Economic Stimulus without Industrial Policy Won't Work (Update-Aug 2011)

Two and one-half years ago, I wrote a short article entitled "Economic Stimulus without Industrial Policy Won't Work" (attached). For quite some time, I have been asked to update it. It took me until now to get around to doing this. I rarely write on economics these days. Although I was a Senior Economist for over a decade, I have long since returned to my technical roots in statistics and SAS and SQL programming (where you can make some serious money).

Before writing this new article (also attached), I updated my knowledge of this subject by reading three new books on this topic*. Two of these -- *The Betrayal of American Prosperity* (2010) by Clyde Prestowitz and *Free Trade Doesn't Work* (2011) by Ian Fletcher -- are excellent, and I strongly recommend them. The other and most recent of the books -- *Death By China* by Peter Navarro and Greg Autry -- provides some useful insights and information, but I believe its orientation and perspective are wrong and would, if followed, be counterproductive (to be explained later).

Since these four authors have covered this subject well and I do not want to try to " re-invent the wheel," I will paraphrase or quote from these three books throughout this update article. Also, I will cover only some of what I think are the most important points the authors presented. There is much more in these books I will not cover, and those of you concerned about America's future economic well-being should read them.

(*Incidentally, these books are remarkably inexpensive -- in the $15 - $17 range online -- and two of them are hardcover.)

"Jump Starting" the Economy

When I wrote the Feb. 2009 article, there was strong support for economic stimulus measures to "jump start" the economy so it would start generating more jobs. I wrote that although stimulus measures have worked in the past, they most likely would not work in 2009 because most of the goods which consumers would spend the stimulus funds on -- e.g., a new flat-screen TV -- are no longer made in the U.S. So purchasing them would not create jobs here.

I was interested to see that the authors of these three new books are in agreement with this position. For example, Navarro and Autry write,

"... For even though a desperate White House has thrown a massive stimulus at America's flagging economy, our unemployment lines continue to stretch for miles. Just why do you think this is so, Mr. President:

Well here's one reason: Trying to jumpstart our economy with a massive stimulus in the absence of a vibrant manufacturing base has been like trying to start a car without spark plugs or gain traction on slick tires. It just can't be done. Sadder yet, a great portion of that stimulus money leaks right out of our economy and stimulates Guang and Shanghai rather than Gary and Pittsburgh. Indeed, the false Keynesian vision of a virtuous cycle of spending just won't play in Peoria when so much of what we buy isn't made here and our biggest trading deficit partner never reciprocates." (p. 55)

There is still talk in Washington of more economic stimulus spending, but it is much more subdued than in early 2009, suggesting that policy makers have a sense of what Navarro and Autry wrote about in the previous paragraph. However, there are still enthusiasts for jump starting the economy through more consumer spending. Robert Reich, the former U.S. Secretary of Labor, writes a weekly column in the *San Francisco Chronicle* where he regularly calls for putting more money in the pockets of middle class workers so they have the means to start spending to get the economy going again. For example, he wrote in the July 17, 2011 edition of *San Francisco Chronicle* (p. E4),

"My first priority is to get Americans back to work. I'm proposing a jobs plan that will do that.

"First, we'll exempt the first $20,000 of income from payroll taxes for the next two years. This will put cash into Americans' pockets and boost consumer spending."

The error in Reich's position, which the three new books cited above clearly point out, is that America's productive capacity has been so severely eroded that we no longer make most of the goods consumers want, e.g., a new microwave oven to replace the one which wore out. So the new jobs resulting from the stimulus spending will be created where the manufacturing is done to meet the increased demand, and in most cases that is not in the U.S. The main problem is not, as Reich suggests, insufficient demand, but rather eroded domestic productive capacity.

What about all the things Americans buy at Walmart, Macy's, Office Depot, etc.?

As written above, there is less enthusiasm today about using economic stimulus measures to use consumer spending to jump start the economy and create jobs. Instead, the job creation measures being proposed today fall into three categories:

- Infrastructure projects such as repairing roads, bridges, etc.
- "Green" industry jobs which include expanding existing activities such as retrofitting / insulating buildings and developing new technologies for alternative energy such as solar and wind.
- Jobs stemming from INNOVATION, which I will discuss later.

What is striking is that the lists of proposals for jobs creation do **not** include growing jobs in the many industries which make all the things we currently buy at Walmart, Macy's, Office Depot, Sports Authority, etc. and online. Consumer activity accounts for about two-thirds of Gross Domestic Product (GDP), and some 35% - 45% of consumer expenditures are for things (products or goods) rather than services. While it is true that America has lost competitiveness in the many of these industries and no longer competes in others, how can proposals for job creation in the U.S. effectively "write off" these jobs and instead focus only on jobs in infrastructure repair, "green" industries, and innovation?

How Will We Pay for Jobs In Infrastructure Repair and "Green" Industries?

Where is the money going to come from for infrastructure and "green" industry jobs? These activities require money to do as evidenced by the fact that many poor debtor countries in the world cannot afford to repair infrastructure or insulate buildings. One way to get the money to pay for these jobs is to earn it in international trade, i.e., we export more than we import and use the earnings for infrastructure and "green" industry jobs.

The U.S. used to do this, but not anymore. Although we were unequivocally the richest country in the world in the decades following World War II and were pretty much number one in everything, we have become a debtor nation. While we used to have trade surpluses (i.e., we sold more than we bought in international trade), "our trade went into deficit in 1971. We have not run a surplus since 1975. (Fletcher, p. 143).

Consistently spending more than we earn is the root cause of our trade deficit.

"AMERICA'S TRADE DEFICIT. $696 billion in 2008. $701 billion in 2007. And a world-record seven hundred and sixty billion dollars in 2006. It did fall by nearly half in 2009, as in past recessions, but 2010 popped back around the $500 billion mark, and 2011 will probably be worse." (Fletcher, p. 1)

"Chronic U.S. trade deficits of $600 billion to $800 billion annually over many years have turned America from the world's leading creditor nation to its largest debtor, thereby dramatically reducing U.S. bargaining leverage with our foreign 'lenders.' (Who argues with his banker?)" (Prestowitz, p. 7)

Hot Off the Press: As I was writing this article, a report was released about our June, 2011 trade imbalance: "U.S. Trade Deficit Widens To $53.1 Billion, Highest Level Since 2008." The report, which I have included at the bottom of this article, says that "The big rise in June's deficit came as a surprise to economists who had been forecasting an improved deficit...". So our competitiveness in trade seems to be getting worse, not better.

