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Different Shades of American Protectionism

Pradhan, Jaya Prakash

Gujarat Institute of Development Research

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Abstract: America now advocates the path of free markets to industrialization. However, a cursory look into its developmental history shows that protectionism has been the hallmark of industrial, investment and trade policies followed in that country. Far from adopting free market regime, it has used the strategic interventions by state to promote American industries, especially knowledge-based ones. Therefore, developing and less developed countries should not neglect the strategic role of the state in development process and completely rely on a regime based on free market forces.

Although America loves to propagate the benefits of a free-market economy to the rest of world, its developmental history tell us a different story. America, simply depending upon the market forces based on the textbook type free trade, industrial and investment regimes, could hardly have reached the level of industrial development where today it stands. So to say: American industrialization is a myth precluding the long pursuance of government interventions and protectionisms.

The US has a long history of using industrial, investment, and trade policies to directly escort the direction of industrial change and foreign trade. Throughout the pre- and post-Civil War periods (1870-1913), the US had accorded high tariff protection to manufactures, especially products like textiles, iron, steel, glass, and tin plates, which are important export items of European competitors (Shafaeddin 1998).

During 1956 to 1992 the US has vigorously pursued the measure of voluntary export restraints (VERs) on cotton textile, wool, man-made textiles, footwear, steel, VCRs, TVs, machine tools, and meat (McClenahan 1991, Satake 2000). These VERs like quotas and tariffs restrict imports into the United States as exporting countries to the US agreed to voluntarily reduce their exports. The most important and often cited VER related to the early 1980s when the US has forced Japan to adopt VER when the rising market share of Japanese car producers threaten the American auto industry.

The WTO era saw the US erecting new trade protectionism like anti-dumping, special safeguard clause, sanitary and phytosanitary (SPS) measures, environmental protection, animal welfare, labour standard, and other types of technical barriers like quality inspection standards, compulsory inspections of imported products etc. Recently, on the service exports also, the protectionist forces are becoming active against the background of growing incidence of business process outsourcing (BPO) to developing countries.

Apart from providing trade protection, the US has actively promoted its strategic industries. Defense spending and government procurement have served as direct industrial policies to encourage innovation in the targeted sectors like electronics, communications equipment, and aerospace industry (Markusen 1985). These measures ensured that USA be among the first movers in these high-technology industries and benefits from direct exports of goods, technology, and arms as well as from the spillovers effects from military-led innovations to the rest of the U.S. economy.

The US was also less open to inward FDI until the mid-20th century (Chang 2004). During this period there was widespread concerns with foreign investment as America was a net importer of capital. A battery of legislations was passed to safe guard the American control in industries attracting foreign capital namely natural resource extraction (agriculture, mining, logging), shipping, and finance. Federal laws restricting mining rights to US incorporated companies and US citizens, barring foreign investment in land, disallowing the voting right to foreign shareholders and reserving director positions to only American citizens in the US national banks, prohibiting employment of foreign workers, etc were enforced prohibiting and discriminating foreign investment. State legislations in various forms like discriminatory taxing of foreign companies, banning established foreign bank branches to undertake banking activities and establishment of new foreign bank branches, etc. were even more restrictive to foreign investments than federal legislations (Wilkins, 1989).

Evidently, as Professor Stiglitz (2003) would agree with us, the US practices protectionism to promote its trade and industrial developments but preaches free markets to others. The American love for free trade and investment took shape only in the twentieth century when American firms emerged as globally competitive due to long standing policy of protectionism. This change of heart was essential as liberal policy regime now can serve its economic interest best than a restrictive policy.

An era of US liberalism ensued with its active role in the multilateral rule-based trade regime, establishment of the World Bank's Multilateral Investment Guarantee Agency, the International Finance Corporation's Foreign Investment Advisory Services, the International Center for Settlement of Investment Disputes, and dragging the Trade-related Investment Measures (TRIMs) into trade negotiations.

These measures were thought to boost US exports and act as encouragement to US direct investment as well as provide it with global security.

The US direct investment were promoted with active government interventions like tax credits and tax deferrals for outward FDI, and the establishment of Overseas Private Investment Corporation as well as the Export-Import Bank for providing low cost finance, loan guarantees, and insurance against foreign wars, insurgency, etc. The U.S. also has policies to prevent foreign governments from expropriating assets of American FDI like the 1962 Hickenlooper Amendment and the 1972 Gonzalez law that respectively connect US bilateral and multilateral aid to repayments for expropriation.

As the US was pushing for a liberal FDI policies in the host countries and greater security for US investment, it is natural that it should follow the same approach towards foreign investment coming into the US economy. Given the large outflows of US FDI as compared to minimal inflows, this liberal approach made more sense to the US during the first half of the ninetieth century.

