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The Dean Rusk Center was established in 1977 to foster interdisciplinary research, service, and education concerning trade and investment. U.S. fiscal and monetary policy has been a major focus of Center study because of its increasing impact on international commerce. Other areas of concern include international political and military relations and various types of social and cultural exchanges. The Center recognizes, however, that internal affairs of nations remain the major determinant of international relations and that domestic concerns about the value of the society, its social dynamics, and the availability of resources will continue to vie for dominance in determining a nation’s posture in world affairs. Thus, much of the Center’s work dwells on domestic events and different disciplinary explanations of their presence and evolution.

Admittedly, the interactions of fiscal and monetary policy, international arrangements, and domestic events cannot be fully analyzed in a specific geographic or subject context. Nevertheless, many of the Center’s policy development activities concentrate on the North American region and on related subjects of agriculture, national development, business-government relations, and public governance. These biweekly “briefings” reflect the convergence of the Center’s diverse activities and interests.

Facts and details of events addressed in Briefings are gathered through a scanning of major daily newspapers and weekly periodicals, which are cited throughout each article. Sources of related policy and disciplinary material appear in a listing following each article. The purpose is to link facts with policy implications and academic points of view in order to present an integrated and in-depth approach to current issues. Views expressed are not necessarily those of the Rusk Center.

1. Fiscal and Monetary Policy

Fiscal - Checking the Growth of Government Expenditures on Health

Federal expenditures on Medicaid and Medicare programs in fiscal year 1982 came to about $67 billion. By 1990, Secretary of Health and Human Services Richard Schweiker testified recently, expenditures will approach $200 billion if current trends are not checked (Hearings, 1982). In order to contain escalating government costs, the Reagan administration has proposed setting ceilings on the amount paid for treatment of particular diagnoses. States are also concerned with rising health care costs. The Georgia Board of Medical Assistance is considering proposals to reduce state Medicaid expenditures by $15 million in fiscal 1983 (Atlanta J., 9-8-82, p. 1), and other states are also making changes in the way they manage the Medicaid program and the health care industry. Prior attempts at cost control have focused on regulation of the health care industry. The present administration, however, is proposing to hold down costs by injecting competition into the industry - that is, giving incentives to participants in the health care market to contain costs. While deregulation and reliance on market forces normally create these incentives, the complex nature of the health care industry could make such an approach unworkable. If it does, the government, as a major purchaser of health care, may be forced to increase its oversight of and intervention in the industry.

A unique feature of the health care market is the division of functions among the various participants in it. In an ordinary market, consumers decide how much of what products to buy and pay for those goods themselves. With health care, consumers typically make only the decision to enter the market for medical treatment. Their ignorance of their health needs leads them to rely on the suppliers (physicians and hospitals) to determine the amount and quality of care purchased. The suppliers, having delivered the care of their choosing, usually collect payment from a third party - either an insurance company or the government. This posttreatment reimbursement is generally made on the basis of "reasonable costs" (Schramm, 1981).
The combination of decision making and cost reimbursement vitiates incentives for either consumers or suppliers to contain costs. Since patients do not pay for their treatment directly, they have little incentive to discriminate among suppliers on the basis of price and are encouraged to make maximum use of health care resources. Posttreatment reimbursement of costs also encourages suppliers to provide more and costlier care (and continually to update the medical technology available to them) with little consideration of whether the extra cost justifies the potential added benefit. The technical nature of medical treatment, which requires the use of judgment on a case-by-case basis, makes it difficult for either government or insurers to monitor the cost-effectiveness of treatment decisions. Moreover, insurers do not have strong incentives to control costs, since they can to some extent pass on price increases to their customers, primarily corporate purchasers of employee health plans (Schrämm, 1981; Watts & Klastorin, 1981).

Businesses likewise have reduced incentives to keep costs low, because premiums for employee health insurance are treated as tax-deductible business expenses to the employer; so also employees, for whom health insurance, as a fringe benefit, is not considered part of income for tax purposes. Thus, in addition to the peculiarities of the market conducive to rapidity rising prices, health insurance, which some view as essentially a personal consumption item like housing or clothing, gives tax preferences that encourage overconsumption of insurance coverage and consequently of health care resources. The value of this tax subsidy has been estimated at $10.6 billion (Watts & Klastorin, 1981).

Several strategies have been used to control health costs. In 1972 Congress established professional standards review organizations, local panels of physicians responsible for monitoring hospital admissions and lengths of stay to prevent unwarranted use of medical facilities. To avoid excess hospital capacity and duplicate purchases of high-cost equipment in a given area, another system of local agencies was established in 1974 to review and approve all hospital investments over $100,000. Congressional Budget Office studies indicate, however, that neither program has been cost effective (Schrämm, 1981).

The government has also helped finance health maintenance organizations (HMOs)—institutions that receive a fixed fee in exchange for assuming responsibility for providing health care services to clients. This "prospective" reimbursement gives suppliers incentives to minimize total costs through preventive care and elimination of unnecessary services. HMOs have been able to deliver care at costs below those of traditional providers without sacrificing quality. However, the reluctance of physicians and hospitals to abandon the fee-for-service system, as well as the risk HMOs must assume, has deterred the widespread development of HMOs. The administration is now attempting to promote private investment in these organizations (Nat'l J., 7-5-82, pp. 1179).