For years our country has been spending more than it earns and borrowing to maintain our lifestyle. How much do we have to borrow? Prestowitz writes, "...just to keep running smoothly without a sharp rise in interest rates, the U.S. economy must have a gross inflow of foreign capital of about $5 billion per day. This puts pressure on the economy by raising the national debt." (p. 8)

Why do other countries continue to lend us (i.e., buy Treasuries) so much money so we can maintain our standard of living? There are two main reasons:

- First, the U.S. has great accumulated wealth (assets) that serve as collateral for loans. This wealth was accumulated during America's years as a manufacturing powerhouse. Although Britain had been number one in industry at the beginning of the Industrial Revolution, "between 1870 and 1900, America surged ahead of Britain in virtually every sector of the economy." (Prestowitz, p. 59). By 1914, "U.S. per capita income was $5,307 as compared to $5,032 for Britain and $3,833 for Germany." (Prestowitz, pp. 60-61)

- Second, the exporting nations of the world -- e.g., China, Taiwan, South Korea, Japan, and Germany -- want to sell their goods in the large, lucrative American market and will let us buy on credit if that's what it takes to make their sales. Also, some of these countries such as China cannot sell all their output in their home markets because their citizens do not the income to buy it so they look to the American market.

About a third of the U.S. deficit is petroleum imports (Prestowitz, p. 10), and at least for the near term we are stuck with this part of the trade deficit. The U.S. once had a lot of oil, but in 1948, "for the first time in its history the United States became a net oil importer." (Prestowitz, p. 231). We now import about 60 percent of the oil we use.

No longer having the domestic supplies of oil we need, we import oil. However, we do not have to import other things we could make ourselves such as computers, flat screen TVs, and cell phones. In fact, we should be selling more of the things which we could make and using our earnings in trade to pay for oil which we can't make. But we are not doing this. We continue to import not only natural resources we don't have, but also products we could be making.

How long can we expect to live on over-extended credit? Fletcher writes, "At some point, America's giant overdraft against the rest of the world must come to an end." (p. 252) The prolonged stalemate over the budget in the U.S. congress and the reaction of markets and of the nations who are our main creditors indicate that our day of reckoning may be approaching.

So returning to the question asked at the start of this section, " Where is the money going to come from for infrastructure and "green" industry jobs?" It will be very difficult to find funds for these activities unless we start making a lot of the things we buy and return to the practice of earning more than we spend, with the extra earnings going to pay for imported oil which we cannot make.

"EDUCATION BUDGET CUTS - Counselors nearing extinction"

This was the title of a front-page story in the *Oakland Tribune* on July 16, 2011. It reported that "Skyline's [high school] principal eliminated all counseling positions because of budget cuts. Across California, the trend of saving money by letting counselors go is growing."

This made me think of what Fletcher wrote (also quoted above), "At some point, America's giant overdraft against the rest of the world must come to an end." (p. 252). Nations which earn enough to pay for them can afford social services like school counselors and more. This report struck a personal note for me because my 13-year-old stepson (who now attends one of the charter schools Governor Jerry Brown founded when he was Mayor of Oakland) graduated from an elementary school in Oakland which offered a range of extra services. It had a resources specialist, a Ph.D. psychologist, a speech pathologist, and counselors. They are all gone because the Oakland school system couldn't afford them anymore.

These are services which affluent nations--which the U.S. used to be--can afford. By borrowing heavily from foreign nations, we have been able to keep them until now. But, as written earlier, "our day of reckoning may be approaching."

And it is not just school counselors that Americans can no longer afford. Support for the Three Strikes Law which Californians demanded when it was enacted has weakened because we can no longer afford to keep all the Three Strikes prisoners in jail.

The extent of this trend toward reduced social services was reported in an Associated Press article which appeared in the *Oakland Tribune* on June 7, 2011, pp. C1-C2) entitled, "Public job losses weigh on economy. Shrinking governments slowing recovery's momentum". It said, "In a health economic recovery, states and localities start hiring, expand services and help fuel the growth. Then there is the 2011 recovery.

"The U.S. economy is moving ahead, however fitfully. Yet state and local governments are still stuck in recession. Short of cash, they cut 30,000 jobs in May, the seventh straight month they've shed workers. Rather than add to U.S. economic growth, they're subtracting from it.

"And ordinary Americans are feeling it -- from reduced services to fewer teachers, police officers and firefighters.

"The Great Recession officially ended two years ago this month. By the same point during previous recoveries, state and local governments were engines of growth: In the two years after the 1990-91 recession ended, for example, they'd added 430,000 jobs. At the same point after the 2001 recession, they had added 249,000.

"This time is different. More than 467,000 state and local jobs have vanished since the recession officially ended in June 2009, including 188,000 in schools.

"Few see the pain subsiding soon. Mark Vitner, senior economist at Wells Fargo Securities, expects state and local governments to slash 20,000 to 30,000 jobs a month through the middle of 2012."

Jobs stemming from INNOVATION

After a digression, we are back on the subject of job creation.

The third main category of job creation being talked about -- in addition to the infrastructure and "green" industry jobs -- are jobs stemming from innovation. Again, it is remarkable that proposals for job creation do not include jobs in industries which make the products Americans buy such as stereos, microwave ovens, or cell phones. Rather we are going innovate (invent) whole new classes of products which do not yet exist.

There are several problems with the "innovation" solution for jobs for Americans, and I will discuss one of them below. Prestowitz and Fletcher cover these issues so thoroughly and so well that I am not going say much about them here other than mention some salient points in their analyses.

- Even if we "innovate" new products here, most of the jobs will be created elsewhere if the products are not manufactured here, e.g., iPods, IPhones, Kindle readers.

- The idea of designing new products here and having them manufactured offshore is not tenable in the long run because of the close two-way relationship between and manufacturing. Fletcher writes, "...other companies are shutting their U.S. design centers and moving them closer to actual production and the know-how that accumulates where it takes place. As Douglas Bartlett, chairman of the printed circuit board manufacturer Bartlett manufacturing in Cary, Illinois, puts it:

  'Anyone who know anything about real-world manufacturing knows that the factory floor and the lab form a continuous feedback loop. Unfortunately, virtually none of our trade and economic policymakers know anything about read-world manufacturing.'" (p. 66)

- Manufacturing nations such as China which have long required technology transfer from foreign companies, e.g., American, that manufacture there, are increasingly requesting that research and development (R&D) be established in their countries as well, and American companies are cooperating.

  Prestowitz writes
  ...Intel recently announced a major new fabrication facility for China that will entail an investment of about $3 billion to $5 billion. Intel has said that the various Chinese financial incentives will result in an additional $1 billion of profits over ten years as compared to operating the same facility in the United States. At the initiation of this project in the Great Hall of the People, in Beijing, Intel CEO Paul Otellini made an interesting comment. Intel's goal, he said, "is to support a transition from 'manufactured in China' to 'innovated in China.'" Innovation, of course, is what the conventional wisdom says America is supposed to do. (pp. 259-60)

Possible Environmental Ramifications of Innovating New Products

Since Prestowitz and Fletcher covered the other aspects of innovation so well, I am going to limit my comments to possible environmental ramifications of the proposals for adding jobs by innovating new products. Americans have a well-earned reputation for being big-time consumers. With about five percent of the world's population, we account for "roughly 25 percent of the world economy." (Fletcher, p. 25). Our strong shopping habits have helped developing and developed economies around the world to prosper by exporting to us.

