# 4

# Economic Sanctions and Threats in Foreign and Commercial Policy

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Analysis of the costs and benefits of manipulating economic flows to influence policies abroad has been an interest of C. Fred Bergsten's and a topic of research at the Peterson Institute for International Economics from the professional beginnings of both. Bergsten launched his career as assistant for international economic affairs to National Security Adviser Henry Kissinger (1969–71), whom he advised on export control issues, inter alia, while Kissinger was crafting his détente policies for the Soviet Union and China. Leaving government in 1971 for the think tank world (at Brookings), Bergsten wrote widely about international economic issues, including implications of the Arab use of oil as a weapon, East-West relations, and possible tensions in the Western alliance arising from increasing economic interdependence. After returning to government in 1977 as assistant secretary of the Treasury for international affairs in the administration of President Jimmy Carter, Bergsten again played a role in US sanctions policy vis-à-vis the Soviet Union as well as South Africa and Iran, among others (with assistance from Treasury colleagues Gary Hufbauer and Jeffrey Schott). In public statements, he generally opposed restrictions on US

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trade or investment flows as ineffective, with the costs likely to outweigh the benefits.[1]

But in a statement to the Senate Committee on Banking, Housing, and Urban Affairs in March 1979, Bergsten noted a telling exception to the economic undesirability of using trade sanctions: "Controls over either exports or imports can be an appropriate measure if they are used as a lever to gain access for U.S. products to foreign markets that are unfairly restricting entry of U.S. exports" (Bergsten 1980, 204). This was just a few years after Congress had approved section 301 of the Trade Act of 1974, which authorizes the president to retaliate against foreign unfair trade practices by restricting US imports in cases where a satisfactory market-opening agreement cannot be reached.

Bergsten also recommended that President Carter respond aggressively to the subsidies that the European Community was providing to upstart aircraft manufacturer Airbus to enable it to compete with Boeing. Eastern Airlines had announced the first-ever purchase of Airbus planes by an American airline, and Bergsten wanted the Treasury Department to retaliate by imposing countervailing duties equal to the value of the subsidies received by Airbus. His recommendations were overruled, however, after Eastern CEO Frank Borman convinced the White House that the airline might not survive deregulation and increased competition if it was prevented from purchasing the planes at the subsidized price. As Bergsten predicted, disputes over subsidies to Airbus remain a problem in US-European trade relations to this day.[2] This incident is indicative of the pragmatic, and aggressive, approach to trade policy and politics that is Bergsten's hallmark (see chapter 2 by I. M. Destler and Marcus Noland).

At the Institute, Bergsten and colleagues tackled issues related to economic sanctions and trade threats immediately. One of the first projects launched after the Institute's creation in late 1981 was *Economic Sanctions Reconsidered,* led by Senior Fellow Gary Hufbauer. He was soon joined by Jeffrey Schott and me, and we all remain on the "sanctions team" as the third edition of the study is now being completed. Bergsten foresaw the utility of a case study approach to this issue as early as 1973 when he was asked by the Ford Foundation to prepare a report on the most important international economic issues in need of further research: "There have been a number of efforts in recent history to use economic leverage for political reasons, running from the League of Nations sanctions against Italy through the U.S. export embargoes toward Communist countries to the United Nations sanctions against Rhodesia, from which we should be able to learn much about such possibilities in the future" (Bergsten 1973, 32).

1. See, for example, the chapters in Bergsten (1980) on export controls, international economic conflict, and sanctions against South Africa.

2. Private conversation with C. Fred Bergsten, August 25, 2006.



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On the trade side, a decade after Assistant Secretary Bergsten had endorsed the idea, Thomas O. Bayard and I adapted the case study methodology to analyze the effectiveness of trade threats and sanctions in opening foreign markets to US exports. In addition to these core studies of sanctions, other authors have studied various aspects of the political economy of using economic leverage to manage trade policy, including Bergsten himself on several occasions, especially with respect to Japan and now China.

This chapter begins with a description of the Institute's major and ongoing project on economic sanctions for foreign policy goals, which has been a staple of Institute research for 25 years. It also discusses other Institute research into the costs and benefits of using economic tools to pursue noneconomic goals. It then turns to the use of threats and sanctions in commercial policy.

