Volume Title: Issues in US-EC Trade Relations

Volume Author/Editor: Robert E. Baldwin, Carl B. Hamilton and Andre Sapir, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-03608-1

Volume URL: http://www.nber.org/books/bald88-1

Publication Date: 1988

Chapter Title: An Introduction to the Issues and Analyses

Chapter Author: Robert E. Baldwin

Chapter URL: http://www.nber.org/chapters/c5954

Chapter pages in book: (p. 1 - 14)

1 An Introduction to the Issues and Analyses

Robert E. Baldwin

1. The Importance of US-EC Trade Relations

A minimum requirement for a viable trading system is the active support of both the United States and the member countries of the European Community (EC). This is not only because their trade makes up about one-half of total world trade but because the United States and members of the EC have been the main architects and supporters of the post–World War II international trading regime. Other major trading groups have generally been willing to accept the leadership of the United States and the EC in initiating multilateral negotiations aimed at reducing protection and modifying the rules of the General Agreement on Tariffs and Trade (GATT).

In recent years a series of United States–European Community (US-EC) disagreements have developed that threaten the degree of consensus between these two trading blocs that is necessary for the maintenance of a stable international trading order. They are on such diverse matters as the consistency with current GATT rules of particular actions taken by one of the parties, the need for new rules and for changes in existing rules to cover forms of trade not now subject to GATT discipline, the adequacy of present dispute settlement procedures, the proper agenda and procedures in new multilateral trade negotiations, and the relationship of trade policies to balance-of-trade deficits.

As the some 90 members of the GATT embark on a new multilateral trade negotiation, the Uruguay Round, the United States and the Eu-

Robert E. Baldwin is the Hilldale Professor of Economics at the University of Wisconsin-Madison, a Research Associate of the National Bureau of Economic Research, and director of the NBER's Trade Relations project.

ropean Community face an historic challenge. They can either use the occasion to move toward the resolution of their disputes and thereby strengthen the trading system or they can adopt inflexible negotiating positions with the likely result that, as others follow suit, the negotiations become the occasion for a further weakening of the rules and arrangements of the world trading system. Fortunately, the Ministerial Declaration adopted in Punta del Este in September 1986 gives some promise that the first course will be followed. Besides agreeing upon a standstill and rollback of trade-restrictive measures inconsistent with the GATT, the participants included in the agenda as subjects for negotiation most of the issues on which US-EC disagreements have arisen.

The purpose of this volume is to facilitate the resolution of the two blocs' present differences by analyzing some of the most important issues of disagreement and considering alternative policy options to reduce tensions and lessen the risks of a breakdown of the trading system. In carrying out this objective, emphasis is placed on utilizing appropriate combinations of historical, theoretical, and empirical analyses. Each general subject is analyzed, in most cases, from both an American and a European perspective.

Of course, many US-EC disputes cover matters on which there is widespread disagreement within the entire trading system. Thus, the theoretical analysis in most of the papers, though not the institutional detail, is also relevant for studying trade policy in general, nonregional terms.

1.2 US-EC Litigation in the GATT

Under the GATT, if one member considers that any benefits accruing under the Agreement are being nullified or impaired as a result of the actions of another member, that member can request consultations with the other party to resolve the problem. Should the dispute not be settled through this procedure, the complaining party can request that a panel of appointed experts make a report to the general membership with their judgment on whether the GATT rules have been violated. The general membership then decides whether or not to accept the judgment of the panel. An appropriate place to begin an analysis of US-EC disputes, therefore, is to examine the nature and frequency of cases between these two parties that have been brought before such panels.

In part 1 of this volume, "The Legal Framework," Robert Hudec (chapter 2) examines the 80 GATT "lawsuits" filed between 1960, when the European Community became a full participant in GATT legal affairs, and 1985. Hudec finds that almost one-third of all the GATT lawsuits (26 of 80) during this period were between the United States and the Community. Furthermore, 45 of the remaining 54 cases involved either the United States or the European Community as one of the parties. The volume of US-EC litigation has increased in recent years, but so too has the volume of GATT litigation in general.

Most of the GATT lawsuits (43 of 80) have involved trade in agricultural products, and in most of these (25 of the 43), the EC has been the target of the complaint. Complaints about subsidies, both export and domestic production subsidies, and about tariffs, including the Community's variable levy on agricultural imports, dominate the list.