The innovation I will refer to here is not, for example, innovation in developing improved solar and wind energy technologies. This falls into the category of "green: industries discussed previously. I refer to the idea of innovating whole new classes of products which would lead to manufacturing jobs for Americans--given that the job creation measures being proposed today do not include plans for getting America back in the business of manufacturing at least some of the things we already consume such as televisions, stereos, personal computers, microwave ovens, and cell phones--the products which fill the shelves of department stores and big-box stores.

Americans already consume a gamut of products so these new products would presumably be in addition to these. Assuming for a second that Americans could afford to buy all these new innovated products, their production and transportation would add to our demands on the planet. Humans, and particularly Americans, are using the planet unsustainably, i.e., they are using its "carrying capacity" faster than Earth can restore it. Put differently, it means that the standard of living we have now cannot be sustained indefinitely and will not be available for later generations -- whether it be our children, our grandchildren, or our descendents after them.

The vital question is how many humans Planet Earth can support at fairly high standards of living such as those of the United States and Europe. Numerous studies have been done to address this question, and they all have produced estimates around 2 billion. To put this in perspective, the planet currently has 6.9 billion people. Cornell University professor David Pimentel's research shows that about 2 billion is the number the planet can sustainably support, if everyone consumes the same amount of resources as the average European (which is less than the average American). Or put differently, it would require the resources of about five Earths to sustain 6.9 billion people indefinitely at the standard of living of the United States

Granted these are estimates and may be considerably off the mark, but to my knowledge groups which may disagree with these estimates have not done their own studies to try to estimate how many humans Planet Earth can support at a standard of living similar to ours. Some critics say that these studies do not take into account human ingenuity and our ability to find ways to accommodate larger and larger populations. But these studies <u>have</u> taken human ingenuity into account.

The business community tends not to think about such topics because it has an instinctive preference for population growth. More people mean more available workers, more customers, more sales, and more profits, especially quarterly profits -- regardless of the long-term consequences of unsustainable population levels.

The European countries and Japan appear to be more sensitive to planetary limitations to growth and have had stable or even shrinking birthrates. This has contributed to their slower economic growth rates compared to that of the U.S. Prestowitz writes,

"The U.S. growth performance has also been somewhat less brilliant than widely imagined. It is, of course, true that the United States' GDP growth rates have been well above those of the European countries and Japan. But one reason for this has been the fact that Europe and Japan have had stable or even shrinking populations, while immigration and high immigrant birth rates have driven substantial U.S. population growth." (p. 19)

Several times in his book Prestowitz invokes Craig Barrett's grandchildren. Barrett is the former chairman of Intel. In a discussion about how most CEO's of U.S. multinational corporations today believe their primary obligation is to their corporations shareholders and do not "feel obligations to community and country," Prestowitz quotes Barrett: "Intel can move wherever it must to thrive, but I sometimes wonder how my grandchildren will earn a living." (p. 5).

I am sure Barrett is also concerned about what kind of planet and environment his grandchildren will inhabit. Members of Congress and business representatives regularly oppose measures to protect the environment because these measures might "hurt the economy." It is dismaying to read this. Don't they consider that the economy depends on the environment (or more generally the Earth's carrying capacity), not the other way around? The environment would do just fine without the economy, but not the other way around. Or as the Prince of Wales put it, "the economy is a wholly owned subsidiary of Nature and not the other way around." (*Newsweek*, 12/14/2009).

This section was about possible environmental ramifications of innovating new products, and it may have appeared to have gone far afield from this topic. But throughout the section the focus was on the implications of the U.S. having a recovery in manufacturing by "innovating" entirely new classes of products which Americans would manufacture and buy in addition to all the other products they already buy; however, the U.S. would continue not to manufacture any of these latter products.

Issues with Incentives for CEOs

Quarterly Earnings Focus

In my Feb. 2009 article, I mentioned the short-term focus of many corporate compared to those of our economic competitors. It is fairly well known that Wall Street places much emphasis on quarterly earnings and that the careers of corporate CEOS ride on them. If things are not going well financially for a company, CEOs are given only a few quarters to turn things around. This is not enough time to develop an industry to be competitive internationally; for example, Chinese and Japanese companies have **much** longer planning horizons than a few quarters.

Americans CEOs can take short-term actions which raise quarterly profits and shareholder value -- and please Wall Street -- but which are not in the long-run interests of the company nor of our nation. Prestowitz provides the example of "Chainsaw" Al Dunlap who became CEO of Scott Paper Company in early 1990s.

"Dunlap quickly axed all R&D activities while throwing into the market anything that could be called new or improved. In one case he ordered a go-ahead without testing for a line of tissue containing talcum powder. Unfortunately, the abrasive powder burned out the bearings of heavy paper-making equipment and caused havoc in the mills. Dunlap also sold off Scott's enormously valuable woodlands in Alabama and other southern states along with the division that had been struggling and eventually fired over 11,000 employees. Needless to say, Scott's extensive charitable giving evaporated. Managers were directed to develop plans to double earnings for the second half of 1993 and to double them again in 1994.

"The company was obviously being structured to be sold off, and its share price rose dramatically from $37 to $84 as market players (risk arbitrage traders, for example) anticipated an acquisition by one of Scott's competitors. The deal came in the summer of 1995 when long-time rival Kimberly-Clark negotiated a tax-free merger of the two companies that effectively valued Scott at $45 per share after a share split, making the comparable price before the split about $90 per share. Many shareholders rejoiced, as the deal made them rich overnight. Other, like me, lamented the passing of a once great company. Of course, those who lost their jobs and the communities and institutions that lost the source of much of their well-being were saddened if not devastated." (pp. 197-98) (Prestowitz' first job out of college was with Scott Paper Company.)

CEOs Focus on Shareholders, But Not on Stakeholders

Prestowitz writes, "The view that had prevailed in America since the Great Depression is that a CEO is responsible to the many people, businesses, and services that have a stake in his or her corporation's welfare--to the society, that is, in which the corporation is embedded." (p. 194)

In the early 1980s, however, a different concept of CEOs' roles emerged and took hold.

"Under the new doctrine, the central concern of CEOS became the steady accumulation of strong quarterly results in order to increase the value of a company's stock. This notion that a CEO's core responsibility is to the shareholders has by now become such widely accepted wisdom that it may seem always to have been the American business creed. But this is not the case." (Prestowitz, p. 194)

"And the fealty to that new creed of shareholder value above all else has by now been taken to such lengths that a host of the most powerful American companies--the companies most crucial to our economic well-being--increasingly do not consider that they have obligations to America or even that they are American." (Prestowitz, p. 194)

The authors of all three books explain that the authoritarian countries where U.S. multinational corporations want to manufacture and sell almost always have more control over them then democratic countries like the U.S. where the CEOs can hire high-priced lawyers and get what they want in court. These authors also show that because the CEOs of these multinationals want to stay in good graces with governments of countries where they have manufacturing operations (e.g., China), they often side with these nations when the U.S. tries to re-negotiate trade agreements with them to help American industries. These CEOs caution the U.S. about being "protectionist."

In his final chapter entitled "Playing to Win," Prestowitz includes a section called "Align Business Interests with America's Interests" which suggests how we might get these CEOs back on our side (pp. 298-300).

