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Volume Author/Editor: Douglas A. Irwin

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Chapter Author(s): Douglas A. Irwin

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## New Order and New Stresses, 1950–1979

Although average tariffs fell sharply during and after World War II, the economic destruction in Europe and Asia due to the war meant that most domestic firms were not threatened by foreign competition. By the mid-1960s, however, Western Europe and Japan had rebuilt their industries to the point where they could pose a challenge to American producers. By the 1970s, other countries in Asia, such as Taiwan and South Korea, had begun to export labor-intensive manufactured goods as well. These developments ushered in a difficult and prolonged period of adjustment for American manufacturers and sparked a widespread backlash against imports, although multilateral negotiations to reduce tariffs continued in the 1960s and 1970s. The growing pressures of foreign competition strained and even reversed old partisan divisions over trade: many Democratic constituencies were now harmed by imports, while Republican constituencies stood to benefit from expanding exports.

### TRADE POLICY BECALMED IN THE 1950S

After an intense period of activity from 1945 to 1947, the political energy devoted to trade policy dissipated over the next decade. The International Trade Organization, as we have seen, generated no enthusiasm at home and died in 1950. The remainder of the decade saw few new trade-policy initiatives being undertaken. Under largely divided government, Congress repeatedly but grudgingly renewed the RTAA.

The lull in trade policy cannot be attributed only to divided government itself, which in the past had been responsible for political gridlock. Rather, even when the government was unified under the Democrats (1951–52) or the Republicans (1953–54), Congress proved more reluctant to

grant trade-negotiating powers than in the past. Furthermore, the president and executive branch officials did not make a compelling case for further efforts to reduce trade barriers.<sup>1</sup>

The trade policy stalemate of the 1950s owed less to differences between the parties than to dissension within each party. The Republicans were divided between internationalists like President Dwight Eisenhower, who supported increased world trade, and conservative economic nationalists in Congress, who were concerned about the potential harm to domestic industries. The once-united Democrats also became increasingly divided over trade policy as the long-standing position of southern Democrats in favor of lower tariffs weakened. As a result, trade policy fell into a holding pattern with no major effort to break out of the status quo.<sup>2</sup>

For example, President Truman requested a three-year renewal of the RTAA in 1951. The Democrats controlled Congress, and passage of the extension should have presented no problem. On the House floor, Richard Simpson (R-PA) reintroduced the peril point provision, as might be expected from a Pennsylvania Republican. But unlike the result in 1949, when the Democrats easily defeated a similar amendment, the House approved it by a vote of 225–168; Republicans voted 184–5 for the amendment, and Democrats voted 162–41 against, but so many Democrats broke ranks that the peril points provision was kept in the renewal. The defectors were led by southerners, comprising twenty-seven of the forty-one Democrats who voted with the Republicans.

The Senate Finance Committee dealt a further blow to the president's request by retaining the House's peril points provision and voting for a two-year extension instead of three. In signing the RTAA renewal, Truman lamented the inclusion of the "cumbersome and superfluous" peril points provision, this time inserted by his own party. He also warned that the "danger of reverting to product-by-product legislation in the field of tariffs is obvious," a reference to the attempt to insert special provisions for particular industries.<sup>3</sup> As Wilkinson (1960, 65–66) concluded, "If the legislation of 1945 represented the zenith of the Trade Agreements Program, the Extension Act of 1951 was certainly the nadir."

The 1951 vote signaled a historic shift in the political economy of US trade policy. For nearly two centuries, the South had been the bedrock of the low-tariff, anti-protectionist force in Congress. This was no longer the case, because the export-oriented interests of cotton and tobacco had weakened, while the import-competing interests of cotton textiles had strengthened.

As late as 1929, cotton was still the largest single export, accounting

for 15 percent of total US exports. But the introduction of agricultural price supports in the 1930s ensured that farmers would receive a guaranteed price, regardless of how much they exported. The price support was set so high that domestic cotton was often priced out of the world market, and exports fell off considerably. As a result, cotton producers looked to Washington, not to world markets, for the income they would receive for their crops. "We no longer farm in Mississippi cotton-fields," the novelist William Faulkner put it. "We farm now in Washington corridors and Congressional committee-rooms."<sup>4</sup> Severing the link between cotton production and the world market made cotton producers less interested in promoting exports by reducing import tariffs.

As government stockpiles of cotton grew, the Agriculture Department introduced an export subsidy to dispose of the surplus. The subsidy created an even greater gap between the domestic and world price of cotton. Somewhat perversely, the United States had to impose an import quota to support the high domestic price and prevent cotton purchasers (textile and apparel firms) from importing cotton—sometimes the very US cotton that had been exported because of the subsidy—at the lower world price.<sup>5</sup> The Agricultural Adjustment Act of 1948 extended price supports to other commodities, such as milk, peanuts, and potatoes, and soon import quotas on those goods were necessary as well. Thus, agricultural price supports not only weakened an important, export-oriented lobby group, but created new demands to limit imports.

A second important factor in changing the trade-policy views of southern members of Congress was the migration of cotton textile production from New England to the South.<sup>6</sup> The spread of electricity meant that textile mills no longer needed to be located near waterways to generate power, freeing the industry from its original sites near rivers in New England. Because wages for unskilled workers were much lower than elsewhere in the country, the South began to attract investment in textiles and apparel and other unskilled, labor-intensive industries. Prior to World War I, about two-thirds of textile production was located in the North. By 1947, as figure 11.1 shows, more than three-quarters of textile production was in the South. Of course, unskilled, labor-intensive industries were precisely the ones in the United States that were vulnerable to foreign competition. The textile and apparel industry had never been a major exporter and had always faced competition from imports, originally from Britain in the nineteenth century and now increasingly from low-wage countries in East Asia, such as Japan.

These developments eroded the long-standing support of southern

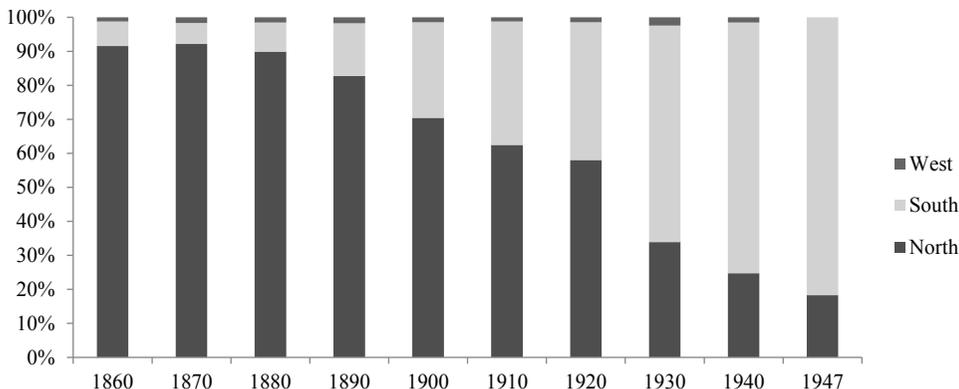


Figure 11.1. Distribution of cotton textile production, by region.  
(US Bureau of the Census, *Census of Manufactures*, various years.)

Democrats for lower tariffs and gave representatives from the region a much greater stake in protecting the industry from imports. In 1955, Senator Strom Thurmond (D-SC) argued that Congress should no longer consider legislation that might result in further tariff reductions, a remarkable statement coming from a representative of a state that once almost seceded from the Union because of protective tariffs. The change in the South's interests made votes on trade bills much more difficult for the Democrats. Northern Democrats continued to be as sensitive to import-competing industries as they had been in the past, including coal from Pennsylvania, textiles, paper, and watches from New England, and chemicals from New Jersey. Meanwhile, Republicans from the North and West remained split between the Old Guard economic nationalists and the new internationalists, who rejected protectionism and isolationism. As a result of these intra-party splits, the traditional partisan divisions over trade policy became blurred in the 1950s.

Domestic political factors were also important in the 1951 vote. With the economies of Western Europe on the road to recovery and the threat of Communism having receded, the foreign-policy rationale for a more liberal trade policy was not nearly as strong in the early 1950s as it had been in the late 1940s. This is not to say that trade policy had become delinked from foreign policy; national security continued to significantly affect congressional voting on trade throughout the 1950s.<sup>7</sup> Had there been no foreign-policy case for maintaining open trade policies, a gradual slide back to more protected markets for certain commodities might have become more pronounced. But as foreign economic policy became less of

an urgent priority, purely domestic factors once again began intruding on trade policy: support for open trade policies became more tentative, and extensions of presidential negotiating authority included more conditions and additional safeguards for import-competing producers.

The election of 1952 gave the Republicans unified control of government for the first time since the Hoover administration. Had the Republican party not adjusted its position on the RTAA in the 1940s, this political swing could have marked a big reversal on trade policy. The party's official position was now one of accepting the RTAA, but pressing harder for "the elimination of discriminatory practices against our exports" and providing more safeguards for domestic industries.<sup>8</sup> Of course, the party was split between conservatives who were dismayed by the loss of protection under the trade agreements program and internationalists who supported open trade and feared the spread of Communism in Europe.<sup>9</sup> In his memoirs, President Dwight Eisenhower (1963, 195) recalled that some congressional Republicans, including Senate Majority Leader Robert Taft (R-OH) and Senate Finance Committee Chair Eugene Millikin (R-CO), "were unhappy with the Trade Agreements Act, and a few even hoped we could restore the Smoot-Hawley Tariff Act, a move which I knew would be ruinous." Coming from the more liberal, internationalist wing of the party, Eisenhower wanted to continue promoting trade, in opposition to the more conservative members of his party. The party split prevented any new initiatives from being launched, but also ruled out any reversal of the tariff reductions that had taken place.<sup>10</sup>

Even before Eisenhower had a chance to make any proposals regarding trade policy, congressional Republicans moved ahead with legislation of their own. Robert Simpson (R-PA) introduced a measure to increase tariffs, impose new import quotas, and give greater powers to the Tariff Commission. To head off the bill, the president had little choice but to delay and compromise. In early 1953, Eisenhower requested a one-year renewal of the RTAA as an interim step, "pending completion of a thorough and comprehensive reexamination of the economic foreign policy of the United States."<sup>11</sup> Despite the lobbying efforts by coal, lead, zinc, and other import-sensitive sectors, Congress defeated the Simpson bill and extended negotiating authority for a single year in exchange for Eisenhower's pledge not to negotiate any new trade agreements. Although neither party seriously considered terminating the trade agreements program or reversing the existing tariff reductions, most Republicans in Congress were content to keep trade policy in an extended hiatus.

As promised, the Eisenhower administration established the Commis-

sion on Foreign Economic Policy to make recommendations about the future of US trade policy. In its February 1954 report, the Randall Commission, as it was known, failed to reach any startling conclusions. The report called for the swift termination of grant-based economic aid, a further increase in two-way trade with Europe to close the remaining "dollar gap," and the rapid convertibility of European currencies into dollars. The report stated that "the nations of the free world would be stronger and more cohesive if many of the existing barriers to the exchange of their goods were reduced, if unnecessary uncertainties and delays caused by such barriers were eliminated, and if adequate international arrangements for discussing and finding solutions to their common trade problems were developed and maintained."<sup>12</sup> The commission called for giving the president new authority to renegotiate the GATT and seek its eventual approval by Congress.

However, the commission was also divided and could not speak with one voice. Three conservative Republicans—Eugene Millikin of Colorado, Daniel Reed of New York, and Richard Simpson of Pennsylvania—dissented from many of the report's recommendations. They argued that the RTAA, if extended at all, should be continued for just two more years, with strengthened administrative procedures to allow any industry harmed by imports to receive an upward tariff adjustment.

In March 1954, a month after the commission issued its report, Eisenhower requested a three-year renewal of the RTAA, complete with peril points and the escape clause, as well as added authority to cut tariffs on specific items by up to 15 percent. The president argued that this would help achieve four interrelated objectives: "aid, which we wish to curtail; investment, which we wish to encourage; convertibility, which we wish to facilitate; and trade, which we wish to expand."<sup>13</sup> The Republican Congress balked at this request, citing other pressing business and, for the second year in a row, approved just a one-year extension of the RTAA as an interim measure.

Eisenhower had only slightly better luck in obtaining trade authority in 1955, because the 1954 midterm elections gave the Democrats a majority in Congress. At least on trade matters, the Republican president had more success working with the Democratic Congress from 1955–60 than with the Republican Congress in 1953–54. The Democratic leadership supported Eisenhower's request for negotiating authority for three years. The House leadership tried to ensure its passage with a closed rule to prevent any amendments, but so many members wanted the chance to slip special-interest provisions into the bill that the closure rule was voted

down. This prompted Speaker Sam Rayburn (D-TX), as he had done at critical moments in the past, to leave his chair and speak from the floor. He warned that "The House on this last vote has done a most unusual thing and under the circumstances a very dangerous thing."<sup>14</sup> With further arm-twisting by the speaker and majority whip, the House reconsidered its action and endorsed by a single vote a closed rule that would limit debate and prohibit amendments from the floor.

The precarious nature of Congress's support for further executive actions on trade policy was exposed again by the narrow defeat of Reed's motion to recommit the House bill by the slim margin of 206–199, with splits in both parties. Democrats voted 140–80 to consider the bill, while Republicans voted 119–66 to send it back to committee. The vote revealed that the House battle was between bipartisan supporters of trade expansion and a group of conservative Republicans and southern Democrats who were opposed.<sup>15</sup>

In the end, Congress approved the 1955 RTAA extension. The negotiating authority allowed the president to reduce tariffs by 15 percent (in three annual installments of 5 percent, thus introducing the idea of phased-in tariff reductions) and to bring down very high tariffs to 50 percent. At the same time, it included statutory language to make the Tariff Commission more inclined to recommend protection in escape-clause cases. The commission only had to find that imports "contribute materially" to the threat of serious injury to recommend tariff remedies to the president, and it was also given authority to block imports that "threaten to impair the national security."