Many ideas have been developed to induce cost-consciousness in the health care market. Some have focused on making consumers more aware of the costs of their treatment. Georgia authorities, for example, are considering the idea of instituting a copayment system for the Medicaid program, requiring beneficiaries to make at least a nominal payment for each hospital stay or doctor's visit. The goal is to deter overuse of health services and to raise additional revenue. Others have suggested reducing the tax advantages of employee health programs to encourage awareness of the costs of medical services. Most proposals for major change in the medical system focus on moving from posttreatment reimbursement to some kind of prospective reimbursement like that used by HMOs (Nat'l J., 7-5-82, pp. 1179).

The Omnibus Budget Reconciliation Act of 1981 gave states the flexibility to experiment with various methods of motivating suppliers to provide care more effectively to the Medicaid program. With the approval of the Health Care Financing Administration, states may now contract with physicians and hospitals for services. The traditional freedom-of-choice provisions which permit Medicaid and Medicare beneficiaries to select their own doctors and hospitals have prevented states from being "intelligent consumers" in agreeing to do business only with those providers charging the lowest fees. In contracting with lowest-cost providers, states can reduce their Medicaid expenditures immediately and will probably induce competition among suppliers for their
business. A similar plan has been proposed for the Medicare program (Nat'l. J., 9-18-82, pp. 1584+).

Another method being used is establishing budget ceilings for hospitals or, alternatively, lowering the amount reimbursable from government programs. Such a system is designed to encourage providers to eliminate unnecessary expenditures. The Reagan administration has adopted this approach in its proposal to set caps on reimbursements for the treatment of particular ailments. Critics charge that the payment limitation system will merely result in shifting the government's problem with rocketing health costs to the shoulders of private sector payers -- insurance companies, government program beneficiaries, corporations, and individuals -- when they already bear part of the burden of rising health costs. Additionally, the government will probably have to monitor the quality of care to ensure that beneficiaries do not receive inferior treatment as costs are cut. Appropriate standards of treatment would have to be established and realistic appraisals of costs determined for such a program to work fairly and effectively. While setting caps on reimbursements seems a simple solution, administratively it will require increased government involvement in the health care market because of the need to determine adequate standards of care and to review the appropriateness of increased health costs in light of associated benefits. Evaluating the worth of continually improving technology will prove particularly difficult. Additionally, some studies indicate that as reimbursement rates are lowered, doctors increase the intensity of medical services to protect their revenue position. Thus, without extensive government monitoring of diagnoses and treatment procedures, providers may be able to frustrate the goal of reducing costs (Rice & McCall, 1982).

Whatever changes are sought in the current health care system will be opposed by those who tend to lose from the changes. But aside from the difficulties of resolving competing interests, consideration of the health care problem forces fundamental moral and legal questions upon policymakers. Ultimately, one's opinion about proper health care policy requires an answer to the question of whether society, acting through its government, owes some minimum level of care to all citizens; and if so, what level of care. It has been argued that failure to provide adequate health care constitutes a deprivation of life without due process of law, and therefore that government provision of health care to the needy is a constitutional mandate. Even if one accepts the government's duty to provide a minimum level of care to all citizens, the problem remains of determining what that minimum level is. Our inability to place a value on human life combined with the national commitment to equal opportunity for all makes it difficult to resist use of the most modern medical technology in every case (Blackstone, 1976).

Limiting public expenditures on health care thus presents a difficult political issue because of the moral concerns which lie at the heart of the problem. In the past, the government's approach has been to expand more and more resources through the Medicaid and Medicare programs while attempting to curb costs by preventing unnecessary care and investment. But the widely held belief that government spending must be contained is now forcing upon policymakers the public task of deciding what limits to place on the government's financing of health care. The debate on this issue will continue in the years to come.


II. INTERNATIONAL ARRANGEMENTS

ECONOMIC/COMMERCIAL - HONG KONG, PAST AND FUTURE

During the late summer, with the stage set for meetings between British Prime Minister Margaret Thatcher and Chinese leaders to discuss the fate of Hong Kong as the 1997 expiration date of Britain's lease draws near, a mood of uncertainty was evident in the economy. The Hong Kong dollar fell to an eight-year low, and the Hang Seng Index lost 20% of its value. The property market continued its mid-1981 decline, much to the dismay of real estate firms which comprise 40% of the value of the colony's stock market. The Hong Kong business community anxiously awaited any indication of what effects the talks would have on their capitalist economy. Although the talks between Prime Minister Thatcher and China's top leader, Deng Xiaoping, were to remain confidential, Chinese Premier Zhao Ziyang revealed statements to the media regarding the importance of sovereignty to the Chinese government, creating apprehension about the future of Hong Kong (Burs. Wk., 8-30-82, p. 38; Economist, 10-2-82, p. 40; Asian Wall St. J. Wkly., 9-20-82, p. 6; N.Y. Times, 9-24-82, p. 3; Wall St. J., 9-27-82, p. 281).

The area in question is small. Hong Kong is a 29-square-mile island. Across the harbor is the small city of Kowloon; the New Territories, which make up 90% of the colony, cover 372 miles. However, its location gives access to the shipping routes of Japan, Korea, the Philippines, Southeast Asia, and most important, China (Moronoff, 1980).