<u>National Economic Strategy / Industrial Policy</u>

I wrote in my Feb. 2009 article,

"We have tried laissez-faire capitalism twice in the twentieth century -- during the 1920s and in the decades since the Reagan Administration -- and twice it has led us off a cliff. We need government economic policies which harness the energy and creativity of the private sector but which guide it and prevent it from self-destructing."

What do these three new books have to say about this topic? The authors are in agreement that most of our economic competitors -- e.g., China, Germany, Japan, Taiwan, South Korea -- follow mercantilist or neo-mercantilist economic policies, while the U.S. follows laissez-faire economic policies.

Neo-mercantilism is a term used to describe a policy regime which encourages exports, discourages imports, controls capital movement and centralizes currency decisions in the hands of a central government. The objective of neo-mercantilist policies is to increase the level of foreign reserves held by the government, allowing more effective monetary policy and fiscal policy.

China, Japan and Singapore are described as neo-mercantilist. It is called "neo-" because of the change in emphasis from classical mercantilism on military development, to economic development, and its acceptance of a greater level of market determination of prices internally than was true of classical mercantilism.

The essence of mercantilism is that government and the private sector develop <u>explicit</u> economic strategies (industrial policies) for the economic advancement of their nation. They do not leave the development of economic strategy to private interests seeking to make a profit, assuming that the "magic of the market" and the "invisible hand" will ensure a desirable outcome.

Prestowitz gives an example of industrial policy in China:

"A small but fundamental point to note in this connection is that in contrast to most American government leaders who are lawyers or economists, most Chinese leaders have been educated as engineers. They preside over the development of a continuing series of five-year economic visions and plans by government ministries that do intensive analysis of the history and plans of other successful developing countries like Korea, Singapore, Ireland, and Japan. They think strategically about which industries will achieve rapid economies of scale, about the linkages that enable one industry to foster another, about the most desirable sector-by-sector structure of the entire economy. Based on this analysis, they allocate tax, investment, training, and other resources and incentives to guide and induce development along the desired lines." (p. 259)

So when China decides which industries to target and which not to target ("picking winners and losers"), it is done after thorough and extensive analysis. The philosophy of Ronald Reagan, which continues to dominate American economic policy, is that picking winners and losers" doesn't work and that "magic of the market" and the "invisible hand" will always do a better job than government economic planners "meddling" in the economy.

Prestowitz writes that "Most of the world's leading economies are guided by strategic industrial policies that aim to achieve a desired overall structure and direction for the economy." (p. 258)

One method China uses to nurture industries it thinks will be "winners" is subsidies. Navarro and Autry present an example of how China might use subsides to win in economic competition.

"On the face of it, the term *export subsidies* seems pretty innocuous. But to understand just how such subsidies represent a real dagger to the heart of any American business, imagine for the moment you a Chinese entrepreneur ready to start up a company that will do battle with a competing manufacturer in Ohio, Pennsylvania, Michigan, or Tennessee.

"To jumpstart your enterprise, the Chinese government will provide you with free land, subsidized energy, and almost unlimited access to low- or no-interest loans. And, by the way, if you get into trouble, you won't have to pay the loans back, as the government owns and controls all the banks, and the Communist Party appoints all the bank's executives.

"Now, once you are ready to export your product to American, you will get a nice and juicy direct subsidy for every item you sell -- on the order of 10 to 20 cents for every dollar shipped. In addition, when the profits start rolling in, you'll be eligible for some hefty income and property tax breaks.

"On top of all this, your Chinese enterprise need never worry that an American competitor will attack you in your own backyard. If foreigners want to sell into your market, they will be forced to set up shop on Chinese soil and become your minority partner.

"Now that you see what American businesses are up against with China's export subsidies alone, do you have a better understanding of why a refrigerator manufacturer in Madison, Wisconsin, a washing machine maker in Clyde, Ohio, or a blender maker in Orem, Utah, has such a hard time competing with the Dragon? And now does it make more sense why a vacuum cleaner manufacturer in Palm City, Florida, a hand tool crafter in New Britain, Connecticut, or a baby crib maker in Barrington, New Jersey, must struggle so hard to stay afloat on the global seas of Chinese mercantilism? (pp. 56-57)

Education Is Not a Panacea

The authors, particularly Prestowitz and Fletcher, provide comprehensive analyses of steps (or solutions) which could help us regain our economic competitiveness. Prestowitz and Fletcher include an analysis of education as a possible solution, but both conclude that improved education, while important, is not going to save us in our attempts to regain economic competeveness. In fact, the title of Fletcher' section on this topic is "EDUCATION WON'T SAVE US" (pp. 59-61). An indication of why more education won't necessarily save us is shown in this example by Prestowitz:

"The circumstances of the establishment of a Motorola facility in Tianjin are instructive from the perspective of the economic theories I've discussed. Former Motorola CEO Gary Tooker told me that at first the Chinese were so inept that even the factory's Motorola sign had to be brought in from the United States. So here was a high-technology factory that required skilled labor coming from a country with plentiful capital, technology, and skilled labor to a location that had only plentiful unskilled--in other words, the opposite of how orthodox theories said things should work. Of course, Motorola was going to supply the capital and the technology, but where did it think it was going to get the requisite skilled labor? By training it course. The factors of production are not immutable. They all, and especially labor, can be changed. And it is critical to note in this regard that the change was not going to be the result of better Chinese K-12 education and universities, but rather of corporate training and technology transfer in the factory. A huge spillover was going to occur because, once trained, the workers in that factory were going to have skills that could be useful in other factories and that could be taught to other workers. Indeed, that factory wasn't going to be so much a factory as a university." (pp. 210-211)

None of the Authors Suggest Importing Smart People as a Solution

We regularly hear calls for importing more smart people from around the world as a solution for regaining our economic competitiveness. For example, a recent *Newsweek* article (June 27, 2011) entitled "14 WAYS TO SAVE AMERICA'S JOBS BY BILL CLINTON" included a section by Carl J. Schramm, CEO of the Kauffman Foundation, entitled "IMMIGRANTS=JOBS There's a simple way to get Americans back to work: Make it easy for talented foreigners to come here and hire them." (pp. 40-41).

As mentioned above, none of the authors of the three books being discussed in this article even mention importing smart people in the list of possible solutions they consider. Incidentally, what Schramm proposes used to be called the "brain drain" and was criticized.

Some comments on Schramm's proposal.

- Many countries which have been most successful in the global economy--Sweden, the Netherlands, Denmark, Germany, Japan, Taiwan, South Korea--have relatively small populations and have not needed to import smart people from other countries to be successful in the global economy.

- The countries cited above have homogeneous populations, unlike the U.S., a diverse immigrant nation which includes African-Americans (who were not immigrants per se because they were brought here as slaves several hundred years ago). It is common to hear Americans say things like, "On my mother's side, I'm French, German, and Italian, and on my father's side I'm Russian and Polish." Or "On my mother's side I'm Chinese, and on my father's side I'm Mexican and Puertorican." Americans can say such things because many of our ancestors immigrated to the United States from different countries fairly recently. The Chinese or Japanese or Koreans cannot say this because their ancestors have lived in those countries for thousands of years. One would think that a country as racially and ethnically diverse as the United States would not have to import smart people from around the world, particularly given that countries which do not have racially diverse populations such as South Korea do not have to do this to be economically competitive.