## Economic Sanctions for Foreign Policy Goals

The Institute's research on economic sanctions was launched in the wake of the grain embargo of the Soviet Union after its invasion of Afghanistan and in the midst of President Ronald Reagan's sanctions campaign against Poland and the Soviet Union over the crackdown on the Solidarity trade union. The conventional wisdom at the time was that "sanctions never work." As the sanctions aimed at political repression in Poland morphed into secondary sanctions against the United States' European allies over their decision to pursue development of a pipeline to import Soviet natural gas, views of the costs and benefits of sanctions grew even more negative. Using an empirical approach based on more than 100 case studies from 1914 to the early 1980s, in Hufbauer, Schott, and Elliott (1983, 1985) my colleagues and I were able to show that the conventional wisdom was mistaken and that sanctions had achieved at least partial success in about a third of the cases studied (table 4.1).[3]

The second edition of *Economic Sanctions Reconsidered* was released in late 1990, in the midst of the comprehensive United Nations sanctions designed to coerce Iraqi President Saddam Hussein to withdraw from Kuwait. This was a time when it was hoped that the end of the Cold War would restore the United Nations' role as a mechanism for international peace and collective security. Because Iraq was heavily dependent on oil

3. Two things about the definition of success in this context are important. First, the goals against which effectiveness are assessed are instrumental foreign policy goals—changes in target country behavior, policies, or leadership—and do not include goals of deterring third parties or signaling toughness to allies, nor do they include domestic political goals of satisfying constituent demands for action. Second, the standard for success does not require total achievement of goals nor do sanctions have to be the decisive element in the outcome. We allow partial achievement of goals with sanctions as a substantial factor but not necessarily the one determining the outcome.



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**Table 4.1 Use and effectiveness of US economic sanctions and threats**

| Overall result | Total number of cases | Number of successes | Success rate (percent) |
|---|---|---|---|
| Foreign policy cases | | | |
| All cases, 1914–2000 | 204 | 70 | 34 |
| Unilateral US cases | 82 | 22 | 27 |
| 1945–69 | 19 | 10 | 53 |
| 1970–89 | 52 | 10 | 19 |
| 1990–2000 | 11 | 2 | 18 |
| US section 301 cases | | | |
| All cases, 1975–94 | 87 | 45 | 52 |
| All cases, 1985–94 | 62 | 38 | 61 |
| Worker rights and GSP | | | |
| All cases, 1985–94 | 32 | 15 | 47 |
| **Goals matter** | | | |
| Foreign policy cases, 1914–2000 | | | |
| Modest goals | 43 | 22 | 51 |
| All other goals | 163 | 48 | 29 |
| US section 301 cases, 1975–94 | | | |
| Border measures | 25 | 19 | 76 |
| Other market barriers | 47 | 16 | 34 |
| Worker rights and GSP, 1985–94 | | | |
| Forced or child labor | 14 | 4 | 29 |
| Subminimum working conditions | 15 | 7 | 47 |

GSP = generalized system of preferences

*Sources:* Hufbauer, Schott, and Elliott (1990, forthcoming); Bayard and Elliott (1994); and Elliott (2000).

exports and because it was nearly landlocked and had few transportation outlets for the oil, the UN sanctions imposed an unprecedented cost on Iraq's economy. At the same time, prewar analysis indicated that American and allied casualties could run into the thousands. The Institute analysis, which suggested that the Iraqi case had many of the elements associated with success, was cited in the Senate debate over the joint resolution authorizing the use of force, which passed by just two votes. A competing resolution, sponsored by Senator Sam Nunn (D-GA), did not rule out the use of force in the future but called on President George H. W. Bush to continue to try to resolve the situation with sanctions and diplomatic measures. It failed by just 4 votes.[4]

4. Roll call results are available at www.senate.gov.



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These hopes for sanctions as an alternative to war echoed earlier cycles of optimism (beginning with Woodrow Wilson's hopes for the League of Nations after World War I), but they were dashed even more quickly. By the time the second edition of *Economic Sanctions* came out in November 1990, President Bush had already concluded that sanctions would not be sufficient. The following January, he ordered American troops into action in the first Gulf War.

