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## **How Trade Made America Great**

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During our years at Yale, the world was a different place. Foreign travel was exotic, expensive and rare among the population as a whole. While some young Americans had been abroad, by far most Americans had not—and those who did go abroad most likely traveled by sea rather than air. In the early 1960s, flying over the oceans was mainly for the affluent.

Long-distance telephone calls were expensive, international calls prohibitively so. From furniture to TVs and appliances, and especially automobiles, American brands dominated consumer spending in this country. We had just a glimpse of the world to come with the proliferating iconic Volkswagen Beetles and the amazingly small Sony portable transistor radios.

These imported products in the U.S. represented a global political vision that pre-dated World War II. In the early 1930s, President Roosevelt and Secretary of State Cordell Hull believed in liberalized trade as a path to world peace and cooperation. With strong administration support, Congress in 1934 passed the Trade Agreement Act, which allowed Hull to negotiate reciprocal trade treaties with numerous countries, lowering tariffs and stimulating trade.

This liberalization reversed the epitome of U.S. protectionism, the disastrous Smoot-Hawley Tariff Act of 1930, which contributed to a staggering 66% decline in world trade between 1929 and 1934. Integral to Hull's vision was the 1947 General Agreement on Trade and Tariffs (GATT), which was signed by 23 countries and committed the U.S. to steadily liberalizing world trade. A central pillar of American postwar policy was enticing producers from around the world with access to the giant U.S. market.

The devastation of Europe and Japan and the emergence of Cold War adversaries provided even greater impetus to the opening of American markets, under the protection of the U.S. Navy and the umbrella of various global alliances like NATO. In April 1966 Malcolm McLean launched his first international Sea-Land container operation between New York and Rotterdam. McLean's shipping-container revolution cut the cost of seaborne trade by a factor of 50 versus loose-cargo stevedoring.

That same month, Juan Trippe (Yale '21) at Pan Am ordered 25 revolutionary jumbo 747 widebody Boeing airplanes equipped with equally leading-edge Pratt & Whitney high-bypass fanjets. When the passenger version of the 747 entered service in 1969, it was two-and-a-half times bigger than the Boeing 707 that had pioneered jet travel. The jumbo jet cut overseas travel costs by 70%.

The 747's hump allowed a freighter version to load cargo through a nose door under the cockpit and into the cavernous fuselage. Because of the cargo-carrying 747F, costs for trans-Pacific airfreight were dramatically reduced, a major factor in the extraordinary GDP growth of the Asian "tiger" economies of Hong Kong, Taiwan, Singapore and Japan beginning in the 1970s. Electronics and other high-tech/high-value-added goods from these emerging markets could be distributed and sold in the U.S. and Europe in a few days—an amazing development.

During the 1970s and 1980s, while container ships and planes became increasingly efficient with each successive model, newly developed fiber-optic cables (patented in 1966) began running underseas, connecting the world at the speed of light, lowering voice and data-communication costs by orders of magnitude. Financial markets became globally integrated and transactions multiplied at an astounding rate.

The U.S. opened its markets to former World War II foes, and Germany and Japan as a result became economic titans. Successive administrations mostly ignored Japan's overt mercantilism and growing trade surplus, given the need for American military bases throughout the country. Eventually exchange rates and domestic political pressure pushed Japanese car makers to set up production plants in the U.S., mostly in the South. Electronics manufacturers such as Panasonic, Sony and Hitachi became world-wide giants on the back of exports from Japan to America and then almost everywhere as global trade steadily expanded.

Parallel to the technological progress of transportation and telecommunications was a remarkable series of congressional actions and GATT agreements that substantially liberalized transport and trade regulations. During the Carter administration, inspired by extensive academic research and the example of ultra-low-fare intrastate airlines in Texas and California compared with high-cost national carriers, many Republican and Democratic lawmakers alike pushed for federal economic deregulation of transportation. The Republican mantra was "free market"; Democrats sought "consumer benefit" by lowering the price of travel and goods for the masses.

