temporary import barriers authorized by the Agreement on Safeguards.[108] In such cases, government oversight of the rehabilitation constitutes industrial policy and the rehabilitation may require exemption of otherwise applicable competition laws. In these instances, trading partners will understand from the outset that although trade barriers have been erected, they are both legitimate (as authorized by the Agreement on Safeguards) and temporary. Other interactions of industrial competition and trading policies are likely to generate trading tensions.

In contrast with the above examples of rehabilitation stand cases in which governments seek to foster a new industry. In Japan, the government sought to foster a world-class semiconductor chip industry in the 1980s, partially by protecting it from foreign competition.[109] Elsewhere, European governments have supported Airbus, inter alia, by providing it preferred financing for some several decades.[110] The aggregate policy mix in these cases reflects the characteristics of the favored industry. Protection was the instrument of choice for the semiconductor chip

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105. *See supra* note 27 and accompanying text.

106. Treaty Establishing the European Economic Community, *supra* note 10, art. 81.

107. *See supra* notes 18–40 and accompanying text.

108. *See supra* note 15 and accompanying text.

109. *See* TYSON, *supra* note 49, at 95–96.

110. Daniel I. Fisher, *"Super Jumbo" Problem: Boeing, Airbus, and the Battle for the Geopolitical Future*, 35 VAND. J. TRANSNAT'L L. 865, 871 (2002); *see also* Jennifer A. Manner, *How to Avoid Airbus II: A Primer for Domestic Industry*, 23 CAL. W. INT'L L.J. 139, 142–44, 160–61 (1992). *Cf.* Ann McKinstry Denman, *Airbus and Its Ilk: Thumbing Their Noses at the GATT?*, 29 HARV. INT'L L.J. 111, 118 (1988).

industry. As discussed above, protection enabled the Japanese domestic industry to advance on its learning curve. Preferred financing has been the instrument of choice for the European commercial aircraft industry where the key element is the "launch" of a new model. Many U.S. observers see a violation of the Agreement on Subsidies in the financing of Airbus, and some see the skewing of competition policy as well.[111] As noted above, some U.S. observers believe that the European Commission decision on the Boeing/McDonnell-Douglas merger was designed to affect the relative competitiveness of the two rivals.[112] On the latter view, competition policy was skewed by industrial policy.

VII. DISAGREEMENTS OVER THE ROLE OF ECONOMICS

As in many trading issues, broad agreement over fundamentals sometimes dissolves into disagreement at the conceptual margins. This phenomenon has arisen, inter alia, in connection with so-called cultural issues and also with newly developed methods of producing food products. The United States and its trading partners have agreed that, in general, they should open their markets to each other's exports. Yet a number of these trading partners want to protect their motion picture and audiovisual industries by reserving "screens" or broadcasting time for the products of domestic producers.[113] The rationale usually given for this protection is a desire to protect national culture.[114] In a similar situation, the EU has barred imports of beef treated with hormones and much genetically-altered food, import prohibitions that are matched by domestic prohibitions on the production of similar products.[115] The EU justifies its import prohibitions on the basis of the precautionary principle: Doubt on health issues should be resolved in favor of safety.[116] Moreover, since the bar treats foreign and domestic

111. Fisher, *supra* note 110, at 874.

112. *See supra* note 56 and accompanying text.

113. *See* discussion *infra* notes 120–31 and accompanying text.

114. *Id.*

115. *See* Werner P. Meng, *The Hormone Conflict Between the EEC and the United States Within the Context of GATT*, 11 MICH. J. INT'L L. 819, 822 (1990) (describing the origin of the ban and its equal application to domestic and foreign sources). The WTO recently ruled that the EU's restrictions on genetically modified foods violate international trade law. *See* Andrew Pollack, *World Trade Agency Rules for U.S. in Biotech Dispute*, N.Y. TIMES, Feb. 8, 2006, at C6.