Disillusion with UN sanctions grew as the decade wore on. Moreover, with a dozen new cases from the 1980s, the second edition of the sanctions book modified the conclusions about the effectiveness of sanctions to note that unilateral US sanctions in the 1970s and 1980s were far less effective than they had been earlier in the postwar period. While the overall success rate for all countries using sanctions across all periods remained at about one in three, the proportion of unilateral US cases that achieved at least modest success dropped from one in two in the early post–World War II period to less than one in five from 1970 to 1989 (table 4.1).

There has been a long lag between the second and third editions, but the increment of new cases is also much larger, with the number of observations nearly doubled to more than 200. This increase reflected the unsettling forces released by the collapse of the Soviet Union and the end of the Cold War as well as the initial optimism regarding the potential for UN sanctions with the strong collective response to the Iraqi invasion of Kuwait. In the first half of the 1990s, the Soviet Union and then Russia imposed sanctions six times in an effort to protect its interests in the newly independent countries emerging from former Soviet republics. This contrasts with no Soviet sanctions in the previous 20 years. Similarly the United Nations mandated economic sanctions only twice during the Cold War (broad sanctions against Rhodesia when it declared independence and an arms embargo against South Africa over apartheid), but on twelve occasions in the decade following 1990.[5]

It was only after it became clear that American policymakers had no intention of lifting the sanctions against Iraq as long as Saddam Hussein remained in power and that the "oil-for-food" program was more likely to be used by Hussein to enrich himself and his cronies than to mitigate the humanitarian costs of the sanctions that a backlash against comprehensive UN embargoes took hold. The backlash peaked with the embargo that was intended to restore democracy in Haiti: Instead it unleashed streams of impoverished Haitians desperately trying to get to the United States in unseaworthy vessels. From 1994 to 2000, the United Nations imposed only limited sanctions and participated in just two new episodes.

5. The UN General Assembly recommended sanctions in at least two other cases documented in *Economic Sanctions Reconsidered*—an arms embargo against North Korea and China during the Korean War and broad sanctions against Portugal over its refusal to grant independence to its African colonies in the 1960s—but the Security Council never acted in either case.



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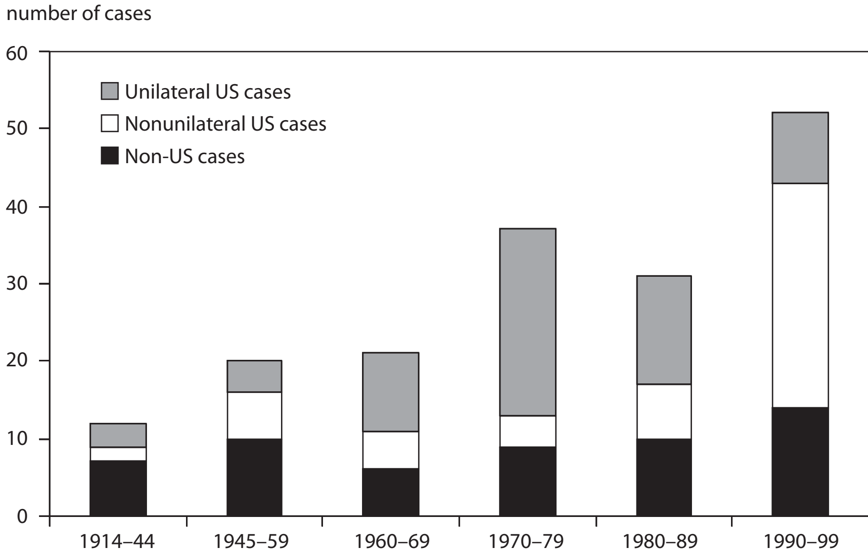
**Figure 4.1 Trends in the use of economic sanctions, 1914–99**




The first half of the 1990s was also a time of angst for the US business community, which feared that a perceived explosion of new *unilateral* US sanctions would undercut its competitive advantage at a time when international trade and investment flows were growing rapidly. Once again, however, empirical research from the Institute was able to show that the conventional wisdom was exaggerated. While existing sanctions against Cuba, Iran, and Libya were expanded and codified in legislation, a worrying trend to be sure, new uses of unilateral sanctions by the United States declined overall, as shown in figure 4.1.