Historical claims to the colony differ. China believes that Britain gained Hong Kong through unfair treaties with the Ching Dynasty during the late 1800s. Britain contends that not only Hong Kong, but a section of the Kowloon Peninsula were yielded to the British indefinitely, and only the New Territories were under lease for 99 years. Despite British contentions, the final decision regarding Hong Kong clearly rests with Peking. The main question is, Will China's demand for sovereignty be negotiable? Whatever its decision regarding Britain, China should want to maintain the present economic environment in Hong Kong since it receives 40% of its foreign income through the colony (Asian Wall St. J. Wkly., 9-20-82, pp. 64; 2-27-82, pp. 11 & 20; Economist, 10-2-82, p. 40).

It was not until the early 1950s that Hong Kong began evolving into the industrialized city it is today. Two factors were responsible for the transformation: a tremendous inflow of labor and capital, and a decline in the colony's role as an intermediary center of trade. In 1949, the end of the Chinese civil war placed a communist regime in China. Of those who left the country, many came to Hong Kong -- people with vast capital resources (mainly Shanghaiese Industrialists), skilled workers, and intelligent younger workers eager for jobs. The capital and labor from China was soon joined by a similar inflow from the West, as Hong Kong became considered the most stable location in Asia. After 1951 trade with China declined markedly, both because the Chinese government began endorsing trade with the Soviet Union and Eastern Europe instead of with Asia or the West, and because during the Korean War Hong Kong enforced the United Nations embargo which forbade the export of strategic products to China. Hong Kong thus lost its position as a transshipment center (Lethbridge, 1980).

Relations between China and Hong Kong were strained through 1967. Afterwards, however, they began to improve. China, more stable politically and interested in economic development, enhanced its contacts with the West and regained its profitable trade relations with Hong Kong. Currently, Hong Kong contributes to China's foreign income through the use of its port for Chinese exports to the third world, in the profits communist-owned businesses repatriated to China, and through purchases from China of about half the colony's food supply (Lethbridge, 1980; Moronoff, 1980).

Under British administration, Hong Kong enjoys the benefits of a virtually unimpeded laissez-faire capitalism. Government ownership is limited to the postal services, water utilities, and rail and air transportation. Electricity, gas, other forms of public transportation, and the telephone industry are privately owned, although the government
supervises each operation, usually through advisory committees. Some
government control is also exercised in the sale of land. Otherwise,
the administration practices a policy of non-intervention. It imposes no
minimum wage laws and grants no tax concessions for capital investment
or loans to industry. It has no central banking system, no foreign
trade restrictions, and no foreign exchange controls. Although some
economists disagree, the government considers fiscal policy inappropria-
te for the colony. In view of the propensity to import, the government
contends that an increase in government spending would result in dollars
spent on imported goods, stimulating output and employment for Hong
Kong's trading partners rather than in the colony itself (Leithbridge,
1980; Woronoff, 1980).

Besides the uncertainties surrounding its future administration,
Hong Kong faces industrial and social challenges. Business leaders
believe that because of heavy competition from China, Thailand, and
Malaysia, production in Hong Kong must be expanded to include high-technol-
ogy manufacturing, particularly of computers. Hong Kong has been
suffering from a decline in exports since mid-1981. In addition, the
administration must recognize that a long indifference to its activities
by the majority of Hong Kong citizens may be undergoing change. Young
Hong Kong workers express a growing interest in politics, and neighbor-
hood organizations to voice opinions and clarify rights are becoming
commonplace (Siu-Kel & Kam-fai, 1982; USA Today, 9-27-82, p. 9A; Leith-
bridge, 1980).

Speculation about the outcome and overall effect of the talks
between Thatcher and Xi Jinping are wide ranging. Possibilities include
(1) British recognition of Chinese sovereignty in exchange for continued
British administration, (2) a new economic environment through the uni-
fication of Hong Kong and the nearby Portuguese city colony of Macau, (3)
exclusion of British administration, and (4) joint Chinese/British
administration. Both governments realize the need to reach a speedy
resolution. Uncertainty over the colony's future may have only a tem-
porary effect on the property market; manufacturing, however, will suf-
fere more because of the hesitance of businesses to invest in research
and development and in the personnel training needed to stimulate the
growth of high-technology industry (Asian Wall St. J. Weekly, 9-27-82,
p. 1 & 26; N.Y. Times, 9-24-82, p. 33). It is thus incumbent upon both
Britain and China to reassure Hong Kong of their shared interest in the
welfare of its economy.

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1980.

III. DOMESTIC ISSUES

VALUES - MODEL RULES OF PROFESSIONAL CONDUCT FOR LAWYERS

At the largest gathering of lawyers in U.S. history last August in
San Francisco, American Bar Association (ABA) members reached one agree-
ment in the heated debate over the proposed Model Rules of Professional
Conduct: they agreed to defer voting on it. The Model would serve as
the ethical standard for lawyers, as well as the law by which they would
be disciplined for breach of standards. Until a new code is adopted, the
1969 Model Code of Professional Responsibility will continue to be the
ABA's prototype for ethical codes implemented by local bar associa-
tions and judicials in each state (Wall St. J., 7-23-82, p. 19).

