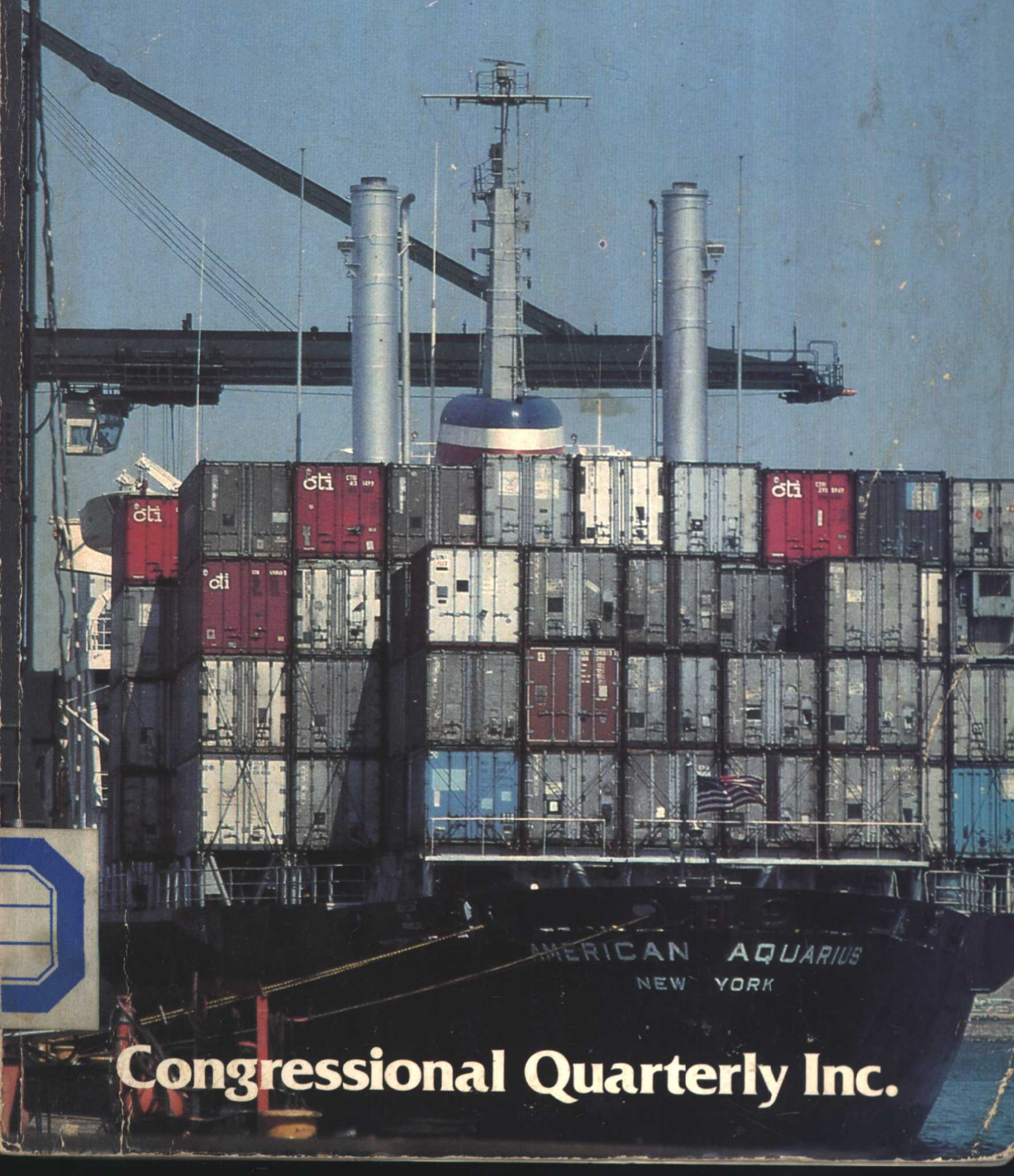
TRADE

U.S. POLICY SINCE 1945



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TRADE

(U.S. POLICY SINCE 1945)

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PREFACE

United States trade policy in the first decades after World War II was founded on the premise that eliminating barriers to the free exchange of goods among nations would benefit not only this country but others as well. Reducing tariffs, quotas and similar trade restrictions made economic sense to U.S. policy makers. The industrialized world had been ravaged by war, except for the United States, which had emerged stronger than ever, with a surfeit of manufactured goods and food to export — products that the rest of the world desperately needed.

