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U.S. Trade Policy and Changing Domestic and Foreign Priorities: A Historical Overview

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Summary

U.S. trade policy involves actions that influence the flow and composition of goods, services, and investments. Resting at the intersection of domestic and foreign policy, trade policy seeks to promote both domestic and foreign policy objectives, economic as well as political. Viewed in historical perspective, foreign policy priorities have dominated U.S. trade policy decisions over long periods of time; conversely, domestic policy priorities have held sway in other eras. In today's post 9/11 world, foreign policy and national security priorities may be gaining increased prominence, although many interest groups and Members of Congress can be expected to push the Bush Administration also to support policies that more directly benefit domestic economic and political interests. This report will be updated as events warrant.

Unique Aspects of U.S. Trade Policy

U.S. trade policy involves government measures that affect the direction and composition of imports, exports, and investments across borders. These interventions can take the form of tariffs, quotas, and subsidies, which serve as distortions to trade. Or they can take the form of negotiations that seek to free up trade and investment flows.

Trade policies provide a means for achieving important domestic and foreign policy objectives. Virtually every major foreign trade decision affects both domestic and foreign economic and political interests. These interests may be described as follows:

- *Domestic political* interests involve responsiveness of democratic institutions and leaders to organized interest groups which may seek to achieve a broad array of political, social, and economic outcomes through trade policy decisions.
- *Domestic economic* interests entail the effects of trade policy decisions on the overall domestic economy in terms of GNP growth, inflation, and employment, as well as on the health and vitality of specific regions, industries, workers, and communities that may have divergent, if not competing, interests;

- *Foreign economic* interests involve the support of a rules-based and non-discriminatory open world trade system that over time promotes global prosperity and stability but in the short-run may be costly to maintain; *and*
- *Foreign political* interests entail the pursuit of foreign policy and national security goals including alliances with friendly countries, which can be solidified by trade policies.

Due largely to changing internal and external factors, there has been a long history where the general thrust of U.S. trade policy has vascillated from emphasizing either domestic or foreign policy goals. A division of U.S. trade history into five broad eras — 1765-1815, 1815-1934, 1934-1962, 1962- 2001, and post 9/11 — illustrates this point. While the boundary lines between these periods are somewhat arbitrary, and exceptions to the general characterization of each period can be found, examinations of them in a trade context can prove illustrative.[1]

Trade policy in the first period (1765-1820) aimed predominantly at establishing nationhood and sovereignty, which are major foreign policy objectives. In the second period (1815-1934) the main orientation of trade policy was on the sale of U.S. products abroad and protection of U.S. industry, primary domestic objectives. In the third period (1934-1962), trade policy emphasized creating a non-discriminatory and open world trading system as well as other foreign policy objectives. In the fourth period (1962-2001), trade policy tilted increasingly towards achieving domestic economic objectives such as protecting U.S. workers and firms from fair and unfair import competition and providing U.S. exporters with equal opportunities to sell in foreign markets. Propelled by the concerns of the fight against terrorism, a new post 9/11 trade policy era may be developing where U.S. priorities again tilt back towards foreign policy and national security concerns. A brief summary of these eras and trends follows.

1765 -1820: Independence and Nationhood

Trade policy played an important role in promoting both independence and full recognition of the United States as a sovereign nation. The initial use of trade as an instrument to achieve foreign policy objectives began when the colonists boycotted British goods to protest the British-imposed taxes imposed by the Stamp Act of 1765 and Townsend Acts of 1767. Massachusetts acted first to boycott most British goods and other colonies soon followed. By cutting British exports to the colonies in half, the boycott helped persuade the British government to rescind the taxes.

In the first half of the 1770s, the colonists again used boycotts of British goods as a response to import duties imposed on tea. King George III refused to budge on the tax despite pleas from merchants, fighting ensued in 1775, and the colonies eventually won their independence in part over an issue of trade policy and who should determine it.[2]

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[1] Richard N. Cooper, "Trade Policy as Foreign Policy," In Stern, Robert M, *U.S. Trade Policies in a Changing World Economy*, MIT Press, 1989, p. 292.

[2] Richard N. Cooper, "Trade Policy as Foreign Policy," pp. 293-294.

Trade policy continued to be used or proposed as a means to achieve foreign policy objectives during the next several decades after independence. Boycotts, partial or total, of British goods were used or advocated to support post-revolutionary France in its struggle with England in 1789 and again in 1810 against Britain and France to induce them to lift their blockades against neutral ships.

1815-1934: Promoting Exports and Restricting Imports

Over the next hundred years, U.S. trade policy was driven almost exclusively by domestic economic and political interests. These included using higher tariffs to protect infant U.S. industries from European competitors and expanding U.S. exports. In pursuit of the latter objective, a main orientation of U.S. foreign policy was to open up foreign markets for U.S. exports. U.S. actions to open up Japan in the 1850s, and support for the "open door" policy in China in the later part of the 19th Century can be viewed in large part as efforts to expand markets for U.S. exports.

