The Gabriel Silver Lecture
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American Trade Policy: An Historical Perspective
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AS PREPARED FOR DELIVERY

Trade policy gets a lot of attention these days.

But most students probably encounter trade topics as an abstruse amalgam of legal complexities and economic formulae.

Knowing the law, the economics, and international regimes of trade is important if you want to influence policy or advise others. Your Dean is one of the world's foremost authorities on those topics—and she contributed to a better trading system.

Today, I will offer a complementary way of viewing trade policy.

I believe we should consider trade as an important factor in a country's relations with the world. And trade is a tale of domestic politics as well.
I'll present my case from an historical perspective. Therefore, I'm delighted to be joined by Adam Tooze, whose economic histories of the early 20th Century and the Global Financial Crisis offer masterful accounts of what scholars used to call "political economy."

I admit that I'm advancing a lonely campaign to retrieve political economy from the academic attic. In my experience, policy-makers need to face problems with a multi-disciplinary toolkit—drawing from politics, economics, law, psychology, and organizational and institutional behavior—all based upon a grounding of history. A SIPA education offers you a wonderful opportunity to learn about political economy and the practice of policy-making.

Let's now step back a few years—say… 243 years.

From the earliest days of their independence, Americans have viewed trade as an expression of liberty.

The Founders of the new United States thought that new rules for trade could create a changed international system; they did not see trade solely as an economic efficiency. After all, the American Revolution arose out of protests against Britain's controls and taxes on trade.

London and other centers of empire had extended trade through conquest; they maintained domination through imperial monopolies. Americans wanted to end Europe's attempts to possess their wealth through exclusive arrangements.

In 1776, which was a busy year for the new U.S. government, Congress ranked trade at the top of its agenda. John Adams took charge of drafting the "Treaty Plan of 1776," a template for commercial arrangements. His key principle was "national treatment"—which trade experts will recognize is an even more audacious objective than most-favored nation status. With national treatment, U.S. merchants and ships—if not goods—would receive the same standing in foreign countries as their own domestic merchants and ships.

In 1778, Ben Franklin employed the model agreement in negotiations with France, establishing one of the United States' first two treaties.

The Americans were moving with the vanguard of new thinking about political economy. Both Franklin and Thomas Jefferson acknowledged the influence of Adam Smith's <u>The Wealth of Nations</u>, published in 1776. Smith argued that all parties would gain from trade, and that commerce was not a zero-sum transaction.

The Americans were in fact aiming at an even bigger target: They wanted to change the international political and economic order. In 1785, John Adams wrote to John Jay, then Secretary of Foreign Affairs for the Confederation Congress, that Adams wanted "a <u>Reformation</u>, a kind of <u>Protestantism</u>, in the Commercial System of the World."

The American plan would supplant imperial mercantilism with the freedom of independent states to trade as they chose.

Pause for a moment to consider the wider implications. The Americans wanted to free private parties—not just states—to conduct affairs with private counterparts in other countries. In today's terminology, the Americans were opening doors for trans-national relations among non-state actors. This was a very big idea in foreign relations. The Founders in fact expected that trade would be the new nation's principal foreign policy.

Moreover, a fair trading system required contracts, respect for private property, letters of credit, and the rule of law. Over time, individual rights would edge into human rights.

But Adams, Jefferson, and the other negotiators of these new-style treaties faced a huge hurdle: Under America's Articles of Confederation, they had no leverage to negotiate. As James Madison later wrote, the need to regulate foreign commerce became a primary and powerful impulse to draft the U.S. Constitution in 1787.

Once the new Constitution was ratified, Treasury Secretary Alexander Hamilton used the regulation of trade to breathe life into his new economic system.

Hamilton had to rely almost totally on customs revenues to fund the new government and pay interest on its huge debts. From 1790 until 1860, tariffs provided about 90 percent of federal government income. In 1792, the new federal government devoted 87 percent of its revenues <u>just</u> to <u>interest</u> payments. Receipts did not cover current expenditures and interest until 1796.