This negotiating authority was put to use in the fourth round of multilateral GATT negotiations in Geneva (1955–56). The Geneva conference resulted in some additional tariff reductions and added several new contracting parties, most importantly Japan.<sup>16</sup> This was controversial because Japan was known to be a potential export powerhouse. Western European countries resisted admitting Japan, fearing the impact of its exports of labor-intensive goods on domestic producers, while the United States insisted on strengthening a key ally in Asia and integrating it into the trade system.<sup>17</sup>

Of course, Japan's accession also generated fears within the US textile and apparel industry. Although overall import penetration was no greater in textiles than for other manufacturing industries in the 1950s, Japan had a tendency to achieve rapid growth in exports of narrow categories of goods, creating problems for certain producers. In the specific case of cotton textiles, for example, imports as a percent of domestic production rose

from less than 3 percent in 1939 to 22 percent by 1958. Prompted by southern Democrats, Congress repeatedly considered legislation or amendments to the RTAA that would protect to the textile and apparel industry. In 1955, the Senate came within two votes of mandating import quotas to assist domestic producers. The Eisenhower administration opposed this effort, but in 1957 Japan agreed to a five-year plan to restrict its exports of cotton textiles. Yet, with a growing number of alternative sources of world supply, country-specific trade restrictions were rendered ineffective: as the share of US cotton textile imports from Japan fell from 63 percent in 1958 to 26 percent in 1960, the share from Hong Kong increased from 14 percent to 28 percent.<sup>18</sup>

At the Geneva meeting, the United States also received a waiver from its GATT obligations regarding its agricultural price supports. The GATT already allowed countries to restrict agricultural imports when they had policies in place to reduce domestic production; the 1955 waiver allowed the United States to restrict imports even when the production or marketing of domestic crops was not being restricted. Other countries followed the United States in obtaining such a waiver, which effectively took agriculture policy outside of GATT disciplines.<sup>19</sup>

The United States missed an opportunity arising from the 1955 Geneva conference to strengthen the institutional foundations of the GATT. The GATT was an executive agreement, not a formal international organization, since it was expected to be superseded by the International Trade Organization. In fact, Congress took pains to signal that it did not necessarily approve of it. Every renewal of negotiating authority during the 1950s—1951, 1953, 1954, 1955, and 1958—included the following disclaimer: “The enactment of this Act shall not be construed to determine or indicate the approval or disapproval by the Congress of the Executive Agreement known as the General Agreement on Tariffs and Trade.”<sup>20</sup>

In March 1955, the contracting parties agreed to set up the Organization for Trade Cooperation (OTC) to administer GATT rules and sponsor international trade negotiations, although it would have no powers over the trade policies of member countries. The next month, President Eisenhower submitted a bill on the OTC to Congress, arguing that “failure to assume membership in the Organization for Trade Cooperation would be interpreted throughout the free world as a lack of genuine interest on the part of this country in the efforts to expand trade.” If the United States did not act to strengthen this institution, the world trading system might erode. “Such developments would play directly into the hands of the Communists,” the president warned. But Congress was wary of the OTC for

the same reason that it did not want to endorse the GATT: it was still skeptical of any executive agreement that might diminish its authority over trade policy. Citing other pressing business, Congress deferred hearings on the bill and then never acted on it.<sup>21</sup>

As multilateral negotiations to further reduce trade barriers were on hold through much of the 1950s, some domestic interests attempted to carve out special pockets of protection with the support of Congress, much as farmers had done with price supports. For example, the petroleum industry repeatedly sought and eventually received government help against imports. The United States had been a net exporter of petroleum before World War II, but expanding production in the Middle East and North Africa depressed the world price, and the United States became a net importer after the war. By the mid-1950s, net imports accounted for more than 10 percent of domestic consumption.<sup>22</sup> The major petroleum producers, such as Standard Oil, Texaco, and Shell, owned vast foreign reserves and had no interest in restricting imports. But small, independent producers in Texas, Oklahoma, and California were not so diversified and suffered from high production costs and idle capacity. They demanded a quota on imports on the grounds that dependence on foreign oil threatened national security.

With the support of coal producers and coal miners in Pennsylvania, Richard Simpson led the charge for an oil-import quota. As gasoline and home heating oil began displacing coal as a source of energy, the National Coal Association and United Mine Workers sought to prop up demand for coal by restricting imports of oil. Thus, the coal states of Kentucky, Pennsylvania, and West Virginia joined with the oil states of Oklahoma, Louisiana, and Texas to support the bid for a quota. Despite his opposition to protection, Eisenhower announced a "voluntary" program of import quotas on oil in 1955 which, not surprisingly, failed. Meanwhile, the Suez Crisis of 1956 disrupted the flow of oil from the Middle East and demonstrated the plausibility of a national-security rationale for standby domestic production capacity. This led to the establishment of a Mandatory Oil Import Quota Program (MOIP) in 1959 that restricted imports of crude oil and refined products to about 12 percent of US production.<sup>23</sup>

The import quota, which was in effect until 1973, had a very important unintended consequence that struck the United States about twenty years later. The MOIP gave preferential treatment to oil imports from Mexico and Canada, but discriminated against imports from Venezuela and the Middle East. These countries responded by forming the Organization of Petroleum Exporting Countries (OPEC) in 1960. Controlling some 80 percent of the oil sold on world markets, OPEC sought to restrict production

and hence increase the world price, which they succeeded in doing in the early 1970s. Thus, the oil-import quota not only led to a more rapid depletion of domestic supply, but helped to spawn the creation of OPEC, thereby contributing to the energy crisis of the 1970s.<sup>24</sup>

The labor movement also began wavering in its support for open trade in the 1950s. After World War II, the sense among major labor unions was that exports sustained more jobs than imports threatened them. The American Federation of Labor and the Congress of Industrial Organizations, which merged in 1955 to become the AFL-CIO, declared their support for gradually lowering trade barriers, provided that adversely affected workers were given adjustment assistance and international fair labor standards were negotiated.<sup>25</sup> By the end of the decade, as imports began to displace workers in the apparel industry (ladies' garment workers, men's clothing workers, textile workers, hatters, and leather goods workers in particular), some unions began to rethink their support for lower tariffs.

Still, with imports stable at less than 3 percent of GDP, protectionist pressures were generally muted through the decade, and new instances of trade protection were rare. The peril points never proved to be much of a hindrance, because multilateral trade negotiations were sporadic and never promised significant changes to existing policy.<sup>26</sup> The escape clause, the main channel for protection, was rarely invoked. From 1947–62, the Tariff Commission conducted 135 escape-clause investigations relating to 106 products. No injury was found in 72 of the 113 completed cases. In the 33 cases in which injury was found, the president accepted 15 and rejected 26.<sup>27</sup> In most instances presidents decided that foreign policy or other interests took priority over stopping injury to the domestic industry, as when President Truman rejected restrictions on garlic imports from Italy. Imports of dried figs, clover seed, women's fur felt hats, watches, bicycles, linen toweling, spring clothespins, safety pins, stainless steel table flatware, lead and zinc, and carpets and rugs were restricted in escape-clause cases, but these goods constituted a tiny fraction of total imports.<sup>28</sup>

Despite the lack of enthusiasm for further trade liberalization in Congress, the political forces in favor of open trade easily sustained the status quo in the 1950s. Although export-oriented interests still influenced votes in favor of liberal trade, the RTAA survived partly due to the linkage of trade policy to foreign policy and national security.<sup>29</sup> Even if members of Congress did not have many strong, export-oriented interests in their constituencies, most were satisfied with existing policy for those broader reasons. In particular, Republicans were sympathetic to the view that freer world trade was an important part of the fight against Communism. As

Eisenhower put it in his 1955 State of the Union message, "We must expand international trade and investment and assist friendly nations whose own best efforts are still insufficient to provide the strength essential to the security of the free world."<sup>30</sup> In a study of Congressional voting patterns in the 1950s, Bailey (2003) reported evidence "consistent with the view that the American people cared deeply about the Soviet threat and were willing to support politicians who pursued even difficult aid and trade policies that furthered national security goals." If public opinion had not been so favorable to supporting foreign allies, the RTAA renewals in 1955 and 1958 would have failed to pass, according to his findings.

### THE CHALLENGE OF THE EUROPEAN ECONOMIC COMMUNITY

As a forum for negotiating the reduction of trade barriers, the GATT was relatively quiet during the 1950s. Congress's reluctance to allow the president to undertake new negotiations was matched by Europe's reluctance to reduce trade barriers when it was still struggling to cope with economic dislocations after the war. The United States strongly encouraged efforts by Western European nations to expand trade with each other in order to promote their economic recovery and wean them off foreign aid. In 1949, looking to the eventual end of financial assistance, the US administrator of the Marshall Plan insisted on the integration of the Western European economy.<sup>31</sup>

To this end, Western European governments worked out programs to restore the multilateral payments system and move toward freer trade in Europe. The European Payments Union was formed to end bilateral trade balancing and help finance trade flows across Europe, a step toward full currency convertibility (in which European currencies could be freely bought and sold for purposes of trade). The members of the Organization for European Economic Cooperation (a forerunner of the Organization for Economic Cooperation and Development, or OECD) agreed to a Code of Trade Liberalization under which increasing shares of their imports would be freed from quantitative restrictions and foreign-exchange controls. Having survived the economic difficulties of the immediate postwar years, Western Europe was soon rapidly recovering from the war, and import quotas and other policies that discriminated against dollar imports were quickly dismantled in 1955 and 1956. In 1958, remaining exchange controls were lifted, and European currencies became freely convertible into dollars for current account transactions.

The capstone of these efforts was the Treaty of Rome, signed in 1957 by six countries: Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands. They agreed to form the European Economic Community (EEC) and create a Common Market. The EEC was a customs union, whereby member countries abolished all tariffs on trade between them and maintained a common external tariff on goods from nonmembers. In addition, seven other nations—Britain, Sweden, Norway, Denmark, Switzerland, Austria, and Portugal—established the European Free Trade Association (EFTA), wherein member countries abolished all tariffs on trade between them but kept their own independent tariffs on goods from nonmembers. The EEC and EFTA were cooperative, not competing, trade arrangements with the potential to create a large free-trade zone within Europe.

The formation of the EEC and EFTA posed a dilemma for US policymakers. The United States supported European economic cooperation in the belief that trade expansion would promote economic growth, foster political stability, and check Soviet expansionism. As much as it desired these outcomes, however, the United States did not want Western Europe to form a separate trade bloc that would have an adverse effect on its exports. For example, since West Germany's goods would receive duty-free treatment in France, while US goods would be subject to the EEC tariff, the level of the external tariff would determine the degree of discrimination against American goods.

Concerns about the adverse impact of the EEC on US exports made the 1958 renewal of the RTAA much easier than in previous years. Eisenhower requested a five-year renewal of trade-negotiating authority and the ability to reduce tariffs by 25 percent from their current levels. Given the difficulties that trade legislation had earlier in the decade, Speaker Sam Rayburn thought it would take "blood, sweat, and tears" to get the package through Congress, but he was wrong. The business community was energized by the formation of the EEC and demanded government action against European preferences, and members of Congress responded. Although the negotiating authority was extended for four years, not the five requested, it was still the longest extension ever. And although the tariff-cutting authority was pared back from 25 percent to 20 percent, larger reductions in duties greater than 50 percent were permitted. In contrast to previous years, the administration was successful in its request because the negotiating authority had a clear and distinct purpose: helping to minimize the impact on US exports when tariffs on trade within Western Europe were eliminated.

The 1958 RTAA renewal put the United States in a strong position to bargain for a reduction in the EEC's tariff. The first stage of the negotiations (1960–61) addressed the conformity of the EEC with the provisions of the GATT and the level of its proposed external tariff. A customs union invariably departs from the most-favored nation (MFN) treatment established in article 1 of the GATT because it discriminates in the tariff treatment of imports from member and nonmember states. But article 23 of the GATT permitted customs unions if two requirements were met. First, import duties and other restrictive regulations of commerce must be "eliminated with respect to substantially all trade between the constituent territories of the union." Second, the external tariff "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union."<sup>32</sup> On the basis of the second condition, the United States insisted that the EEC establish a low tariff, but the EEC countered that any concessions given on its tariff had to be reciprocated by other countries.

In the second phase of the negotiations, from 1961–62, known as the Dillon Round, the United States and Europe discussed tariff reductions.<sup>33</sup> The EEC offered to cut its tariffs on industrial goods by 20 percent, although it refused to consider agricultural duties while it was formulating a Common Agricultural Policy. But the United States was unable to respond effectively to this offer. Negotiators could not match the 20 percent offer for fear of violating the peril points provision; although that provision constituted no real legislative constraint, there would be a political cost to going beyond it. In addition, the State Department was still required to negotiate on a selective, product-by-product basis and was not authorized to undertake across-the-board tariff reductions.

The Dillon Round ended shortly before the president's trade-negotiating authority expired in June 1962. The tariff reductions amounted to only a 4 percent weighted average cut, insufficient to reduce the margin of preference given to European goods and thereby leaving the problem for American exporters unresolved.

#### THE TRADE EXPANSION ACT OF 1962

The election of John F. Kennedy as president in 1960 restored unified government under the Democrats. Coming from Massachusetts, with its declining textile industry, Kennedy was not naturally predisposed to promote further trade liberalization. In fact, he made a campaign prom-

ise to help protect industries troubled by imports. At the same time, the new president was firmly committed to strengthening ties with Western Europe and preventing any disintegration of the Atlantic alliance.<sup>34</sup> Furthermore, policymakers and exporters continued to worry about trade diversion resulting from the formation of the EEC. They also worried about investment diversion: if American businesses found it more difficult to export to Europe, they might shift some of their investment spending from the United States to Europe in order to reach consumers behind the EEC's tariff. Thus, the Kennedy administration united the foreign-policy objective of strengthening the Atlantic alliance with the economic objective of minimizing Europe's discrimination against American exports in pressing forward with a revitalized trade program.

With trade-negotiating authority expiring in mid-1962, the new administration had the option of choosing a simple renewal of the RTAA or proposing something bolder. At the urging of Undersecretary of State George Ball, Kennedy decided to revise the trade agreements program in light of the disappointing Dillon Round. The RTAA "must not simply be renewed, it must be replaced," the president was to argue.

In January 1962, Kennedy unveiled his administration's proposal to revamp the trade agreements program. The primary rationale for the Trade Expansion Act was to promote the strength and unity of the Western alliance. "The two great Atlantic markets will either grow together or they will grow apart," the president said, and "that decision will either mark the beginning of a new chapter in the alliance of these nations—or a threat to the growth of Western unity." Kennedy argued that the new legislation was critical for five reasons: to respond to the challenge of the EEC, to reverse the deterioration in the balance of payments, to boost economic growth, to counter Communist efforts at capturing a greater share of world trade, and to promote the integration of Japan and other developing countries into the world trading system. The president emphasized that congressional support should be bipartisan: "This philosophy of the free market—the wider economic choice for men and nations—is as old as freedom itself. It is not a partisan philosophy. For many years our trade legislation has enjoyed bipartisan backing from those members of both parties who recognized how essential trade is to our basic security abroad and our economic health at home. This is even more true today. The Trade Expansion Act of 1962 is designed as the expression of a nation, not of any single faction, not of any single faction or section."<sup>35</sup>

The Kennedy administration's proposal built on past practice but was new on several dimensions. The president requested the authority to make

across-the-board tariff reductions of up to 50 percent, thereby abandoning the bilateral product-by-product negotiating approach that had been used since 1934. In addition, peril points were to be scrapped, and the Tariff Commission was required simply to advise the president on the broader economic effects of tariff reductions, clearing the way for more significant cuts.