The trend towards higher average tariff levels during this period can be explained by two factors. The first was a fiscal consideration that tariff collections accounted for a significant proportion (as high as 40 percent) of total federal revenues. (The income tax was not enacted until 1918). The second was due to the responsiveness of lawmakers to demands from industrialists for protection from import competition. Absent a theory about the damage protection could yield, as well as absence of concern about the impact of U.S. trade barriers on U.S. foreign interests, protection from foreign competition during this period was considered a right to which all interests were entitled, not an exception to established policy.[3]

The nineteenth century pattern of treating tariffs as a domestic policy issue, however, was shaken in 1930 as a result of the passage of the Smoot-Hawley Tariff Act. Setting the average U.S. tariff at an all-time high of over 55 percent, the act contributed to the world depression and precipitated retaliation from U.S. trade partners. By 1932, U.S. exports and imports had plunged by nearly 70 percent. The results ultimately contributed to a major shift away from a preoccupation with domestic economic and political considerations in the making of U.S. trade policy.[4]

1934-1962: Dominance of Foreign Economic Objectives

In response to the deleterious consequences of the Smoot-Hawley tariff and heavy lobbying by Secretary of State Cordell Hull, Congress in 1934 passed the Reciprocal Trade Agreements Act (RTAA). Under this three page law, Congress delegated to the executive branch authority to enact reductions of up to 50 percent in U.S. tariffs provided that foreign countries reciprocated in turn. The RTAA not only created a new congressional-executive branch relationship for making trade policy, it also established a new philosophical framework. This approach rested on the notion that (1) U.S.

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[3] Cohen, Stephen D., Joel Paul, and Robert Blecker, *Fundamentals of U.S. Foreign Trade Policy*, Westview Press, 1996, pp. 27-31.

[4] Schwab, Susan C. *Trade-Offs: Negotiating the Omnibus Trade and Competitiveness Act*, Harvard Business School Press, 1994, p. pp.21-22.

prosperity depended on access to foreign markets, not on tariff protection; and (2) that increased trade and interdependence were building blocks for world peace, because increased trade in the long run would enhance living standards and help reduce the economic dissatisfaction that can breed war.[5]

The end of World War II, which reduced much of Europe and Asia to political disarray and economic devastation, provided a test for the new trade policy. Questions of war and peace and the need for U.S. allies to become economically prosperous assumed great urgency, particularly with the advent of the Cold War. Toward this end, domestic policy concerns associated with U.S. trade policy decisions came to be increasingly subordinated to foreign policy concerns.

In addition to economic aid, U.S. trade policy was used to bolster the economies of Europe and much of Asia and integrate them into a rules-based and nondiscriminatory international economic system organized under the newly created General Agreement on Tariffs and Trade (GATT). During the first decade of the GATT trading system (1948-1958), U.S. policymakers actively encouraged imports and did little to promote U.S. exports. And export controls were employed to restrict commerce with communist bloc countries, especially to limit their access to technologies with military applications.

Given that the United States emerged after World War II with a predominant economic position, many observers argued that Washington could afford to be altruistic on a global scale. However, as the economies of Europe and Japan recovered in the 1950s and 1960s, U.S. firms and workers began to experience much more competition at home and abroad. Accordingly, the U.S. private sector began complaining about a U.S. trade orientation that sacrificed domestic interests for foreign policy advantage.[6]

1962-2002: Tilt Back Towards Domestic Priorities

The end of the trade policy era dominated by foreign policy objectives was signaled by several events. Retrospectively, one could see the seeds of change in the 1962 Trade Expansion Act. In this legislation, which authorized U.S. participation in what became known as the Kennedy Round of trade negotiations, Congress took an initial step in making U.S. trade policy more attentive to domestic interests. Propelled by growing dissatisfaction in the private sector about the dominance of foreign policy considerations in trade policy, Congress relieved the Department of State of its lead negotiating responsibility on trade issues, and created the position of the Special Trade Representative (STR) - the precursor of the Office of the United States Trade Representative.

A more definitive shift occurred in August 1971. In that month, with an overvalued dollar contributing to a rapid decline in U.S. trade surpluses, President Nixon took the world by surprise by acting to reduce the value of the dollar. He did this by suspending the U.S. obligation to support the value of its currency by selling gold reserves on demand and by imposing a "temporary" 10 percent surcharge on all imports. The effect was to

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[5] Raymond J. Ahearn. "Political Determinants of U.S. Trade Policy," *ORBIS,* Summer 1982, pp. 413-429.

[6] Stephen D. Cohen, et. al. *Fundamentals of U.S. Foreign Trade Policy,* p.35.

end a U.S. postwar policy of altruism that, in part, accepted that U.S. products would be sold at a disadvantage because of unfair exchange rates.