U.S. fiscal policy necessitated an accommodating foreign policy. When revolutionary France went to war with Britain and others across Europe, the United States turned to a policy of Neutrality in order to maintain commerce and the vital revenue from trade.

Hamilton also recognized that tariffs could assist his plan to support domestic manufacturing. But contrary to later protectionists, Hamilton wanted to apply tariffs sparingly because he recognized that taxes on trade raised prices for users of goods, sheltered inefficient producers, and encouraged smuggling. He preferred using subsidies to encourage new industries.

A decade later, in 1807-09, President Jefferson attempted to translate America's trade into a weapon of policy. Frustrated by British and French seizures of U.S. ships and sailors during the Napoleonic Wars, Jefferson embargoed all U.S. maritime exports. The policy hurt Americans much more than Europeans. The states of New England threatened secession.

Over the two centuries to follow, Americans continued to experiment with sanctions—of trade, and more recently, of finance—to weaken adversaries, or at least signal displeasure short of going to war.

After Jefferson, until the Civil War in 1861, Congress's trade policy was the result of its revenue—and debt—policies, as determined by political battles among regions and producers. The bills to set tariffs were one of Congress's most important items of legislation.

In general, new manufacturers sought protection, and farmers wanted lower prices and opportunities to export. The average tariff on dutiable goods rose to about 25 percent in 1820.

Then, in 1828, Congress passed what became known as the Tariff of Abominations. That name should offer a hint: Through a process of maneuvering for political favors, Congress bargained the average tariff up to 62 percent. South Carolina threatened to secede—over tariffs, not slavery. A compromise in 1833 set tariffs back on a downward path to an average of about 20 percent in 1859.

The Civil War led to another shift in U.S. trade policy, from raising revenue to restricting imports as well. Congress raised the average tariff to about 50 percent, where it stayed for the rest of the century. The North needed money to fight the war. The secession of the Southern states—and then the long political domination of Republicans after the war—favored the North's industrial interests. The United States had also wracked up huge war debts and obligations to veterans. Between 1860 and 1913, customs receipts still provided about half of governmental revenues.

America's interest in trade encouraged the development of the U.S. Navy. Indeed, the United States first commissioned six heavy frigates to protect U.S. merchants against attacks of the Barbary pirates in the Mediterranean; rather than pay tribute, Jefferson fought back. That story is the origin of the clause about fighting "to the shores of Tripoli" in the Marine Corps hymn.

The Navy, in turn, assisted in opening new markets, most notably Japan in the 1850s, spurring the Meiji Restoration and the creation of Japan as a modern state and power.

Dreams of a potentially vast trade with China drew American merchants and then a host of other transnational actors: missionaries; educators; doctors and nurses; soldiers of fortune; engineers, miners, and railway builders; and adventurers of all types.

U.S. trade policy blundered into foreign policy, intentionally or not. In 1876, the United States enabled the Hawaiian Islands to export sugar advantageously. But when the United States eliminated all duties on sugar in 1890, Hawaii's economy plummeted because Hawaii's sugar producers lost their edge. In 1893, the powerful community of American planters in the islands overthrew Hawaii's last monarch and sought U.S. annexation.

Congress reimposed sugar duties in 1894, while restoring Hawaii's preference. This time, the Cuban economy tumbled, because it had benefited from zero duties on sugar. The turmoil fed the Cuban insurgency, which prompted a Spanish crackdown. These events contributed to the violence that led to the Spanish-American War of 1898.

At the turn of the 20th Century, the world economy appeared to be in the midst of a major shift. As Europe's empires expanded in Asia and Africa, Americans feared exclusion from raw materials and markets. Germany and France offered trade concessions to others but discriminated against the United States. The British Empire, which had led the way for freer trade for decades, initiated an internal system of preferences. In 1897, Canada, historically an important market for the United States, began discriminating against America in favor of London.

