

to work, they must be simple enough to be clearly defined. Free trade encompasses such simple rules. It can also assist in resisting the pressures of special interest politics. It lets the marketplace allocate resources, limiting intervention to clearly delineated instances of market failure and, perhaps, defensive reaction against predatory targeting by other governments in sectors where we are clearly competitive.

5. CONCLUSIONS

"After several years of theoretical and empirical investigation, ... it has become clear that the strategic trade argument, while ingenious, is probably of minor real importance."

—Paul R. Krugman⁴⁷

In theory, a role for strategic trade policy emerges in two situations: imperfect competition and economies of scale in production. Prices in imperfectly competitive world markets typically exceed incremental production costs. Consequently, companies can make above normal profits or *rents*. In some theoretical cases, a government, by supporting its companies in international competition, can raise national welfare at another country's expense. The basic idea is to shift rents from foreign rivals to domestic corporations. The strategic trade policy argument is linked to the industrial policy argument.

Industrial policy works by shifting resources from sectors that the government does not consider important to ones that are considered worth encouraging in the economy. There are many popular reasons for industrial targeting. However, the economic logic of industrial policy rests on appropriable monopoly rents and spillover benefits. It may be possible to point out industries of the future. In practice, nonetheless, it is not easy to decide which corporations should be on the government list to get taxpayers' money and which ones left off. Moreover, once the authorities have designated the winning sectors, the nature of competition among special interests is such that most of these subsidies will amount to transfers of funds from taxpayers to large corporations and to foreign consumers (if the goods are primarily for export).

Most importantly, a general property of strategic trade policy is that its usefulness depends on an exact reading of the situation. The large amount of information that governments would need before being able to operate a targeted industrial policy makes chances of its success highly remote. For instance, everyone appreciates that there are beneficial spillovers from the

⁴⁷ Paul R. Krugman, "The Narrow and Broad Arguments for Free Trade", *American Economic Review, Papers and Proceedings*, (83) May 1993: 362-66.