Each year some 50,000 students graduate from U.S. law schools. The
recent enormous growth rate in the legal profession is one reason tradi-
tional informal policing mechanisms seem to be breaking down. This
situation is not at all unique to lawyers, however. Rapid growth has
casted other businesses and professions to develop more formal rules of
ethics. After nearly five years of study, the United Nations Inter-
governmental Working Group on a Code of Conduct hopes soon to conclude
its development of a code of conduct for transnational corporations (CIT

Another reason for the interest in legal professional ethics is
confusion over the ethical demands of the profession and dissatisfaction
with the ethical training young lawyers receive (Kutak, 1981). According
to Supreme Court Chief Justice Warren Burger, the poor ethical stan-
dards of law school graduates make them more "a menace to society and a
liability" than a benefit. He believes that ethics should receive as
much emphasis in the law school curriculum as constitutional law (N.Y.

For most of American history the ethical conduct of lawyers was
left to the individual's conscience and peer pressure. Until the mid-
1800s, most states had neither requirements for engaging in legal prac-
tice nor disciplinary standards for policing the profession. Codes of
ethical standards first appeared as isolated phenomena. In 1908 the ABA
promulgated the Canons of Professional Ethics, patterned after the first
legal code of ethics developed by Alabama in 1887. The Canons remained
the ABA's recommended ethical standard until the current code was
adopted in 1969 (Hearings, 1981:3-12). The movement to create a new
code began in 1977 when the ABA established the Commission on Evaluation
of Professional Standards, known as the Kutak commission. The primary
objective of the commission was to reconsider ethical premises and prob-
lems faced by lawyers as a result of the growth and changes in the prac-
tice of law (Wall St. J., 7-23-82, p. 19).

Although the disparity of opinion in the legal profession is great
concerning the proposed Model, there is nevertheless a consensus that
the 1969 Code is inadequate. One weakness of the 1969 Code arises from
its tripartite format. The three parts of the code are:

(1) Disciplinary Rules -- binding rules, the breach of which
may subject an attorney to disciplinary action by the
local bar, including disbarment.

The format of the 1969 Code was a factor in the absence of uniform-
ity in required professional conduct across the nation. Several states
adopted the 1969 Code without retaining the Ethical Considerations,
while in other states they were elevated to the rank of mandatory Disci-
plinary Rules. Some courts have now used the Canons and Ethical Considera-
tions as enforceable rules when Disciplinary Rules are not applicable
(Hearings, 1981:3-12; Barrister, Fall 1981, pp. 4+).

Another weakness of the 1969 Code stems from changes in the legal
profession since the turn of the century, from which many of the code's
provisions date. The 1969 Code overly addresses the needs of the trial
attorney and does not deal with the common problems of lawyers repre-
senting corporations, associations, or governmental organizations (Hear-
ings, 1981:3-12). Finally, critics argue, the 1969 Code is vague,
uncertain, and inconsistent. The purposes behind the rules often remain
obscure, and even detailed rules use general standards which leave their
specific implications in doubt. Some provisions have been given con-
tradictory interpretations and so have aggravated instead of alleviated
ethical confusion among lawyers (Finman & Schneyer, 1981).

The Kutak commission was "to produce rules of professional conduct
that preserve fundamental values while providing realistic useful guid-
ance for lawyers' conduct in an environment that finds the profession...
undergoing significant change" (ABA J., 8-82, p. 1019). The commis-
sion's success, however, has been questioned by thousands of pages of
criticism concerning such matters as format, elements of the lawyer's
duty of confidentiality, and the nature of corporate representation.

The Model replaced the tripartite format with single rules followed
by comments and notes explaining each rule and comparing the Model with
the 1969 Code. The rules are divided into sections dealing with various
roles, relationships, and responsibilities of the lawyer;
(1) Client-Lawyer Relationship
(2) Counselor
(3) Advocate
(4) Transactions with Persons Other than Clients

Proponents of the Model contend that the new format is easier to understand and use since it avoids the confusion caused by the inconsistency, ambiguity, and variable enforceability of the 1969 Code's Ethical Consideration and Canons. Opponents, however, argue that the legal profession, having studied and grown familiar with the old format, will have difficulty with the new. Furthermore, they argue, simply changing the format will not avoid disparate state ethical standards, since each state retains its ability to accept some rules and discard others (ABA J., 12-81, pp. 1624; Barrister, Fall 1981, pp. 4).

Lawyers occupy a unique position with regard to the obligations they have to their clients, the court, and society. They must observe the strictest confidence with regard to the knowledge they obtain from their clients and yet they have a duty of candor to the court as its officers and a further obligation as members of society to avoid assisting in unlawful acts. The three duties can at times conflict. When they do the question is, Which is preeminent?

Proponents of the Model feel it solves this problem with a general rule stating that all information relating to representation of the client is to be kept confidential unless the information falls within one of the exceptions to the rule. Exceptions allow disclosure to provide self-defense for a lawyer charged with misconduct, to prevent future crimes or fraud with serious or life-threatening consequences, and to rectify the consequences of a client's criminal or fraudulent conduct that occurred as the result of the use of the lawyer's services. Disclosure exceptions are discretionary, and only the information necessary to prevent or rectify harm may be disclosed. Two rules, however, mandate disclosure: one requires truthfulness and candor to the courts about both the relevant law and the facts of a case, while another requires similar truthfulness to third parties. That is, lawyers may not knowingly conceal or misrepresent the facts or the law, particularly when doing so would assist in a criminal or fraudulent act.