As a result, legislation was enacted for air cargo (1977), passenger air services (1978), interstate truck and rail transportation (1980), and the federal pre-emption of intrastate trucking in 1994. Both the Civil Aeronautics Board (CAB) and the Interstate Commerce Commission (ICC), the air and surface economic regulators, were abolished, in 1985 and 1995 respectively.

In the 10 years following the Staggers Act of 1980 that substantially deregulated railroads, the perennially loss-making rail industry was able to halve the rates charged to customers while restoring financial stability. Surface-transport deregulation also spawned an entire new industry of flexible truckload common carriers to meet the needs of emerging "big box" distribution and retailing models such as Wal-Mart and Target. Revolutionary production systems, based on just-in-time supply and fast-cycle manufacturing, were made possible only because of the deregulation of trucking.

From 1977 to 1994, a century's worth of heavy regulation of transportation rates, routes and services that had begun with the railroads was cast aside, with profound effects on the U.S. economy. By the beginning of the 21st century, overall logistics costs were reduced from 16% of GDP during the 1970s to under 9%, thereby making possible substantial increases in government social spending resulting from the Medicare and Medicaid legislation in the 1960s.

On the global-trade front, the GATT framework of 1947 had been "temporary," as Congress refused to approve the International Trade Organization envisioned by the participants at the 1944 Bretton Woods Conference that established the World Bank and the International Monetary Fund. Even so, under GATT there were seven successive negotiating "rounds" and agreements until the World Trade Organization (WTO), a modernized International Trade Organization, was finally established in Geneva in 1994.

The GATT/WTO did not cover sea trade, given the traditionally liberal rules regarding shipping except within national regulated waters. Thus unimpeded, containership lines of many registrations proliferated, facilitating the astonishing growth in maritime business and the development of megaports in Asia, Europe and the U.S.

International aviation was likewise a separate regime, but as agreed by 54 nations at the Chicago convention of 1944, international flying was for decades tightly controlled by governments through a labyrinth of bilateral treaties (4,000 at present) that limited competition and regulated rates and services.

Beginning in 1992, however, the U.S. and the Netherlands enacted the first of many Open Skies agreements, which have grown now to 117, including a multilateral treaty with 28 European countries. Passenger airlines opened scores of new routes. New air-cargo and door-to-door express services were also initiated.

Together, these regulatory changes and transport innovations made possible the fantastic growth of travel and trade, which grew two-and-a-half times the rate of world GDP for a quarter-century.

From less than \$50 billion in total trade in 1966, the U.S. now imports and exports over \$4 trillion annually in goods and services. Container ships have grown from carrying a few hundred boxes on each trip to the new Triple-E behemoths that transport over 18,000 containers called TEUs, or 20-foot-equivalent units. The cost is 1/500th of the shipping rates per pound of the early 1960s. The profusion of agricultural products from the “Green Revolution” pioneered by Norman Borlaug, combined with ever more efficient shipping, has resulted in massive amounts of grain traded around the world, something unimaginable to farmers 50 years ago. American railroads were integral to the growth in the nation’s maritime trade by moving containers from Pacific ports to the mega markets in the East.

All of these factors have created a global trade market that exceeds \$15 trillion annually. Now, the Panama Canal is being widened, which will permit, beginning later this year, massive container ships to cross the Pacific and unload directly into improved Gulf of Mexico and Atlantic Coast ports, further reducing the cost of Asia-U.S. trade.

Handling the enormous increase in financial transactions was made possible by a fantastic increase in computer-processing power. The emergence of the Internet in 1994 has allowed the ubiquitous offering of millions of products for fast delivery from anywhere in the world to anyone with a desktop computer . . . then a PC . . . then a tablet . . . and now a smartphone. Languages are translated; products can be instantly, visually displayed; and orders effortlessly entered. The capabilities are unprecedented in the history of commerce.