These were the conditions that contributed to Secretary of State John Hay's "Open Door" policy for China in 1899-1900. The European powers, Russia, and Japan were carving up China into concessions and colonies, as they had recently done in a scramble for Africa. Hay aimed to maintain China's territorial integrity with an open door to trade on equal terms. Hay's "Open Door" policy was as American in concept as John Adams' Treaty Plan of 1776—as Professor Tooze's work recognizes.

Trade politics were shifting at home, too. Traditionally, U.S. farmers and ranchers—especially of cotton, grains, and meats—were exporters. By the turn of the 20th Century, big U.S. industrialists, such as Andrew Carnegie, realized that they could compete overseas. Smaller producers disagreed; once protections create vested interests, the favored few fight hard to hold on to their advantages.

Nevertheless, Douglas Irwin, the author of a comprehensive history of trade policy, points out that President McKinley edged away from a U.S. policy of restriction to a new idea of reciprocity. On September 5, 1901, McKinley declared his fresh approach in a speech to the Pan American Exposition in Buffalo, New York. Economic "isolation is no longer possible or desirable," announced the President. "Reciprocity treaties are in harmony with the spirit of the times, measures of retaliation are not." A day later, a deranged man assassinated the President.

The Progressive movement of the early 20th Century also pressed the trade debate in new directions. Ida Tarbell, the muckraking journalist who attacked the oil and meat packing trusts, argued that tariffs imposed an unfair tax burden on working families' purchases of shoes, clothes, food, and energy. Her colorful accounts revealed that tariffs were the grease of corrupt politics. Others contended that tariff distortions promoted monopolies and industrial concentration.

When Woodrow Wilson won the Presidency in 1912, his top priorities were cutting tariffs and antitrust. Even more important for the future, the newly ratified 16th Amendment to the Constitution authorized an income tax. In 1913, tariffs still accounted for 45 percent of federal revenues. With the new income tax, the customs' share fell to 28 percent by 1916 and under five percent after World War I. Without the income tax, the United States would have struggled to pay for the war. With the income tax, America could cut tariffs without risking unacceptable fiscal costs.

World War I—like the Napoleonic Wars a century before—underscored the ties between America's trade with conflicts overseas.
The German U-Boat assault on America's long-standing Neutrality policy—dating back to Washington and Hamilton—pulled Wilson into war in 1917.

The war also transformed America's international economic standing. The volume of U.S. exports nearly doubled between 1914 and 1926, and sales of finished manufactured goods tripled. Imports fell. The United States shifted from being an international debtor to a huge creditor.

The second and third of President Wilson's "Fourteen Points" of January 1918—in effect, America's war aims—sought the freedom of the seas and the removal of barriers to an equality of trade. But Wilson failed to focus on economic and trade topics at the peace conference in Paris in 1919. Nor would Wilson compromise with the Senate to save the peace treaty—including his priority, the new League of Nations.

By 1920, the average U.S. dutiable tariff had fallen to 16 percent, the lowest since 1792. In the wake of post-war inflation and recession, the Republican Congress turned to its favorite economic remedy: higher tariffs.

The Republican Administrations of the 1920s recognized that the post-war international economy faced a serious problem. Germany had to pay large reparations to France and Britain, which in turn owed large debts to the United States. Europeans could only pay their U.S. debts if they received new loans, transferred gold, or sold goods to America. But America was increasing barriers to foreign goods. The Europeans could neither pay their debts nor buy more from the United States. One American who would later play a key role in transforming U.S. policy, Cordell Hull, observed "[w]e have learned that a prohibitive protective tariff is a gun that recoils upon ourselves."

The Trump Administration may wish to recall Hull's plain-speaking.

America's economic officials recognized the interconnections among Germany's reparations, foreign debts to the United States, and debtors' abilities to earn dollars by exporting to America. But domestic politics blocked the development of a comprehensive solution. Charles Dawes and Owen Young patched together debt and reparations rescheduling as a stopgap.

Then U.S. trade policy fell over a precipice.