The administration also proposed a new way of helping workers harmed by imports. Rather than limit imports through the escape clause, direct government aid in the form of trade adjustment assistance (TAA) would be provided to workers and communities adversely affected by imports. TAA included income support, relocation benefits, training assistance, and other financial compensation for displaced workers. The program helped win the support of George Meany, the president of the AFL-CIO, for the legislation.<sup>36</sup> Kennedy also proposed tightening the eligibility requirements in escape-clause cases; now a prolonged shutdown of production facilities or unemployment caused by imports had to affect an entire industry, not just one product in an industry.

These features marked a bold change from the traditional RTAA approach. The original goal of the RTAA was to eliminate the excessive tariffs in the Hawley-Smoot schedule in exchange for tariff concessions by other countries. In this incarnation, the RTAA aimed to reduce tariffs on a selective basis and thereby avoid harm to domestic interests, although the escape clause was included to allow tariffs to be raised temporarily when "unforeseen developments" resulted in injury to an industry. With the abandonment of the selective approach, the proposed legislation explicitly recognized that some domestic interests would be harmed by tariff reductions and that the remedy should not be import restrictions but direct government assistance. This assistance was designed to promote the adjustment of labor and capital to the new competitive conditions and to help workers find employment in other sectors of the economy. As Undersecretary of State Ball put it, "The concept that we must protect every American industry against the adjustments required by competition is alien to the spirit of our economy."<sup>37</sup> The end of peril points also signaled a recognition that figuring out which particular tariff level might bring "harm" to an industry was impossible to determine.

The Kennedy administration was so politically shrewd in selling this package to Congress that its legislative proposal passed largely intact. The administration organized a nationwide campaign to enlist business support with the rallying cry "trade or fade." As in the past, a number of broad coalitions (both industry and labor groups) testified before Congressional

committees in favor of the new negotiating authority, while many smaller business interests spoke against it. Stimulated by the emergence of the EEC, a large number of corporate executives and exporter groups testified in favor of negotiations in 1958 and 1962, many more than in the early and mid-1950s. The National Association of Manufacturers, American Farm Bureau Federation, and other umbrella organizations supported the bill because their constituents were worried about European discrimination against their products.<sup>38</sup>

The Kennedy administration also managed to neutralize the opposition of import-sensitive industries so that they would not campaign against the legislation. For example, the biggest obstacle to the legislation was expected to be the textile bloc of roughly one hundred members from the Northeast and South who would fight any proposal that might harm the textile and apparel industry. To win votes in the South during the 1960 election campaign, Kennedy promised to help textile producers. Shortly after taking office, Kennedy announced a seven-point program to assist the industry, including a conference of textile importing and exporting countries to discuss managing trade in textile products.<sup>39</sup>

Responsibility for negotiating the agreement fell to Undersecretary of State George Ball. It was not a task that he and other liberals relished. As Ball (1982, 188) recalled, "During his Presidential campaign, [Kennedy] had committed himself to taking care of textile import problems, and the industry promptly demanded that he redeem his promise. The President turned the problem over to me. It caused me more personal anguish than any other task I undertook during my total of twelve years in different branches of the government." Ball fundamentally opposed protecting the industry and could not understand why domestic producers did not invest abroad to take advantage of lower wages in Asia: "Rather than concentrating 1.3 percent of our labor force on the production of textiles, our country might have shifted more rapidly to the capital-intensive and knowledge-intensive industries and services that befitted a nation with an advanced economy" (188).

Despite his personal views, Ball carried out the president's wishes and thereby prevented the industry from opposing the administration's trade plan. In July 1961, the State Department helped conclude the Short-Term Arrangement (STA) on cotton textiles with other importers (the EEC, Britain, and Canada) and exporters (Japan, Hong Kong, India). The exporters agreed to set quantitative limits (in essence, export quotas) on their textile shipments for one year. In February 1962, a five-year Long-Term Arrangement (LTA) was concluded. The LTA capped the rate of growth of exports

of cotton textiles and expanded the number of products covered to include wool, man-made fibers, and silk products as well. The LTA involved nineteen countries and stipulated a minimum annual growth in quotas of 5 percent. It also introduced the concept of "market disruption," in which a sharp increase in imports would be enough to trigger additional limits on imports, even if injury was not proven, as would be required in an escape-clause case. The LTA was renewed in 1967 and expanded to include many other exporters and products.

Advocates of a liberal trade policy, including Ball, viewed the textile quotas—which, alongside import quotas on agricultural goods, was the most glaring retreat from the principles of the trade agreements program since its inception—as a very high price to pay for the passage of the Trade Expansion Act. Still, the quotas served a political purpose. The LTA was so successful in satisfying the demands of the textile and apparel industry that it actually won the support of the American Cotton Manufacturers Institute (ACMI) for the bill. At its annual meeting, the directors of the AMCI expressed their thanks to the Kennedy administration for its "unprecedented degree of thoughtful consideration" and stated, "We believe that the authority to deal with foreign nations proposed by the President will be wisely exercised and should be granted by the Congress."<sup>40</sup>

To build further support for (or prevent opposition to) the bill, Kennedy made implicit promises to help the lumber and oil industries. In March 1962, the president accepted the Tariff Commission's recommendation for relief in two escape-clause cases, significantly increasing import duties on woven carpets and flat glass. This decision was perfectly timed to coincide with the Ways and Means Committee hearings on the Trade Expansion Act (TEA). Although the legislative package proposed by the Kennedy administration was initially greeted with skepticism by the committee's chairman, Wilbur Mills (D-AR), the escape-clause action helped win his support.

As if to demonstrate the need for a new trade agreement with Europe, several trans-Atlantic trade disputes broke out at this time, the most famous being the "chicken war."<sup>41</sup> In July 1962, the EEC introduced a variable import levy on foreign poultry as part of its new Common Agricultural Policy. The levy roughly doubled the previous duty of about 15 percent and reduced US poultry exports by two-thirds within a few weeks. After eighteen months of fruitless negotiation, the United States retaliated by imposing higher duties (technically, withdrawing tariff concessions from previous GATT negotiations) on potato starch, dextrin, brandy, and light trucks that were imported primarily from Western Europe. The higher

tariffs on the first three goods were eventually lifted, but the 25 percent tariff on light trucks has persisted to this day. All of this showed to policy-makers at the time the dangers of a retaliatory trade war if countries began to impose trade restrictions and depart from GATT principles.

The mobilization of business support, the pacification of potential opponents, and the growing risk of a trade war with Europe greatly eased the bill's passage through Congress, although Finger and Harrison (1996, 217) note that "Kennedy was criticized by members of his own party for the mercenary way in which he put together the votes needed to pass the TEA." Public opinion was also broadly supportive of the legislation. A March 1962 Gallup poll suggested that, of those who had heard of the Kennedy plan, 38 percent favored lower tariffs, 15 percent favored higher tariffs, 18 percent wanted them kept about the same, and 29 percent expressed no opinion. However, just 13 percent of those questioned were familiar with the details of the legislation.<sup>42</sup>

Of course, legislators adjusted the bill somewhat to their own liking. The Ways and Means Committee stripped control of the trade negotiations from the State Department and created the ambassador-ranked position of Special Trade Representative in the Executive Office of the President to conduct foreign trade negotiations. This reflected Congress's growing belief that trade policy and foreign policy should be undertaken by separate entities. Legislators had long-standing concerns that the State Department was too focused on diplomatic objectives and therefore too weak in representing the country's commercial interests. Even strong supporters of lower trade barriers, such as Paul Douglas, a Democratic Senator from Illinois and former economics professor at the University of Chicago who had co-organized the economists' petition against the Hawley-Smoot tariff in 1930, wanted the change. Douglas was appalled at the State Department's indifference to foreign discrimination against American exports, particularly through the use of non-tariff barriers.<sup>43</sup> Douglas advocated taking a stronger stand against countries that so brazenly blocked American exports.<sup>44</sup>

In June 1962, the House passed the Trade Expansion Act by an overwhelming margin, 298-125. Democrats voted 218-35 in favor, while Republicans voted 90-80 against. The Republican split was due largely to its traditional concerns about the potential harm to import-competing industries and the substitution of trade adjustment assistance for trade remedies such as peril points and the escape clause. In September, the Senate easily passed the legislation by the margin of 78-8; Democrats voted 56-1, and Republicans voted 22-2 in favor.

This Senate vote marked a major shift in how Congress passed trade

legislation. At least since the Civil War, the majority leadership in the House was able to enforce rules restricting amendments and limiting the floor debate so that a party-line vote—usually with strict party discipline and few defectors—was the outcome. As a result, the House vote was usually a predictable win for the majority party. The problem always came in the Senate, where party discipline was weak, and members could propose amendment after amendment to hold up passage. For this reason, the Senate became known as the “graveyard” of tariff reform for Democrats and the source of the logrolling problem for Republicans, as demonstrated in 1929–30. Now, starting in 1962, party discipline in the House was weakening, as the rank-and-file members felt they could disregard the party’s whips if a particular vote might harm their chances for reelection. The result was more party defections and increased difficulty in passing controversial trade legislation. Meanwhile, Senate votes on trade issues were becoming more bipartisan and more internationalist because fears about reelection were less pressing. The ease with which the Senate was able to pass controversial trade legislation became particularly evident from the 1970s onward: the hard, close trade votes were now in the House, not the Senate, where support for trade agreements and negotiating authority became much more predictable.

In signing the bill in October 1962, Kennedy hailed the legislation: “We cannot protect our economy by stagnating behind tariff walls, but . . . the best protection possible is a mutual lowering of tariff barriers among friendly nations so that all may benefit from a free flow of goods. Increased economic activity resulting from increased trade will provide more job opportunities for our workers.” He also emphasized the foreign-policy rationale for the bill: “A vital expanding economy in the free world is a strong counter to the threat of the world Communist movement,” and trade expansion is “an important new weapon to advance the cause of freedom.”<sup>45</sup> Over the next half century, presidents of both parties would consistently invoke these two themes—creating jobs at home and fostering a freer world abroad—in pushing for new trade agreements.

The Trade Expansion Act ended the trade-policy drift of the 1950s and paved the way for the Kennedy Round of GATT negotiations. “By permitting the reduction of American tariffs to very low levels and making possible the Kennedy Round, [the Trade Expansion Act] marked a major turn away from a course that was otherwise coming close to stopping the process of American trade liberalization altogether,” Diebold (1999, 268) observed. “And that would have been tantamount to setting back the liberalization of the global trading system as well.”

## THE KENNEDY ROUND AND CONGRESSIONAL BACKLASH

The sixth round of multilateral trade negotiations among the contracting parties of the GATT got off to a slow start. After months of preparatory work, the Kennedy Round negotiations finally began in Geneva in May 1964 with the participation of forty-six countries. The main goal of the United States was to reduce the EEC's external tariff in order to cut the margin of preference given to European firms and against American firms selling in the Common Market. The main goal of the EEC was to address the high spikes in the US tariff schedule, but also modify various objectionable policies, such as the American Selling Price (which applied the US price in assessing duties on imported goods), the Buy America Act (which gave preferences to domestic firms in government procurement contracts), and the escape clause (which they feared would close the market to their goods).

Compared with previous multilateral negotiations, the Kennedy Round was prolonged and difficult, taking three years before finally concluding in June 1967. About half of 1965 was lost when the EEC was unable to participate due to a dispute between France and its partners about negotiating objectives. By early 1966, little progress had been made. The talks might have continued indefinitely had the president's negotiating authority not been due to expire in 1967. In addition, the number of participants in the negotiation had grown. The number of contracting parties to the GATT had risen from the original twenty-three to more than seventy by the conclusion of the Kennedy Round. However, the negotiations were still primarily between the United States and the EEC, with Japan and Britain also playing an important role; developing countries did not participate in the tariff negotiations.

The first battle concerned the precise formulae to be used for reducing tariffs. When the United States proposed a uniform 50 percent reduction in tariffs, with limited exceptions, the EEC objected, arguing that some peaks would remain very high in the US tariff schedule, while its own would be at a uniformly low rate. The EEC suggested lowering tariffs to some target level, such as 10 percent for manufactures, 5 percent for semi-manufactures, and zero for raw materials. In the end, the EEC accepted the US position that all parties attempt to reduce tariffs uniformly, with some exceptions.

The United States also insisted that agricultural goods be subject to the same liberalization as industrial goods, but the EEC refused to agree.

"Because of the powerful agricultural protectionism in the Common Market, it was obvious that we would not get all the concessions we wanted for American agriculture," President Lyndon Johnson (1971, 312) recalled in his memoirs. "The question was whether we should accept what we could get, plus a major liberalization of trade in industrial products, or abandon the effort."<sup>46</sup>

In May 1967, after reviewing the final package item by item in the Cabinet Room, Johnson's advisers unanimously endorsed the agreement, and the president agreed. Top officials in the Johnson administration then briefed the congressional leadership and reported that "the questioning was keen and specific, but the general results favorable." As Johnson (1971, 313) noted,

As expected, members of Congress paid closest attention to items of concern to their own states and districts. Speaker McCormack, whose home state of Massachusetts manufactures shoes, asked about increased shoe imports under the new agreement. Senator Robert Byrd of West Virginia asked about glass imports. Senator Herman Talmadge of Georgia worried about textiles and farm products. Senator George Aiken of Vermont wondered whether maple sugar sales to Canada would be affected. One sweeping question was in many minds, and it was eventually asked by Senator John Patore of Rhode Island: Had we lost our shirt in our eagerness to make the Kennedy Round a success?

Johnson (1971, 314) believed that "we had bargained hard and patiently," but recognized that members of Congress "would soon hear complaints from nervous special-interest groups back home, though they probably would hear little from the vast majority of constituents who would benefit from the trade agreement."

On June 30, 1967, just a few hours before the president's negotiating power was due to expire, Ambassador Michael Blumenthal, the deputy trade representative, signed the Kennedy Round agreement for the United States. The primary accomplishment of the round was the reduction of tariffs on industrial products by about 35 percent, on average. Table 11.1 shows the average tariff rates in the United States, EEC, United Kingdom, and Japan before and after the round. The largest cuts were in machinery, transportation equipment, and chemicals, with smaller cuts in iron and steel. The duties on textiles and woolen goods were largely exempt from any reduction. The lower duties went into effect by executive order and were phased in over five years, starting in 1968 and finishing in 1972.