Both opponents and supporters of the Model agree that an attorney must be able to assure the client that information will be kept confidential in order to obtain the trust needed to protect the client's interests and ensure adequate representation (ABA J., 4-82, pp. 429). The debate centers on the exceptions to confidentiality, which neither side claims are absolute.

Critics of these provisions insist that the Model Code will widen the exceptions to confidentiality. They argue that it will change the role of the lawyer from an advocate to "a watchdog or policeman whose primary tasks include enforcement of what he thinks are proper standards of conduct for his clients to observe." Moreover, as a result of these exceptions clients will be less candid with their attorneys, thus under-mingling the role of the adversary system in the legal process. Supporters, however, contend that in many jurisdictions current exceptions are even larger than those in the Model Code, so that it will actually narrow the restrictions on confidentiality. In addition, they believe that while lawyers have a duty to their clients, they also have duties to society and the courts which at times take priority. For them, the Model Code constitutes a compromise between strict confidentiality and the erosion of the attorney-client privilege (Kutak, 1981; Crystal, 1982; ABA J., 4-82, p. 429; Wall St. J., 7-23-82, p. 19).

A recurring problem addressed by the Model Code is that of the lawyer who represents an organization such as a trade union or corporation. The Model makes clear that the organization is the client, not the directors, officers, employees, or shareholders. The lawyer must represent the interests of the organization as a whole and disregard conflicting interests of other parties. If a lawyer discovers illegal activity, he or she must bring the information up the organizational hierarchy even if it means going over someone's head in the chain of command (Bus. Wk., 8-31-81, p. 56; Crystal, 1982).
During the upcoming midwinter meeting in New Orleans, the Model Code will be on the agenda again. At the meeting each rule will be separately considered and voted upon. Assuming passage at this meeting, state bar associations would each decide whether to recommend approval of the Model by their states' highest court. Should that recommendation be made and approval granted, the state government would then determine whether to accept or reject the Model, since states retain final authority over their own professional ethical standards. However, the code could be used in malpractice suits as an indication of professional standards regardless of state approval (Vail St. J., 7-23-82, p. 19).

Another possibility for the future of legal ethical standards is the assentance of an argument against detailed rules and for a declaration only of fundamental principles to be applied by individual lawyers, with guidance provided as needed by the ABA standing ethics committee. Some observers point out that in both the 1969 Code and the Model Code, fundamental principles are not clearly spelled out. Ethical conflicts which could be easily resolved by invoking basic concepts turn into legalistic harangues over interpretations of key words. These people believe detailed rules induce "meaningless rituals for the sake of shifting responsibilities or getting us involved in the tangles of administrative deliberations, and we can only wonder whether this kind of code is a despicable spectacle" (Hearings, 1981:13-30).


IV. NORTH AMERICA

EFFECTS OF ECONOMIC CRISIS ON THE MEXICAN SOCIAL STRUCTURE. - On October 8 President Reagan met with Mexican President-elect Miguel de la Madrid in Madrid, first stopping in Tijuana to lay a wreath at the grave of Benito Juarez, Mexico's great peasant hero and national leader, and then visiting informally at a California vacation resort (N.Y. Times, 10-8-82, p. 6; 10-9-82, p. 3; J. of Commerce, 10-8-82, pp. 1-4). Although Mr. de la Madrid will not be in charge of the government until December 1 and so cannot speak officially for Mexico, the meeting was important in setting the tone for relations between the two countries over the next six years. It occurred in the midst of Mexico's attempts to deal with its most dramatic economic upheaval in recent times -- the peso now severely devalued, strict exchange controls in effect for the first time, the banks nationalized barely a month, and the country near bankruptcy from the burden of a staggering public and private international debt.

The tone of the talks belied the recent strains between Mexico and the U.S. President Lopez Portillo, reportedly angered by suggestions that the U.S. was ready to exploit the Mexican crisis for its own benefit, upset the U.S. by giving public credence to those notions and intimating that Mexico would not meet its financial obligations to the U.S. From his protected position near, but not in, the seat of power, Mr. de la Madrid has instead been quietly stressing Mexico's intentions and ability to take whatever steps necessary to meet his country's commitments, and arguing that the U.S. can best serve its own interests by helping Mexico through this difficult period. (Indeed, the U.S. had already moved to offer nearly $3 billion in agricultural credits, short-term credits, and advance payments for oil for the U.S. strategic reserve.) Aside from these themes, Mr. de la Madrid demonstrated the strong nationalistic feelings of many Mexicans by emphasizing that Mexico must work out its own solutions to its economic problems without outside interference. President Reagan, in turn, acknowledged that the present situation was conducive to strained relations but offered Mr. de la Madrid the respectful cooperation and friendship of this nation.
Below this diplomatic plane, the Mexican government is struggling
to find specific ways to handle the details of the crisis. Negotiations
continue with the International Monetary Fund for an aid package of $4.5
billion which could oblige Mexico to follow austere fiscal and monopo-
tary policies it would prefer to avoid (Chn. Sci. Mon., 9-29-82, pp.
14). In the meantime the government has found it must relax exchange
controls in the regions bordering the U.S. to prevent massive business
and banking failures. The economies on both sides of the border are
tightly interlocked. Unable to obtain dollars through their local
banks, Mexican business executives have taken their accounts across the
border, where numerous exchange booths are in operation, in an effort to
obtain dollars to pay their U.S. debts and maintain lines of supplies
and credit (J. of Commerce, 10-6-82, pp. 14). In another move a few
days after the meeting between Mr. Reagan and Mr. de la Madrid, the
Mexican government offered somewhat skeptical foreign banks the oppor-
tunity to exchange a portion of their debt holdings in Mexican firms for
up to 15% of the firms' equity. Whether this offer would supersede the
long-standing requirement that all companies operating in Mexico be at
least 51% Mexican owned remained unclear (J. of Commerce, 10-13-82, p.
1A).