116. *See* Terrence P. Stewart & David S. Johanson, *The WTO Beef Hormone*

producers alike, it is nondiscriminatory. By contrast, the U.S. position on these issues is based solely on the economics of trade. Markets should be open and consumers should decide for themselves whether to purchase foreign cultural products or whether to consume food products altered through hormone technology or genetic manipulation.[117]

A. CULTURAL ISSUES

A host of recent trade disputes have revealed that cultural and attitudinal differences carry a potential for generating tensions over trade. A number of jurisdictions, for example, have adopted regulations that set minimum requirements for local media content, such as television programming or motion picture exhibitions.[118] These regulations have the effect of blocking foreign-produced television programming and motion pictures in a manner analogous to a quota or quantitative restriction. They are generally justified on a ground related to a need to preserve local culture. France, Italy, the EU, Canada, and Australia are among the jurisdictions that impose local-content regulations.[119]

Because the United States is a major exporter of motion pictures and of television programming, it has generally taken a critical view of local content requirements. Nonetheless, the original GATT (1947) explicitly authorized the parties to impose restrictions in favor of domestically-produced motion pictures.[120]

Dispute: An Analysis of the Appellate Body Decision, 5 U.C. DAVIS J. INT'L L. & POL'Y, 219, 229–30 (1999) (discussing the European Community's contentions based on the precautionary principle and the rulings of the panel and Appellate Body on those contentions).

117. *See* discussion *infra* notes 118–40 (describing the U.S. position on both issues as favoring open markets and consumer choice).

118. *See, e.g.*, Council Directive 89/552, 1989 O.J. (L 298) 23 ("Council Directive of 3 October 1989 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities"); Joseph Devlin, Note, *Canada and International Trade in Culture: Beyond National Interests*, 14 MINN. J. GLOBAL TRADE 177, 180 n.18 (2004); John David Donaldson, *"Television Without Frontiers": The Continuing Tension Between Liberal Free Trade and European Cultural Integrity*, 20 FORDHAM INT'L L.J. 90 *passim* (1996).

119. Sandrine Cahn & Daniel Schimmel, *The Cultural Exception: Does It Exist In GATT and GATS Frameworks? How Does It Affect or Is It Affected by the Agreement on TRIPS?*, 15 CARDOZO ARTS & ENT. L.J. 281, 282–83 (1997); Frederick Scott Galt, Note, *The Life, Death, and Rebirth of the "Cultural Exemption" in the Multilateral Trading System: An Evolutionary Analysis of Cultural Protection and Intervention in the Face of American Pop Culture's Hegemony*, 3 WASH. U. GLOBAL STUD. L. REV. 909, 924–28 (2004).

120. GATT, *supra* note 11, art. IV.

Whether these provisions governed television and other audiovisual matter, however, was a subject of a dispute which was never successfully resolved prior to the Uruguay Round negotiations.[121] In addition, both the Canada-U.S. Free Trade Agreement and the North American Free Trade Agreement (NAFTA) exempt "cultural industries" from their provisions.[122] The Uruguay Round negotiations over the General Agreement on Trade in Services (GATS) culminated in an agreement that nominally appears to include audiovisual services[123] but which allows nations to exempt specified services from the most-favored nation treatment that the Agreement generally mandates.[124] Although the Annex provides that these exemptions should not exceed a period of ten years, it also contemplates that they may be the subject of future negotiations.[125] In the view of many commentators, the results of the GATS negotiations have left the long-term legal status of cultural controls over audio-visual services in a state of suspended ambiguity.[126]

Critics of cultural exceptions have questioned their legitimacy on several grounds. Local content regulations are unnecessary if the mass of people want local content. Local content regulations override consumer choice and to that extent are undemocratic. Also, the bite of cultural exceptions occurs at the level of popular culture, a realm that is generally unconcerned with the history and tradition on which the higher culture (that is often closely associated with national identity) is based.[127] Again, incidents in which local programming replaces foreign programming with similar content raises the issue of whether claims for cultural exceptions are—to some significant degree—actually protectionist devices meant to provide economic bene-

121. *See* Robin L. Van Harpen, Note, *Mammas, Don't Let Your Babies Grow Up to be Cowboys: Reconciling Trade and Cultural Independence*, 4 MINN. J. GLOBAL TRADE, 165, 169–70 (1995).