- The U.S. already has a large population -- 311,474,000 -- compared to countries with much smaller populations such as Sweden, the Netherlands, Denmark, Germany, Japan, Taiwan, and South Korea which have been successful in the global economy.

- As Prestowitz noted, our economic competitors in "...Europe and Japan have had stable or even shrinking populations, while immigration and high immigrant birth rates have driven substantial U.S. population growth." (p. 19). However, even though we have had high immigration rates and our economic competitors have not, it is they who are winning in economic competition. In June 2011, for example, our deficit with Japan climbed 53 percent to $4 billion.

- America has no shortage of smart people. In fact, it has many smart people working in jobs way below their potential and lots of other smart people without a job.

- Immigration drives population growth in both destination and source countries, and at this point in history population growth is not good for our planet.

<u>Two of the books are objective and take a neutral stance on values.</u>

I wrote at the beginning of this section,
"What do these three new books have to say about this topic [i.e., national economic strategy / industrial policy]? The authors are in agreement that most of our economic competitors -- e.g., China, Germany, Japan, Taiwan, South Korea -- follow mercantilist or neo-mercantilist economic policies, while the U.S. follows laissez-faire economic policies."

The authors agree on the empirical aspect of this: i.e., these countries have mercantilist, industrial policies. However, they disagree on the values aspect of this: Prestowitz and Fletcher maintain an objective tone throughout their books. They simply explain that these countries have made a conscious choice and have rejected the American laissez-faire trade model; they have chosen a mercantilist, economic strategy model. The authors provide quotes from high-ranking economic officials of these countries who state this clearly.

Navarro and Autry, in contrast, say the Chinese are not playing fair and are cheating because they use techniques such as subsidies to create "winners." These authors do not accept that the Chinese have consciously chosen an economic system different than ours. For example, they write,

"Well, Communist China, Democratic America is still waiting for you to keep that free trade promise. And, as we wait, your illegal export subsidies continue to hammer hardest at some of North America's most important pillar industries: steel, petrochemicals, paper, textiles, semiconductors, plywood, and machinery. The list is as long as the unemployment lines in Stockton, California; Las Vegas, Nevada; Monroe, Michigan; and Rockford, Illinois," (p. 57)

I will discuss the orientation of Navarro's and Autry's book further later in this article.

General Truths in Logic, Mathematics, and Economics

In logic, mathematics, and economics, a principle or concept is only a general truth if there does not exist a single counterexample which refutes it.

Example 1

There is a general concept in economics that if the government stays out of the economy and lets market forces drive events, the economy will perform better than when the government intervenes to guide the outcome. China's guidance of its economy is clearly working, providing not just one, but many counterexamples to the laissez-faire principle regarding government's role in the economy.

So there is **not** a general truth that the economy will perform better if the government stays out of the economy and lets market forces drive events This means it has to be determined on a case by case basis what role the government should play in developing national economic strategies.

Although most reasonable people would agree that what China is doing with its economy is working: its rise from the legacy of colonialism to an industrial powerhouse in a few decades has been spectacular. However, some ardent devotees of laissez-faire deny that what China is doing is working and claim that its protectionist policies are hurting it and will backfire on it. Fletcher writes, "Even if China's protectionist policies actually hurt it -- a repeated claim of free traders -- China's government obviously doesn't think so, as *it* chooses to define its own national interest." (p. 77)

Example 2

There is a general principle in economics that financial markets are self-regulating and that intervention by government bureaucrats is not only unnecessary but harmful. A principle is a general truth only if there does not exist a single counterexample which refutes it.

For this example, I will draw from Mark Zandi's book *Financial Shock* (July 2008). (Mark Zandi is chief economist of Moody's Analytics, where he directs research and consulting. Moody's Analytics, a subsidiary of Moody's Corporation, is a leading provider of economic research, data and analytical tools.)

The material presented deals with housing bust which occurred during late 2007 - early 2008.

"Chairman Greenspan's reluctance to flex the Fed's regulatory muscles stemmed from his own oft-voiced skepticism about regulation. Greenspan believed a well-functioning market with the appropriate incentives could police itself more effectively than could government bureaucrats. Mortgage lending qualifies as such a market, Greenspan thought. Lenders ultimately had to answer to smart and self-interested global investors, who surely saw no lasting profit in making bad mortgage loans.

"Greenspan wasn't the only policymaker who held such views; the 1980s and '90s had been marked by a steady march toward deregulation. The trend climaxed in 1999 with Congressional passage of the Gramm-Leach-Bliley bill, which overturned Depression-era banking laws barring banks from merging with securities dealers and insurance firms. The resulting financial holding companies were put under the regulatory domain of the Federal Reserve. The Basel II rules on banks' capital reserve requirements were being fashioned at about the same time. These rules rely heavily on market forces; how much capital banks need, and therefore how aggressive they can be in their lending, is determined mainly by the market value of their holdings. The fashion in banking circles was to let the market--not old-fashioned regulators--determine what was appropriate." (pp. 152-153)

"Policymakers' confusion was exacerbated by their inability to gather timely and accurate information. Unlike past financial crises when most of the players involved were regulated and had to report regularly on their risks and financial health, rapidly evolving institutions that had little or no regulatory supervision were driving this crisis. Policymakers knew little to nothing about them. Global regulators did have discussions about whether and how these new institutions should report on their activities, but they had gotten nowhere. The U.S. Treasury was particularly uninterested in restricting the financial system; officials there believed the marketplace could discipline itself. The Bush administration's philosophy was to keep government out; financial markets whould work out problems on their own. Yet without a regulatory structure in place, policymakers at the U.S. Treasury, the Federal Reserve, and elsewhere had no way to judge the severity of the shock, and they lacked the expertise to respond to it." (p. 196)

Later in early 2008, as the crisis worsened, "The Bush administration quickly retreated from its long-held positions in an effort to stem the financial crisis and developing recession. Markets weren't figuring it out by themselves--they needed government help. And the parts of government most valuable in addressing the crisis were the very ones the administration had previously wanted to restrict or dismantle. The administration viewed the FHA, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks as, at best, anachronistic and, at worst, risks to the financial system; these institutions were now the centerpiece of the policy response to the subprime finance shock." (p. 208)

By spring, 2008,

"The official response to the subprime financial shock had gone from timid to bold. In summer 2007, the Federal Reserve had been uncomfortable lowering interest rates; by spring 2008, policymakers were gearing up for the largest government intervention in the financial system since the savings and loan crisis of the early 1990s. The failure to act decisively early in the crisis had contributed to the need for even more aggressive action later. The fast-approaching presidential election surely had something to do with the transformation; voters demanded that policymakers act. However, just as important was the realization that the subprime financial crisis was bigger than the market's ability to manage it." (pp. 211-212)

So it is **not** generally true that financial markets are self-regulating and intervention by government bureaucrats is not only unnecessary but harmful. This means it has to be determined on a case by case basis when government regulation of financial markets is called for.