Whatever strategies are taken and accommodations worked out as
Mexico adopts to its new situation, the economic crisis has already pro-
foundly affected a broad spectrum of Mexican society. The poor, faced
with steeply rising food prices, will find survival more problematic and
their hopes for a better life dashed. Many from the middle and upper-
classes must also face circumstances dramatically different from their
expectations of a year or two ago. That the peso was significantly
overvalued has been known or suspected for some time, leading wealthier
Mexicans to participate extensively in the U.S. real estate market.
Some properties were paid for in full; the remainder, however, require
mortgage payments in dollars which can no longer be legally obtained
(N.Y. Times, 9-29-82, p. 10). Mexicans caught in this position face the
dismal prospects both of having to accept large, unanticipated financial
losses and of being vilified (or worse) for contributing to the outflow of Mexican capital that has played a part in the country's
near financial collapse. Widespread nervousness over the latter possi-
ability developed after President Portillo, in his state of the union
address on September 1, cryptically gave Mexicans one month to sell
their U.S. property or face unannounced consequences. Nationalization of
the banks has put the government in a position to obtain information
about individuals' foreign dealings if it chooses to do so (N.Y. Times,
9-9-82, p. 12). (However, the implications for upper-echelon bureau-
crats, politicians, and their families and friends, should the govern-
ment move against people with foreign holdings, could prevent it from
carrying out its threats.)

If the problems of owning U.S. real estate and otherwise transfor-
mimg Mexican pesos out of the country affect a certain segment of Mexi-
can society, the consequences of the general business and industrial
slowdown have been much more widely felt. In the Monterrey region,
which produces 25% of the nation's gross domestic product, industrial
activity is estimated to have dropped 40% during August and September
(Chn. Sci. Mon., 10-4-82, p. 12). A basic problem for many firms is
that they cannot import the necessary raw materials to keep their opera-
tions going. With no guarantees of payment for goods sold or of ability
to repatriate profits, foreign suppliers and parent companies of Mexican
subsidiaries have stopped shipments of a broad range of goods to Mexico.
Some multinationals have found themselves seriously overexposed in Mex-
ico; others are assessing the level of exposure they are willing to
accept. At the same time, domestic companies that sprang up and
expanded rapidly in response to strenuous government efforts to develop
the nation's oil wealth are now without prospects of obtaining new gov-
ernment contracts (Wall St. J., 9-17-82, pp. 1-1). Some have performed
work for which they no longer expect to be paid.

The conditions present in Mexico threaten not only the survival of
the poor and the wealth of some of the wealthy few, but strike at the
heart of middle-class aspirations.

A few short years ago Mexico seemed a land of boundless opportunity
to anyone with education or training, and families have struggled to
provide at least some of their children with the skills that would permit them to rise within the system. The expanding government bureaucracy was an early means of upward mobility, but all development opened up the avenues of opportunity in both government-owned and private industry. In particular, the upper-middle and middle classes (comprising roughly the 35% of households below the top 5%) have benefited significantly over the last three decades, as the table below shows. While a strong and growing middle class is generally seen as an essential component of economic development — providing both skills and buying power — some economists have pointed out (rightly in the case of Mexico) that middle-class gains have come as much or more at the expense of the poor as at the expense of the rich (Soils, 1981:96-112). Nevertheless, a vigorous and viable middle class also provides a vital link between the society’s economic extremes; and for the not-so-poor, it offers the promise of future possibilities.

**DISTRIBUTION OF MEXICAN DISPOSABLE HOUSEHOLD INCOME, 1950-1975**

<table>
<thead>
<tr>
<th>Top 5% (Upper Class)</th>
<th>1950</th>
<th>1968</th>
<th>1975</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40.2%</td>
<td>29.2%</td>
<td>35.9%</td>
</tr>
<tr>
<td>Next 5% (Upper-Middle Class)</td>
<td>8.8%</td>
<td>17.8%</td>
<td>15.2%</td>
</tr>
<tr>
<td>Next 30% (Middle and Lower-Middle)</td>
<td>26.4%</td>
<td>34.6%</td>
<td>31.7%</td>
</tr>
<tr>
<td>Next 20% (Lower Class)</td>
<td>10.3%</td>
<td>10.3%</td>
<td>9.7%</td>
</tr>
<tr>
<td>Last 40% (The Poor and Destitute)</td>
<td>14.3%</td>
<td>7.8%</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

(Hawlett & Weltner, 1982:268)

Part of the attractiveness of Mexico to those with an entrepreneurial spirit was the basic development decision made some years ago: to pursue growth over socioeconomic equity in the belief that without a larger accumulation of national wealth, more equal distribution of it would be of little value. In truth, all classes except the poorest 20% (see the table following) are now to some degree better off in real terms than they were in 1950. Even so, this development strategy has led to increasing imbalance in the distribution of national income. Although the upper-middle and middle classes grew in importance from 1950 to 1968 -- their increase in share of national income coming at the expense of the top 5% as well as the bottom 40% of households -- by 1975, they had lost some of the ground gained in the proportion of national income at their disposal, while upper-class households recouped about half of what they had lost during the previous 18 years. The overall effect has been to widen the gap between the rich and poor. This trend has likely continued from 1975 to the present.

