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The Dollar and US Trade Politics

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As a general rule, the United States is one of the least exchange-rate conscious of countries. Unlike Tokyo residents, who see flashing downtown signs displaying the latest number of yen to the dollar—akin to New York signs flashing the Dow—Americans don't tend to think of the dollar in relation to another currency. The image of a shrinking dollar evokes domestic inflation, not devaluation of the dollar in currency markets. The dollar's exchange value is therefore not central to our politics, as other currencies' values can be to theirs.

But for the growing portion of US economic actors who are engaged in international transactions or who compete with those who are, the dollar does matter. For that reason, changes in the international value of the dollar have had an important impact on US trade politics, dating from at least the Nixon administration. Overvaluation before 1971 helped fuel protectionism and the threat of statutory import quotas in 1970. Conversely, by 1973, negotiated devaluation and further downward floating of the dollar had led to visible, month-by-month improvement in the US trade balance just as executive branch trade officials were lobbying the House to pass the trade bill authorizing the Tokyo Round. They found this trend most helpful. Similarly, trade troubles early in the Carter administration were triggered in part by the mid-1970s dollar resurgence; the overwhelming final vote for the law implementing the Tokyo Round agreements in 1979 was facilitated by a dollar decline in 1977 and 1978.

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The most dramatic case was in the 1980s, of course. The huge (40 percent), generally unanticipated rise in the dollar fueled an unprecedented surge in the volume of US imports while exports stagnated—their nominal level in 1986 was below that of 1980. The political impact is well remembered: the biggest upsurge in demands for trade protection since the 1930s and the demoralization of protrade internationalist business. Interestingly, the balance of trade politics began to right itself with the Plaza Accord of September 1985, and the dollar declined from that year forward. The reason lay not only in the actual improvement of the trade balance that eventually followed; the anticipated effect allowed the Reagan administration and other protrade forces to assert that the overall numbers would get better, but (given the J-curve) not right away. In fact, US exports doubled between 1986 and 1992, and a particularly sharp rise in 1988 coincided with the modification, in a congressional conference committee, of some of the rougher provisions in the omnibus trade legislation completed in August of that year.

As these examples suggest, a strong dollar inflicts a ''double whammy'' on expansion-minded trade policy. It stimulates imports, arousing industries that compete with these imports to enter the political arena. It dampens exports, reducing the trade policy interest of industries that typically act as a counterweight to protectionism. Thus, as a general rule, a rise in the dollar is a useful leading indicator of the rise of producer protectionism. By contrast, a weaker or declining dollar is trade policy's friend.

Other things being equal, therefore, a rise in the dollar worsens the merchandise trade balance. But the dollar figures understate the economic impact, especially on the import side, because foreign products come in cheaper than before. So the rise in import volume exceeds the rise in import value. From 1982 to 1986, for example, the value of US imports rose by 48 percent, from $248 to $368 billion. That in itself seems like a staggering increase in a period of diminishing inflation, but the quantity of imports rose even faster, by 65 percent, as measured by the Department of Commerce's quantity index.

Similar statistics give us a sense of the political burden carried by current US trade policy. Although the dollar did not rise as rapidly in the late 1990s as it did in the early 1980s, import volume (again measured by the quantity index) rose 63 percent between 1996 and 2000. Since then, US imports and exports have both fallen significantly. (In all cases the statistics refer to merchandise imports, excluding services, chosen because goods producers remain the economic actors with the greatest impact on trade politics.)

The political response at the onset of this decade has been decidedly less ferocious than that of the 1980s. One reason is that the US economy has been, until recently, in much better shape overall, with higher growth and lower unemployment. Another is that US producers have had an

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additional decade and a half to internationalize. Still, the strong dollar has contributed notably to the problems of steel and agriculture, the two issues that sullied President Bush's free trade reputation last spring. And it meant that this administration, unlike its Nixon and Reagan predecessors, had to sail into a strong exchange rate wind to win Trade Promotion Authority (aka fast track).

As this and previously cited examples suggest, the main political reaction to high dollar valuation has been to attack not the exchange rate itself but its effects, particularly on the import side. But there have been a variety of other responses. One, seen mainly during the Reagan administration but of equal economic relevance today, is to call for changes in fiscal policy as a means of reducing the overall US savings deficit. A related reaction, more relevant in the 1980s than today, is to call for easing of US monetary policy. Another political response, visible now as well as then, is to charge other nations with currency manipulation and promote US pressure on them to desist. A fourth is to call for changes in policy toward exchange rates themselves—seeking to change what the treasury secretary either says or, together with the Federal Reserve Board, does in foreign exchange markets.

A conference like this one is testimony to the fact that the dollar has become an issue in and of itself. Whether this will lead to compensating political action is uncertain at best. Fortunately for US trade policy, it is likely that the dollar will fall significantly from present levels before there is another trade vote in Congress as important as those of 2001 and 2002.

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