The conclusion that emerges from this research is that the correct question to ask is not whether sanctions work but when and under what circumstances. In simple terms, sanctions are more likely to be effective when the costs of defying the sanctioner's demands exceed the costs of complying with them. The problem for the analyst is that, while the costs of defiance can be relatively easily identified and measured, it is far harder to assess the costs that a target might bear by acquiescing to pressure to forgo weapons of mass destruction or to hold free and fair elections. In addition, while Hufbauer, Schott, and I are interested in whether sanctions have contributed toward foreign policy goals, such as changes in behavior or regimes, we recognize that sanctions are often used for other purposes, including to mollify domestic constituents outraged by a target country's behavior. Sanctions that are designed primarily to respond to domestic political demands may not be effective in achieving foreign policy goals. Thus it has proved difficult to come to robust conclusions about the factors



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that contribute to effective sanctions. Econometric testing of the data conducted for the third edition of *Economic Sanctions* has not identified many variables that are statistically significant, and the variables included account for only a small share of the variation in outcomes.

Still, the data compiled for this project do show clear correlations between certain variables, and these patterns, while they are no guarantee of success, can offer useful lessons for policymakers. Just a few examples are discussed here, illustrating both how the data support the conventional wisdom and where they raise questions about it.

Some of the conclusions are fairly straightforward. For example, it is surely no surprise that more modest foreign policy goals, such as Arab League sanctions to deter Canada from moving its embassy in Israel to Jerusalem, are more achievable with economic measures than more ambitious ones, such as inducing Iraq to withdraw its forces from Kuwait prior to the first Gulf War. Overall, Hufbauer, Schott, and I judged half of sanctions cases with modest goals to have been at least partially successful, compared to less than one in three for more difficult ones (table 4.1). Also not surprisingly, sanctions are on average more effective the higher the economic cost they impose on the target. The average cost to the target as a share of GNP is more than 50 percent higher in successful cases than in failed ones, even when outliers such as the UN sanctions against Iraq are excluded. And the more difficult the goal, the higher the cost imposed generally must be to achieve a positive outcome.

Other patterns in the data are less intuitive, however. For example, a staple of the sanctions literature is that multilateral sanctions should be more effective than unilateral ones, because the costs imposed should be higher. The Institute database paints a more nuanced picture. Multilateral cooperation can certainly be helpful, but that cooperation can be difficult and time-consuming to organize, and so a sanctioner with modest goals may not bother to seek cooperation from others. In other cases, cooperation may be necessary but still not sufficient if the costs of compliance are higher than the costs of defiance, even when the latter are quite high.

Overall in the data, there is no relationship between the degree of international cooperation with a sanctions effort and the probability of a successful outcome, and there is even a negative relationship with respect to cases involving relatively modest goals, such as release of a political prisoner or demands for regime change. Positive outcomes in cases involving more ambitious goals, including efforts to disrupt a relatively minor military adventure, to impair the military capability of another country, or to achieve other major goals such as the surrender of territory, are positively correlated with higher degrees of international cooperation. But the probability of success in cases with more ambitious goals, even if they involve a relatively high degree of cooperation, generally remains low because economic pressure is usually inadequate to achieve goals that could threaten a target country's national security.



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## Concerns about the Costs of Economic Sanctions

Because the United States has been by far the major user of sanctions over the past several decades and because they have been relatively ineffective since the 1970s in achieving US foreign policy goals, a recurring theme in the policy debate is that the economic costs to American firms usually outweigh the foreign policy benefits. The first Institute entry in this debate was J. David Richardson's *Sizing Up US Export Disincentives* (1993). Richardson used a variety of quantitative methods to assess the impact on US exports of national security export controls and economic sanctions as well as tax and regulatory policies. He concluded that US export losses in 1989 due to government policies were probably around $20 billion. He also found that export controls accounted for most of the forgone exports, with other economic sanctions accounting for perhaps $3 billion (the effects of tax and regulatory policies were inconsequential) (Richardson 1993, 127–32).