Guided by those facts, the United States, during the 1940s, 1950s and 1960s, led a largely successful assault on breaking down the most blatant obstacles to trade among free world nations. Those roadblocks primarily were tariffs, the first target of the original 23 signatories to the General Agreement on Tariffs and Trade (GATT), formed in 1947. The GATT members pledged to negotiate multilateral agreements that would reduce tariffs and eliminate other impediments to free economic interchange. By the end of 1983, 90 governments had subscribed to GATT, and most other Western nations that did not belong informally adhered to its principles.

Perhaps the very success of GATT, evidenced by the results of several rounds of trade negotiations that dramatically reduced tariff levels, laid bare the more intractable barriers to trade. These nontariff restrictions included not only quotas on imports but often more fundamental practices of national governments such as subsidies to exporting sectors of the economy and industrial policies designed to promote certain growth industries, often at the expense of foreign competitors. The whittling away of tariffs, ironically, even may have caused governments to strengthen other protectionist measures, particularly during a time of worldwide inflation, recession and crises in energy supplies.

These pressures took their toll on the pursuit of free trade.

Increasingly during the late 1960s and 1970s protectionism crept into the shaping of trade policy throughout much of the world. The concept of reciprocity assumed a new meaning. Previously the cornerstone of a doctrine that rested on extending mutual trade concessions, reciprocity by the 1980s had come to be linked with pursuit of measures designed to counter, or retaliate against, what were seen as unfair or restrictive trade practices by other nations.

Trade: U.S. Policy Since 1945 traces the evolution of U.S. trade relations in the postwar decades. The book highlights the difficult issues confronting the United States as it attempts to deal with persistent trade and balance-of-payments deficits caused by overseas competition and an overvalued dollar (which made U.S. products more expensive, and therefore less attractive, for foreigners to purchase).

An introductory chapter provides an overview of the major challenges confronting U.S. trade policy in the 1980s, followed by background chapters on the development of U.S. economic relations with the industrialized nations, the third world of developing nations and communist countries, particularly the Soviet Union and the People's Republic of China. Separate chapters examine U.S. trade relations with Japan and Canada, controls on high-technology transfers, export subsidies and the role of the Export-Import Bank, America's large agricultural trade and proposals to fashion a comprehensive industrial policy to orchestrate an effective trade and growth effort.

Chapters 1 through 4, 7, 8, and 9 were compiled and written by Margaret C. Thompson and chapters 5, 6 and 10 by Nancy A. Blanpied. Material for the chapters was based in large part on Congressional Quarterly's *Congress and the Nation*, vols. I-V, articles appearing in the *Congressional Quarterly Weekly Report* and reports written by the staff of CQ's *Editorial Research Reports.*

Margaret C. Thompson
January 1984

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Chapter 1

U.S. TRADE POLICY: ISSUES IN THE 1980s

President Ronald Reagan's speech to the nation Jan. 25, 1983, made it clear that, in economic terms, the state of the union was more closely entwined with the state of the world than ever before. "Every American has a role and stake in international trade," Reagan told the nation. "One out of every five jobs in our country depends on trade. We export over 20 percent of our industrial production, and 40 percent of our farmland produces for export."

The theme was woven throughout the president's State of the Union address. "In at least half the pages of his text, he made references to programs that impact on trade," noted U.S. Trade Representative William E. Brock III, the administration's chief trade negotiator with foreign governments. The reason, said Brock, was that the 1982 decline in trade contributed greatly to unemployment in the United States. "The very essence of trade is to deal with that problem," he said.

Reagan was not alone in emphasizing trade. The Senate Finance Committee had met earlier in the day to discuss the same issue. "I really believe trade is going to be the most important issue we face this year," said Sen. Lloyd Bentsen, D-Texas. In their response to Reagan's speech, congressional Democrats also staked out international trade as important ground. "It's time the United States began to deal with the reality of the international economy that we live in today," said Senate Minority Leader Robert C. Byrd, D.-W.Va. "America must get just as tough on trade as our world competitors.... That could be the difference in thousands and thousands of jobs a year."