Hudec concludes that the United States has litigated in the GATT mainly to satisfy certain domestic political imperatives, while the Community has litigated primarily for defensive purposes, without really believing in the process. Nevertheless, he believes the lawsuits between the two trading blocs have provided a peaceful alternative to real economic warfare. Although he thinks there is some reason to wonder whether GATT litigation can retain political credibility, he is generally optimistic that political leaders will continue to strengthen the dispute settlement procedures of the GATT.

1.3 Current Issues: Agriculture, Embargoes, and Declining Industries

As Hudec's analysis demonstrates, the leading area of dispute between the United States and the European Community is agricultural policy. Much of the success of the Uruguay Round is likely to be judged on the extent to which these two parties resolve their differences on agricultural trade relations. In part 2, "Agriculture: Trade and Protection," Dermot Hayes and Andrew Schmitz (chapter 3) and Alexander Sarris (chapter 4) tackle this difficult issue and propose policies for dealing with the trade problems that have arisen.

Both Hayes/Schmitz and Sarris agree that the Community's Common Agricultural Policy (CAP) entails heavy economic costs both to the United States and the Community and substantially distorts world agricultural markets. Hayes and Schmitz also show, however, that recently adopted U.S. farm legislation has long-run implications that are surprisingly similar to those of the CAP.

Having described the Community's CAP and the U.S. agricultural policy, especially the Food Security Act of 1985, and shown how these policies have led to an international price war, Hayes and Schmitz propose specific policy changes they consider both politically feasible and welfare-enhancing. Under their proposal, all production would be sold at whatever price the market would yield, but through the use of a per-unit production subsidy, the government would ensure a certain reference income to those farmers whose operations are at the size that it most wants to support. Smaller, less efficient farmers would receive an income that is less than the reference income but more than from their market sales, while larger, more efficient units would receive at least the reference income, either from their market sales or the government. Hayes and Schmitz believe that this alternative to present agricultural policies would help alleviate the world oversupply situation in agriculture by shifting producers' emphasis from output-increasing technology to cost reduction and output-price enhancement.

Sarris reviews US-EC agricultural policies from a European perspective. He outlines a simple model with random demand and supply shocks that is designed to capture the key economic features of the trade in grains between the two blocs and uses the model to estimate empirically the effects of actual and alternative US-EC grain policies.

Sarris focuses in particular on three policy options available to the United States to offset some of its economic losses resulting from present EC policies. One is to take advantage of U.S. monopoly power by imposing an optimal export tax on grains; the second is to institute an optimal buffer stock scheme; and the third is to inflict a budget loss on the EC by introducing an export subsidy on U.S. grains. He concludes from his empirical analysis that an optimal export tax would more than compensate the United States for its CAP-induced losses but suggests that such a response is probably not politically feasible, since the U.S. Treasury rather than the U.S. farmer would be the big gainer. He also finds that an export subsidy is likely to prove too costly for the United States, since to inflict a $100 million annual budgetary loss on the Community would cost the U.S. Treasury $530 million. The best alternative, in his view, is the use of a government stockpiling policy. By buying for storage when world prices are low and selling when they are high, the U.S. Treasury is not hurt, producers benefit when they need it most, and consumers get more stable prices.

While agricultural issues dominate the list of US-EC trade disputes, there are several areas of trade in manufactured goods and services where disagreements between the two trading blocs have arisen. Part 3, "Embargoes and Strategic Trade Issues," examines their differences over the use of embargoes as a means of inducing foreign countries to change a particular political action. A recent example is the U.S. embargo, introduced after the imposition of martial law in Poland in 1981, on sales by U.S.-based firms and their affiliates in foreign countries of equipment for use in building the Soviet gas pipeline from Siberia to Western Europe. Henryk Kierzkowski (chapter 5) and Alasdair Smith (chapter 6) point out that the difference in views between Western Europe and the United States on the wisdom of imposing embargoes has been evident on many other occasions.

An imperfectly competitive framework is especially suitable for analyzing the embargo issue, and both Kierzkowski and Smith utilize this approach. In doing so, both conclude that embargoes generally are not very effective in carrying out their intended purpose.