After a brief post-war recession, most of U.S. economy boomed in the 1920s. But farmers struggled. The agricultural Midwest sought price supports. Failing to get that aid, farmers called for tariff protection.

But U.S. agriculture was a net exporter; it depended on worldwide prices determined by global supply and demand. Domestic protection would have little effect.

As Congress considered tariffs for farmers, the stock market crash of October 1929 spread into a banking crisis and a Depression.
The Tariff Act of 1930, known as the Smoot-Hawley bill, became a frenzy of logrolling to raise tariffs. It specified duties for almost 3,300 products. Though over 1,000 economists urged President Herbert Hoover to reject the bill, he signed it anyway.

The vast majority of economists now believe that monetary and financial factors were the primary causes of the depth and length of the Great Depression. The Smoot-Hawley bill compounded the problems and triggered a wave of higher tariffs and retaliatory reprisals.

The average U.S. tariff peaked at 59.1 percent in 1932. Between 1929-32, the value of U.S. exports and imports plummeted nearly 70 percent.

Congress never seriously considered the foreign reaction to the bill. Some 65 governments protested, but Senator Reed Smoot of Utah countered, “the tariff is a domestic matter…. No foreign country has a right to interfere.” Professor Irwin found 20 pages of debate in the Congressional Record about tariffs on tomatoes, but few words on the international effect of Congress’s handiwork.

Other countries established economic blocs based on preferences, special licenses, exchange controls, quotas, and even barter. Germany looked to southeast Europe and then national economic autarky. Japan created its “Great East Asia Co-Prosperity Sphere.” The volume of world trade fell 26 percent between 1929 and 1933.

The United States would spend much of the 1940s and ‘50s attempting to clear away the international economic debris of the Tariff Act of 1930. Smoot-Hawley left a bad taste with the American public, but U.S. trade policy remained adrift until 1933, when Cordell Hull had his opportunity to reshape trade history.

Hull had a long political education in the Congress and Democratic Party politics. He wrote in his memoirs that, “I was thirty-six years old when in my maiden address in Congress I pleaded for lower tariffs and fewer trade restrictions. I was sixty-two years old when we finally won the fight to reduce them…."

Hull had gotten to know Franklin Roosevelt in the 1920s and offered FDR early support in the presidential campaign of 1932. After 12 years out of office, and Woodrow Wilson's highly personalized foreign policy for eight years before that, the newly-elected Roosevelt led a Democratic Party thin on international expertise. Hull's Congressional ties, standing as a Southern leader, political loyalty, and familiarity with international issues through tariff policy made him a reasonable candidate for Secretary of State. In that era, the State Department was responsible for trade negotiations. In any event, FDR's first priority was the economic crisis of the Great Depression, and the supremely confident President probably felt he would run foreign policy anyway. Hull served as Secretary of State from 1933 to 1944, the longest tenure of any person in the post.

In 1934, after early frustrations with FDR and the New Deal's experiments with economic controls, cartels, and collectives, Hull persuaded Roosevelt to back a simple, three-page bill to authorize trade negotiations: The bill became the Reciprocal Trade Agreement Act of 1934.

Hull's bill gave the President the authority, through trade agreements, to reduce import tariffs from the Smoot-Hawley rates by up to 50 percent. Moreover, the tariff cuts would apply to <u>all</u> countries with U.S. agreements that included unconditional most-favored nation clauses. These agreements did not require approval by Congress.

By structuring the bill as a Congressional grant of authority to the President, the Administration bypassed the Senate's role in ratifying treaties. FDR even tried—as with other New Deal legislation—to get Congress to delegate its authority without time limit. But Congress wanted to keep a watch over trade policy, so it insisted the authority would lapse after three years unless Congress extended it.

Roosevelt and Hull achieved a sweeping shift of authority—from Congress setting individual tariffs to the Executive negotiating agreements covering a range of products. Scholars have been intrigued by this example of regime change. It eased the politics of support for trade. The face of the trade issue shifted from how <u>high</u> to set tariffs to agreements to <u>lower</u> barriers. Consumer and export interests would now have a voice. And the Executive Branch had the ability to factor national security and foreign policy considerations into trade policy.