TABLE 11.1. Average tariff on dutiable imports: Pre- and post-Kennedy Round (non-agricultural, dutiable imports, other than mineral fuels), percentage

	Before Kennedy Round	After Kennedy Round
United States	13.5	9.6
EEC	12.8	8.1
United Kingdom	16.6	10.6
Japan	15.5	9.5

Source: Preeg 1970, 208-11.

In addition, the Kennedy Round negotiations reached several "codes" on non-tariff barriers to trade. The United States agreed to abolish the American Selling Price (ASP), which was a way of raising the effective tariff (mainly on chemicals) by using the domestic price rather than the foreign price as the way of valuing imports. A new antidumping code required a change in US law: dumped imports had to be the "principal cause" of material injury, whereas the existing US law had no injury requirement.

Despite its support for the Trade Expansion Act, Congress did not welcome the results of the negotiation. A major complaint about the Kennedy Round was its failure to deal with agriculture, particularly the adverse effects of the EEC's Common Agricultural Policy on US farm exports. The negotiation was also believed to have inadequately addressed non-tariff barriers against American exports while further opening up the US market to imports. In 1966, before the round had been completed, Sen. Everett Dirksen (R-IL) complained that "the United States appears intent upon concluding an agreement which will not repair the damage to our farmers, while inflicting new damage upon manufacturing. . . . It looks very much as though we are offering to give them [other countries] our shirt in exchange for a handkerchief."<sup>47</sup> Congress was also dismayed by the drafting of codes that would standardize antidumping regulations and abolish the ASP. Thus, within the executive branch, Evans (1971, 299) notes, "The euphoria generated by the successful conclusion of the Kennedy Round in the summer of 1967 was short-lived, and was soon replaced by serious doubts that the agreement could withstand the forces being mobilized against it."

Although the Kennedy Round tariff reductions went into effect by executive order, Congress needed to approve other elements of the deal. In the spring of 1968, President Johnson requested that Congress abolish the ASP, approve the antidumping agreement, and grant new tariff-cutting au-

thority, which had expired in late 1967. The Ways and Means Committee hearings on this proposal went poorly: rather than endorsing the administration's request, representatives of the textile, footwear, steel, and oil industries called for import quotas. With a presidential election on the horizon, Congress ignored Johnson's request and did not act on the ASP and antidumping codes. This was a harbinger of difficult years ahead for trade policy. Although the strong economy and a low rate of unemployment had kept trade politics in abeyance during most of the 1950s and 1960s, higher inflation and unemployment, along with growing balance of payments problems, were around the corner. Indeed, America's position in the world economy was about to change in a way that would put existing policies under enormous stress.<sup>48</sup>

The presidential election campaign of 1968 was dominated by a debate over domestic affairs and the Vietnam War, but trade policy was not entirely neglected. The Democrats pledged to build upon the Trade Expansion Act "in order to achieve greater trade cooperation and progress toward freer international trade."<sup>49</sup> By contrast, the Republicans promised a tougher approach, including "hard-headed bargaining to lower the non-tariff barriers against American exports." While offering "to work toward freer trade among all nations of the free world," Republicans also underscored the problems caused by imports:

A sudden influx of imports can endanger many industries. These problems, differing in each industry, must be considered case by case. Our guideline will be fairness for both producers and workers, without foreclosing imports. Thousands of jobs have been lost to foreign producers because of discriminatory and unfair trade practices. The State Department must give closest attention to the development of agreements with exporting nations to bring about fair competition. Imports should not be permitted to capture excessive portions of the American market but should, through international agreements, be able to participate in the growth of consumption. Should such efforts fail, specific counter-measures will have to be applied until fair competition is re-established.<sup>50</sup>

The Republican platform was widely interpreted as endorsing "fair trade" as an objective of trade policy. The statement was prescient in describing the major concerns of US trade policy over the next two decades.

Just as Kennedy had in 1960, the new Republican president, Richard

Nixon, was willing to use trade policy for electoral purposes. During the campaign, Nixon openly courted import-affected workers in an attempt to win the endorsement of organized labor in the North and textile workers in the South. When campaigning in the Carolinas, Nixon promised to reinforce the Kennedy administration's limits on textile imports to cover woolen and synthetic fabrics in addition to cotton products.<sup>51</sup>

After winning the election, Nixon made good on his pledge by seeking to expand restrictions on Japan's textile exports to include the rapidly growing category of man-made fibers, such as polyesters, acrylics, and nylons. Even though imports of man-made fibers constituted less than 4 percent of domestic production, domestic producers strongly supported further limits on imports.<sup>52</sup> In November 1969, Nixon and Japan's prime minister reached a secret agreement whereby the United States would return the island of Okinawa in exchange for tighter limits on textile exports. Believing it had solved the textile problem, the Nixon administration submitted a bill to Congress asking for a four-year authorization to reduce import tariffs up to 20 percent from 1967 levels, including the power to eliminate the ASP. It also proposed strengthening executive powers to retaliate against foreign unfair trade practices and expanding government aid to industries and workers harmed by trade by easing the statutory requirements for import relief and adjustment assistance.

In taking up the administration's proposals in early 1970, the chairman of the House Ways and Means Committee, Wilbur Mills (D-AR), took the unusual step of adding a provision to impose quotas on imported textiles and shoes. Though Mills favored free trade in principle, he thought this provision would improve his own political fortunes as well as give the Nixon administration negotiating leverage to secure a more effective textile agreement with Japan. In fact, by early 1970, it was clear that Japan's prime minister could not persuade other government officials or industry executives to enforce the new export restraints.<sup>53</sup> And Mills's strategy did not work: Japan refused to make further concessions, and Nixon threatened to veto the measure if it imposed limits on imports other than textiles, such as shoes.

Mills also lost control of the bill. The Ways and Means Committee added a provision imposing quotas on every imported good whose share of the US market exceeded 15 percent. Although this provision was later dropped, the House passed the bill in November 1970 with quotas on textiles, apparel, and footwear that would limit imports by category and country of origin to their average level of 1967–69, allowing no more than

a 5 percent annual increase thereafter.<sup>54</sup> The Mills bill passed by a 215–165 vote, with both parties split over the measure. Democrats were divided geographically: Southern Democrats strongly supported it by 70–11, while Northern Democrats went 72–67 against it. Meanwhile, Republicans were narrowly opposed by 82–78. The vote marked an important change: for the first time, Democrats were supporting greater protection for domestic industry, and Republicans were opposed. In addition, the old North-South division over trade that held from the early nineteenth century until at least the 1930s had dissolved. As figure 11.2 shows, a new geographic pattern was evident in which the South and Northeast were largely in favor of import restrictions, and the West was largely opposed.

The Mills bill died when Congress adjourned before the Senate could act on the measure. This marked the end of an extreme trade measure that would have imposed significant trade barriers for manufacturing industries affected by imports, something not seen since the days of the Hawley-Smoot tariff. Although it almost certainly would have drawn a presidential veto, the unexpected popularity of the Mills bill was an indicator of growing protectionist pressures. After forty years of Congressional support for open trade policies, the ground was shifting in US trade politics.

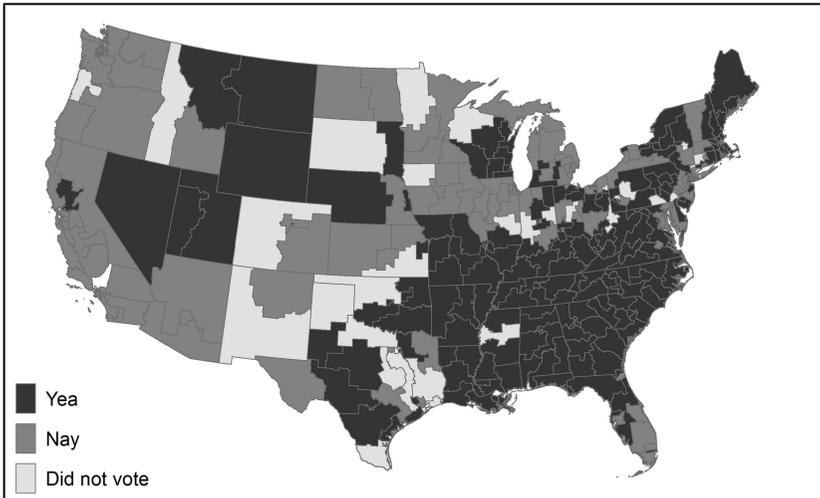


Figure 11.2. House vote on Mills bill, November 19, 1970. (Map courtesy Citrin GIS/Applied Spatial Analysis Lab, Dartmouth College.)

## A NEW WORLD FOR US TRADE POLICY

What was happening to make Congress adopt a more protectionist outlook? Ever since the Reciprocal Trade Agreements Act in 1934, Congress had taken a step back from active control over trade policy. Although it refused to endorse the International Trade Organization in the 1940s and other trade initiatives in the 1950s, Congress had accepted most executive branch actions on trade policy. The Mills bill of 1970 represented a reassertion of congressional authority to regulate trade and threatened a significant departure from the trade policies established after World War II. This change reflected an important new development: some domestic industries were now facing much greater foreign competition than they had seen in many decades, if ever. Trade politics was about to become much more difficult simply because imports were starting to play a much larger role in the economy. After World War II, imports were less than 3 percent of GDP, an unusually low level in historical terms. Because the economic recovery of Western Europe and Japan from the war had taken so long, imports as a share of GDP were no higher in 1965 than they had been in 1950. Starting in the mid-1960s, however, imports began to rise while exports remained at about the same proportion of GDP.

The rise in imports might have been anticipated as other countries recovered from the war, but it nonetheless came as a surprise to industry leaders and policymakers. In 1950, the United States accounted for 27 percent of world GDP and 23 percent of world exports. By 1973, the US share of world GDP had fallen to 22 percent, and its share of world trade to 16 percent.<sup>55</sup> The US share of world exports of manufactured goods declined from 25 percent in 1960 to 19 percent in 1972. Thanks to their strong economic recovery, Europe and Japan began to make their presence felt in world markets, which was interpreted by many as a worrisome decline in US competitiveness. In reality, this was simply a return to normal conditions of competition. The immediate postwar position of the US economy as the world's sole industrial power was unsustainable. That the growing economic strength of Europe and Asia was not only inevitable but desirable did not make the experience any less painful for some domestic producers. Having grown accustomed to operating in a world without serious foreign competition, many industries and their workers were now forced to adapt to a new situation.

Aside from the postwar economic boom, another factor behind the expansion in world trade was the container revolution. Introduced in the mid-1960s, the container streamlined the process of loading and unload-

ing cargo and dramatically reduced the costs of shipping goods. "Before containerization, international trade was extremely expensive: crating, insuring, transporting, loading, unloading, and storing goods being exported often cost 25 percent or more of the value of goods," Levinson (2006b, 49–50) notes. "By making goods transportation drastically cheaper, containerization allowed manufacturers, wholesalers, and retailers to stretch their supply chains around the world with little concern for the expense of transporting inputs and finished products." One study found that, starting in the early 1970s, containerization increased trade among developed countries by about 17 percent and, with a 10–15 year lag, increased trade among all countries (including developing) by about 14 percent.<sup>56</sup>

The impact of the container on New York City was particularly striking. The share of containers in shipping entering the port of New York rose from 6 percent in 1960 to 31 percent in 1970. The use of containers led to a huge improvement in port efficiency and a steep decline in port-related employment. The container played a key role in the dramatic collapse of the industrial base around New York City between 1967 and 1975, when the city lost a quarter of its factories and a third of its manufacturing jobs, particularly in garments and apparel.<sup>57</sup>

Yet another factor behind the growth in imports was that tariffs were relatively low and still falling. For nearly twenty years, from the early 1950s until the late 1960s, the average tariff on dutiable imports was roughly unchanged at about 12 percent. As a result of the Kennedy Round and import-price inflation, the average tariff was cut in half to about 6 percent by 1975.<sup>58</sup> While this decline in tariffs certainly encouraged more imports, it was not the primary factor behind the growth of imports. Regardless of any changes in US policy, the enormous expansion of production in Europe and Asia and improvements in transportation efficiency were responsible for bringing more imports into the domestic market.

To many observers, the most visible manifestation of the country's loss of international competitiveness was the erosion of the US trade surplus during the 1960s. The merchandise trade surplus shrank over the decade, and in 1971, the United States was poised to run its first trade deficit since the 1930s. The export surplus of the immediate postwar period, which policymakers said needed to be maintained to support jobs and also justified reducing trade barriers, had disappeared. Government support for exports had also shrunk over this period. In 1960, about 13 percent of US exports received government financing through loans and grants, foreign agricultural assistance under Public Law 480, and military grant aid; by 1977, that figure had shrunk to just 1.5 percent.<sup>59</sup>

Which sectors of the economy were the most vulnerable to foreign competition? Compared to other countries, the United States had always been a high-wage economy, and therefore it was no surprise that unskilled, labor-intensive industries were among the first segments of American manufacturing to feel the pain of greater foreign competition. The textile and apparel industry was particularly vulnerable because production was very labor-intensive and based on standardized technology. The share of imports in domestic consumption rose steadily over the postwar period. The industry had tremendous political clout: it employed 2.3 million workers in 1967, almost 12 percent of total manufacturing employment, most of which was concentrated in the South. The textile and apparel industry had successfully persuaded the Eisenhower and Kennedy administrations to force Japan into limiting its clothing exports when this competition emerged in the mid-1950s. The footwear industry was in a similar situation, facing intensified foreign competition, but it failed in repeated attempts to get similar trade restrictions because it employed fewer workers and was less regionally concentrated.

Labor-intensive industries were not the only segments of manufacturing that began to have problems with imports. Highly concentrated, capital-intensive industries, often with strong labor unions, also ran into difficulties. The steel industry was first on this list. As we have seen in earlier chapters, the steel industry had been a powerful force for protective tariffs in the nineteenth century, but had become internationally competitive around the turn of the century. However, domestic production was highly concentrated among a small number of imperfectly competitive producers. They had the power to set prices, accommodate union demands for higher wages, and pass those costs onto consumers with little fear of foreign competition.<sup>60</sup>

The steel industry's trade problems began at the end of the 1950s. In July 1959, the United Steel Workers shut down domestic production for 116 days, the longest industrial strike in the nation's history. During the strike, steel-consuming industries, such as construction and automobiles, desperately sought alternative sources of supply and turned to imported steel. In 1959, for the first time in the twentieth century, imports of steel exceeded exports. Imports jumped from 1.5 percent of domestic consumption in 1957 to 6.1 percent in 1959.