However, in the late 1970s and 1980s when US became a net-importer of FDI with growing number of foreign acquisition of American business enterprises, the US lost no time in becoming less liberal to inward FDI once again. President Ford signed the Executive Order 11858 in 1975 that brought into existence the Committee on Foreign Investment in the United States (CFIUS) which later emerged as powerful enforcement agency following the Exon-Florio Amendment in 1988.

The Exon-Florio Amendment, which was introduced to prevent acquisition of Fairchild's semiconductor equipment manufacturing segment by Japanese company Fijitsu in 1986 and such other foreign acquisitions, made screening of FDI by the CFIUS mandatory. The Amendment authorizes the President with a high degree of discretionary power to prevent foreign ownership in the national security interest of the United States. The phrase 'national security interest' is so broad to block foreign acquisition in any line of production activities. This is clearly reflected in the five factors, which the Amendment identified for considering the effects on national security.

These are: (1) domestic production needed for projected national defense requirements; (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services; (3) the control of domestic

industries and commercial activity by foreign citizens as it affects the capability and capacity of the US to meet the requirements of national security; (4) the potential effects of the transaction on the sales of military goods, equipment, or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and (5) the potential effects of the transaction on US technological leadership in areas affecting US national security¹.

Not only inward FDI in the form of mergers and acquisitions are subjected to restrictions in the US, the greenfield FDI also faces protectionist provisions. The US has ownership restrictions in the case of airlines, nuclear facilities, and broadcasting. A foreign investor is allowed to hold only up to 49 per cent of the equity and 25 per cent of the voting stock in US airline (Travel Insider 2003). The Federal Aviation Act of 1958 also requires that two-thirds of management and board of the U.S. airline license holder must be US citizens.

In the case of telecommunication, foreign investors are barred from holding licenses for U.S. TV and radio stations. Even in the case of broadcast, common carrier, or aeronautical radio stations they can be denied licenses if the Federal Communication Commission find it to be in the public interest. Presently the foreign ownership is restricted to a maximum of 20% for any firm that holds a U.S. radio broadcasting license (Lowry 2001).

The shipping and related activities is another area where US still have restrictions on foreign ownership. The Jones Act (Section 27 of the Merchant Marine Act, 1920) restrict the privileges for waterway transportation of merchandise or passengers in the coastwise trading or domestic fishing to vessels that are U.S.-built, U.S.-documented, or U.S.-owned. Different sections of the Atomic Energy Act, 1954 exclude the issuance of license to an entity that is owned, controlled, or dominated by an alien, a foreign corporation, or foreign government for the operations, production, acquisition, and possessions of nuclear materials.

The financial sectors also have restrictions in many respects. Under the federal law all the directors of a national bank must be citizens of the US. There are also federal as well as many state level measures that do not permit foreign banks with

¹ U.S. Department of Treasury web site accessible at <http://www.treas.gov/offices/international-affairs/exon-florio/>

direct deposit-taking branches or bank subsidiaries in the United States to establish or acquire interests in banks. A foreign firm is also prohibited from being designated as a primary dealer in U.S. government debt obligations unless reciprocated by the home country of foreign firm on the same or similar terms. Federal law prohibits branches of foreign insurance companies to provide surety bonds for U.S. Government contracts. If foreign firms want to engage in securities advisory, they are required to register as investment advisers under the Investment Advisers Act of 1940 where the same does not apply to domestic banks.

The US federal and state level laws continue to be discriminatory in practices towards foreign ownership of real property. Foreign investment in real estate is not permitted in the case of public land, the gains derived from ownership of U.S. real estate is taxed discriminatorily, and are subjected to the non-tax reporting requirements. There are also reciprocity requirements imposed for foreign investment in real estate. Many of the state laws and regulations imposed strict guidelines on foreign ownership of agricultural land and real property or even prohibit acquisition of them.

There are many lessons to be learned from the developmental history of the US. The American industrial success cannot be totally ascribed to free market forces as US wish others to believe today. Rather protectionisms, some might prefer to call as strategic interventions, were the drivers of American industrialization. Free markets were dismissed when US industries are threatened by foreign competitions but adopted when they are larger than the competition. The US has consciously employed trade and industrial policies to provide security to its industries whenever needed and to put new industries in advantageous position compared to foreign rivals, especially in high technology sectors.

The US may pretend to forget its past and may advocate free market as the best policy for development but developing and less developed countries like India should not fall to the US pretensions. They need to redraft the form of government interventions given the new business and policy environment, not abandoning it. Otherwise, developing countries are sure to suffer from substantial loss in development inflicted by the unfair protections that remains and grows in disguise in developed countries like the US.

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