Losing Industrial Clusters / Networks

Business clusters are a vital component of economic development. A business cluster is a geographical location where enough resources and competences amass and reach a critical threshold, giving it a key position in a given economic branch of activity, and with a decisive sustainable competitive advantage over other places, or even a world supremacy in that field (i.e. Silicon Valley, Hollywood, and America's former Industrial Heartland in the Midwest).

America has been losing market share and some industries to our economic competitors, but even more worrisome is the loss of our industrial clusters and networks. Prestowitz writes,

"Another more significant example of [this] is Amazon's Kindle electronic reader, one of the 2009 Christmas season's bestsellers. The key innovation that makes this product possible is the electronic ink invented and made in the United States by Cambridge, Massachusetts-based E Ink Corporation. Nevertheless, the Kindle cannot be made in the United States because the special glass of the display, and virtually all the other key components like its semiconductor chips and its battery, are made only in Taiwan, Korea, Japan, and China. Thus, of the $185 total estimated manufacturing value added per Kindle, only $40 to $50 is added in the United States, and that may soon decline to zero.

Some analysts believe that E Ink's production and R&D will also soon be moved to Asia, not because of cheap labor (the product is not labor intensive), but because Asia has a more friendly investment, tax, and regulatory environment and offers various direct and indirect export subsidies, including undervalued currencies.

"This suggests the most significant aspect of the above examples. The next e ink is unlikely to be developed in American, because we will lack the supporting components and skills of the innovation ecosystem. The special displays are made with lithographic equipment originally used to produce semiconductors, a technology that left the United States for Asia in the 1980s and 1990s as Japan and then Korea and Taiwan targeted the semiconductor and semiconductor equipment industries for strategic development. The battery technology that powers the Kindle left American with the consumer electronics industry in the 1960s and '70s. Much of the glass technology also left with the consumer electronics industry. As Silicon Valley entrepreneur, corporate director, and author Richard Elkus says, 'Eventually, everything is related to everything else.'

"These were not just losses of market share or of a few factories and jobs. They were losses of what Harvard Business School's Gary Pisano and Willy Shih call the 'industrial commons.' Like the common pastures and fields of medieval times or the common transportation infrastructure that supports modern life, the industrial commons is the collective operational capabilities that underpin new product and process development in the United States. Their loss represents not a relative shift but an absolute subtraction from the total assets of the productive base of the economy." (p. 253)

Technology Transfer

A major factor which has contributed to the decline of American industrial competitiveness has been the ease and rapidity with which U.S. multinational corporations with manufacturing facilities in East Asia nations have transferred U.S. technology -- whose original R&D were sometimes paid for by U.S. taxpayers -- to these nations. The authors of the three books cover this subject in detail. China was by no means the first Asian nation to require technology transfer, and Prestowitz provides numerous examples of how the Japanese did this before the Chinese.

"Sony got the keys to its kingdom for $25,000. Think about that for a moment. AT&T's research arm, Bell Laboratories, had spend hundreds of millions, and U.S. telephone uses had paid billions to finance the generation of that technology. Sony, a company based in a Japan that was then compelling U.S. companies to transfer their technology to its companies as a condition of being allowed to enter the Japanese market, got it for almost nothing." (p. 77)

"Meanwhile, new laws and programs to promote the [Japanese] electronics industry were instituted, and even as the Japanese government agreed to allow Texas Instruments, IBM, and other foreign companies to begin doing business in Japan, it did so by insisting that they transfer technology to or conclude joint ventures with Japanese companies. Both of these steps entailed substantial transfer of proprietary technology to active or potential competitors." (p. 97)

Of course, the books also include more recent examples of China requiring technology transfer from multinational American corporations as a condition for being able to have manufacturing facilities in China and access to China's markets. Navarro and Autry write,
"...it [China] mandates *forced technology transfer*. To wit, American companies must surrender their intellectual property to their Chinese partners as a condition of market entry. The practical effect of this condition is to facilitate the dissemination of various technologies not just to the Chinese government and other potential Chinese competitors. By surrendering to this condition, Western companies, in effect, create their own Chinese competitors virtually overnight." (p. 81)

Such technology transfer is certainly very different than in the past when nations carefully guarded their technology, knowing it was key to their continued prosperity. Quoting from my spring 1997 dissertation,

"Three hundred years ago, stealing or disclosing the secrets of silk-spinning machinery in northern Italy was a crime punishable by death. At the beginning of the industrial Revolution, Britain protected its supremacy in textile manufacturing by prohibiting both the export of machines and the emigration of men who knew how to build and run them" (p. 257)

The following information about how Venice guarded its trade secrets is from the 1973 Newsweek history book *Venice*. I am also including some information on the nature of their economy:

"The pageantry that surrounded the doge on such occasions reflected the staggering wealth that Venetian fleets brought to the lagoon city from every corner of the civilized world. By the middle of the fifteenth century, that wealth had grown incalculably large; Venice enjoyed a virtual monopoly over trade with the East and her navy – the largest in the world – was in absolute command of the Mediterranean sea routes.

"La Serenissima's phenomenal prosperity was generated and maintained by a system that has been defined as authoritarian state capitalism. In Venice's case, where almost all wealth came from the sea, this meant that the state owned everything that had to do with the sea. The state owned most of the trading galleys, the docks and shipyards, and all industries having to do with the fitting of ships. Furthermore, it owned all trading facilities – warehouses, loading equipment, and freight barges – both domestic and foreign. Private citizens actually owned only the cargoes that they bought, transported, and sold – and even these were heavily taxed by the state." (p. 48)

"The government also closely regulated the activities of its manufacturers. The secrets of Murano glass manufacture, which gave the Most Serene Republic a near monopoly on fine glassware in Europe, were jealously guarded by the Council of Ten, and glassworkers were not allowed to leave Venice or fraternize with foreigners." (p. 49)

If Mercantilism Works For Our Competitors, Why Aren't We Doing It?

The U.S. has not been doing well in international trade for quite some time as evidenced by our trade deficits and no longer "manufactures the vast range of consumer and industrial goods on which its wealth and power were originally built." (Prestowitz, p. 26) So why aren't we trying mercantilism which appears to be working for our competitors?

Prestowitz shows that indeed we used to follow mercantilist policies starting as far back as the early nineteenth century when our young nation was trying to "catch up" with Britain which was the world's dominant industrial country at the time.

"Called the American system, it consisted of government policies and programs aimed at developing advance infrastructure and protecting and subsidizing development of intellectual property and manufacturing industries. This, of course, was antithetical to the free-market, laissez-faire policies about to be adopted by Great Britain. But American was aiming to catch up and eventually surpass Britain." (p. 45)

Our economic strategy worked: "...between 1870 and 1900, America surged ahead of Britain in virtually every sector of the economy. (Prestowitz, p. 59)

After World War II, "the United States was number 1 in virtually everything." (Prestowitz, p. 73) Concerned about the spread of communism, our focus shifted from economic strategy to geopolitics.