The lesson that management took from the costly shutdown was that labor peace had to be purchased with generous wage concessions in order to keep factories running and prevent consumers from buying foreign steel. By the mid-1970s, average wages in the steel industry were more

than 70 percent higher than the average wage in manufacturing; by the early 1980s, this premium had risen to 95 percent.<sup>61</sup> While the generous wage settlements pacified the steel workers, it also saddled the firms with high labor costs that did not reflect underlying improvements in labor productivity. While the steel industry was able to pass along higher wages to steel consumers in the absence of foreign competition, this was no longer feasible when consumers had access to a growing number of foreign suppliers.

Meanwhile, steel production capacity steadily grew in Japan and Germany. The United States accounted for 53 percent of world steel production in 1950, but just 21 percent in 1970. In itself, this decline did not indicate any failure by the industry, because maintaining such a high share of world production would have been unrealistic; the earlier share reflected the artificial distribution of production capacity immediately after the war. But the rise of foreign competition exposed the lack of robust domestic competition that allowed high-cost firms to survive, as well as poor choices in technology.

Burdened with inflated costs, domestic producers began to price themselves out of the market and lose market share to foreign steel. Import penetration rose from less than 5 percent in 1960 to about 15 percent in 1970, as shown in figure 11.3. The steel industry and its workers had a huge stake in arresting this growth in imports. Management wanted to prevent foreign competition from undermining profitability, while workers wanted to preserve their high wages and current employment levels. As a result, the industry demanded protection from imports. In late 1967, Senator Vance Hartke (D-IN) introduced legislation to limit steel imports to 9.6 percent of the domestic market. To discourage such legislation, the Johnson administration welcomed an offer from Japan and Germany to cap their steel exports. In the resulting voluntary restraint agreements (VRAs), Japan and the EEC agreed to hold their steel exports to 5.8 million tons each, down from 7.5 million tons for Japan and 7.3 million tons for the EEC, with 5 percent growth each subsequent year. The VRAs were in effect for three years (from 1969 to 1971) and were later renewed for another three years (until 1974). Though the volume of steel imports fell, foreign producers upgraded the quality of their exports to higher value stainless and alloy steel products, so the overall value of imports did not fall. Furthermore, Japan believed that some categories of steel (fabricated structural steel and cold finished bars) were not covered by the agreement and those exports were not restricted.

This steel action, preceded by the Long-Term Arrangement on trade in

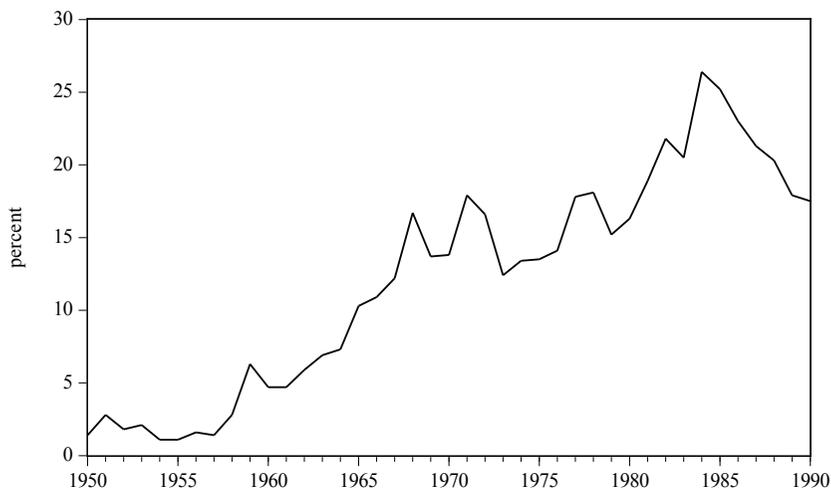


Figure 11.3. Imports as a share of domestic consumption: Steel, 1950–1990. (American Iron and Steel Institute, *Annual Statistical Report*, various years; measured by volume [net tons].)

cotton textiles negotiated by the Kennedy administration in 1962, was just the tip of the growing protectionist iceberg that was developed over the next two decades. For the next twenty years, the same scenario would repeat itself time and again: as import penetration would rise, producers and workers would complain, Congress would consider legislation mandating a sharp cutback in imports, and the executive branch would negotiate “voluntary” export restrictions with other countries to manage the situation.

As policymakers in the executive branch and Congress sought to understand and cope with the new global environment, the early 1970s became a period of trade-policy turmoil. The sense that America’s position in the world economy was under threat was reflected in a report by the president’s Commission on International Trade and Investment Policy (the Williams Commission) released in July 1971. The report (1971, 1–3) began by stating, “The world has changed radically from the one we knew after World War II. At the conclusion of World War II, the United States emerged, alone among the major industrial countries, with its production capacity and technological base not only intact, but strengthened. We did not have to worry about our competitive position in the world. The main limitation on our exports was the ‘dollar shortage’ of our trading partners.” As a result, the United States took a leadership role and assumed responsibility for the economic support and defense of the non-Communist world.

Now, however, there was “new mood” in the United States and a “de-

veloping crisis of confidence in the system." The report noted that this was reflected in

mounting pressures in the United States for import restrictions as foreign-made textiles, clothing, shoes, steel, electronic products, and automobiles penetrate our market; growing demands for retaliation against foreign measures which place American agricultural and other products at a disadvantage in markets abroad; a growing concern in this country that the United States has not received full value for the tariff concessions made over the years because foreign countries have found other ways, besides tariffs, of impeding our access to their markets; labor's contention that our corporations, through their operations abroad, are 'exporting jobs' by giving away the competitive advantage the United States should derive from its superior technology and efficiency; a sense of frustration with our persistent balance-of-payments deficit and a feeling the other countries are not doing their fair share in making the international monetary system work; an increasing concern that the foreign economic policy of our government has given insufficient weight to our economic interests and too much weight to our foreign policy relations, that it is still influenced by a 'Marshall Plan psychology' appropriate to an earlier period.<sup>62</sup>

The Williams Commission called for a "new realism" in trade policy. The American market was generally more open to foreign goods than were the markets of other countries, because the United States supposedly had lower tariffs and maintained fewer non-tariff barriers than its trading partners. Therefore, the report argued, the United States should be more aggressive in demanding that Western Europe and Japan share the responsibility for maintaining the system of open world trade.

The Williams Commission report was released in the midst of a tumultuous year for trade policy. In that year, 1971, the United States recorded its first merchandise trade deficit since 1935. By later standards, the trade deficit was small, and import penetration was miniscule, but this was a new development, and the news triggered alarms about the country's deteriorating competitiveness. In April 1971, Treasury Secretary John Connally stated that the United States was "in bad shape" in world trade, that trade policy needed "a radical change." The country would reach "a point of decision fairly soon on how we are going to proceed in this decade and hereafter," he asserted. "The standard of living in the United States is at stake—no less than that."<sup>63</sup>

The appearance of a trade deficit was far from the only concern as the economy began to falter and the unemployment rate ticked up from 3.5 percent in 1969 to 5.9 percent in 1971. These developments fanned protectionist pressures, and Congress was soon awash with new proposals to limit imports. The most controversial one was the Burke-Hartke bill, named for its legislative sponsors, Rep. James Burke (D-MA) and Sen. Vance Hartke (D-IL). Introduced in late 1971, and like the Mills bill before it, the Burke-Hartke proposal would have created a huge system of government-managed trade on a product-by-product, country-by-country basis. Under the bill, the quantity of imports, by product category and by country, would not be allowed to exceed the average quantity of imports during 1965–69. This would effectively roll back the volume of imports in 1972 by one-third. By one calculation, the reduction in trade would be equivalent to increasing the average tariff on dutiable imports from 6.8 percent to 19.6 percent.<sup>64</sup> Once trade had been cut back to 1965–69 levels, the ratio of imports to domestic production would not have been allowed to grow, effectively freezing import penetration on a product and country basis. A new government agency would be set up to administer the quotas and grant exemptions, as well as tighten the restrictions if imports were “inhibiting” domestic production. The agency would also have the authority to restrict foreign investment and oversee antidumping and escape-clause actions.

The change in view of the principal sponsor of the legislation, James Burke of Massachusetts, reflected the broader political shift on trade. A Democrat, Burke had voted for the Trade Expansion Act of 1962, arguing that trade would create “more jobs, more business and a stronger all-around economy.”<sup>65</sup> Less than a decade later, Burke was in an entirely different camp. This was true for many other Northern Democrats from the manufacturing belt. “Our international trade policies have collapsed, American industries are injured, and six million Americans are unemployed,” Hartke complained. “Yet this administration has no policy to meet this crisis.”<sup>66</sup>

The simultaneous appearance of higher unemployment and a trade deficit led many to attribute job losses to foreign competition. An AFL-CIO report stated that, as a result of growing imports and lagging exports, “between 1966 and 1969 US foreign trade produced the equivalent of a net loss of half a million American jobs.”<sup>67</sup> This widely publicized job-loss figure shifted the trade debate away from foreign-policy goals and improving foreign market access to the counting of domestic jobs gained or lost as a result of trade. A Bureau of Labor Statistics official responded that

“the relationships between domestic employment and import levels are complex” and that “these figures (on jobs and imports) are so hypothetical that any conclusions drawn from them can be misleading or erroneous,” but the union analysis resonated with the public and members of Congress.<sup>68</sup> Later studies showed that job losses were much more closely tied to rising labor productivity and shifts in domestic demand than to declining exports or rising imports. For example, studying nineteen industries from 1963–71, Frank (1977) found that, of the four sectors that experienced declining employment (textiles, apparel, leather products, and fabricated metal products), the rise in net imports was a dominant factor in only one sector (leather products).

At this point, organized labor was more opposed to foreign investment by American companies than to imports. Starting in the late 1960s, companies began shifting labor-intensive assembly operations in the United States to other countries—particularly final stages of the production of apparel and consumer electronics—in order to reduce production costs. For example, in the case of televisions, electronic components would be fabricated in the United States, shipped to Mexico for assembly, and then returned to the United States for final sale. This was encouraged under sections 806.30 and 807 of the US tariff code, which allowed for the duty-free entry of US components sent abroad for further processing or assembly. This provision affected only a small amount of imports, but the offshore assembly provision was an important factor in the overseas relocation of the apparel and electronics industries.

Although it was widely recognized that the off-shoring of labor-intensive assembly operations could reduce costs enough to prevent all production in those industries from moving abroad, organized labor opposed any loss of jobs associated with the multinational relocation of production and assembly.<sup>69</sup> Consequently, it sought in Burke-Hartke the legislative means not just to regulate imports, but also to prevent the relocation of production abroad.<sup>70</sup> It was no secret that organized labor, especially the AFL-CIO, was behind the Burke-Hartke legislation.<sup>71</sup> As a member of the Williams Commission exclaimed, “Labor wants to dismantle the whole goddamned system of international commerce!”<sup>72</sup> Although the labor movement complained more about foreign investment than imports, it was easier to implement policies to reduce imports than to stop foreign investment.

The Burke-Hartke bill was a radical piece of legislation that would have restricted imports based on mandated quantities. It would have completely undermined the postwar trading system based on market compe-

tition and GATT rules on using tariffs instead of quotas. Of course, the Burke-Hartke bill had little chance of being enacted: it was never reported from committee and never came to a vote in the House; it would probably have encountered strong resistance in the Senate, and almost surely would have been vetoed by the president. Still, it was a signal of some of the trade pressures building in the political system.

### THE NIXON SHOCK

One source of the country's growing trade difficulties was the increasing overvaluation of the dollar relative to other foreign currencies. The misalignment of the dollar made US products more expensive relative to foreign products at home and abroad, and reflected structural problems with the fixed exchange-rate system that originated with the Bretton Woods agreement of 1944. The Bretton Woods system formalized the dollar, ostensibly backed by gold reserves, as the world's key reserve currency. The exchange rates between foreign currencies and the dollar were fixed but adjustable with the permission of the International Monetary Fund (IMF).

As we have seen, Europe faced a shortage of dollars after World War II, but by the 1960s the dollar shortage had become a dollar glut. The growing supply of dollars meant that, by the late 1960s, foreign holdings of dollars (nearly \$50 billion) far outstripped US gold reserves (about \$10 billion). The United States could never meet its obligation to exchange gold for dollars if foreign central banks started demanding gold for their dollar reserves.<sup>73</sup>

The United States itself had limited policy options to deal with the situation. Because the dollar was the world's reserve currency and the anchor of the international monetary system, other countries could revalue or devalue their currencies against the dollar, but the United States could not unilaterally devalue the dollar against other currencies. As the US balance of payments position shifted from surplus to deficit, foreign central banks were obligated to purchase excess dollars to maintain the fixed exchange rate and prevent the dollar from depreciating, which partly explains the increase in their official holdings of dollar reserves. European countries and Japan became increasingly concerned about the inflationary impact of their growing dollar reserves. At the same time, they were reluctant to revalue their currencies against the dollar for fear of reducing the growth of their exports, but some began to consider exchanging some of their dollar reserves for American gold.

The Nixon administration viewed the refusal of other countries to revalue their currencies as a betrayal. In its view, the United States had made

enormous efforts to promote the economic recovery of Western Europe and Japan after the war, and now those countries were unwilling to adjust their exchange rates and help the United States because it might jeopardize the competitive position of their export industries. This attitude only reinforced the administration's predilection to "get tough" with foreign allies. As Treasury Secretary John Connally put it, "My philosophy is that the foreigners are out to screw us. Our job is to screw them first."<sup>74</sup>

The United States did not have an exchange-rate problem with all countries. The British pound and French franc were both chronically weak and had been devalued against the dollar in the late 1960s; the United States continued to run trade surpluses with those countries, and their exports did not contribute significantly to protectionist pressures at home. Nor was West Germany viewed as a major problem, because its government, fearing the spillover of inflation from the United States, had revalued the Deutsche mark against the dollar in late 1969. In May 1971, Germany abandoned the fixed rate and allowed the mark to appreciate against the dollar. However, Japan firmly opposed any change in its exchange rate, which had been established at 360 yen per dollar in 1949 and had remained there ever since. The Japanese government was extremely reluctant to do anything that might impede the country's ability to export to the United States. Therefore, from the US perspective, Japan was considered the major obstacle to achieving an appropriate adjustment of the dollar.<sup>75</sup>

Given the protectionist pressures in Congress and the mounting imbalance between US gold reserves and the foreign accumulation of dollars, the Nixon administration began preparing for changes in the international monetary system in 1971. Connally wanted to end the "benign neglect" of the deteriorating balance of payments situation and take control of events to avoid facing a sudden run on US gold reserves by foreign central banks. Connally wanted to close the gold window—that is, suspend the ability of foreign central banks to convert their dollars into gold—at a time of his own choosing rather than being put in the embarrassing position of having to deny foreign official requests for gold. Paul Volcker, the Undersecretary of Treasury for Monetary Affairs, headed an interagency planning group to prepare for this eventuality.