The world recession, which caused global trade to drop in 1982 and 1983, drove home the full implications of the United States' increased dependence on trade. And the effects of recession were exacerbated by a new reliance on mercantilism in the world, with governments adopting extreme measures to increase exports and decrease imports. Because one nation's imports were another's exports, the conflicts of this strategy were clear, if difficult to escape.

The United States officially continued to preach the virtues of free trade. "As the leader of the West and as a country that has become great and rich because of economic freedom, America must be an unrelenting advocate of free trade," Reagan said in his address. But even as he spoke, labor and business leaders as well as members of Congress were looking abroad for the culprit responsible for the nation's economic woes. They maintained that America's trading partners and traditional allies, by applying aggressive export policies and limiting U.S. imports to their own markets, were in effect exporting domestic unemployment to the United States.

Reagan's critics said that a more realistic trade policy than the "free-trade" approach favored by the administration was what America needed to get its ailing industries back on their feet and American workers back on the job.

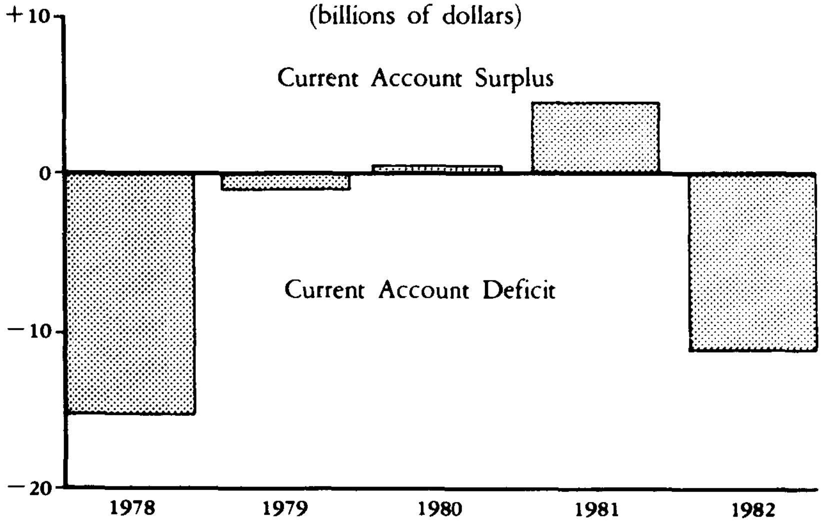
Rising Trade Deficit, Unemployment

Ten years earlier, trade issues did not receive such attention. But in 1973 trade accounted for only 6 percent of the U.S. gross national product (GNP). By 1983 it represented more than 12 percent. Although the U.S. economy was less dependent upon foreign trade for its health than those of most industrialized nations, a number of key domestic industries relied heavily on export sales of their products for survival, while others were particularly vulnerable to imported products with which they had to compete on the domestic market. Brock pointed out in January 1983: "In recent years four out of five of the new U.S. jobs in manufacturing have been created by international trade. One out of every three acres planted by American farmers is producing crops for export. Two trillion dollars of goods and services currently are being traded internationally and the potential for growth is unlimited."

In spite of a 15.6 percent drop in oil imports in 1982, the United States registered a record trade deficit of $42.7 billion, after posting a $39.7 billion deficit the previous year. While the trade statistics indicated a lack of growth on both sides, with a 7 percent decline in imports and a 9 percent fall in exports, the overall deficit underscored the plight of export-dependent industries. Preliminary figures for 1983 did not look any brighter. In the second quarter of the year the deficit in the U.S. current account (the balance of exports and imports of goods and services) rose

U.S. Balance of Payments

Current Account
(billions of dollars)



The balance on current account is an aggregate of international transactions in goods, services and government and private unrepaid transfers.

Source: U.S. Department of Commerce, International Trade Administration, August 1983.

to $9.7 billion from $3.6 billion, largely as a result of a widening of the merchandise trade deficit to $14.7 billion from $8.8 billion in the first quarter of the year. Commerce Department officials expected a total trade deficit of between $65 billion and $70 billion for 1983 and warned that it could be as high as $174 billion by 1990.