In addition to these results, Richardson's research contributed the idea of using a "gravity model" of trade to assess the impact of sanctions on exports. The gravity model has performed well in predicting bilateral trade flows based on the size and wealth of two trading partners and the distance between them. Not surprisingly, the countries with the largest estimated shortfalls between actual and predicted imports from the United States were the Soviet Union and the Eastern European countries subject to sanctions and export controls as well as a number of other countries that were the subject of US sanctions (Richardson 1993, chapter 5).[6]

In Hufbauer et al. (1997), an extension of the gravity model approach, we used the foreign policy sanctions database and created a dummy variable indicating the relative severity of sanctions imposed by the United States against trading partners (limited, moderate, or extensive). This paper was updated by Hufbauer and Oegg in 2003 using Andrew Rose's version of the gravity model, which included several additional variables that might affect trade between two parties. Both efforts incorporated variables not used by Richardson to reflect common borders, languages, or membership in various types of trade blocs, and both found a lower impact on trade from economic sanctions—$15 billion to $17 billion in Hufbauer et al. and $5 billion to $10 billion in Hufbauer and Oegg. Of course, these estimates, unlike Richardson's, were after the end of the Cold War and after export controls against the former Soviet bloc had been loosened. Even more interesting, these papers raised questions about the long-held business complaint that the costs of sanctions linger long after they are

6. Collins and Rodrik (1991) also analyzed the global effects on both trade and capital flows of the broader changes in Eastern European and former Soviet economic policies and of their integration into the world economy.



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lifted because of reliability and reputational effects. This concern was not supported by the results in either paper.

Still, the impact on costs has been frequently cited by US-based businesses and others who are interested in trying to reform the process by which sanctions are imposed and who wish to see more cost-benefit analysis in the process. Thus far, these efforts have had only limited success. One reform that was adopted in a few cases of legislatively imposed sanctions was an automatic sunset provision so that they would not go on for years with no resolution, as has the embargo of Cuba. The reform has not had the hoped-for effect, however, as legislation imposing sanctions against Iran and Burma have been repeatedly extended, most recently this year.

## Other Studies Exploring Uses of Economic Leverage for Foreign Policy Purposes

Hufbauer, Schott, and I have applied the general framework and data from the sanctions project to particular cases or functional questions in Institute working papers and policy briefs, testimonies, and other articles and papers. The issue of targeted sanctions attracted a great deal of attention in the late 1990s from scholars in as well as outside the Institute. Concerns about the humanitarian impact of the broad sanctions against Iraq and Haiti led to a search for "smart" sanctions that could be targeted against rogue regime leaders while sparing innocent civilians. These include travel bans and financial asset seizures targeted against individuals as well as arms embargoes. Both Hufbauer and Oegg (2000) and I (Elliott 2002) concluded that targeted sanctions could be useful in certain situations, particularly to serve symbolic or political goals, but that they were unlikely to be effective in achieving most foreign policy goals.

This analysis proved useful when attention turned to disrupting financial support for terrorists and their operations after the September 11, 2001, attacks. Within weeks, Hufbauer, Schott, and Oegg released a policy brief summarizing past cases where sanctions had been used to influence state sponsors of terrorism, including Iran, Iraq, Libya, and Syria, and drawing lessons from that experience for squeezing terrorist finances. The authors noted that sanctions had not been very effective in bringing state sponsors of terrorism to heel, though sanctions and international isolation did eventually convince Libya's Muammar Gaddhafi to moderate his support for terrorist groups and give up aspirations for weapons of mass destruction. The authors also surveyed US government efforts to disrupt financial flows to individual terrorists and groups (and drug traffickers) and found even more limited effectiveness. They concluded that the financial sanctions adopted after September 11 were likely to play at best an "auxiliary role" in the war on terror.



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In 2004, Edwin M. Truman, in collaboration with University of Maryland economist Peter Reuter, completed a comprehensive study of American and international anti–money laundering strategies. In *Chasing Dirty Money,* the authors analyzed how anti–money laundering and other enforcement tools available to the US government could be used to disrupt terrorist financing. The book also analyzed how these same tools could be used to deny corrupt dictators the fruits of their illicit activities or to seize stolen assets and return them to the home country. The Truman and Reuter analysis of what can be expected of these tools and how to make them more effective is clearly relevant to the debate over "targeted" economic sanctions, which include the freezing of assets held abroad by individuals in rogue regimes. In particular, Truman and Reuter identify obstacles to seizing "kleptocratic" assets that also underscore the limitations of using targeted sanctions to vanquish the bad guys without hurting innocent civilians.