In the 1970s and 1980s, with the U.S. economy becoming increasingly exposed to trade and foreign competition, particularly from Japan and the new Asian tigers, the U.S. trade policymaking pendulum began swinging even more towards domestic priorities and interests. In the 1974 Trade Act, Congress began to use trade policy to cushion the decline of weak industries by encouraging favorable findings in import relief cases. In the early 1980s, legislative emphasis switched to opening foreign markets for U.S. exporters as an alternative to closing U.S. markets to imports. This movement for greater reciprocity in U.S. trade relations was marked by the creation of various statutory processes that forced the executive branch to systematically address and redress the extent to which foreign unfair trading practices were burdening U.S. commerce. In addition, Congress began to keep the executive branch on a shorter leash — provision of tightly defined goals and consultations- in order to insure that trade negotiations were not used as an instrument of foreign policy.[7]

This is not to say that the United States did not use trade for foreign policy purposes during this period. The U.S. denial of most-favored-nation-treatment to communist countries, often combined with export controls or embargoes, and preferential agreements such as the Generalized System of Preferences, the Caribbean Basin Initiative, and the U.S.-Israeli free trade agreement are all examples of the use of trade policy to achieve foreign policy objectives. But they were pursued against a backdrop of growing emphasis, particularly in Congress, on domestic considerations.

With the fall of the Berlin Wall, a major constraint on elevating domestic economic objectives was lifted. While the Cold War tended to provide the United States, Europe, and Japan an overriding rationale to compromise on economic issues in order to maintain a grand anti-Soviet alliance, the disappearance of a common enemy opened opportunities for all countries to more aggressively promote domestic economic objectives.[8]

Post 9/11: A Tilt Towards National Security Priorities?

The events of September 11, 2001 may have set the stage for trade to be utilized more extensively as an instrument of U.S. foreign and national security policy. In a speech delivered 10 days before the opening of the WTO trade ministerial in Doha, Qatar to launch new global trade negotiations, U.S. Trade Representative Robert Zoellick explained how a successful meeting was necessary in the fight against terrorism.[9]

> The events of September 11 have set the stage for our work.... Just as our Cold War strategy recognized the interconnection of security and economics, so must America's strategy against terrorism. By promoting the WTO's agenda ... these 142 nations can counter the revulsive destructionism of terrorism.

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[7] Stephen D. Cohen, et. al. pp. 36-39.

[8] Destler, I.M. *American Trade Politics,* Institute for International Economics, 1995, p. 62.

[9] Robert B. Zoellick, "The WTO and New Global Trade Negotiations: What's At Stake?" Speech delivered at the Council on Foreign Relations, Washington, D.C. October 30, 2001.

The Administration's effort to link the need for a successful Doha Round with the fight against terrorism was widely credited with facilitating the launch of global negotiations. National security and associated concerns helped to provide an overriding need for agreement and consensus to be reached.

Subsequently, the Bush Administration has staked out a larger role for foreign policy considerations in the choice of potential free trade agreement partners. In a May 8, 2003 speech, USTR Zoellick stated that countries seeking free trade agreements with the United States must, at a minimum, cooperate with the United States on its foreign policy and national security goals.[10] Accordingly, some of the countries that backed the U.S.-led invasion of Iraq or supported the war on terrorism — such as Australia, Bahrain, Dominican Republic, several Central American countries, Morocco, and Thailand — have been rewarded with designation as a free trade negotiating partner. Others that have not shown similar support for U.S. foreign policy goals, such as New Zealand and many Caribbean countries, have been ignored.[11]

This explicit foreign policy test has raised concerns in both Congress and the business community that future free trade agreements could come at the expense of U.S. economic interests. Specifically, some have questioned whether the administration's decision to negotiate agreements with Morocco and Bahrain, countries that have small markets but are on the front line in the war against terrorism, could come at the expense of countries such as Taiwan and Egypt that are more commercially significant markets.[12]

There are also concerns about subordinating U.S. economic interests to broad foreign policy concerns regarding relations with Japan and China. With security objectives of coaxing China to keep North Korea from going nuclear and getting Japan to commit troops and money to Iraq, some argue that the administration has elected not to pressure these countries to accept a rise in the value of their currencies against the dollar - a change that could help reduce the U.S. trade deficit with these countries.[13]

While security considerations appear to be playing a larger role in U.S. trade policy decision making since 9/11, there are also numerous counter-examples — such as the imposition of steel tariffs and passage of the Farm Bill in 2002 — where domestic economic and political concerns appeared paramount. Whether the war against terrorism leads to a new and consistent pattern of trade policy decisions remains uncertain. Congress, with constitutional responsibility "to regulate foreign commerce" is bound to play a major role in determining how the balance between domestic and foreign priorities is struck.

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[10] *Inside U.S. Trade,*"Zoellick Says FTA Candidates Must Support U.S. Foreign Policy," May 16, 2003.

[11] *Financial Times,* "Strains Show in U.S.-Caribbean Relations," October 23, 2003, p.2.

[12] *Inside U.S. Trade,* "Business Treads Carefully In Assessment of Administration Trade Policy," June 30, 2003.

[13] C. Fred Bergsten, "Muzzling Our Economic Negotiators," Washington Post, September 10, 2003, p. A19.