Kierzkowski focuses on the following question: Can protection of a domestic industry considered to be strategic be justified when there is the possibility of an export embargo by a foreign producer? Since strategic industries often have a relatively small number of firms, to analyze this question he utilizes a model in which imperfect competition prevails. He demonstrates that, in the extreme case where open competition results in the product being produced in only one country, it could be advantageous for the importing country to produce the product for itself under import protection rather than risk the loss of the product because of a foreign embargo during the time needed to establish domestic production. Yet, when this extreme case is set aside and there are at least a domestic and a foreign firm supplying the domestic market, he finds that a foreign embargo cannot deal a devastating blow to the domestic economy. Strategic interdependence, as he terms the latter case, is, therefore, a far better state of affairs for a country than strategic dependence, as he terms the former situation. He argues, however, that strategic interdependence may be achieved without sacrificing efficiency by liberalizing foreign investment and providing for the freedom of establishment. As was demonstrated in the pipeline embargo case, a foreign monopoly operating within the frontiers of a country is less likely to deny goods and services to the host country even if ordered to do so by its home government.

Smith presents a model of multilateral investment to focus on the embargo issue from a somewhat different viewpoint. How does the fact that the home-country government may impose an export embargo and thus reduce the profits of the multinational affect the company's decision to invest abroad? He assumes that it is also possible for a host-country firm to produce the good for its own market.

Among the possible outcomes in this duopoly situation, two cases are of particular interest for the embargo issue. In one case, the multinational will choose not to invest abroad but instead to export its product to the foreign country if there is no threat of an export embargo by its government, but if this threat is strong enough, it will undertake foreign investment and thereby make the embargo ineffective. In the second case, the embargo threat is not strong enough to induce foreign investment by the multinational, but when the embargo is introduced, it becomes profitable for the host-country firm to undertake production and thereby make the embargo ineffective. As a practical policy issue, Smith concludes from his historical and theoretical analysis that, in most instances, embargoes are quite unlikely to succeed.

In both the United States and the European Community there are a number of industries facing severe competition from third-country sources. The attempts to adjust to these new circumstances have led to US-EC disputes with these third countries and with each other. Part 4, "Industry: New Protectionism and New Competitors," examines certain aspects of protectionism and responses to this policy in two industries, steel and textiles.

David Tarr (chapter 7) analyzes what he describes as the crisis that has arisen in the steel industries of the United States and the European Community as declining demand and the emergence of new lower-cost producers have reduced production and employment in both regions by more than one-third since 1974. The EC and the United States, he notes, have responded by adopting similar external policies, namely, greater import protection, but quite different domestic policies. At first, the Community attempted to maintain minimum prices for certain steel products with a system of voluntary production quotas; when this did not work, EC officials imposed mandatory production quotas. Shortly thereafter, a code on the subsidies provided by national governments to steel producers, aimed at reducing and finally eliminating such subsidies, was adopted. In contrast, the U.S. government has not intervened directly in the domestic market and has allowed losses suffered by domestic firms to be the guide in plant closings.

These differences in domestic policy led to a major trade dispute in 1982 when U.S. producers filed charges of dumping and subsidization of steel exports against the EC. The U.S. Department of Commerce agreed that EC producers were being subsidized, some by substantial margins, and the International Trade Commission found that U.S. firms had suffered material injury. After the dispute reached the highest political level in both regions, however, and before countervailing duties were imposed, the Community agreed to a Voluntary Restraint Agreement (VRA) on steel.

Tarr argues that a more viable, efficient EC steel industry would emerge if the Community eliminated its domestic controls on prices, output, and investment. These controls, he contends, create more distortions over time and make the adjustment problem worse. He also believes that the United States and the European Community should eliminate the nontariff barriers they have erected. His empirical investigations indicate that the costs of these trade barriers far exceed the adjustment costs they are designed to save.

Carl Hamilton (chapter 8) considers two aspects of the protection of textiles that has been introduced by the United States and Europe by means of quantitative import restrictions: the levels of protection that these controls provide and the levels of rents earned by exporters of textiles because of these restrictions. The importance of these questions is reflected in the fact that trade in textiles and clothing makes up 9 percent of world trade in manufactures and 25 percent of the manufactured exports of the developing countries.