Lower exports and higher imports also meant job losses. In September 1983 the seasonally adjusted unemployment rate for all civilian workers stood at 9.5 percent. According to Alfred E. Eckes, chairman of the U.S. International Trade Commission (a non-partisan government advisory agency), each $1 billion change in the trade balance affected at least 25,000 jobs. Thus an increase in the deficit of $60 billion might put 1.5 million Americans out of work. Many of those lost job opportunities would be in manufacturing, where the deficit was widening rapidly. Between 1979 and 1982, employment fell by 39 percent in the U.S. auto industry, 47 percent in steel, 19 percent among shoe manufacturers and 17 percent in the apparel industry.

On the other hand, protectionist measures to save jobs often were self-defeating and costly, particularly for consumers. According to a study by C. Fred Bergsten and William R. Cline, in the late 1970s U.S. consumers paid an estimated $58,000 annually per job saved by protecting domestic manufacturers of specialty steel, television sets and footwear. That would amount to about $92,000 annually per job at 1982 prices.

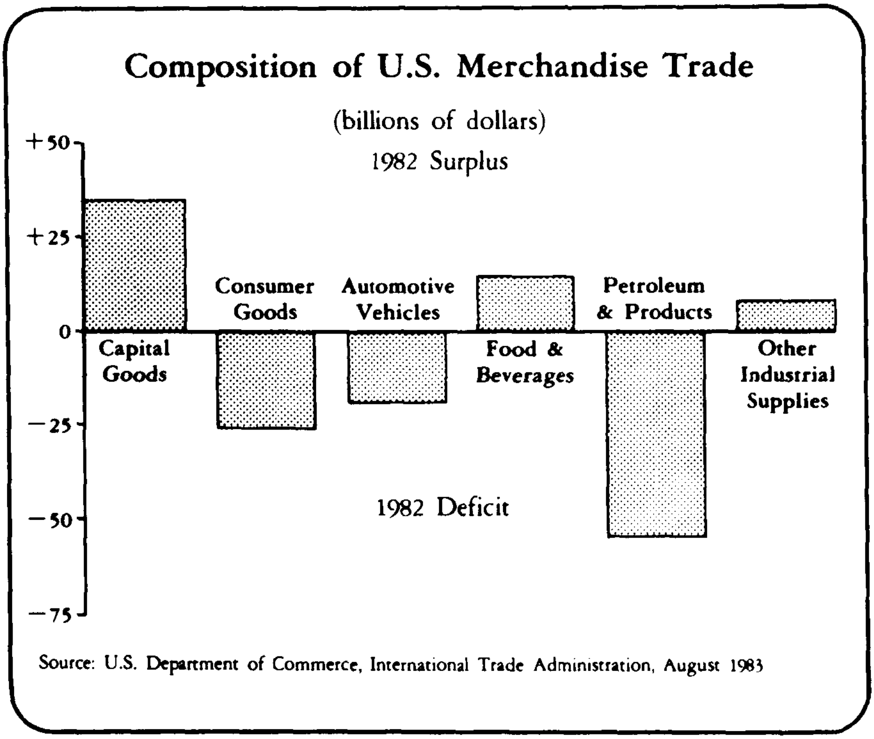
Decline in Agricultural Exports

Over the past decade Americans have been able to pay their foreign energy bills thanks largely to a significant increase in agricultural exports, which rose from $7.3 billion in 1970 to $43.3 billion in 1981. In 1982, however, agricultural exports, while maintaining a comfortable surplus over imports, had fallen to $36.6 billion and were expected to decrease still further in 1983. The reasons for this decline, according to Jim Donald, chairman of the Department of Agriculture's World Food and Agricultural Outlook and Situation Board, were "very weak world economic conditions, along with the strength of the dollar." Due to the increased value of the dollar over nearly all major currencies in 1982 and 1983, U.S. agricultural commodities tended to be priced higher in overseas markets than comparable products of other countries. *(Dollar's strength, box, p. 12)*

Other analysts pointed to the U.S. embargo on grain sales to the Soviet Union, imposed in 1980 in response to the Soviet invasion of Afghanistan, as a crucial factor in diverting foreign buyers to other, more reliable, grain suppliers, in particular Argentina and Canada. At the same time, favorable weather conditions among grain exporting nations and weak demand due to the recession caused sizable surpluses of grain stocks. This further depressed prices for those commodities, which account for almost half of all U.S. agricultural exports. *(For further discussion, see chapters on U.S. Farm Exports and Trade With Communist Nations.)*