The "Nixon Shock" of August 1971 focused mainly on new domestic policies, particularly the imposition of wage and price controls to reduce inflation, but also international policy due to several events that summer.<sup>76</sup> In May, a Treasury Department study concluded that the dollar was overvalued by 10–15 percent and that a foreign exchange crisis was inevitable.<sup>77</sup> In July, the Williams Commission published its report and

proposed that "if our balance of payments problem persists, and if other countries find a further accumulation of dollars objectionable, the United States should indicate its readiness to adopt a temporary uniform import tax and export subsidy" to force other countries to revalue their currencies.<sup>78</sup> New data was also released that month showing that the United States ran an unexpectedly large trade deficit in June and was on track to have its first annual trade deficit since World War II. These data convinced Treasury officials that the existing dollar parities could not be maintained for much longer.

On Friday, August 6, a report by the Joint Economic Committee of Congress reached the "inescapable conclusion" that "the dollar is overvalued." (Ironically, the report was entitled "Action Now to Strengthen the US Dollar.") The report stated that "dollar overvaluation leads to the perpetuation of US [trade] deficits and thus increases the risk of an international monetary crisis that would break the system apart."<sup>79</sup> That same day, the Treasury also announced that it would sell about \$200 million in gold to France and use nearly \$800 million of foreign exchange to buy back dollars from Belgium and the Netherlands.

These developments contributed to strong selling pressure on the dollar on Monday, August 9. Over the course of that week, foreign central banks intervened massively to support the dollar, buying about \$3.7 billion to prevent their currencies from appreciating. Meeting with the president, Connally proposed closing the gold window and imposing a 10 percent import surcharge. The purpose of the surcharge would be to compel Japan and other countries to revalue their currencies, since they were reluctant to do so voluntarily. The president liked this idea—"the import duty delights me," he said—because it was a way of striking back against other countries and extracting concessions from them.<sup>80</sup>

On Friday afternoon, August 13, Nixon brought a small number of economic advisers and aides to Camp David for a secret meeting to decide what to do. Although Federal Reserve chairman Arthur Burns strongly opposed closing the gold window, everyone else thought that this step was necessary. Connally argued that simply closing the gold window by itself would not necessarily get other countries (Japan) to revalue their currencies and insisted upon the 10 percent import surcharge as a way of forcing them into doing so.<sup>81</sup> He argued that it would be politically popular at home and should remain in effect until new exchange-rate parities were negotiated.<sup>82</sup> The president endorsed the idea, saying that "the border tax is not too damned aggressive, just aggressive enough."<sup>83</sup> When the president asked if other countries could retaliate against the surcharge, he was

told that they could not retaliate under GATT rules if it was imposed for balance of payments purposes, which seemed to clinch the case.

On the evening of Sunday, August 15, President Nixon announced the new policies in a nationally televised speech. Most of the address focused on the domestic economic situation, particularly the decision to impose a ninety-day wage and price freeze and other emergency measures to control inflation. The decision to close the gold window was not described as leading to a devaluation of the dollar, but as a way of improving the competitive position of US manufacturing in the global market. The surcharge was not the main focus of the speech, but was mentioned:

I am taking one further step to protect the dollar, to improve our balance of payments, and to increase jobs for Americans. As a temporary measure, I am today imposing an additional tax of 10 percent on goods imported into the United States. This is a better solution for international trade than direct controls on the amount of imports. This import tax is a temporary action. It isn't directed against any other country. It is an action to make certain that American products will not be at a disadvantage because of unfair exchange rates. When the unfair treatment is ended, the import tax will end as well. As a result of these actions, the product of American labor will be more competitive, and the unfair edge that some of our foreign competition has will be removed. This is a major reason why our trade balance has eroded over the past 15 years<sup>84</sup>

Nixon and Connally were correct in thinking that the import surcharge would be popular: 71 percent of Americans surveyed approved it, while 14 percent disapproved, and 15 percent were unsure, according to one poll.<sup>85</sup>

Having shocked the world with these moves, the Nixon administration insisted that other countries revalue their currencies in exchange for the removal of the surcharge. Connally's opening bid was for a 24 percent revaluation of the yen and an 18 percent revaluation of the mark. This was not a problem for Germany, which had already allowed the mark to appreciate, but Japan resisted the demand.<sup>86</sup> The Nixon shock unleashed massive selling of the dollar on foreign exchange markets, forcing Japan's central bank to intervene massively to prevent the yen from appreciating. On Monday and Tuesday, August 16–17, Japan bought \$1.3 billion to support the dollar and keep the yen at the old rate of ¥360. The volume of trading on foreign-exchange markets eventually proved stronger than the

government's willingness to buy dollars and prevent the appreciation of its currency. By the end of August, Japan's Finance Minister announced that the government would allow the yen to float, although there would be continued government intervention to slow its appreciation.<sup>87</sup>

Although foreign-exchange markets were forcing currencies to deviate from their official parities, foreign governments were still reluctant to agree to a formal change in exchange-rate parities. The surcharge also became an increasing source of international tension. While it had been aimed principally at Japan, the 10 percent surcharge applied to dutiable imports from all countries, including those running trade deficits with the United States. The EEC filed a complaint against the United States in the GATT, and other countries hinted that they might retaliate. By September, there was growing dissension within the Nixon administration, led by National Security adviser Henry Kissinger, about continuing the surcharge.<sup>88</sup> By late November, with Kissinger constantly reminding him of the foreign-policy difficulties caused by the unresolved exchange-rate issue, Nixon began to worry about the political costs of the stalemate and signaled to Connally that he should settle the matter as soon as possible.

The new exchange-rate parities were finally established at a meeting at the Smithsonian Institution in Washington in December. On the first day of the negotiations, the United States asked for 19.2 percent revaluation of the yen and 14 percent for the mark. Germany agreed to a 13.57 percent revaluation of the mark, which put pressure on Japan, because German officials insisted that the yen be revalued by at least 4 percentage points more than the mark, or at least 17.57 percent. Japan's finance minister insisted that the number had to be less than 17 percent, telling the story of the finance minister who was assassinated in 1930 when he revalued the yen by that amount after Japan went back on the gold standard. Connally settled for a 16.9 percent revaluation of the yen. (The finance minister later revealed that he had received permission from the prime minister to revalue the yen by as much as 20 percent.)<sup>89</sup>

President Nixon hailed the Smithsonian agreement as "the most significant monetary agreement in the history of the world."<sup>90</sup> The trade-weighted depreciation of the dollar against major currencies was slightly less than 8 percent, or 12 percent excluding Canada. However, the new parities merely formalized what foreign exchange markets had already established. Two days later the president signed an executive order removing the 10 percent surcharge, which had been in effect for four months. The surcharge only applied to about half of US imports, because it did not apply to duty-free imports (about one-third of total imports) or imports subject

to quantitative restrictions (about 17 percent of dutiable imports, including petroleum, sugar, meat, dairy products, other agricultural imports, and cotton textiles that were covered by the Long-Term Arrangement on textiles). Still, the surcharge is estimated to have reduced affected imports by 6–8 percent, enough to get the attention of other countries.<sup>91</sup>

Despite Nixon's grandiose statement about the Smithsonian agreement, the new exchange rate parities only lasted about a year. In March 1973, more pressure from foreign exchange markets forced governments to give up responsibility for maintaining fixed exchange rates and allow currencies to fluctuate in value, marking the formal end of the Bretton Woods exchange-rate system. The collapse of the fixed exchange-rate regime had important implications for trade policy. In the short run, the depreciation of the dollar against other currencies helped reverse the trade deficit, and the United States recorded merchandise trade surpluses in 1973 and 1975. The depreciation of the dollar also helped ease the protectionist pressures that had been building up in Congress, as reflected in the Mills bill of 1970 and the Burke-Hartke bill of 1971. Volcker (1978–79, 7) later stated, "The conclusion reached by some that the United States shrugged off responsibilities for the dollar and for leadership in preserving an open world order does seem to me a misinterpretation of the facts. . . . The devaluation itself was the strongest argument we had to repel protectionism. The operating premise throughout was that a necessary realignment of exchange rates and other measures consistent with more open trade and open capital markets could accomplish the necessary balance-of-payments adjustment."<sup>92</sup> Indeed, the exchange-rate adjustment helped ensure that Burke-Hartke-type legislation was not reintroduced, and Congress even began considering new legislation to reduce trade barriers.

In the longer run, the ending of the system of fixed exchange rates and the adoption of floating rates permitted countries to relax the controls they maintained on international capital movements. Such controls helped ensure that exchange rates remained fixed, but now they were no longer necessary. The dismantling of capital controls led to an enormous rise in international capital flows and would enable countries to run large current account imbalances in coming years. This led to large exchange-rate movements that would have significant repercussions for trade policy, particularly in the 1980s, as will be seen in chapter 12.

Despite the exchange-rate agreement, Japan continued to be the major focus of trade policymakers. After more than two years of wrangling, the long-standing textile dispute with Japan was finally resolved. The Nixon administration ratcheted up the pressure in September 1971 with an ulti-

matum: either agree to further restraints on textile exports on US terms, or import quotas would be imposed under the emergency authority in the Trading with the Enemy Act of 1917. The threat of using that particular statute to instigate a trade action against an ally was a huge diplomatic slap and persuaded Japan to adopt export restraints on non-cotton goods, such as wool and man-made fibers.<sup>93</sup> Ironically, the export quotas adopted by Japan were never binding, because the country's wages were rising so rapidly due to its strong economic growth that textile production was moving to other lower-wage Asian countries.

The US restrictions on imported textiles had global ramifications. As Asian producers diverted some of their textile exports from the United States to Europe, the EEC sought to protect its own industry from increased imports. American officials welcomed the EEC's participation in the textile agreements, because it seemed to legitimize its own restrictions. In 1974, these countries created a general framework for managing trade in textiles and apparel known as the Multifiber Arrangement (MFA). The MFA constituted a multilateral system of bilateral restraints on trade in textiles and apparel involving eighteen countries and covering about three-fourths of world imports of cotton, wool, and man-made fibers. Informal agreements ("understandings") were reached with ten other exporting countries that restraints might be imposed if their exports grew too rapidly and caused problems for domestic producers. The entire arrangement depended on compromises by both exporters and importers. The importing countries were able to limit foreign exports of man-made and wool fibers (in addition to cotton), while exporters were given fairly high annual growth rates in the bilateral quotas (not less than 6 percent, as opposed to 5 percent in the original LTA with Japan). In addition, exporters benefited from some flexibility in being able to shift exports between years and product categories, so they could carry over unused quotas from the past or borrow from the future.

Thus, what had begun as a "short-term" deal in 1957 between the United States and Japan to regulate trade in cotton textiles had metastasized into an enormously complex, multilateral arrangement covering dozens of countries and many types of fabrics. Of course, the whole managed-trade arrangement was a blatant violation of GATT provisions, since the measures were discriminatory in their application and used quotas and not tariffs to intervene in trade. (Ironically, the MFA was monitored by the Textile Surveillance Body in the GATT.)

The steel industry also got its protection renewed in 1972 when Japan and the EEC agreed to a three-year extension of the VRAs through 1974.

The extension cut export volumes, specified tonnage limits on different categories of steel, and reduced the annual allowable growth rate in those exports. The continuation of limits on imported steel was not tied to any improvement in performance by the domestic industry. Critics charged that the VRAs fostered complacency by domestic producers and allowed workers to bargain for higher wages and benefits.<sup>94</sup>

Although the depreciation of the dollar, the reappearance of a trade surplus in 1973, and the decline in the unemployment rate helped alleviate the sour mood on Capitol Hill regarding trade, the country's sense of vulnerability was shaken with the oil price shock in late 1973. The Organization of Petroleum Exporting Countries (OPEC), formed after the United States imposed an import quota on oil in the late 1950s, imposed an oil embargo on the United States for its support of Israel in the 1973 Arab-Israeli war. The shock severely disrupted the world economy and tipped the United States back into recession. It also had a huge effect on trade: Petroleum imports more than tripled in value in 1974, accounting for a quarter of all imports. While imports doubled as a share of GDP, exports kept pace with the rising imports because of the depreciation of the dollar and rising commodity prices for agricultural exports.

#### THE TRADE ACT OF 1974

The exchange-rate adjustments of the early 1970s, as well as the import limits on textiles, apparel, and steel, helped ease protectionist pressures on Congress. It also gave the Nixon administration the opportunity to approach Congress, cautiously, about renewing the president's trade-negotiating authority, which had lapsed in 1967. In April 1973, Nixon requested a renewal of trade-negotiating authority for five years, with permission to reduce tariffs by up to 60 percent in reductions staged over ten years and to eliminate tariffs under 5 percent. The main justification for the new authority was the desire to address foreign subsidies and non-tariff barriers that impeded exports to Europe and elsewhere, including the expansion of the EEC to include Britain, Denmark, and Ireland. Drawing on the 1971 Williams report, the administration also proposed extensive changes to the trade laws governing import remedies and adjustment assistance.

Labor unions immediately attacked the administration proposal on the grounds that a further reduction in trade barriers would damage the economy. AFL-CIO President George Meany declared that "the proposals provide no specific machinery to regulate the flood of imports and, indeed,

some would increase the amount of damage to American employment and industrial production."<sup>95</sup> Import-sensitive industries lined up to oppose the administration's request, including textiles and apparel, chemicals, shoes, stone products, iron and steel, cutlery, hardware, and watches.

Others favored the president's request, including producers of paper, machinery, trucks and tractors, and aerospace products. These export-oriented industries complained about foreign non-tariff barriers that inhibited their sales and saw new negotiations as a way of addressing them. With world commodity prices at record highs in the early 1970s, farmers and agricultural groups also took a new interest in global markets and supported the administration's proposal. Stung by the EEC's Common Agricultural Policy, which impeded farm exports, these groups also wanted Europe's agricultural subsidies cut and its import quotas on farm goods eliminated.