Using data on the prices of quota rights in Hong Kong and (for a short interval) in Taiwan, and an indirect method to calculate the degree of restrictiveness of quotas imposed on South Korean and Taiwanese textiles, Hamilton estimates the tariff equivalents of quotas plus tariffs on imports of textiles into the United States and the European Community from Hong Kong, Taiwan, and South Korea. He finds that the combined rate of protection from quotas and tariffs in the United States on textiles from these three suppliers ranges from about 45 percent to 65 percent. In contrast, the degree of restrictiveness on textile imports into the EC ranges from only about 25 percent to 35 percent. Rents derived by Hong Kong, Taiwan, and South Korea because of the quotas imposed by the United States and the EC are estimated by Hamilton at more than $500 million in 1983 alone. Some 80 percent of this amount is due to U.S. quantitative restrictions.

While the United States and the European Community impose quantitative import restrictions on textiles from major developing-country exporters, they use only tariffs to restrict the flow of textiles between themselves. These policies, as Hamilton points out, can have the effect of mitigating and even nullifying the restrictive effects of tighter quantitative controls against the developing countries by stimulating increased textile trade between the two trading blocs. He notes in particular the prospect of increased textile exports to EC countries from Portugal and Spain when they become full members of the EC. Hamilton finds some empirical evidence that this kind of trade deflection has in fact occurred in textile and footwear trade.

1.4 New Issues: Services, High-Tech Products, and Strategic Trade Policy

History will probably see as the most notable feature of the Uruguay Round of multilateral trade negotiations the fact that for the first time the member nations of GATT negotiated on trade in services as well as on trade in goods. When in 1982 the United States first proposed that services trade be covered in the next round of trade negotiations, the idea was rejected both by the developing countries and the European Community. The EC eventually agreed to support the proposal but the opposition of many developing countries led to the compromise that the services negotiations be formally separate from the negotiations on goods. In part 5, "Trade in Services," André Sapir (chapter 9) and Richard Neu (chapter 10) illustrate the kinds of problems and opportunities faced by negotiators in this field by examining two key areas of services trade, international telecommunications services (Sapir) and international trade in banking services (Neu).

Sapir points out that negotiations on almost all forms of services are hampered by the absence of good data on the actual volume of transborder trade and inadequate conceptual understanding of the differences between services and goods trade, especially whether the same economic principles can be used to evaluate the effects and benefits of services trade as have been traditionally used to appraise goods trade. His discussion of these problems indicates, however, that sufficient progress has been made on both issues to justify moving forward with a services negotiation.

International telecommunications are, according to Sapir, an especially important service because they have not only enhanced the tradability of traditional services, such as banking services, but have increased the opportunities for international trade in new forms of information services, such as data processing and data-base services. Furthermore, a rapid series of innovations in information technologies and deregulation in the U.S. telecommunications markets are opening up new opportunities and challenges for the industry.

There are, however, significant differences in views between U.S. and EC industry leaders over the extent to which trade in telecommunication services should be liberalized. European leaders generally favor the traditional view that national markets for telecommunication services should be organized on a monopolistic basis under government ownership or regulation to be economically efficient. The view in the United States is that deregulation increases efficiency. U.S. suppliers are now engaged in intense competition among themselves and they also want to compete in foreign markets. Interestingly, a new argument being put forward in Europe for restricting access to its markets is the need to have the opportunity to catch up with technological development in the United States, a development that may in part be a result of deregulation. Sapir notes that this type of disagreement is likely to arise in the negotiations on many forms of services.

Richard Neu questions the official American position that the liberalization of international trade in banking services is a desirable trade policy objective. He supports his view with three main arguments. He first stresses the difficulties of trying to reconcile legitimate national needs to regulate banking with the demands for freer and fairer international trade. In the process, many important interests will be threatened and considerable time, energy, and political capital will have to be expended that, in his view, could be better used in negotiating on such issues as restrictions on foreign workers, rules for foreign direct investment in service industries, and international information flows.

Neu also fears that too much liberalization may erode the safety and stability of the global banking system. The greater emphasis on foreign operations by the major banks may, for example, increase rather than reduce their riskiness. Similarly, an increased "interconnectedness" of the international financial system may make it easier for shocks to move through the system. Competitive pressures on regulatory authorities to ease socially desirable requirements and the possibility of the banking system's being dominated by fewer, bigger banks are other concerns he expresses. Finally, Neu believes that technological advances in communications plus some changes in regulatory and establishment rules may enable local representative offices with good communications links to the bank's headquarters to handle all of the functions that now require the local presence of a foreign bank. In short, he believes that making liberalization of international trade in banking services a U.S. priority is to risk failure of the talks, and, more importantly, that success might bring about changes we may one day regret.