Plight of Auto and Steel Industries

In addition to declining exports, many sectors of the U.S. economy faced steep competition from imported goods. Chief among these was the auto industry, which continued to lose its share of the domestic car



market in 1982, when the value of auto imports rose to $20.6 billion from $18.4 billion the year before. Imports in 1982 accounted for 27.9 percent of all cars sold in the United States. If the trend continued, said Eugene I. Casraiss, Jr., legislative representative of the United Auto Workers (UAW), imports could account for 35 to 40 percent of the U.S. automobile market by the end of the 1980s. This, he said, would have a disastrous effect on jobs. By the fall of 1983, however, there were signs that the industry was recovering, although the strength and longevity of that recovery were uncertain. *(Competition from Japan, p. 150)*

Another basic industry troubled by the recession and foreign competition was steel. While iron and steel imports fell by $1.3 billion in 1982 to $9.9 billion — partly as a result of a 1982 agreement with European Economic Community (EEC) producers setting quotas on imports to the United States — domestic steel mills operated at only 40 percent capacity and reported a staggering 50 percent unemployment rate for the year.

The steel industry as a whole was faced with an urgent need to replace outmoded equipment — and quickly — if it was going to have any chance of competing successfully against highly efficient manufacturers in Japan, subsidized producers in Europe and cheap-labor mills in developing nations. But industry representatives said that companies could not afford to make costly investments in modern equipment unless they were protected in the meantime against imports, which foreign producers allegedly were "dumping" on the U.S. market at prices that were below cost. While U.S. steel spokesmen conceded that new tax laws and revised environmental regulations had provided significant incentives for investment, they said that protection from unfair foreign competition also was a prerequisite for modernization.

Responding to pressure from U.S. steel producers and members of Congress from steel-producing states, President Reagan July 5, 1983, raised tariffs and set quotas on specialty steel imports. The decision placed an extra 10 percent tariff on imports of stainless steel sheet and strip, declining to 4 percent over a four-year period; on stainless steel plate imports, the tariff started at 8 percent and would decline to 4 percent. The new tariffs were in addition to existing tariffs on stainless steel products, which ranged from 7 to 11.5 percent. The president also set quotas on imports of stainless steel bars and rods and on alloy tool steel.

The action followed a ruling by the U.S. International Trade Commission in June that U.S. steel makers had suffered injury from European steel imports. European and Canadian officials, however, complained that the tariffs and quotas violated a commitment made at the May 1983 summit meeting in Williamsburg, Va., of the heads of leading industrial nations to resist protectionism. But Trade Representative Brock said the move was designed to promote free trade by combating the "serious distortions" in foreign steel trade practices.

Structural Changes in the World Economy

The problems confronting U.S. industries, both domestically and abroad, as well as the general global recession, had parallels in the international economic climate that prevailed after World War I. That period, too, was marked by intense competition from foreign-made goods, and the result was similar — mounting domestic pressure for protecting American jobs. Tariff rates were raised in 1922 to the highest levels since 1897, thus making it difficult for the European allies to repay their war debts to the United States. It is generally agreed that the tariff policies of the 1920s contributed to the Depression of the 1930s.

As early as 1921 the Baltimore *Evening Sun* warned: "A tariff wall that keeps foreign goods out may also keep American goods in; that unless we buy from the outside we cannot sell to the outside." But most Americans ignored such prophets of doom. "The American people . . .," wrote historian Thomas A. Bailey in *A Diplomatic History of the American People* (1969), "continued to believe that imports were basically bad." This prejudice toward imports was embodied in the Smoot-Hawley Tariff of 1930, which raised tariffs on imported durable goods to a record high level of 59 percent by 1932.

A turnabout in American tariff policy was inaugurated with the Reciprocal Trade Agreements Act of 1934. The movement toward lower tariffs was led by Secretary of State Cordell Hull, a Tennessean committed to the position long popular in the South that low tariffs were good for the country. The 1934 act gave the president authority to negotiate trade agreements with individual countries and greatly reduced duties in return for similar concessions on their part. *(For further background discussion, see pp. 31-33.)*

Foreign Challenges to U.S. Markets

After World War II the United States took the lead in trying to establish a broader approach to tariff reduction and trade liberalization. It was due largely to American initiative that 23 countries in 1947 signed the General Agreement on Tariffs and Trade (GATT).