"Meanwhile, for most of the rest of the world, recovery from wartime devastation was the overwhelming priority. Especially for Germany and Japan, and later for the so-called Asian Tigers (South Korea, Taiwan, Singapore), developing competitiveness trumped geopolitics, which they were glad to leave to Americans. Or, perhaps it would be more accurate to say that becoming competitive was their form of geopolitics." (Prestowitz, p. 73)

Even as our emerging competitors were adopting mercantilist economic strategies, we moved away from these same strategies which had helped our nation become rich and powerful, and we moved toward laissez-faire. Whereas before our nation worked to protect and nurture its industries, we now moved toward open trade. Prestowitz writes,

"As the new world leader, the United States could also now see that a revitalized Europe and Japan or a stable Middle East offered potential long-term benefits that could justify making short-term economic concessions. With the advent of the Cold War, trading technology and access to the U.S. market for the right to station troops in a critical country began to look smarter than on insisting on narrow reciprocity and on maintaining complete U.S. industrial and technology leadership.

"This conclusion was greatly facilitated by the fact that American industry had become more dominant than any other country's had ever been. In a world of unregulated free trade, American CEOs, like their British predecessors in the nineteenth century, were convinced they could not fail to win every time. Similarly, American labor also thought it would be a big winner because it was far and away the world's most productive workforce, Thus, by 1950, after nearly a century and a half, Alexander Hamilton was out, and Adam Smith and David Ricardo were in." (p. 84)

This shift to a laissez-faire role for the U.S. government in economics began around the mid-twentieth century. However, the phenomenon of strong and active dislike -- or even hatred -- for government did not begin until the 1980s when Ronald Reagan was president (1981-1989). This trend is strong today, e.g., the Tea Party movement.

This dislike of government appears to be driven by emotion rather than any objective analysis of what the government can and cannot do well. For example, in recent decades the powerful financial industry used their influence to get the government to greatly diminish or eliminate regulation of their industry. Then their risky financial activities led to a crash, and the government had to come in to bail them out (see Mark Zandi's analysis above). And then the anti-government faction blames it all on the government.

Prestowitz writes,
In fact, a bizarre schizophrenia characterizes the relationship between the American people and the American government--as was wonderfully articulated by the man at recent town hall meeting who shouted at his congressman to "keep the government's hands off my Medicare." Statements like that, which make you wonder whether to laugh or cry, reveal the essential irrationality of the discussion. In this case, the guy loved what the government was doing for him as long as he didn't know it was the government doing it. (p. 284)

This individual who loves his Medicare but hates his government probably thinks that the government can't do anything right and should not be "meddling" in the economy. However, as Prestowitz writes,

"The truth is that the story of America's development into the world's leading country is one of private sector-government partnership. Sometimes as kind of experiment I will ask an audience if anyone knows who invented the internet. The guesses usually include Bill Gates, Steve Jobs, Intel, AT&T, and Google. The never include the right answer: the U.S. government. Or even more correctly, the long partnership between the Defense Advanced Research Projects Agency (DARPA), the National Science Foundation, our research universities, and companies like Bolt, Beranek and Newman. From the American System and the Erie Canal to the construction of the railroads to the development of aviation to the mobilization for the world wars to the founding of companies like RCA to the atomic bomb and nuclear energy, to the moon landing and the internet, American industry and government have worked hand in glove to achieve unprecedented progress." (p. 285)

The authors of the three books being discussed all warn us that America which follows laissez-faire policies is losing badly in economic competition to nations which for the most part follow mercantilist policies with national economic strategies (industrial policies). Our industries are already badly eroded, and if we continue our present laissez-faire policies, we will continue to decline to the point where there is no longer any hope for us

The authors of the three books have hope for the U.S. economy and believe there is still time -- although not much time -- to turn things around. In fact, they all devote at least a chapter in their books to strategies for pulling us out of the hole we've dug for ourselves. Among other recommendations, they recommend that we review the economic strategies and the private sector-government partnerships our nation used for a century and a half which made America number one economically in the world. **However, the national economic strategies they recommend all entail a larger role for the government in the economy. The roadblock the nation faces in this respect is that many Americans want the government to have a smaller, not a larger role in the economy, for example, Michele Bachmann of the Tea Party movement.**

Why do Americans dislike their government so much? They didn't use to. They certainly didn't dislike it during the presidency of John F. Kennedy. This dislike really didn't surge until the presidency Ronald Reagan. What did all those blue-collar Reagan Democrats discover during this period which made them change parties and ardently want to get the government off their backs? Were they converted into devotees of laissez-faire by reading Milton Friedman's books? Did they discover new evidence of government incompetence proving that government can't do anything right?

Think about it. Americans liked their government during the presidency of John F. Kennedy, but not during the presidency of Ronald Reagan. Yet the government had not become any less competent in economic affairs in the years of the Reagan administration than it had been during the Kennedy administration. In fact as Prestowitz' thorough research shows, the government's role in the economy had been decreasing since the 1950s and was already smaller during the Reagan era than during the Kennedy years.

The Government's Role in the Economy Is **Not** the Root Cause of This Dislike

I do not believe that Americans' dislike of government had anything to do with economics or new evidence of government incompetence in economic matters. The root cause of Americans dislike of their government stems from our racial divisions. I am including here a section from my spring 1997 dissertation which had to do with the government's role in promoting sustainable development. But the same issues also apply to the government's role in nurturing the economy.

"The United States, with the largest economy in the world, needs to help lead the worldwide change to more sustainable practices, and this will require a comprehensive, integrated, and large-scale commitment by government.[146]

"Unfortunately, socio/political developments during the last two decades or so greatly hamper the government’s ability to play such a role. Nowadays, many American citizens not only believe that government is inherently inefficient, but also actively dislike it. Historically, this point of view was associated with the wealthy who generally resented government interference in their affairs and abhorred progressive government policies that redistributed wealth from the well-to-do to lower-income groups. (FDR was called a "traitor to his class" for his progressive social policies.)

"However, those who dislike government today come from a wide range of socio-economic levels. Notably, many of these people come from the working class ranks which constituted the bulwark of FDR's support half a century ago. Presumably, the grandfather of Timothy McVeigh, the Irish-Catholic American suspect in the bombing of a federal building in Oklahoma City and an ardent hater of government, supported the New Deal and believed that government had an important and vital role to play in the economy.

"What has caused such a change in the attitude of working-class people toward government? Does McVeigh have some new insights into the appropriateness and effectiveness of government's role that his grandfather lacked? And do Americans have insights that those of other countries lack since this phenomenon of intense dislike of government is particular, if not unique, to this country?