122. Can.-U.S. Free Trade Agreement arts. 2005, 2012, Jan. 2, 1988, 27 I.L.M. 281 (1988); North American Free Trade Agreement arts. 2106, 2107 & Annex 2106, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289.

123. General Agreement on Trade in Services, 1869 U.N.T.S. 183 (1995).

124. *Id.* art. XXIX.

125. *Id.* annex II(5).

126. *See, e.g.*, Galt, *supra* note 119, at 914–15; Beverly I. Moran, *United States' Trade Policy and the Exportation of United States' Culture*, 7 VAND. J. ENT. L. & PRAC. 41, 48–49 (2004).

127. *See* ERNEST GELLNER, NATIONS AND NATIONALISM 35–36, 117 (Cornell Univ. Press 1983) (identifying high culture and nationalism); F.H. Buckley, *Liberal Nationalism*, 48 UCLA L. REV. 221, 243 (2000) (discussing national identity and high culture).

fits to local business interests. The barring of a U.S. country music channel on Canadian cable and its replacement by a Canadian country music channel gave such an appearance.[128] Some commentators have suggested that European officials may advance cultural arguments, at least in part, for economic ends.[129] Finally, it is not always clear how domestic content regulations actually protect local culture. France, for example, requires that sixty percent of its television programming be produced within the EU and that French-language jurisdictions produce forty percent.[130] Yet it is not clear that a "European Union culture" (presumably composed of almost as many languages and traditions as there are Member States in the EU) exists.[131] Nor is it clear how U.S.-produced entertainment programming differs from Canadian-produced English-language entertainment programming.

B. HEALTH ISSUES AND THE PRECAUTIONARY PRINCIPLE

The United States and the EU have been at odds for more than a decade over the issue of hormone-treated beef. The EU has banned the importation of hormone-treated beef since 1989.[132] In a WTO dispute settlement proceeding, the Appellate Body affirmed a panel ruling in favor of Canada and the United States, holding that the EU ban violated its obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS)[133] because it was not supported by scientific evidence.[134] The EU sought to justify its position on the precautionary principle, but the Appellate Body ruled that the precautionary principle does not justify actions that are other-

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128. *See* Devlin, *supra* note 118, at 180.

129. Lisa L. Garrett, Comment, *Commerce versus Culture: The Battle Between the United States and the European Union Over Audiovisual Trade Policies*, 19 N.C. J. INT'L L. & COM. REG. 553, 569 (1993).

130. Galt, *supra* note 119, at 927.

131. Donaldson, *supra* note 118, at 155 (quoting Ambassador Carla Hills raising this issue).

132. *See* Kristin Mueller, Note, *Hormonal Imbalance: An Analysis of the Hormone Treated Beef Trade Dispute Between the United States and the European Union*, 1 DRAKE J. AGRIC. L. 97, 99 (1996).

133. Agreement on the Application of Sanitary and Phytosanitary Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, 1867 U.N.T.S. 493 [hereinafter Agreement on Sanitary Measures].

134. Appellate Body Report, *European Communities—Measures Concerning Meat and Meat Products*, ¶¶ 124–25, WT/DS26/AB/R, WT/DS48/AB/R (Jan. 16, 1998) (adopted Feb. 13, 1998); *see* Stewart & Johanson, *supra* note 116, at 236–38.

wise in violation of Article 5 of the SPS.[135] The EU has refused to comply with the ruling and has since adopted a new directive confirming its ban.[136] The United States, in turn, has applied sanctions on EU imports for its non-compliance.[137]

An analogous issue involves genetically-modified food products (GMOs). Because of an apparently extremely slow-moving approval process for GMOs, the United States, Canada, and Argentina instituted a WTO proceeding against the EU in 2003.[138] In this dispute, like the dispute over beef hormones, the United States is objecting to restrictions on the importation of food products that are not justified by scientific evidence and the EU is relying upon the precautionary principle. Although the ultimate decision will involve an application of the SPS, and the SPS requires that long-term restrictions justified on health grounds must be based upon scientific evidence, the SPS—in paragraph 7 of Article 5—does permit short-term restrictions on imports based upon lesser evidence.[139] Some commentators believe that paragraph 7 provides a temporary safe harbor for EU restrictions on the production and importation of GMO products.[140] A WTO Panel recently held that the EU's restrictions on GMO products violate international trade law, but the EU is appealing the issue.[141]