Although GATT represented a multilateral attempt to mediate differences among the contracting nations over changing trade patterns, many observers believed more attention should be paid to the structural changes that had brought about those shifts, so that a more coherent and effective international trade strategy might be devised for the future. For example, the postwar reindustrialization of Western Europe and Japan, as well as the emergence of newly industrialized nations, had an enormous impact on trade.

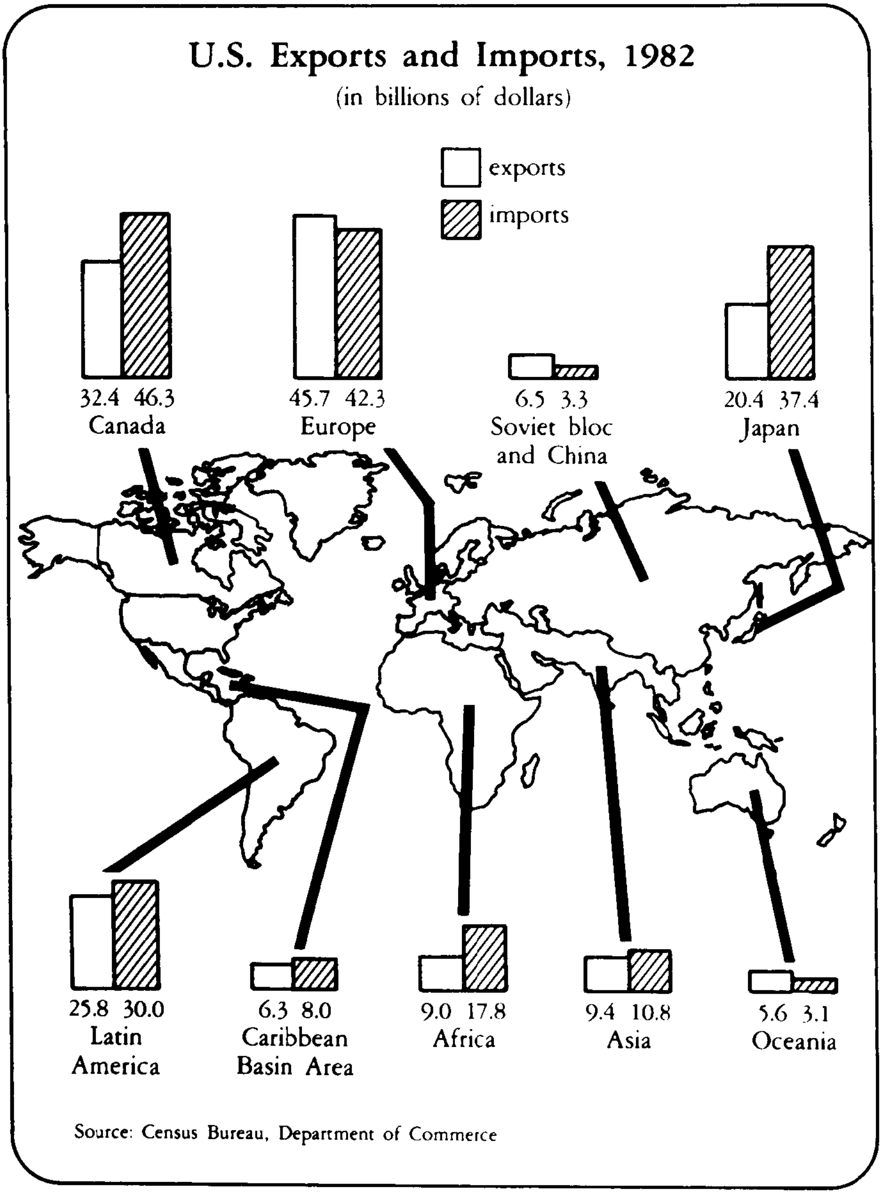
Before the oil shortage shocks of the mid- and late-1970s, postwar international trade had grown about 7 percent a year, due in part to the removal of barriers during several rounds of multilateral GATT negotiations that substantially reduced tariffs and import quotas. The undisputed winner during this period was the United States, which claimed in the economic boom years of the 1950s and 1960s about one-fourth of the world market in manufactured goods. By 1979 the U.S. share had fallen to approximately 17 percent.