One rogue nation that has attracted repeated attention from Institute scholars over the past decade or so is North Korea. During the 1993–94 crisis over Kim Il-sung's efforts to acquire nuclear weapons, I applied the sanctions framework to what was publicly known at the time about the North Korean economy and then revisited the case when concerns about North Korea's nuclear activities flared up again early in the administration of President George W. Bush.[7] I concluded that a carrot-and-stick strategy, including economic sanctions, could contribute to resolution of the crisis *if* key countries—China, Japan, and South Korea—cooperated and *only* if Kim viewed nuclear weapons as a bargaining chip rather than as essential to his regime's survival. The framework agreement reached between the United States and North Korea in 1994 initially seemed to support the bargaining chip hypothesis, but subsequent cheating on the agreement by North Korea raised questions about the regime's motives.[8]

Marcus Noland, one of a handful of experts on the North Korean economy, analyzed various scenarios for reform or collapse in *Avoiding the Apocalypse* (2000), as well as how to handle North Korea's challenge to regional and global stability, including via the use of economic leverage. In *Korea after Kim Jong-il,* Noland explicitly modeled a scenario involving comprehensive economic sanctions and concluded that it would raise the probability of regime change in that country to nearly 50 percent (Noland 2004, 39–41). Most recently, he testified before the US Senate Committee on Homeland Security on how the North Korean regime fi-

7. A version of the paper originally prepared in the midst of the 1993–94 crisis was ultimately published in Elliott (1997), while the output in the second round was an Institute policy brief (Elliott 2003).

8. By this time Kim Il-sung had died and been succeeded by his son, Kim Jong-il.



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nances itself through illicit activities and what US policymakers might be able to achieve by disrupting those flows.[9]

## Use of Trade Threats and Sanctions in Managing Trade Policy

In the mid-1980s, a great deal of research focused on the US trade deficit and the role of trade policy in addressing it. Destler's various editions of *American Trade Politics* cover this period well. Responding to the Japan bashers in Congress and elsewhere, Bergsten and Cline (1985) and Balassa and Noland (1988) emphasized the macroeconomic and structural sources of the deficit. These studies focused on the need to bring down the overvalued dollar and reduce the large government budget deficit in the United States as well as address structural obstacles to domestic consumption, imports, and more balanced growth in Japan. But recognizing that the effects of these policies would be seen only over the long run, attention also turned to how trade policy could be used to dampen rising pressures to protect US firms and workers from import competition (see chapter 3 by Hufbauer and Schott and chapter 2 by Destler and Noland).

In 1985, the Reagan administration implemented a dual-track strategy. First, newly appointed Secretary of Treasury James Baker joined with European and Japanese allies at the Plaza Hotel in New York in September 1985 to engineer a decline in the value of the dollar. Second, knowing that dollar devaluation would take time to work through to trade balances, the Office of the US Trade Representative shifted trade policy to the offensive, adopting an "aggressively unilateral" approach to opening foreign markets by bringing down "unfair" trade barriers to US exports. A year later, the administration also succeeded in getting trading partners to agree to launch a new multilateral round of trade negotiations to reduce trade barriers globally. Several years later, President Bill Clinton adopted a more explicitly "managed trade" policy toward Japan, which was still viewed as the major problem in US trade relations.

### Aggressive Unilateralism in US Trade Policy

Building on the model of the sanctions work, I joined with Thomas O. Bayard and adopted a similar case-study methodology to analyze the costs and benefits associated with the use of threats of trade retaliation to beat back protectionist pressures in the United States by opening up markets abroad. In this case, in Bayard and Elliott (1994), we used the "data-

9. This testimony is posted on the Institute's Web site at www.iie.com.



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base" provided by US experience with section 301 of the Trade Act of 1974, which authorizes the president to retaliate against unfair trade practices by US trading partners. In addition to statistical analysis of 72 section 301 cases, and with contributions from Charles Iceland and Amelia Porges, we also analyzed seven case studies in depth. Later, I worked with David Richardson to update and extend the statistical analysis (Elliott and Richardson 1997).

These analyses again raised questions about the conventional wisdom of the time. Bayard and I found that US trade policy in this period was less aggressive than often alleged—the US Trade Representative repeatedly threatened trade sanctions but seldom imposed them—and also less unilateral—US officials took care to act consistently with the spirit if not always the letter of international rules under the General Agreement on Tariffs and Trade (GATT).[10] Also in contradiction to frequently expressed concerns, US trade sanctions in commercial disputes seldom resulted in counterretaliation by trading partners and never in tit-for-tat trade wars with escalating sanctions. Nor was there much evidence that US negotiators used threats to conclude discriminatory deals that benefited US exporters at the expense of others.