Another notable feature of the agenda for the Uruguay Round is the explicit recognition of the growing importance of high-technology products in world trade. Community officials were skeptical about the appropriateness of including this subject on the agenda for a new trade round when U.S. officials first suggested doing so in 1982. While the Uruguay Ministerial Declaration mentions the importance of high-tech products, they are not specifically included in the subjects for negotiation. In part 6, "Trade Policy in Oligopolistic Environments," Kala Krishna (chapter 11) examines the industries producing high-technology products and asks whether such sectors require special consideration from a trade policy viewpoint. In the second paper in part 6, Barbara Spencer (chapter 12) raises another important trade policy issue of concern to U.S. and EC officials, given the fact that a large share of world trade is conducted by firms operating in an oligopolistic environment: Is there a need for the basic "unfair trade" rules of the GATT, such as the one covering countervailing duties, to be modified?

Krishna points out that many high-tech industries are not only organized oligopolistically but often have a number of other special characteristics. One is the existence of network externalities, which exist when the usefulness, and thus willingness to pay for a good or service, increases with the number of other people who use the good or service. For example, the more people owning a phone, the greater the benefit each owner derives from the phone. Similarly, if the amount of software is related to the number of computers in use, an increase in the number of computers sold increases the available stock of software which, in turn, raises the amount consumers are willing to pay for the computer.

As Krishna rigorously demonstrates, when a firm producing a product with network externalities competes with a foreign firm at home and abroad, the home government may be able to increase its country's economic welfare by subsidizing the domestic consumption of the firm's product. By increasing domestic sales at the expense of foreign sales in the home market, the subsidy will help the domestic firm in both the home and foreign market as consumers in both become more willing to purchase the product because of its greater use. In imperfectly competitive markets, this action could shift profits from foreign firms to domestic firms in both markets to an extent sufficient to raise national welfare. Of course, as she notes, this result does not mean that government subsidization could in fact increase national welfare. The government may not be well enough informed to identify a welfare-increasing policy; lobbying by interested pressure groups may bring about welfare-reducing actions that were not expected by government bureaucrats; and the effects of foreign retaliation might more than offset the expected benefits.

A quite different problem in an industry with network externalities is that a firm in the industry may choose to make its product incompatible with foreign competitors' products, thereby impeding competition and reducing national welfare. High-tech industries are also characterized by high research and development expenditures and significant experience effects. The first raises problems with international counterfeiting, while the second leads to pressures on the government to subsidize domestic firms so they can gain the advantages brought by experience.

Aside from the existence of network externalities, when markets are imperfectly competitive government actions may be able to improve the strategic position of domestic firms relative to foreign firms and thereby raise national welfare at the expense of foreign welfare. Barbara Spencer, a pioneer in pointing out this possible effect of a government subsidy, asks whether countervailing duties levied by a government to offset the injury to its producers caused by foreign government subsidies to foreign firms will in fact just offset this injury when markets are imperfectly competitive.

GATT rules (Article VI:3) state that no countervailing duty shall be levied in excess of the amount of the estimated subsidy. Thus, if the subsidy is estimated to be 5 percent of the per unit value of a product, the countervailing duty cannot exceed 5 percent of the per unit value of the product. Spencer points out that whether countervailing duties levied under this rule just offset the harm done to domestic producers by foreign subsidization depends crucially on the nature of the subsidy. If the foreign subsidy takes the form of a direct subsidy per unit of exports, a countervailing duty equal to this amount will restore the production and profits of domestic producers to their pre-foreign-subsidy levels. But, as she shows, quite different outcomes occur when the subsidies apply to capital. If, as often is the case, the subsidy must be used by foreign firms to purchase new plant and equipment, a countervailing duty equal to the subsidy may be insufficient to restore the production and profit levels of domestic firms. In contrast, if the subsidy is applied to existing capital equipment by foreign firms, the countervailing duty will result in a situation where foreign firms are worse off and domestic firms better off than before the subsidy.

The implication of Spencer's analysis is that in applying the rules on countervailing duties in imperfectly competitive market structures, there is a need to examine more carefully the manner in which producer subsidies are utilized and to make the GATT rule more flexible to accomplish the intended purposes of these duties. It is important to resolve disputes such as those between the United States and the European Community over the proper way to measure the degree of subsidization, but even more fundamental issues relating to the GATT countervailing duty rule are in need of attention.