By the late 1970s South Korea, Taiwan, Hong Kong, the Philippines, Mexico and Brazil had emerged as efficient producers of synthetic textiles, footwear, automobile components and simpler consumer products; they also moved into steel production and shipbuilding (South Korea, for example, developed one of the world's largest shipyards). Advances in transportation and communications, along with an adaptable international financial structure, meant that the manufacture of more and more products could be parceled out around the globe to where they could be produced most efficiently. This growth of multilateral corporations and U.S. foreign subsidiaries adversely affected the U.S. balance-of-payments picture because goods previously manufactured for export now were being produced abroad.

While U.S. domestic industries were ceding some of their power to Japan, Western Europe and, increasingly, to the newly industrialized nations of East Asia and South America, the services sector began to grow. As early as the mid-1950s, the number of American workers employed in the services sector began to exceed those in the blue-collar industries. As a result of this "deindustrialization" process, seven out of every 10 non-agricultural workers in the United States were employed in the services sector in 1983, and the number was expected to grow. "The millions of jobs that are going to be created in this world in the next 20 or 30 years — most of them are going to be in the services area," said Brock, shortly before a November 1982 GATT ministerial meeting that addressed trade in services.

At the same time, the growing participation of the third world nations in the international economy emphasized nations' interdependence. In 1982 alone, the less developed countries (LDCs) bought more than 40 percent of all U.S. exports and more than one-quarter of total exports from the 24 members of the Organization for Economic Cooperation and Development (OECD), a group of Western industrialized nations.

In an article appearing in the Spring 1983 issue of *Foreign Affairs*, Robert B. Reich, professor of business and public policy at Harvard University, described the changes in the world economy confronting the United States in the 1980s. The rapidly industrializing nations had become major producers of complex products such as automobiles, color televisions and small computers. At the same time, some of the less developed countries began to take over production of clothing, footwear



and small electronics.

Robots and computers were substituting for semiskilled labor in many countries; as a result, Japan, West Germany, France and other highly industrialized countries began to emphasize production of exports requiring highly skilled labor, such as precision castings, specialty steel, special chemicals and sensors and large-scale integrated circuits. *(For a further discussion, see Chapters 6 and 10.)*

One result of these changes was that governments were working with labor to shift their countries' economic base to products in which they had an international trade advantage. At the same time, they selectively raised entry barriers, reduced production costs, retrained workers and provided investment incentives for development of new industries. The dilemma for the United States was how to fashion a policy that preserved jobs while changing to more efficient production techniques in sectors of the economy where it had a competitive advantage on the world market.

Competition From Japan

Responding to the fall in the volume of world trade and the rise in protectionist sentiment among U.S. trading partners in the 1980s, Reagan administration officials — notably Trade Representative Brock and Commerce Secretary Malcolm Baldrige — began to call for strengthening U.S. and international trade rules. Although GATT had been largely successful in reducing import quotas and tariffs, by the 1980s a number of potentially explosive trade disputes had developed, particularly among the United States, Japan, Western Europe and Canada.

With the contraction of economic growth and exports brought on by the global recession, numerous conflicts erupted among the principal trading blocs, which were locked in increasingly fierce competition to maintain their overseas markets while protecting their domestic ones. Japan, the strongest of these, enjoyed a surplus of nearly $30 billion in 1982 in its trade with the United States and the EEC (also called the European Common Market). It was an embarrassment of riches for Japan, which was accused by its trading partners of building its surplus by unfairly excluding many of their goods from the Japanese market.

The Japanese Ministry of International Trade and Industry maintained that the trade imbalance was due to factors other than tariffs or nontariff barriers (such as import quotas and stiff quality-control standards). It pointed out that the Japanese economy also was troubled by rising unemployment and a slowdown of its basic industries, including steel and autos. Japan's exports in fact fell by more than 13 percent in the second half of 1982. Officials in Tokyo, fearing isolation by Japan's