**TRENDS IN AVERAGE REAL INCOME OF HOUSEHOLDS, 1950-1975**

<table>
<thead>
<tr>
<th>Top 5% (Upper Class)</th>
<th>1950</th>
<th>1968</th>
<th>1975</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>100.0%</td>
<td>149.9%</td>
<td>179.2%</td>
</tr>
<tr>
<td>Next 5% (Upper-Middle Class)</td>
<td>100.0%</td>
<td>449.5%</td>
<td>372.0%</td>
</tr>
<tr>
<td>Next 10% (Middle Class)</td>
<td>100.0%</td>
<td>507.5%</td>
<td>270.5%</td>
</tr>
<tr>
<td>Next 20% (Lower-Middle Class)</td>
<td>100.0%</td>
<td>243.0%</td>
<td>200.9%</td>
</tr>
<tr>
<td>Next 20% (Lower Class)</td>
<td>100.0%</td>
<td>203.5%</td>
<td>172.4%</td>
</tr>
<tr>
<td>Last 20% (The Poor)</td>
<td>100.0%</td>
<td>131.5%</td>
<td>129.5%</td>
</tr>
<tr>
<td>Last 20% (The Destitute)</td>
<td>100.0%</td>
<td>87.8%</td>
<td>78.9%</td>
</tr>
</tbody>
</table>

(Hawlett & Weltner, 1982:269)

Within this context, the implications of the shifting fortunes of the middle classes are important to Mexico's future. In particular, one must ask, What will happen when the growth stops? Two significant trends are the large growth in income of the second 5% of households and the expanding share of national income of the top 5%. These groups have clearly taken full advantage of rapid development over the past two decades. Some have also undoubtedly used their positions of authority to aggrandize their personal fortunes — a practice that, until recently, was viewed less as corruption than as just reward for service to the system and perseverance in rising to the top (Chr. Sci. Mon., 10-6-82, pp. 11).

While the upper-middle class commands less than half the income of the upper class, the spread between these two groups has narrowed while income disparity with the next lower group has increased. Some express fears that without continued economic growth, the aspirations of the middle class will be thwarted. Others have noted astutely that this situation is one of the classic preludes to revolution (Brinton, 1938). One possible scenario is that a small portion of the middle class will
join the ranks of the wealthy, while the remainder face deteriorating economic circumstances. The result would be an increasingly polarized society, especially as the situation of the poor becomes more desperate.

Whether Mexico actually faces the prospect of polarization and political instability is uncertain at this point. That the country should now take steps to avoid it is not. Early indications are that its leaders may be doing just that. In the meantime, Mexico has two great strengths to sustain it: a national pride resentful of the mere suggestion that Mexico could go the way of a Salvador or Guatemala, and an adaptive and resilient political structure in the form of its governing party (the Partido Revolucionaria Institucional, or PRI). One long-time observer has described PRI as "less a political party in the traditional sense than a system of control that ensures its survival" (Christian Science Monitor, 10-8-82, p. 13). The nationalization of the banks may indeed have been a crucial move in maintaining the necessary balance between competing domestic interests and ideologies. If the segment of PRI which advocates the equal distribution of wealth now has more authority and prestige as a result of nationalization, that could well be to the long-term benefit of the nation. It may also make Mr. de la Madrid's task of dealing both with the issue of corruption and with Mexico's external creditors somewhat easier in the months ahead.

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V. EDITORIAL

U.S. Trade Relations and Domestic Policy: Will Crisis Force Their Integration? The U.S. Congress, in extensive hearings during 1977 and 1978, analyzed the emerging role of trade in our domestic economy and examined impediments to expanded U.S. exports. Subsequently, numerous proposals were made to increase public awareness of our dependence on international trade and to encourage greater public and private sector involvement in promoting it. Unfortunately, these initiatives have been eclipsed by the current pervasive public concern over federal deficits and volatile interest rates and by President Reagan's sweeping fiscal responses to them. Some time will pass before we know whether these bold steps have reduced the nation's problems. Meanwhile, other less generalized crises require immediate attention and action. The dilemma for the nation's leadership as well as its citizens is that many of these crises are not reconcilable within a single coherent strategy.

Major public concern regarding specific domestic economic problems focuses on the continued slump in the auto and related industries, record high unemployment rates, and competition in the U.S. from overseas producers in such key sectors as steel and electronic consumer goods. Two of our largest trading partners -- Japan and Mexico -- are accused of being central to these domestic crises. Ironically, they, too, are facing adverse economic conditions calling for immediate action. Japan's sluggish growth rate and other internal economic conditions prompted Prime Minister Suzuki to declare an economic state of emergency in order to organize diverse political interests to cope more effectively with these escalating problems. In response to U.S. pressures, Mr. Suzuki has also advocated making Japanese markets more open to U.S. goods and services. In the midst of these controversial initiatives, the prime minister himself added to the crisis by resigning from office. In contrast, Mexico, which shares a 1,400-mile common border with the U.S., has devalued its national currency relative to the dollar from 24 to between 70 and 100 pesos. When this measure did not stem the flight of Mexican wealth to other countries and currencies, the Mexican government took control of all banks and implemented currency regulations.
restrictions having a noticeably adverse impact on U.S. interests. Simultaneously, the government has expanded exports into the United States to compete with manufacturing sectors already in distress (such as auto parts) and has not materially curbed the influx of Mexicans seeking U.S. jobs along with the expanding ranks of unemployed U.S. citizens. There is no immediate promise of relief for any of the three countries.