Bayard and I concluded that section 301 investigations were most likely to result in market opening abroad when the practice targeted was a traditional—and visible and measurable—border measure. We also found that the target country's degree of dependence on the US market (exports to the United States as a share of total exports) and the bilateral trade balance were statistically significant correlates with successful outcomes. Richardson and I subsequently added several new cases and variables to the analysis but generally confirmed the conclusions of the original. Noland (1997) used evidence from the annual *National Trade Estimate Report on Foreign Trade Barriers* as well as section 301 cases and other formal US trade actions to examine similar issues regarding the political economy of US trade policy. He concluded that the bilateral trade balance was the most reliable predictor of US trade policy attention and, like the studies above, also found that the target country's dependence on the US market offered the best explanation of success in bilateral trade initiatives.

In a conference paper (Elliott 2000, also summarized in Elliott and Freeman 2003), I again used the case-study method to assess the effectiveness of using conditionality under the generalized system of preferences (GSP)—which grants developing countries duty-free access to the US market for eligible exports—to improve respect for worker rights. I concluded

10. GATT rules required a consensus before a member could be authorized to retaliate against another member's violation of the rules. Bayard and I found that the US Trade Representative was more likely to behave aggressively if implementation of a GATT panel ruling had been blocked by the "defendant" or if the dispute was in an area not covered by GATT rules, such as services or intellectual property.



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that threats to revoke GSP eligibility if worker rights were not improved had a success rate similar to that for modest foreign policy goal cases and for commercial goals in section 301 cases—that is, they were effective about 50 percent of the time. Within that overall average, such threats were more likely to achieve demands to improve technical working conditions, such as raising the minimum wage, than to change more socially entrenched practices, such as the use of child or forced labor. And as with the section 301 cases, countries that were more dependent on the US market appeared to be more vulnerable.

## Japan and Managed Trade

With respect to Japan (and Korea), where suspected trade barriers were rooted in "ways of doing business," or bureaucratic discretion, problems in enforcing market-opening agreements led to demands for quantitative benchmarks and "measurable results." The first such agreement was in 1986 with Japan, requiring that it import a minimum quantity of semiconductors from the United States. The seeming success of this agreement resulted in demands for similar deals in other sectors, culminating in the Clinton administration's proposal for a "framework agreement" that included negotiations on a number of structural and sectoral issues and that sought to expand the use of quantitative indicators (Bergsten, Ito, and Noland 2001, chapter 5).

Revisionist arguments and nontraditional policy proposals for dealing with Japan (and Korea) have been analyzed by several Institute scholars, including Fred Bergsten. One of the most prominent of these analyses was authored by visiting fellow Laura D'Andrea Tyson (and published by the Institute), which helped lay the foundation for the Clinton approach. Her *Who's Bashing Whom? Trade Conflict in High-Technology Industries* (1992) was released just before her appointment to head Clinton's Council of Economic Advisers. This and related studies in this period did not focus on sanctions per se but addressed the uses of economic leverage by the United States to influence commercial policies abroad. Tyson's report was particularly strong in arguing for the renewal of "Super 301," which was originally passed by Congress in 1988 to force the administration to be more aggressive in tackling barriers to US exports and to identify unfair trading *countries* as well as individual unfair practices.[11] She was especially concerned about protecting US competitiveness in high-tech sectors

11. The 1988 trade act required the US trade representative to identify trade negotiation priorities, including both unfair foreign practices and those that would have the most positive effect on US exports. The 1988 legislation authorized this so-called Super 301 provision for only two years but it was revived by executive order in 1994 under President Clinton (Bayard and Elliott 1994, chapter 2).



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that she concluded were important to American economic health and national security.

Bergsten and Noland (1993) refined the Tyson arguments, examining in more detail the potential costs as well as benefits of a more aggressive approach in responding to Japan's industrial and trade policies in high-tech and other sectors. The authors did not rule out the use of aggressive tactics in some cases, but they did oppose renewing Super 301 and developed stringent criteria for resorting to managed trade tactics to penetrate the Japanese market. In general, the authors favored using the international rules under the GATT whenever possible to address unfair foreign trade barriers.

