

Collapsing Case For Free Trade

By Paul Craig Roberts

America enjoys a singular advantage that shields us from our economic problems: the dollar serves as the world's reserve currency and is thus guaranteed a high level of demand. Foreign central banks hold their reserves in dollars, and countries are billed in dollars for their oil imports. The world demand for dollars means that the U.S. can hemorrhage debt for a protracted period on a scale that would promptly wreck any other country's currency.

Currently, the U.S. trade and budget deficits are adding to our indebtedness at an annual rate of \$1 trillion. Most of these dollars go into the hands of foreigners, who are content to add them to their reserves and to convert them into ownership of U.S. assets. The problem arises when foreigners become loaded up with dollars and no end to the dollar flood is in sight.

Three factors have kept the oversupply of dollars from ending the dollar's reserve role: the size of the U.S. economy, America's leadership in world affairs, and the lack of an alternative reserve currency. But the protection offered by these three factors is declining. The formation of the European Union is creating an internal market larger than the U.S. market and a new currency, the euro, that has strongly appreciated against the dollar during the past two years. Japan's economy is high-tech and large. Developments in China and India have both countries on track to becoming the world's largest economies. The policies of the Bush administration have undermined America's world leadership and isolated the U.S. One result could be that oil producers abandon the dollar as the means of payment.

The U.S. is ceasing to be a manufacturing economy. In the early '80s, our trade deficit was due to oil imports. Today, the trade deficit in manufactured goods—including advanced technology products—is three and a half times the oil-import bill.

Offshore production and job outsourcing are prime contributors to the burgeoning trade deficit. When American firms produce and hire abroad to serve U.S. markets, domestic goods and services are turned into imports. The use of foreign locations and labor has resulted in the loss of 3 million high-productivity, high-paying jobs over the last four years. Forcing U.S. workers into domestic service jobs means lower incomes that result in slower growth in the consumer market and a declining share of world income.

As long as the rest of the world is willing to accept the outpouring of dollars, the U.S. can ignore these problems. But the day the world decides that its hoard of dollars represents claims that the U.S. cannot meet, dollar dumping begins. When it does, financing for trade and budget deficits dries up. Interest rates rise sharply. Cheap foreign goods become unaffordable. Living standards plummet.

The Bush administration should begin by asking how America benefits from the transfer of U.S. capital, technology, and know-how to foreign competitors. The "gains from trade" argument defines trade gains as the result of each country specializing in those economic activities in which it has comparative advantage. But comparative advantage cannot operate when a country moves its productive factors to another country. Offshore production and job outsourcing benefit the recipient countries and turn what was formerly domestic production into imports. Americans lose their incomes while the trade deficit and pressure on the dollar's value increase. Clearly, there are no net gains to Americans from this transaction.

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The Bush administration must confront this problem and cease its obedience to multinational corporations, which improve their profitability and CEO bonuses by substituting foreign labor. The U.S. is not losing competitively to foreign producers. U.S. firms are lowering their costs of production by abandoning American labor and moving abroad. This new phenomenon is not covered by the case for free trade.

Free-trade economists are incapable of recognizing the problem. It is their view that freedom of economic action is the ultimate value and that every U.S. firm has the right to abandon America if it is in the firm's interest. One can make an argument for this, but it is not the argument upon which the case for free trade rests.

The Bush administration must immediately confront and prepare contingency plans for what happens when the dollar loses, through overproduction, its role as the world's reserve currency. Should U.S. puppets in oil-producing countries be swept aside by rising anti-Americanism in response to our invasion of the Middle East, new Islamic states can destroy the American superpower simply by requiring that countries pay their oil bills in euros.

The central economic problem faced by the U.S. is that the movement offshore of the production of goods and services that are sold in U.S. markets makes it impossible to bring balance to the trade deficit that threatens the dollar's role as reserve currency. The continued movement offshore of American jobs guarantees the collapse of the dollar and the U.S. economy. ■

Paul Craig Roberts was Assistant Secretary of the Treasury under President Reagan and is the author of The Tyranny of Good Intentions.

Govern Best, Govern Least

By Robert A. George

Dear Mr. President:

Congratulations on your impressive victory. Below are a few suggestions that might assist you as you strive to govern on a stated belief in the basic concept of limited, accountable government.

1. A Color-Blind Society—Get rid of the color-coded terror alerts. On a practical level, no one knows what the colors mean, and the average citizen doesn't know what to do when the level is raised. Worse, the new normal in America is the elevated/yellow level. Yes, yellow is the signal for caution. But more people associate yellow with cowardice. This is not a nation of cowards. If necessary, switch to a numerical alert system. Def Con 3, anyone?

2. Extreme Makeover: Cabinet Edition—Many people who should be your strongest supporters are dismayed at your inability to hold accountable those charged with executing your policies. Your Secretary of Defense made profound errors in planning for postwar Iraq. Those errors—largely because of the lack of troops—place American soldiers and Marines in continued danger. Other fallout from those errors includes the Abu Ghraib scandal that has caused what will be a decades-long public relations nightmare for the U.S. If you don't wish to dismiss the good secretary for cause, at least allow him to depart with "the thanks of a grateful nation." His replacement should be a new face, someone not tainted by the missteps of the current DOD structure.

Oh, retaining a Treasury Secretary who tells voters that job-loss is a "myth" may not be a great idea either. Just a thought.

3. Tax Not, Spend Not—If tax-and-spend is wrong because of what is taken from the productive segments of society and given to the unproductive, then tax-cut-and-spend is wrong

because of what is taken from future generations and given out to the current one. Obviously, in a wartime economy, spending on defense and homeland security is a necessity. But if "everything changed on 9/11," then it is perfectly acceptable to say to members of Congress that that includes spending. Yes, the Congress proposes spending bills, but the president has the ability just to say, "No." The drunken-sailor spending days must come to an end.

4. Bomb Iran?—Probably not the best idea. A nuclear Iran is something no one wants. But the younger generation of Iranians are those most likely to be friendly to the West. Bombing their country to eliminate possible nuclear laboratories is not a way to engender good sentiments.

5. The Gift That Keeps on Giving—That Medicare legislation must have seemed good at the time, but news that the true costs were hidden disappointed many of your conservative supporters. Not only is it expensive, but you may have set a trap for Republicans in the 2006 elections. Perhaps you have heard of the "donut" problem? Between the \$2,250 and \$5,100 levels of coverage, there is a hole that will force seniors to pay for drugs out of their own pockets. Some might say that that is only fair. But given that seniors are likely to hit that coverage hole in the summer and fall of '06, who are they likely to

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blame right around the time they are getting around to voting? Consider defusing this electoral time bomb. Otherwise, your last two years in office could be somewhat unpleasant.

6. Folsom (& Other) Prison Blues—Finally, consider forming a bipartisan commission to look at the problems of the prison population—everything from prison rape (an issue that several in the conservative media, including *The American Conservative*, have raised) to readjustment into law-abiding society. This would be an aspect of compassionate conservatism because it would address the problems of incarceration compassionately, while recognizing the struggles of the families of the incarcerated. That's family values.

All the best in your second term. ■

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