For the next 80 years, Presidents would have to battle with Congress to retain trade negotiating authority. Over time, Congress insisted on adding limits, procedures, and eventually, votes on agreements.

But first Hull had to show that he could achieve results. He had to overcome bureaucratic foes that wanted a form of managed trade, making the government into an integrated trading house. One can hear echoes of those debates today through President Trump's calls for specific purchases and state-to-state directions to reduce trade deficits.

Hull succeeded in negotiating 31 agreements with 28 countries and lowering the average U.S. tariff to below pre-Smoot-Hawley levels. By 1939 and the opening of World War II, U.S. exports to countries with agreements rose 63 percent, as compared to 32 percent with other nations.

Even more important, Hull had revolutionized U.S. trade policy. After the Second World War, the United States was able to forge a comprehensive trade policy to complement the reconstruction and recovery of the Marshall Plan. The architects of post-war policies had learned lessons from the failures of international finance, debt, and trade policies in the 1920s and '30s.

In 1947, the United States met with other countries in Geneva to create a General Agreement on Tariffs and Trade—also known as GATT. The GATT's core principles—non-discrimination, unconditional MFN, and shifting from quantitative barriers to tariffs—were drawn from Hull's bilateral agreements.

The politics of trade, however, remained hazardous. The principal U.S. negotiator of GATT, Under Secretary of State Will Clayton, faced a crisis on the homefront. In 1947, just as Clayton was trying to launch the GATT, a popular bill in Congress would have pegged the wool tariff at 50 percent. Australia, dependent on wool exports, threatened to walk out of the GATT negotiations. If Australia dropped out, Britain, as leader of the Commonwealth countries, would have exited, too. Without Britain, the continental Europeans saw few prospects.

So Clayton returned to Washington to plead his case directly to President Truman. Truman gave 15 minutes each to Clayton and the Secretary of Agriculture. The Secretary of Agriculture warned Truman that the President would lose up to seven states in the 1948 election if he vetoed the wool tariff bill and scoffed at the complaints of other countries. Clayton pointed to America's long-term interest in the international economy and urged Truman to give GATT a chance to succeed. Truman vetoed the bill; he even gave Clayton authority to cut the wool tariff by 25 percent. Later in 1947, 23 nations agreed on the new GATT, cutting tariffs on 45,000 items, covering about half of world trade.

Clayton later referred to Truman's veto as the greatest act of political courage he had ever seen. America's leadership role on trade and the international economy has always required Presidential fortitude.

Over the following 50 years, the membership of the GATT expanded, and the economies conducted eight more rounds to lower barriers to trade. The negotiations over manufactured goods added agriculture, services, standards, rules on unfair practices, intellectual property protections, and dispute settlement. In 1994, the United States and its trading partners created the World Trading Organization, the WTO, building on the GATT rules and strengthening the dispute settlement system. Countries retained their sovereign rights to ignore the rules—but if they did, others could retaliate by raising barriers. Your Dean became one of the leading figures on the WTO Appellate body.

The trading system helped America's allies and partners to recover and grow, expanding opportunities for Americans, too.
The process of European integration—begun with the Marshall Plan and carried forward through today's European Union—prospered within this global trading system.

In East Asia, Japan, South Korea, Taiwan, Singapore, and economies in Southeast Asia pursued export-led development strategies, creating the "East Asian Economic Miracle."

Around the world—Latin America, China, Africa—countries relied on the U.S.-led trading system to connect to international supply-chains, draw investment, and gain know-how.

Starting in the 1980s, the United States began negotiating Free Trade Agreements, FTAs, to complement the GATT and WTO negotiations. Bilateral or regional FTAs could more easily become innovators in developing rules in new areas—such as services, anti-corruption, transparency, border procedures, IT standards, the environment, and core labor standards. FTAs eliminated almost all tariffs, rather than just reduce them.