These events in Mexico, Japan, and the U.S. have prompted various proposals from a wide spectrum of U.S. interests. Many members of Congress, industry executives, and labor union officials have advocated stiff controls on imports of steel and auto products. Manufacturers of high technology components and people with farm interests are demanding that the Japanese open their markets to more U.S. exports. Financiers and multinational corporations press Japan to permit greater foreign participation in its capital markets in keeping with similar opportunities available to the Japanese in the U.S.

While these demands are in direct response to perceived inequitities in trade and while specifics of the proposals address concerns of particular interest groups, some are also founded on broader principles which underlie the General Agreement on Tariffs and Trade (GATT). This international arrangement, which since the late 1950s has been the framework for several massive tariff reductions among major trading countries, is still viewed as the embodiment of basic principles of free and fair trade associated with long-term U.S. foreign policy. Unfortunately, the appeal to GATT principles is diminishing in its effectiveness because the domestic crises of most major trading countries have forced them increasingly to deviate from those principles. The claims and counterclaims of GATT violations now being exchanged between Europe, the United States, and Japan have reached a volume which mocks the vitality of GATT and its implementation structure.

Recognizing that current domestic difficulties will not be resolved simply by the federal government lodging protests and negotiating contentious issues before relevant international bodies, many interest
groups and their representatives in Congress are resorting to domestic legislation requiring reciprocal treatment from trading partners on an industry-by-industry basis. Thus, flexible inspection standards for Japanese cars imported into the U.S. must be matched by flexible import standards for U.S. cars entering Japan. Access of Japanese interests to U.S. capital markets will be contingent on U.S. access to Japanese markets without hidden government constraints. In a different vein, other proposed legislation would set standards requiring that a specified portion of the value of major industrial imports be comprised of U.S. goods produced by U.S. labor. Though appealing in their simplicity, these solutions unfortunately focus only on short-term problems while presenting major challenges to the economic and political structures of Mexico and Japan. For example, Mexico already sets stringent limitations on imports to reduce balance-of-payments deficits. U.S. reciprocity legislation would place enormous, and possibly unsustainabil able, financial pressures on that country, given its present difficulties.

Some politicians, including administration leaders, recognize this dilemma and have called for more creative long-term solutions. Treasury Secretary Regan, in advising steelworkers not to have high hopes for resolution of their problems through steel import limitations, is implying that the U.S. steel industry can no longer compete successfully with foreign steel producers and must face the reality of retrenchment. Steelworkers should actively retrain for other jobs. Changes of revaluation in the auto industry seem more promising. It is now engaged in revolutionizing its labor-management relations to develop a strategy that will transform its present position of weakness to one of competitive strength both here and abroad. Because of the complexity of auto production and the diversity of electronic and non-electronic industries supporting it, the U.S. may be able to regain its competitive momentum in world markets. Rising industrial countries like South Korea are not likely to move effectively into this area, despite low labor costs. Thus, major U.S. competitors will remain concentrated in Japan and Europe.
However, resolving the problems of domestic industries will not provide a total solution to renewed economic health if countries with which the U.S. is significantly interlocked remain in distress. Some U.S. leaders are suggesting methods of facilitating Mexico's trade balancing efforts in the face of an oil oversupply. The U.S. has already agreed to replenish its strategic petroleum reserve with major increases in Mexican oil imports. This will help directly to ease the government's resort to restrictive currency measures which are rapidly alienating U.S. financial and industrial interests now critical to Mexico's economic health. On a broader scale, some leaders are advocating that we further stimulate the flow of Mexican oil into the U.S. by using it to supply nearby Gulf Coast refineries. Alaskan oil, expensive to use in the southern part of the U.S. because of transcontinental transport costs, could be shipped to Japan in place of the Mexican oil it presently receives, reducing Japan's transportation costs as well. Although this three-way arrangement holds many advantages, it conflicts directly with a basic public perception that we should not sell scarce oil supplies to foreigners.

This conflict highlights the need for a better integration of U.S. trade policy with domestic policy. It does little good for two or three major trading partners to seek gains or concessions on the same trade issue. Each must assign priorities to their domestic problems and then attempt to understand the priorities of others. Ideally, we should acquire the political discipline that would allow us to be responsive to another country's priorities in return for their responsiveness to matters of high U.S. priority. Once these major international exchanges are achieved, it is incumbent upon the domestic structure to allocate internal resources partially to recompense the advocates of low-priority interests who have not been accommodated in the international bargaining process. The mechanisms for achieving these ends are not obvious, and their implementation is often painful. We cannot, however, defer our quest for them, because experience suggests that other alternatives produce escalating conflict at an economic level which can only undermine essential international structures.

--- Frederick W. Huszagh