In 1995 those rules—and the costs of pursuing an aggressively unilateral trade policy—changed significantly with the creation of the World Trade Organization (WTO). It prohibited the use of trade sanctions by one member against another unless authorized by a WTO dispute settlement panel finding that a member country had failed to correct a violation of WTO rules.[12] That the WTO would in fact constrain US policy was confirmed not long after its creation when US negotiators backed down from a threat to retaliate against alleged Japanese barriers to imports of autos and auto parts. Japan announced that it would file a complaint in the WTO if the United States imposed unauthorized sanctions and US negotiators settled for a face-saving agreement that did little to change Japanese policy or to increase US exports of auto parts. With the creation of the WTO, and after a decade of economic stagnation, Japan-specific policies faded. Bergsten, Ito, and Noland (2001) recommended that there be "no more bashing" and that US policymakers formally bury the Japan-specific economic policies that had been followed by successive presidents for the previous 20 years.

Around the same time, attention turned to China, which has since replaced Japan as the country with the largest bilateral trade surplus with the United States. Most of the Institute research on China, like that on Japan earlier, emphasizes the role of macroeconomic factors—the exchange rate, an unbalanced growth strategy in China, and, again, the fiscal deficit in the United States. But out of concern that continued large trade imbalances could trigger a protectionist backlash, and despite the fact that China joined the WTO in 2001, Bergsten testified in March 2006 that passage of legislation imposing a surcharge on Chinese exports might be necessary if China did not allow its currency to appreciate. Bergsten's preferred course if China did not revalue the renminbi was for the Trea-

12. In a major reform of the old GATT rules, the WTO Dispute Settlement Understanding allowed retaliatory sanctions to be imposed by a consensus minus one member, meaning that a country in violation of the rules could no longer block enforcement measures against it. Note, however, that these constraints do not apply to foreign policy sanctions, which are generally exempted under Article XXI allowing trade restrictions for national security reasons.



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sury Department to label the country a currency manipulator under existing legislation, to seek international cooperation in pressuring China from US allies and the International Monetary Fund, and, if China still did not respond, to have the administration drop opposition to and Congress expeditiously pass legislation introduced by Senators Chuck Grassley (R-IA) and Max Baucus (D-MT) to impose lesser sanctions on any country, notably China, whose currency was in "fundamental misalignment." But in testimony before the Senate Finance Committee in March 2006, Bergsten cautioned:

> *If the first four steps in the strategy fail to produce the necessary results in the near future, Congress should pass the Schumer-Graham legislation to impose an across-the-board surcharge on imports from China.* Such a step would be highly regrettable but must be envisaged as a last resort if all else fails to resolve the issue.[13] (emphasis in original)

## Summary and Conclusions

As illustrated here, the use of economic leverage to achieve both foreign and commercial policy goals has been a theme of Institute research from the beginning. The emphasis in this area, as in most Institute research, has been on providing rigorous empirical analysis to illuminate the costs as well as benefits of different policy approaches, including the option of doing nothing. A continuing concern of Director Bergsten is that *not* taking action may be more costly over time if imbalances and protectionist pressures reach the breaking point than breaking some crockery with trade threats and sanctions if doing so contributes to resolving the problem.

A thorough, integrated analysis of the data across both the foreign policy and commercial policy fields remains to be done. One lesson seems to come through clearly, however. Economic threats and sanctions appear to work best when the demand is not only limited but clearly defined so that compliance can be monitored and more readily enforced. The broader and more vague the demands, such as demanding that a country "effectively enforce" its laws protecting intellectual property or worker rights, the harder it is to specify when a violation of any agreement has occurred and therefore the harder it is to make credible threats to retaliate against violations. Thus, in table 4.1, as noted above, modest foreign policy goals are more likely to be achieved than more ambitious ones. In the commercial policy area, section 301 cases were more likely to result in market opening abroad when they involved traditional border measures than when they involved less tangible and behind-the-border barriers such as services regulations or enforcement of rules protecting intellectual property. GSP

13. C. Fred Bergsten, The US Trade Deficit and China, Testimony before the hearing on US-China Economic Relations Revisited, Committee on Finance, United States Senate, March 29, 2006.



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conditionality on worker rights also tended to work better to achieve limited changes in policy, such as an increase in the minimum wage, than to rectify broader problems, such as child labor.

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