CONCLUSIONS

The concepts in which the world's trade agreements are cast are often ambiguous or unclear at their margins. Although lack of clarity at the margins is a general characteristic of language, it lends itself to exploitation, creating tensions among nations that are interested in how resolving that ambiguity will affect the terms of trade. In the trade context, governments are sub-

135. Appellate Body Report, *European Communities—Measures Concerning Meat and Meat Products*, *supra* note 134, ¶ 125.

136. *See* Raj Bhala & David A. Gantz, *WTO Case Review 2004*, 22 ARIZ. J. INT'L & COMP. L. 99, 114 (2005) (describing the history of the dispute over beef hormones and the WTO litigation).

137. *Id.*

138. *See* David Winickoff et al., *Adjudicating the GM Food Wars: Science, Risk, and Democracy in World Trade Law*, 30 YALE J. INT'L L. 81, 82 (2005).

139. Agreement on Sanitary Measures, *supra* note 133, 1867 U.N.T.S. at 496.

140. Robert Howse & Petros C. Mavroidis, *Europe's Evolving Regulatory Strategy for GMOs—The Issue of Consistency with WTO Law: Of Kine and Brine*, 24 FORDHAM INT'L L.J. 317, 367–69 (2000); Winickoff et al., *supra* note 138, at 121.

141. *See* Pollack, *supra* note 115.

ject to a variety of pressures, especially to those generated by interests having a stake in trade. In nations with a large national market like the United States, domestic producers for the internal market (and the unions representing their workers) are prone to lobby for protectionist ends. In so doing, they exploit the available trade rhetoric in their public relations campaigns, attempting to generate political support for their goals. Other nations are subject to analogous interest group pressures that pursue increasingly sophisticated goals, such as those discussed under the rubrics of industrial policy and strategic trade policy. This essay has shown how the latter issues can sometimes blur into protectionist constructions of competition laws. Indeed, interpretations whose protectionist consequences are unknown to the interpreting officials can generate protectionist results. Accordingly, there is a moral to be drawn from this discussion: observers of the world trading scene cannot be too sensitive to the potential of language to be exploited for policy goals, including policy goals that may even be at odds with the goals in the minds of the original authors. Of course, international agreements are often cast in intentionally ambiguous language in order to defer the resolution of a troubling policy issue. That is the negotiating game. The GATS handled the issue of the audiovisual cultural exception in exactly this way, postponing for another day the issues surrounding the absorption of audiovisuals into the Agreement's framework. Yet while the specialists are fully aware of the way that they handle the nuances of language, the broader public may miss these subtler issues. Consequently, the resulting ambiguities lend themselves to exploitation. Indeed, even officials administering one set of policies may miss the impact of the rhetoric they employ on other policies. Thus, officials too can prepare the ground for lobbying and political manipulation.

The trade issues discussed in this essay are rooted, in substantial part, in the different ways that the language embodying solid and broad agreement on core matters can be construed at the margins. As these differences arise, they identify ambiguities contained in the relevant treaty language, sometimes ambiguities that had gone previously unnoticed and sometimes ambiguities that the parties had intentionally inserted. Tensions are likely to increase in direct proportion to the trading importance of the ambiguities. Ultimately the ambiguity will likely be resolved, either through WTO dispute resolution procedure, or through further negotiation. That is the function of tension:

to bring matters to a head for resolution. In some cases, however, tension continues indefinitely—the beef hormone dispute is an example. Neither side will either concede or compromise. Other examples include differences in competition law and some aspects of the ways industrial policies affect the terms of trade. These issues generate tensions, but the parties find it easier to live with the tensions than to resolve the underlying disputes.