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In discussing trade issues, I am generally asked about the future of trade legislation this year. Of course, that is not really the question on everyone's minds. We are going to have trade legislation this year, fairly early -- that's not news. The real question -- often unstated -- is whether it will be protectionist legislation.

Unfortunately, that question both misses the point and does a disservice to the issue and to the Congress. Instead, we should begin with agreement on what the problems are with the current trading system; what solutions are in the United States' interest; and how to legislate solutions effectively. The reason that kind of discussion is difficult is because of the myths that get in our way. I believe there are three of them.

The first myth, the biggest one of all, is that the world trading system is based on free trade. That is utterly wrong. I brought with me a 300 page rebuttal of this commonly held myth prepared by the U.S. Trade Representative. It provides clear evidence that countries are getting away with economic murder by ignoring the law of comparative advantage.

If Japan for more than 20 years is able to protect its infant industries by keeping all kinds of competitors out -- not just the United States, but all kinds -- it has in effect provided a large subsidy that protected companies can use to enhance their research, their development, and their production engineering. With that advantage they can leap frog their competitors' technology and engineering in a way that Adam Smith and other free trade economists never anticipated. We are no longer dealing with simple production processes that are easy to enter or leave. Nor is the labor force as mobile as economists assume. In the high tech sector particularly, generations of products change rapidly with earnings from sales of one generation critical to research, development and production of the next. Dumping or subsidies that unfairly cost domestic producers market share also make it impossible for them to recover such investments through subsequent product development. The Japanese have shown themselves to be masters at the tactic of capturing market share literally at any cost and then holding on to it tenaciously with the result that American competitors suffer severely.

Without question the best known protectionist nation is Japan. I hesitate to bore you with a long list, but the United States has had market opening or trade barrier negotiations with them -- and this is not a complete list -- on electronics, pharmaceuticals, tobacco, aluminum, medical equipment, telecommunications, forest products, transportation machinery, semi-conductors, leather, computers, wine and liquor, chocolate, construction services, and numerous agricultural products.

Another example is Brazil, which has a very direct method of distorting the market. Brazil has a Law of Similars which simply says that the government can block the importation of anything that is also produced in Brazil. And the Brazilians use it. They have a market reserve policy which allows for the total exclusion of both foreign investment and imports from selected sectors,

Well, in addition to those two, there are some 38 other countries in the USTR report that are to varying degrees implementing the same system that Japan in its way and Brazil in a different way are practicing. By doing so they have effectively repealed the law of comparative advantage and the principle of the free market.

I said there are three myths. The second myth is that the shrinking dollar is going to cure all ills. We all think back to 18 months ago when Secretary Baker announced his initiative to bring the dollar down and thereby solve many of our trade imbalance problems. Well, the initiative has occured, but the expected results have not. True, on a trade weighted basis against a conventional basket of currencies, the dollar has dropped in value approximately 25 percent from its peak.

But a number of analysts have begun looking much more closely at the numbers, and what they have discovered is that the dollar has not dropped significantly against a number of very important currencies. Our largest trading partner is traditionally Canada, and, rather than weakening, the dollar has strengthened versus the Canadian dollar. It has also defied conventional wisdom and likewise strengthened against Singapore, against Korea, against Taiwan, and against Hong Kong.

If you look at our 17 largest trading partners, you will find that the dollar has not depreciated 25 percent or 40 percent, as it has against the yen, but only 4% from its peak value in February 1985. Then, if you look at the seven largest of those trading partners which now account for 61 percent of our trade, what you see is that the value of the dollar versus those 7 largest didn't go down, it actually went up 11 percent.

If you want to be a little more selective, and take 6 of those 17 -- Mexico, Canada, Taiwan, Korea, Hong Kong and Brazil -- which together account for 35% of U.S. foreign trade, you would find that the dollar has actually risen 71%. Now, you don't have to be much of a businessman to understand the effect of having your largest trading partners have weaker currencies. American businesses and their workers have been coping with this continuing problem for five straight years. The new record trade deficit for 1986 should serve as the apropriate exclamation point!

This situation is compounded by the fact that even in those countries where the currency has appreciated versus the dollar, there is little interest in absorbing the effects of the appreciation. Producers continue to focus on maintaining market share rather than profit levels.

In the steel industry, for example, which is still of some significance in my state, Japanese steel prices over the last 14 months "declined• 7.5 percent while the yen was going up some 22%. This clearly has helped to maintain market share -- and to keep price levels down domestically, preventing the domestic industry from recovering. And it is those marginal imports that set the price. That's what I learned when I was at the Harvard Business School, nearly twenty-five years ago. It is one of the things I learned that is still true today. And the consequence is that the United States is paying a very heavy price. How long this can be sustained is an open question. And how long we will have to endure the pain it entails lies partly in how long the Japanese government will continue to provide subsidies to businesses hurt by yen appreciation. I sometimes wish our country had found a way to help our exporters who have been hurt by dollar appreciation -- but we don't do those kinds of things here...at least not yet. Except in agriculture.

Steel, of course, is only one example. In category after category, the world is awash in excess capacity made worse by government determination to maintain production for political rather than economic reasons. To continue to believe that the dollar's decline has had, or even can have, a significant impact on reversing our current fortunes is to remain mired in economic theory that is irrelevant to the closing years of the 20th century.

The third myth is that there is nothing Congress can or should do about our problems. That is a view periodically expressed by some in the White House. Depending on whom you talk to, it is based on:

1) the view that the problem is one of macroeconomic variables either out of our control entirely or outside the scope of the trade policy debate;

2) the belief that our trade problems are due solely to American lack of effort and competitiveness; or

3) the fear that almost any cure the Congress might vote would be worse than the disease we have now.