There was still bipartisan support for negotiations to sweep away foreign trade barriers in other countries. Most members of Congress argued that American firms could successfully compete in world markets as long as they had a "level playing field": that is, if foreign markets were genuinely open, and unfair trade practices were eliminated. Congress was "tired of the United States being the 'least favored nation' in a world which is full of discrimination," Senator Russell B. Long (D-LA) said. "We can no longer expose our market, while the rest of the world hides behind variables levies, export subsidies, import equalization fees, border taxes, cartels, government procurement practices, dumping, import quotas, and a host of other practices which effectively bar our products."<sup>96</sup> Members of Congress believed that the US market was much more open to imports than those of other countries, and therefore the United States had little to lose and much to gain in seeking to open foreign markets for US exports. In fact, for the year 1966, a greater share of US imports (36 percent, mainly textiles and apparel) were impeded by non-tariff barriers than the EEC's imports (21 percent, mainly agricultural) or Japan's imports (31 percent, mainly agriculture).<sup>97</sup>

The bill also included a new provision called "fast track" to facilitate congressional consideration of any negotiated agreement. In the past, trade negotiations had only dealt with import tariffs, and the president could simply issue an executive order to implement the lower import duties that resulted from an agreement. In the Kennedy Round, however, negotiators came up with agreements on non-tariff barriers to trade that required Congress to approve changes in domestic law. Yet, as we have seen, Congress refused to consider any of the codes negotiated during the Kennedy Round.

With tariffs on industrial products already fairly low, new trade agreements would have to focus on non-tariff barriers to open trade further. But the EEC and other trading partners were reluctant to engage in negotiations if Congress was unlikely to approve the outcome.

To get around this problem, Congress agreed to set up a "fast-track" procedure. Under fast track, Congress agreed to vote either up or down, without any opportunity for amendment, on any trade agreement reached by the president within ninety days of submission. Since any agreement dealing with non-tariff barriers necessarily involved changes in domestic law, both the House and Senate would have to approve the legislation implementing an agreement. With the fast-track process, Congress also pledged not to alter the agreement itself or delay making a decision about whether or not it should be approved.<sup>98</sup> Support for fast track was bipartisan, because everyone recognized that some new congressional procedure would be required to conclude any trade agreement that went beyond simply cutting tariff rates. It also made the executive branch cooperate more closely with members of Congress before finalizing any agreement to ensure their eventual support of it.

The administration's proposal moved slowly through the House in 1973. The Ways and Means Committee rejected a proposal for mandatory import quotas in cases where the foreign-market share exceeded 15 percent, an idea that received some support from Democrats, another indication of how much the party's support for open trade had slipped. In December 1973, the House passed the bill by a vote of 272-140. While the minority Republicans voted heavily in favor by 160-19, the Democratic majority split over the bill. Northern Democrats voted 101-52 against the bill, led by those from states producing steel (Pennsylvania and Ohio) and footwear (Maine and Massachusetts). Southern Democrats voted 60-20 in favor, because the opposition of the textile and apparel industry had been neutralized by the recently concluded MFA.<sup>99</sup>

Senate action on the bill was delayed for most of 1974 by debate over an amendment sponsored by Charles Vanik (D-OH) and Henry Jackson (D-WA) that tied the granting of MFN status to the Soviet Union to the freedom of Soviet Jews to emigrate.<sup>100</sup> The Nixon administration wanted the president to have the unqualified power to grant MFN status to Communist countries, but Congress refused. In December 1974, the Senate passed the bill by an overwhelming margin, and remaining differences with the House version were quickly resolved in a conference committee.

By then, Nixon had resigned over the Watergate scandal, and Gerald Ford had become president. In a trip to Japan just three months after tak-

ing office, Ford (1979, 210–11) assured the prime minister that he “had always been a proponent of free trade and that [he] wasn’t about to alter those convictions despite obvious political pressures to which [he] would be subjected during a period of high unemployment at home.” However, as he recalled in his memoirs, Ford was unhappy with the trade bill. Although it was “the most significant trade legislation in the past forty years,” Ford (1979, 224–25) “was concerned by its inclusion of language that could only be viewed as objectionable and discriminatory by other nations, primarily the Jackson-Vanik Amendment.” However, he “decided reluctantly to sign the measure into law” because he believed “a veto would have been overridden by an overwhelming majority” in Congress. In January 1975, Ford signed the Trade Act of 1974.

The Trade Act of 1974 granted the president negotiating authority over tariffs and non-tariff barriers, allowing the United States to participate more actively in the Tokyo Round of GATT negotiations that had begun in November 1973 (to be discussed shortly). The president was permitted to reduce import duties by as much as 60 percent and eliminate those under 5 percent. The fast-track procedure was established to expedite Congress’s approval (or disapproval) of any agreement covering non-tariff barriers that required legislative changes to domestic law. Congress also agreed to give the president the authority to give duty-free access to selected goods from qualified developing countries under a program called the Generalized System of Preferences (GSP).

The Trade Act of 1974 demonstrated that Congress was interested in opening markets to more trade and the negotiation of rules on non-tariff barriers, not just in protecting import-competing industries. At the same time, it made it easier for industries affected by imports to receive protection and workers to receive adjustment assistance. By this time, it was generally recognized that the attempt in the Trade Expansion Act of 1962 to shift government support away from escape-clause protection and toward trade adjustment assistance had failed. The 1962 legislation certainly made it more difficult for industries to receive escape-clause protection: in the twenty-nine investigations from 1962 to 1969, the Tariff Commission ruled affirmatively in only three cases.<sup>101</sup> But trade adjustment assistance proved equally difficult to obtain: over that same period, the Tariff Commission did not accept a single petition for assistance. From 1969 to 1973, the commission approved just four cases—earthenware, marble, pianos, and sheet glass—covering only 3,180 workers.

The Trade Act of 1974 eased the requirements to receive escape-clause

protection and adjustment assistance without attempting to substitute one for the other. Section 201 set out the new statutory requirements governing escape-clause actions. The 1962 requirement that injury must be "a result in major part of concessions granted under trade agreements" was dropped; section 201 simply required that imports be a "substantial cause of serious injury," allowing any increase in imports, even those unrelated to previous tariff concessions, to be grounds for receiving protection. This vastly increased the number of cases in which industries could seek temporary relief from imports.

The legislation also specified a strict timetable for the disposition of escape-clause cases. The Tariff Commission was renamed the International Trade Commission (ITC) and now had to make an injury determination within six months of receiving the petition. If the injury was found, then the president would have sixty days to decide whether or not to grant the relief proposed by the ITC. Congress also tried to shift the default outcome to the granting of relief by mandating that the president "shall" provide the trade relief recommended by the ITC "unless he determines that provision of such relief is not in the national economic interest of the United States." The temporary import relief could last up to five years, with the possibility of being renewed for an additional two years, and could take various forms, usually tariffs (declining each year) but also import quotas, orderly marketing arrangements, or other measures. The import duties had to be applied on a non-discriminatory basis to imports from all countries.

The Trade Act of 1974 also strengthened trade adjustment assistance. As already noted, the statutory criteria governing adjustment assistance were so strict that the Tariff Commission approved only four applications in more than a decade. The difficulty in obtaining adjustment assistance turned organized labor, which had strongly supported it in 1962, against it. The head of the AFL-CIO dismissed it as "burial insurance" and bluntly stated that "adjustment assistance cannot solve modern trade problems."<sup>102</sup> To address this problem, the legislation eased the certification requirements and shifted authority over the program from the Tariff Commission to the Department of Labor.

The new law also made it easier for firms to obtain relief from dumping. Previously, dumping meant a foreign producer was selling its exports at a price below the exporter's home-market price. The 1974 act made exporting at "less than average cost" another actionable form of dumping, a definition that accounted for the possibility that the home market price

might be artificially depressed along with the export price. The legislation also imposed strict time limits on the administrative process, which had been known to drag on for years.

Finally, section 301 of the Trade Act of 1974 strengthened presidential authority to deal with “unjustifiable, unreasonable, and discriminatory” foreign trade practices found to burden or restrict US commerce.<sup>103</sup> Section 301 allowed a US exporter to petition the Special Trade Representative about objectionable foreign policies or practices that discriminated against US producers. The trade representative could then decide whether to initiate an investigation and seek a negotiated settlement to end the practice. If a solution was not forthcoming, the president was authorized to impose retaliatory duties on the exports of the offending country. Seven of the first ten section 301 actions were aimed at the EEC and focused on various discriminatory policies, such as its levy on egg imports; minimum import prices for canned fruits, juices, and vegetables; export subsidies on malt and wheat exports; a feed-mixing requirement for livestock; and preferential tariffs on oranges and grapefruit juice.

Finally, the Trade Act of 1974 made several institutional changes. Congress formally established the position of the Special Representative for Trade Negotiations, which previously existed only by executive order, and provided for greater congressional involvement in trade negotiations, in addition to creating private-sector advisory groups.<sup>104</sup> Thus, the Office of the US Trade Representative (USTR) became the negotiating arm of the executive branch. Congress also changed the name of the Tariff Commission to the International Trade Commission (ITC), as already noted, and made it an independent agency, not part of the executive branch. As an independent agency, the ITC had to submit its proposed budget directly to Congress, giving it greater leverage over the agency’s activities.<sup>105</sup>

In sum, the Trade Act of 1974 was a key piece of trade legislation. After the outburst of protectionist pressures in the early 1970s, Congress sought to create a system that would shift political pressure for import relief away from legislative remedies and toward administrative ones by opening legal avenues for more escape-clause cases and antidumping actions. The bill contained an odd mixture of trade liberalization and trade protection. On the one hand, it gave the president the authority to liberalize trade further, expanding both exports and imports, and gave developing countries duty-free access to the US market through the Generalized System of Preferences (GSP). At the same time, it gave import-competing firms and workers greater access to government assistance through temporary tariffs or additional unemployment insurance.

The passage of the Trade Act of 1974 also confirmed that partisan divisions over trade policy had become blurred. The new divisions were based on changing constituency characteristics. On the whole, Democrats found it more difficult to support open trade policies because of their ties to labor unions, which feared job losses, especially in the industrial northeast and Midwest. Meanwhile, Republicans still had concerns about reducing trade barriers and ensuring that market access was reciprocal, but they were also much more willing to oppose protectionist measures that might indirectly harm exports than they had been in previous decades.

### THE TOKYO ROUND

As early as 1972, the United States, the EEC, and Japan declared their intention to start a new round of multilateral trade negotiations, the seventh such round since the original 1947 GATT conference in Geneva. The Tokyo Round began in November 1973 with the hope that Congress would soon give the president negotiating authority. Although the world economy was reeling from a recession and high inflation, the Tokyo Round sought to reduce tariff levels further and restrict the use of non-tariff barriers.<sup>106</sup> In the negotiations, the United States, the EEC, and Japan agreed to cut tariffs by 34 percent, on average, although average tariffs were already fairly low at this point, as Table 11.2 shows. As in the Kennedy Round, tariffs were reduced by formula, such that higher duties were cut proportionately more than lower ones, rather than by the old method of bilateral bargaining over particular rates.

With tariffs having fallen to relatively low levels, the negotiation put

TABLE 11.2. Average tariff levels pre- and post-Tokyo Round, in percentages

	All industrial products		Raw materials		Semi-finished articles		Finished manufactures	
	Pre-Tokyo Round	Post-Tokyo Round	Pre-Tokyo Round	Post-Tokyo Round	Pre-Tokyo Round	Post-Tokyo Round	Pre-Tokyo Round	Post-Tokyo Round
United States	6.5	4.4	0.9	0.2	4.5	3.0	8.0	5.7
European Community	6.6	4.7	0.2	0.2	5.1	4.2	9.7	6.9
Japan	5.5	2.8	1.5	0.5	6.6	4.6	12.5	6.0
Canada	13.6	7.9	1.0	0.5	14.8	8.3	13.8	8.3

Source: Congressional Budget Office 1987, 32.

some emphasis on regulating the use of non-tariff barriers. (The lowering of tariffs was likened to the “draining a swamp” that “revealed all the snags and stumps of non-tariff barriers that still have to be cleared away.”<sup>107</sup>) The Tokyo Round addressed non-tariff barriers through six codes covering government procurement, technical barriers to trade, subsidies and countervailing duties, customs valuation, import licensing procedures, and antidumping.<sup>108</sup> Given the difficulty in defining and regulating such barriers, these codes were largely procedural in content and contained few specific obligations. The codes spelled out broad and general rules, such as requiring transparency and national treatment, but the negotiating countries were not obligated to sign them, and thus participation was optional. Still, the codes represented an initial attempt to extend the disciplines of GATT rules to different regulatory impediments to trade.

The negotiations also addressed subsidies and countervailing duties. The EEC employed subsidies to a much greater extent than the United States: in 1978, the share of manufactured exports supported by official export credits was 56 percent in the United Kingdom, 34 percent in Japan, 30 percent in France, and just 11 percent in Germany and the United States.<sup>109</sup> A key US negotiating objective was to restrict such subsidies on the grounds that they distorted resource allocation and impaired the functioning of markets to the detriment of the United States. By contrast, the EEC only wanted such subsidies penalized if they caused injury to another country's industry. In the compromise outcome, the EEC agreed to limit domestic subsidies that affected trade, and the United States agreed to a material injury test in countervailing duty cases. In other words, subsidized exports had to be causing harm to a domestic industry for countervailing duties to be imposed; previously, the United States did not have such a requirement. The antidumping code was also adjusted to the less demanding US standard in which dumped imports had to cause material injury, and not necessarily be a “principal” cause of injury, in order to be countered by duties.

The Tokyo Round was the first in which developing countries began playing a more active role in the GATT. That role was still quite limited, because developing countries received “special and differential treatment,” meaning that they did not have to reduce their own tariffs in order to receive the benefits of tariff reductions by developed countries. The poorest developing countries also benefited from various tariff preference schemes, such as the Generalized System of Preferences, which technically violated the MFN clause.

Like previous negotiations, the Tokyo Round failed to deal with agri-

cultural trade. The EEC refused to reduce the level of subsidies or liberalize the trade barriers in the Common Agricultural Policy, despite US insistence that something be done. Negotiators also failed to reach an agreement on the question of whether safeguards could be discriminatory in their application. Article 19 of the GATT required that safeguards, such as the section 201 escape clause, be applied in a non-discriminatory way against imports from all sources. The GATT had no provision for selective and discriminatory arrangements such as voluntary export restraints and orderly marketing arrangements, which had been introduced and would proliferate over the next decade.