Three other factors central to the development of these enormous global commercial systems have occurred since 1966: The evolution of a vast world-wide oil market; the integration of the economies of the U.S., Mexico and Canada with the North American Free Trade Agreement (Nafta) of 1994; and the emergence of China as a great commercial power.

The oil cartel known as the Organization of the Petroleum Exporting Countries overplayed its hand in the 1970s when, for economic and political reasons, OPEC embargoed shipments to the U.S. Market forces finally sorted out oil supply and demand in America after President Reagan in 1981 dismantled the vestiges of government regulation in the industry. Oil has hardly been immune to the vagaries of any commodities market, but the U.S.—thanks to the

technological breakthrough of hydraulic fracturing—is the world’s largest producer of natural gas and is on track this decade to surpass Saudi Arabia and Russia as the world’s largest oil producer.

True to the central tenet of FDR and Secretary of State Hull that liberalizing trade is inherently beneficial, the U.S. led the effort for China to join the WTO in 2000. Beginning with the Nixon-to-China rapprochement, the industrialization of America’s Cold War enemy has lifted more people—hundreds of millions—out of poverty, faster, than ever in history. From the late 1980s and accelerating after the WTO accession, efficient Chinese manufacturing, especially technology-based goods, has rewarded Western consumers with low-cost products that have substantially improved standards of living. Americans and Europeans don’t need to be affluent to afford cellphones, digital TVs, furniture and appliances.

China, however, has followed Japan’s mercantilistic practices, which have led to a \$300 billion trade surplus with the U.S., thanks to state support of Chinese industry and restrictions on foreign competitors. These policies have created a strong political backlash in the U.S., which made the recent congressional renewal of Trade Promotion Authority—which allows the president to negotiate trade treaties and was for years a routine process—extremely difficult.

Today, given low growth in most of the world, rising wages in China and petroleum costs declining because of U.S. fracking technology, the trajectory of the world’s commerce is somewhat uncertain. Trade and global GDP are now growing roughly at parity. Following the 2008 financial crisis, protectionism has shown a troubling popularity in many countries, including the U.S. Stringent new security regulations have also slowed goods crossing many borders.

The Nafta pact has clearly been an economic success. Over the past 20 years, U.S. trade with Mexico and Canada has risen to \$1.2 trillion in 2014, from \$737 billion. While the immigration issue often gets erroneously conflated with Nafta, the economic numbers tell a clear story. Moreover, some production is now moving back to North America from Asia, given lower transport costs, faster delivery, the increase in Chinese production expenses, easier customs clearance, and the more balanced nature of Nafta trade compared with the massive U.S. deficit with Asia—particularly China and Japan.

Once again, in its own messy, unpredictable political fashion, the U.S.—after a hiatus during the first Obama administration—is pushing for further trade liberalization, with initiatives such as the Trans-Pacific Partnership, the Trans-Atlantic Trade and Investment Partnership, and the Trade in Services Agreement. The WTO likewise continues to push for a new Trade Facilitation Agreement dealing with security and customs issues; the WTO Information Technology Agreement; and a new overall world-wide trade agreement—the so-called Doha Round negotiations. These efforts by many nations under the WTO show continued commitment to further global integration despite the well-publicized difficulties in doing so.

More than three billion people are now connected to the Internet. Billions more have aspirations for a better life and are likely to come online as global consumers. The odds are good, therefore, that today’s remarkable transport systems and technologies will continue to improve and facilitate an even larger global economy as individual trade is becoming almost “frictionless.”

History shows that trade made easy, affordable and fast—political obstacles notwithstanding—always begets more trade, more jobs, more prosperity. From clipper ships to the computer age, despite economic cycles, conflict and shifting demographics, humans have demonstrated an

innate desire to travel and trade. Given this, the future is unlikely to diverge from the arc of the past.

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