The first I have already discussed and dismissed. The second no doubt has some truth to it, but is not an adequate explanation for problems as broad and deep as ours. The third remains to be seen but can hardly be taken as a given. If you review the record of what Congress has actually enacted into law over the past 20 years -- rather than what individual Members have proposed from time to time -- you can see it is an extraordinarily responsible one. In some respects more responsible than that of Administrations during the same period.

Thus the case against trade legislation is hardly proved. On the other hand, the case for it must be demonstrated. The proof lies in the world trading system as it exists in reality -- not in myth.

That reality is that the United States undertook, in the aftermath of World War II, a policy that was at the time very much in our self interest. We engaged in a policy of rebuilding the shattered Western world through the creation of a strong Western alliance -- both economic and political. In 1945, we accounted for 60% of the free world's gross national product. It was in our interest to promote trade and investment, and we encouraged other countries to use technology, acquire capital, and manage it efficiently. And it was smart of us to do so. The cost to us was small -- we were relatively independent of world trade -- and the gains great.

But over the last 40 years, that policy has succeeded without us fully understanding its implications. Other countries have developed their own paths to the mercantilist policies I described earlier. They have essentially caught up and gone beyond us in competitiveness at the very time our own real growth and standard of living have slowed down.

And having done so, they have neither met their new responsibilities as we met ours when the world was different, nor have they addressed the new problems these policies have created. As I mentioned, excess capacity has become a global disease. So far it appears to be fatal primarily in the United States, but that, too, will spread, as the Japanese are beginning to see.

The traditional explanations for over capacity are rising productivity and weak global aggregate demand. Add to that the factors I have mentioned:

-- increasing government subsidies that keep the inefficient in business;

-- the reluctance of high tech producers to shut down costly production facilities when demand slackens;

-- the new obsession with maintaining market share at the expense of profits and prices; and

-- the globalization of capital and technology movements that bring on new capacity in unexpected locations.

I submit that this is not a temporary detour on the road to free trade. Development means the continuing expansion of new producers, but it does not guarantee an equal growth of consumption. The result is NIC gains at the expense of more market-oriented producers. So far the chief victim has been the United States. Today we accept 40 percent of all Korea's exports. Of Japan's - 40%, of Taiwan's - 50%, of Canada's - 80%, and of LDC's - 58%. We have been, and we continue to be the engine of growth for the free world.

But the problem is that while it was the right policy for its time, it is one we quite frankly can't afford anymore, because our engine is fueled by debt: national debt, trade debt, consumer debt, business debt, student debt. We are over leveraged. It is fuel that is either going to run out or is just going to produce less and less horse power to pull an ever-lengthening consumption train.

The consequences of all this were dramatically reflected in an article in the "Washington• "Post• on December 14 which analyzed what's been happening to our economy for the last 20 years. Since 1973, Americans have been living higher on the hog while they've been getting poorer. Since 1973, real per capita manufacturing wages have declined approximately 14 percent. Real manufacturing wages are today lower than they were in 1961. 25 years ago.

How is it that people can manage to make ends meet? Well, one way is more work force participation. Women working. Two -- more debt. And we've done a great job in both respects. But there's not much give left. And in the present system, if we run out of gas, everybody's car stalls. Unless we have a more equitable division of responsibility in the trading system. And the best basis for that is the market system -- a form of justice we all should be able to accept.

Those are the problems that I submit are really behind the concern in Congress for trade legislation. The conceptional solution is to create a regime that really does enforce the notion of free trade. We certainly don't have it now. And we desperately need it. And unless we get the market to make economic decisions worldwide, we will inevitably see our government making far more than its fair share of economic decisions out of self-defense. Just as we see abroad. That trend is already underway -- whether you call it industrial policy or competitiveness or whatever. It all means government intervention in the market place. But what we've got will seem like a drop in the ocean compared to what will happen.

So what that means to me is that if we are going to prevent this erosion of the market system here and roll it back elsewhere, then we have to move vigorously to attack unfair trade practices wherever we find them. A lot of people say, well Senator or Mr. President, or whoever they're talking to, you know you can tear down all those trade barriers -- in Japan or the common market or Brazil -- and it will really only make a very modest contribution to addressing the trade deficit.

From an extreme short term perspective that is true. But just as it took 20 or 30 years for us to get where we are now, if we really want the long term benefits of comparative advantage and the free market it's going to take 10 or 15 years to see them, even if we could create the perfect conditions tomorrow.

All of those countries that have sent their exports to us and grown as a result of the policies I have described, are not going to change easily. Why should they? The current system is a brilliant success for them. We are the losers, not they. This may be why we ought not to expect too much from the new GATT Round -- the EC, Japan, and the Newly Industrialzing Countries have little more to gain and a lot to lose in any move toward real free trade. Yet, even if we do make real changes, it will take 10 or 15 years before we see the leveling effect of dismantling the protectionist barriers of other countries.

Why should we do it? Because if we don't one of two things will happen:

-- either our competitive position will continue to erode and our debt continue to increase past the point where fundamentals like our national security and economic infrastructure are threatened; or

-- there won't be a market system at all, and eventually we will find our government stepping in and running things like it is beginning to do in semiconductors and machine tools, at which point we'll be like all the other countries we point our finger at.

That is what is driving trade legislation in Congress -- not just frustration over the present but real concern for the future. Much of what has happened is irreversible. Jobs lost will never be regained.

Dead industries will not be resurrected. That means, obviously, adjustment legislation will be a major part of what we do. That is the proper way to address the short term. But salvaging the long term will be the core of our work. That will mean many of the things that have been proposed under the umbrella of competitiveness, even though that will mean a larger government role in the economy. But it will also mean an all-out assault on trade barriers worldwide.