In 1992, the United States, Canada, and Mexico completed the North American Free Trade Agreement, or NAFTA. NAFTA was always much more than a trade agreement. During the 1980s, Mexico's old one-party corporatist state was breaking down. Mexico's President foresaw that NAFTA could offer an economic and legal framework within which the United States and Canada could support Mexico's democratization, opening of civil society, and economic growth. The United States envisaged NAFTA as the cornerstone for deeper cooperation across many issues—immigration and workforce, the environment, and economic and foreign policies.

As Mexico's income rose, Mexicans would both buy and supply more to the United States and Canada. All three economies, with deeper integration, would be stronger competitors globally.

For reasons of history, the United States, Canada, and Mexico are highly protective of their independence and sovereignty. Therefore, NAFTA created a model of economic integration that respected national sensitivities. The NAFTA approach contrasted with the EU's plan for "shared sovereignty."

NAFTA also became the first example of deeper economic integration between developed and developing economies.

In the 21st Century, the United States should view North America as its continental base. A stronger base will help the United States to extend power globally.

The United States used other FTAs to deepen cooperation, trade and investment, and economic reforms in other countries, both developed and developing.

Today, the United States has FTAs with 20 other countries, representing about ten percent of world GDP but between 40 to 50 percent of U.S. exports. In the first five years after the FTAs went into effect, U.S. exports grew about three times as fast as exports to other countries.

The Trans-Pacific Partnership, negotiated by the George W. Bush and Obama Administrations, sought to build upon bi-lateral FTAs with six countries by adding five more to forge a regional FTA. President Trump withdrew from the TPP, but the other 11 economies went ahead without the United States.

As the U.S. economy struggled to adapt to changes in international trade, technology, and the economy, public and Congressional support for openness waned. Exchange rate gyrations and manipulations caused pain for workers in many industries. Some developing countries became powerful competitive threats. Americans complained of a lack of reciprocity. U.S. programs to help people adapt to change have fallen far short.

The United States is now in the midst of reassessing the country's global connectivity.

In his Inauguration speech, President Trump declared that he was a protectionist—the first president to overtly embrace that position since Herbert Hoover. If anyone was still in doubt, Trump proudly labeled himself a "tariff man."

I believe that trade protectionism—like Trump's anti-immigration policies and infatuation with a wall with Mexico—are core connections to his political base. He needs to keep these issues boiling.

Historically, America's openness—to goods, capital, people, and ideas—have given the United States an advantage. Competition compelled the United

States to recognize its mistakes and fix them. Yet there are periods where the pace of change or other fears have led the United States to pull back.

Today, the forces of globalization and fragmentation pull in different directions, creating political tensions. Challenges of security, technology, disease, migration, the environment, and financial and information flows are likely to increase, not decrease. At the same time, people demand reassurance. Some feel a loss of identity and confidence in America’s governing institutions.

Americans will need to decide what type of international trade, technology, economic, and environmental systems they want. The spirit of 1776 looked to liberty, reformation, innovation, private initiative, and opportunity. So did the flexible design created after World War II, with adaptations over 70 years. A breakdown or repudiation of the system of economics, security, and international politics will prove costly and dangerous—as we are already beginning to see.

I was encouraged to see that the recent survey of the Chicago Council of Global Affairs stated that 87 percent of Americans believe trade is important for the U.S. economy—and 63 percent recognize that trade benefits both the United States and its trading partners.

But the opponents of trade are more outspoken—and act with greater political intensity.

The U.S. economy is now encountering the costs and confusions of protectionism. The harms have spread globally. Companies are deferring investments. Supply and logistics chains have become more costly and uncertain.

Without economic cooperation, cooperative action on other cross-border problems – such as climate change and preserving bio-diversity – will become harder.

I believe your generation will determine America’s course on trade and economic and environmental partnerships. As you do so, I hope you can recall some of the history we touched on today.

I hope you keep in mind that trade is much more than economic efficiency and equations.

Trade has been—and will remain—a key element of America’s relations with the world.