The Tokyo Round generated relatively little domestic controversy. One group that feared the outcome was the textile and apparel industry. In a show of political strength, the industry and its workers persuaded Congress to pass a bill in late 1978 that would prohibit trade negotiators from reducing tariffs on textile and apparel. Senator Ernest Hollings (D-SC) argued that the industry was in dire straits, explaining that "when a man is hemorrhaging, you don't cut another vein."<sup>110</sup> Representatives from the South backed the legislation and appealed to President Jimmy Carter, who was from Georgia, to sign the measure. The president's advisers were strongly opposed, on the grounds that it would constitute a bad precedent that would lead other industries to seek similar exemptions. It would also jeopardize the ongoing negotiations and prompt other countries to withdraw their offers of tariff reductions affecting US exports. With inflation running at high levels, they argued, the country did not need a policy that would further increase prices. Other interests groups, particularly retailers and some manufacturers, also weighed in against the bill.

In November 1978, Carter vetoed the bill on the grounds that it would "not address the real causes of the industry's difficulties." The benefits to the industry would be "transient" but "would prompt our trading partners to retaliate by withdrawing offers in areas where our need for export markets is the greatest—products such as tobacco, grains, citrus, raw cotton, paper, machinery, poultry, and textile-related areas such as mill products and fashion clothing." The president concluded that "the loss of these export areas is too high a price for our Nation to pay."<sup>111</sup>

The Tokyo Round concluded in April 1979. Overall, its achievements were mixed. While import tariffs in advanced countries were cut to even lower levels, developing countries were not expected to reciprocate. The codes on non-tariff barriers were vague, and their adoption was optional—and agricultural trade remained unaddressed. Two months later, the Carter administration submitted the Tokyo Round implementing legisla-

tion to Congress for approval. Congress had to move quickly because the fast-track provision in the Trade Act of 1974 required an up or down vote without amendment within sixty days. US Trade Representative Robert Strauss, a skilled Democratic operator, had made great efforts to keep Congress and interested private-sector groups informed during the negotiations. This helped ensure that major constituencies were not surprised by, and would broadly support, the outcome. As Strauss (1987, vii) later recalled, "I spent as much time negotiating with domestic constituents (both industry and labor) and members of the US Congress as I did negotiating with our foreign trading partners." For instance, Senator Russell Long (D-LA) and the Senate Finance Committee staff insisted that they participate in the drafting the implementing legislation to ensure that Congress would support it. As a result of this legislative-executive cooperation, the Trade Agreements Act of 1979 sailed through Congress, passing in the House by 395-7 and the Senate by 90-4.<sup>112</sup> The overwhelming margin of support reflected Strauss's exceptional political acumen and demonstrated that no domestic groups felt seriously threatened by the results of the negotiation.<sup>113</sup>

However, Congress made the passage of the Trade Agreements Act of 1979 contingent on further administrative changes to trade policy, in particular, an executive order by the president shifting authority over the antidumping process from Treasury Department to the Commerce Department. Congress had long complained that Treasury did not take dumping petitions seriously and was responsible for long procedural delays due to its reluctance to impose duties. For example, when Zenith filed an antidumping complaint about imports of black-and-white television sets in 1971, the Tariff Commission ruled that the industry had suffered injury, but Treasury did not act on the finding until 1978, when it rejected it.<sup>114</sup> Congress clearly wanted more zealous enforcement of the antidumping law, and the Commerce Department, an agency whose constituency group was American business, was more likely to welcome such petitions than Treasury.

In addition, the Office of the US Trade Representative (USTR) was formally created and given primary responsibility for formulating and coordinating trade policy in the executive branch. USTR had principal responsibility for negotiating trade agreements, but in doing so it had to reflect a balanced perspective from many government agencies, including those representing foreign-policy interests (State Department), business interests (Commerce Department), farm interests (Agricultural Department), worker interests (Labor Department), competition concerns (Justice De-

partment), and consumers and economic efficiency interests (Council of Economic Advisers). Thus, USTR led an extensive, interagency consultative process that guided the formulation of US trade policy.

### CREEPING PROTECTIONISM

America's participation in world trade deepened significantly in the 1970s. Merchandise exports and imports as a share of GDP doubled over the decade, rising from nearly 4 percent of GDP in 1970 to roughly 8 percent in 1979. While merchandise trade surpluses gave way to merchandise trade deficits after 1976, they were initially driven by large imports of petroleum after the oil shock of 1973. The United States continued to have trade surpluses on agricultural and manufactured goods, as well as services. In addition, a growing share of trade was conducted with Asia: about 40 percent of US imports in the 1980s came from that region, up from 17 percent in the 1950s. This reflected the rapid economic development of several East Asian countries, particularly Japan, Hong Kong, Taiwan, and South Korea. As a result, policymakers began shifting their attention away from Europe and toward newly industrializing countries across the Pacific.

Overall, the manufacturing sector held its own during the 1970s, but important structural changes were occurring within manufacturing which led to many painful adjustments. Exports were shifting toward newer, more advanced goods, where America's technological superiority over other countries was the greatest, such as machinery and aerospace, where skilled workers earned relatively high wages. Meanwhile, the United States began importing more labor-intensive manufactured goods, such as textiles and apparel, as more and more East Asian countries industrialized. In standardized, capital-intensive goods, such as basic steel products and even automobiles, foreign production capacity had increased significantly, which led to greater competition at home and abroad. Thus, while advanced industries in high technology and machinery performed well, older industries experienced protracted difficulties. This process of adjustment entailed the reallocation of labor and capital away from older, established industries (textiles, apparel, footwear, and steel) and toward newer industries (electrical machinery, aerospace, semiconductors, computers, and telecommunications equipment).

Despite the growing trade surplus in manufactured goods during the 1970s, the industries suffering from import competition inevitably attracted most of the attention. The restructuring process gave rise to the perception that manufacturing as a whole was suffering. Although manu-

facturing production rose 36 percent during the 1970s, the story was different with respect to employment. Manufacturing employment rose by almost four million in the 1960s, but manufacturing ceased to be a source of net job creation over the 1970s. Instead, the number of workers in manufacturing fluctuated around nineteen and twenty million over that decade, although this leveling off masked significant declines in some labor-intensive industries and increases in other industries. In the industries where employment fell, most studies indicated that the major factors were changes in demand and productivity growth, not imports.<sup>115</sup>

As we have seen, Congress recognized that legislating industry assistance on a case-by-case basis was time-consuming and controversial. Therefore, it modified the laws governing trade remedies in the Trade Act of 1974 to allow firms and workers harmed by imports to obtain temporary relief more easily in the form of higher tariffs. Although these provisions had been in place for decades, the rising foreign penetration of the domestic market helped unleash a spurt of new import-relief cases in the late 1970s. The main legal avenues by which firms could petition the government for higher duties on imports were the escape clause, antidumping duties, and countervailing duties. The escape clause was supposed to be the principal avenue by which industries harmed by imports could receive temporary protection from imports. Under section 201 of the Trade Act of 1974, if the ITC found that imports were "a substantial cause of serious injury," it could recommend imposing a higher tariff (declining over five years) on imports from all sources. The president had complete discretion about whether to grant import relief or not.

In fact, the escape clause failed to provide much help for petitioning industries. From 1975 to 1980, forty-four section 201 cases were filed, but only nine resulted in tariffs being imposed. In seventeen of the forty-four cases, the ITC ruled that the petition did not meet the statutory requirements for import relief. In the other twenty-seven cases, the ITC ruled that imports were a cause of injury and recommended higher tariffs in twenty-four cases and adjustment assistance in three others.<sup>116</sup> In most cases, however, Presidents Ford and Carter denied relief on the grounds that it would be contrary to the national economic interest, because trade barriers would put a significant burden on consumers, add to inflationary pressures, damage relations with foreign countries, and bring a windfall to the prosperous firms in the industry while offering little help to those most harmed by imports.<sup>117</sup>

The escape clause had another problem: the higher duties had to be applied to imports from all sources and not selectively on the imports

causing the problem for the domestic industry. Thus, all foreign exporters would be subject to the trade restrictions, even if just one country was responsible for a sharp increase in imports. This was one reason why presidents were reluctant to grant relief: they did not want to inflict needless harm on Canada and Western Europe if imports from Japan and South Korea were the main source of competition for domestic producers. Thus, presidents faced a difficult choice. If the president granted escape-clause relief, it might satisfy the domestic industry, but it would anger foreign countries whose exports were not a source of the problem. If the president denied import relief, the domestic industry would be upset and might turn to Congress for a remedy.

The compromise outcome that satisfied almost everyone was a negotiated settlement involving a voluntary export restraint (VER) or an orderly marketing arrangement (OMA), in which only the country (or countries) whose exports were harming domestic producers would agree to limit its sales in the United States. To the extent that those exports were restricted, the domestic industry would be satisfied. The foreign exporters were relieved that they were not being hit by higher tariffs, as would happen if escape-clause or antidumping measures were imposed. Even better for them, exporters who restricted their sales often found that the higher price they were able to charge in the United States would more than compensate for the lower quantity sold, possibly increasing their profits. The higher revenue earned by the constrained exporters was called a "quota rent." Some foreign firms even approached American officials and asked that a VER or OMA be arranged, even if no US industry had complained about imports, because they were seeking such rents for themselves.

The exporters in countries that were not part of the VER or OMA were also happy with these arrangements, because they were free to increase their exports and fill the gap left by the constrained exporters. This often left the import relief so porous that the domestic industry found it of little value. For example, in an escape-clause case involving non-rubber footwear, President Carter decided to negotiate OMAs with Taiwan and South Korea rather than impose higher tariffs, as recommended by the ITC. The OMAs were in effect from 1977 to 1981 and only limited the exports of these two countries. As a result, the decline in exports from Taiwan and Korea was quickly offset by a rise in exports from Hong Kong and the Philippines. The Carter administration then came under pressure to extend the import restrictions to cover these new suppliers. The administration responded in 1978 by requiring certificates of origin from Hong Kong's footwear exports, since many suspected that Taiwan and Korea were sim-

ply reshipping their goods via Hong Kong to avoid the export restraint. In addition, Taiwanese and Korean firms started changing the types of goods they sold to avoid the OMA restrictions. South Korean producers reduced the leather content of their athletic shoes, adding more rubber and fabric so that they were not “non-rubber footwear” as defined under the agreement and therefore did not fall under the export limits.<sup>118</sup> In the end, the OMAs failed to slow imports of footwear and hence did not prevent the continued decline of the domestic shoe industry.

An OMA covering imports of color televisions also failed to help the domestic industry. After imports surged from 1.1 million sets in 1975 to 2.9 million in 1976, a group of labor unions and smaller firms filed a section 201 petition. The ITC ruled that imports were a substantial cause of serious injury and proposed imposing tariffs starting at 25 percent and declining to 10 percent over five years. Instead, President Carter negotiated a three-year OMA with Japan to reduce the number of imported television sets to 1.56 million. While television imports from Japan fell, imports from South Korea increased by a factor of nine (from 97,000 units to 437,000 units), and imports from Taiwan doubled (322,000 units to 624,000 units) in a single year. Despite the OMA, the number of imported color television sets was about the same in 1978 as it had been in 1977.<sup>119</sup>

The administration then forced Korea and Taiwan into the OMA in 1979, capping their exports at 526,000 units each. In response, the product mix changed: imports of assembled televisions fell off, but imports of un-assembled televisions rose from virtually zero in 1976 to nearly 3 million by 1980. These examples illustrated the limits of trade remedies as a way of helping domestic industries overcome foreign competition. The globalization of manufacturing production meant that country-specific trade restraints were easily evaded, because foreign supplies could come now from any number of countries. Because the OMAs were so easily circumvented, they were largely ineffective in helping domestic producers maintain their share of the market.

Politically influential industries, such as textiles and apparel and steel, also received special trade protection, sometimes supplemented with anti-dumping and countervailing duties. The textile and apparel industry continued to be protected by the Multifiber Arrangement (MFA), which had become institutionalized as part of US trade policy. In December 1977, during the Tokyo Round negotiations, twenty-one countries finalized a second Multifiber Arrangement (MFA-II) that updated restrictions on exports from developing countries of cotton, wool, and man-made fiber clothing products. This time the EEC, rather than the United States, was behind

the effort to tighten the MFA quotas by reducing the annual growth rates, constraining the ability of exporters to shift supplies across years and product categories, and allowing "reasonable departures" from the quotas (meaning tighter limits) if import surges caused injury to domestic producers. This patchwork of export-restraint agreements remained in force from 1978 until 1981, when it was updated once again.<sup>120</sup>

The second round of VRAs on steel expired in 1974, a time when the world steel market was booming. But steel producers in Europe and Japan added production capacity during this period, which led to significant overcapacity once world demand began to weaken. Even worse, from the standpoint of domestic steel producers, European governments often subsidized their firms to prevent plant closings and minimize unemployment, thereby prolonging the adjustment process by keeping capacity operational that otherwise would have been shut down.<sup>121</sup> To some degree, the US industry was a victim of the subsidized excess capacity abroad that kept world production higher and world prices lower than would otherwise have been the case. At the same time, the domestic steel industry failed to improve productivity enough to make its products competitive in the market and suffered from high costs that arose from the substantial wage premium paid to unionized workers.

When steel demand softened in 1977, domestic producers resumed their efforts to get new import restrictions. The Carter administration sought to reach OMAs with foreign suppliers: Japan agreed to such an arrangement, while the EEC did not. Consequently, the steel industry filed numerous antidumping petitions against European producers. Concerned that the antidumping duties might create insurmountable barriers to imports, the Carter administration proposed a "trigger-price mechanism" (TPM): the government would monitor prices and accelerate an antidumping investigation if imports arrived at prices below the specified triggers. The "fair value" reference prices for imports were based on estimated Japanese production costs, profit margins, and other expenses. The TPM increased the likelihood of duties being imposed, and the price floors applied to all imports, so that there could be no supply diversion. Once accepted by the US and European steel industries, the trigger-price mechanism was put in place in January 1978.

Almost immediately the domestic industry complained that the trigger prices were set too low. Because the trigger prices were based on Japanese costs, higher-cost European producers were still permitted to "dump" steel and increase their share of the market. In March 1980, US Steel filed antidumping and countervailing duty petitions against European produc-

ers, prompting the Carter administration to suspend the price floors. The trigger-price mechanism was reinstated several months later at a 12 percent higher price level in exchange for a withdrawal of the petitions.<sup>122</sup>

All of these trade actions were relatively mild, however, compared to what was to come over the next few years. The 1970s was a decade of transition. The United States no longer dominated world manufacturing, and many industries now faced competition from imports. In addition, the emergence of large capital flows between countries, something that had not been a feature of the Bretton Woods system, meant that trade flows were now much more likely to be affected by exchange-rate movements. A confluence of factors meant that even stronger political pressures to restrict imports would emerge in the 1980s.