1.5 Trade Policy and the Trade Deficit

The massive U.S. trade deficit with all major trading blocs has evoked a multitude of trade policy proposals to correct the imbalance. Not only is there considerable disagreement within the United States about the effects of these proposals but between foreign and U.S. political leaders. Thus, part 7 is devoted to the topic, "Interaction Between the Macroeconomic Environment and Trade Issues."

Rachel McCulloch (chapter 13) explains why a country's current account balance is a macroeconomic phenomenon and describes how the massive U.S. budget deficit, coupled with a tight monetary policy, financial and industrial deregulation, enhanced fiscal incentives, capital inflows induced by actual and threatened increases in U.S. trade barriers, and liberalized restrictions on capital outflows from Japan combined to raise sharply the international value of the dollar and thus to increase the current account deficit significantly. She points out that reductions in the U.S. budget deficit and economic expansion abroad can help correct the U.S. external imbalance but cautions against overreliance on these measures. They will work, she notes, only if they reduce domestic absorption relative to domestic production and raise absorption abroad relative to foreign production.

Trade policies that raise import barriers and provide for export subsidies in various forms are not likely to decrease the U.S. trade deficit, since they are unlikely to have much effect on the aggregate domestic production and absorption conditions that determine the state of the current account. Individual industries may benefit but their gains will be offset by import increases and export decreases in other sectors. Thus, while political pressures may bring about increased import protection and export subsidization and thereby worsen US-EC trade relations, it is doubtful that these policies will alleviate the cause of these political pressures, the U.S. current account deficit with the European Community and other regions.

The need for closer coordination by the major economic blocs of their macroeconomic policies to prevent conditions of excessive inflation, unemployment, or trade imbalances in the world economy is being increasingly stressed by both public and private leaders. Macroeconomists have responded by using game theory to investigate the economic consequences of governments' pursuing cooperative versus noncooperative policies.

Giorgio Basevi, Paolo Kind, and Giorgio Poli (chapter 14) extend this line of research by developing a game-theoretic model that abandons the simple dichotomous approach to the issue—complete cooperation or no cooperation at all—and, instead, permits combinations of cooperation and noncooperation among countries on different macroeconomic policies. Its purpose is to provide insights into the problems of coordinating monetary and trade policies among countries within the European Community and between the EC or individual EC members and the United States.

In response to an assumed exogenous shock that reduces output by 10 percent in all nations, the three countries in the model, representative of Germany, Italy, and the United States, each seek to minimize the deviations of consumer prices, the mark/dollar exchange rate, and the mark/lira exchange rate from their equilibrium values in the country. Each country uses changes in its money supply to achieve these goals. In addition, each country tries to minimize the deviations of aggregate output from its equilibrium value and uses import protection to stimulate national output.

Postulating standard functional relationships for aggregate supply, aggregate demand, nominal wages, and a demand for money-based price levels, exchange rates, tariff rates, and interest rates, and assuming "realistic" values for the various parameters, the authors simulate the effects of various combinations of cooperative and Cournot-Nash noncooperative strategies among the countries. Among the cases analyzed are (1) cooperative strategies by all three countries on both monetary and trade policy, (2) noncooperation among the three on these policies, (3) cooperation between Germany and Italy on monetary and trade policy but confrontation with the United States on these policies, (4) cooperation by all three on monetary policy but trade policy cooperation only between the two EC countries, and (5) cooperation on monetary policy only between the United States and Germany and on trade policy only between Germany and Italy.

One important conclusion from the analysis is that cooperation between the Community and the United States in achieving their price level and exchange-rate goals, coupled with a lack of cooperation on output objectives, leads to great fluctuations in output that, by inducing protection, result in worse output outcomes than from the original supply shock. The authors point out that this means that noncooperative solutions may be superior to partially cooperative ones. As might be expected, cooperation between the EC countries at the monetary and real levels is preferable collectively to each country's going it alone. But compensation payments by Italy to Germany and the United States would be required to induce the latter two countries to accept this strategy.

An interesting result is that cooperation between Germany and the United States on monetary matters, coupled with no trade policy cooperation among the three countries, yields the preferred arrangement when trade policy cooperation between the European countries and the United States is ruled out. Consequently, as the authors note, dealing separately with cooperation at the monetary and the real levels leads to a situation in which European cooperation tends to fall apart because of the advantages to Germany and the United States of cooperating on monetary matters.

This Page Intentionally Left Blank