"Here is an explanation of this development: This American phenomenon of contempt for government is a by-product of this nation's racial problems. It first began to manifest itself after the Civil Rights era of the 1950's and 1960's as "white backlash." During the early stages of the Civil Rights era, there was widespread acceptance of and support for changes to correct the unjust treatment of Black Americans. However, when these reforms began to impact the white population, e.g., hiring quotas, support changed to resentment and opposition. During the New Deal, government was perceived as looking out for the welfare of the average working-class person, who was usually white. In recent decades however, government has no longer been viewed in this way by many whites, but rather as doing too much for minorities at their expense.

"This sentiment was kept in check during John F. Kennedy's idealistic term and during the Vietnam War when the activities of protesters caused an increase in support for government. However, an economic trend was developing in that era which fueled white middle-class discontent: this was the rise of strong international competition which severely impacted American manufacturing and the secure, well-paying jobs that had elevated blue-collar America into the middle class. In general, a smaller economic pie exacerbates other social and racial problems.

"Although Nixon courted the "silent majority," it was during the presidencies of Ronald Reagan and George Bush that anti-government sentiment swelled and was given legitimacy. Reagan fanned the flames of this sentiment and fostered Americans' distrust and dislike of government. His theme was "get the government off the people's backs." His supporters have claimed they are pro-liberty and that government deprives them of their freedoms. In contrast, the grandparents of today's white working class supported the New Deal because they believed that government could play an important role in helping the average working person. In recent decades however, government has increasingly been viewed as an entity which helps minorities, but is no longer the champion of middle class workers. It should be noted that contempt for government has now taken on a life of its own, and some who despise government do not necessarily harbor animosity toward minorities.

"The timing of this development is very unfortunate because government has a crucial and indispensable role to play in sustainable development..." (pp. 76-78)

I wrote my dissertation 14-plus years ago during which time race relations in this country have improved significantly. So the last sentence in the above paragraph should probably now read, " It should be noted that contempt for government has now taken on a life of its own, and **most** who despise government do not necessarily harbor animosity toward minorities."

So today hating our government has become to a large extent a habit separated from whatever factors caused it originally. If someone, for example, is unhappy with their situation in life, they automatically blame it on the government. However, the authors of the three books **believe the government will have to play a larger role in the economy** for us to be able to compete with our mercantilist competitors who are quite literally clobbering us. Prestowitz writes, "...I believe it is essential for the revitalization of American that Americans stop automatically dissing their government." (p. 284)

<u>Some Issues with *Death By China: Confronting the Dragon--A Global Call To Action* by Peter Navarro and Greg Autry</u>

I wrote near the beginning of this article,
" Before writing this new article (also attached), I updated my knowledge of this subject by reading three new books on this topic. Two of these -- *The Betrayal of American Prosperity* (2010) by Clyde Prestowitz and *Free Trade Doesn't Work* (2011) by Ian Fletcher -- are excellent and I strongly recommend them. The other and most recent of the books -- *Death By China Confronting the Dragon--A Global Call To Action* by Peter Navarro and Greg Autry -- provides some useful insights and information, but I believe its orientation and perspective are wrong and would, if followed, be counterproductive (to be explained later)." I will now explain my concerns about *Death By China*.

The authors of all three books agree on the basic fact that China follows mercantilist, industrial policies. However, they disagree on the values aspect of this. Prestowitz and Fletcher maintain an objective tone throughout their books. They simply explain that China has made a conscious choice and has rejected the American laissez-faire trade model; it has chosen a mercantilist, economic strategy model. They don't say that China is moral or immoral or that it is right or wrong, and they do not approve or disapprove of it. They just say that China runs its economy differently than we run ours.

Navarro and Autry, in contrast, take a values stance that China's system is morally wrong. The tone of their approach is set on the page immediately following the title page which says, "To all of our friends in China. May they one day live in freedom--and until that day remain safe." This is followed on the next page by a quote from Albert Camus, "It is the job of thinking people not to be on the side of the executioners." This is folowed by a three-page foreword by Baiquao Tang, Tiananmen Square protester and co-author of My Two Chinas: The Memoir of a Chinese Counterrevolutionary. Although *Death By China* is a very new book (with First Printing, May 2011), Navarro's and Autry's stance is reminiscent of traditional anti-communism.

Yes, China has a different political system than we have and has different concepts about freedom than we do. However, governmental and economic systems in China grew out of internal forces in China whether we approve of them or not. They were not imposed on China by a foreign power.

<u>Selling Us Poisonous and Defective Products</u>

In PART I (see below), Navarro and Autry write about the nasty things the Chinese are doing: poisoning us with cheaply-made food products and making defective toys which maim our kids. And they're making these products by "the pervasive use of slave labor." (p. 2) Two things strike me about PART I:

- Prestowitz and Fletcher present extensive, thorough, and scholarly research on China's economy, but they do not mention any of these bad things that Navarro and Autry report on in PART 1. Prestowitz and Fletcher treat the Chinese as economic competitors without talking about how nasty they are.

- If they Chinese were really producing such junk and harmful products as Navarro and Autry say, you would think that these products would not pass the test of the market in stores in America.

PART I: "BUYER BEWARE" ON STEROIDS

Chapter 2: Death by Chinese Poison: Bodies for Bucks and Chicks for Free

Chapter 3: Death by Chinese Junk: Strangling Our Babies in Their Cribs

<u>"Arming Itself to the Teeth" (p. 5)</u>

Although Navarro, a business professor at University of California at Irvine, is the author of the best-selling *The Coming China Wars* (which deals with " China's rampant environmental pollution, exploitation of workers, drug trafficking, arms trading, piracy, counterfeiting and other ills"), he and Autry are <u>not</u> calling for war against China in *Death By China*. However, the four chapters in PART III (shown below) are dedicated to the military threat China presents. In marked contrast, Prestowitz and Fletcher do mention in their books that America's eroding industrial base threatens our military power and vice versa for China, but their focus is primarily on China as an economic competitor, not as a military adversary.

PART III: WE WILL BURY YOU, CHINESE STYLE

Chapter 8: Death by Blue Water Navy: Why China's Military Rise Should Raise Red Flags

Chapter 9: Death by Chinese Spy: How Beijing's "Vacuum Cleaners" Are Stealing the Rope to Hang Uncle Sam

Chapter 10: Death by Red Hacker: From Chengdu's "Dark Visitors" to Manchurian Chips

Chapter 11: Death by Darth Liu: Look Ma, There's a Death Star Pointing at Chicago

I repeat that Navarro and Autry are **not** encouraging military action against China. However, the U.S. has taken military action in the past against countries with political / economic systems we considered to be immoral and which we considered to be potential military threats.

"Regime Change" in Vietnam

It was hoped that America learned in Vietnam that it is not a good idea to try to forcibly change a government which grew out of internal forces in that country even though we do not approve of it. It is not a good idea for moral reasons nor even for geopolitical reasons.

But this happened in Vietnam. Ho Chi Minh was the leader of the Viet Minh, a national movement which arose after the defeat of the Japanese in World II who had occupied French Indochina during the war. When the French tried to retake their colonies in Indochina after the war (with the approval of the United Kingdom, the United States, and the Soviet Union), the Viet Minh fought and defeated the French. If elections had been held in Vietnam at that time, it was estimated by President Dwight D. Eisenhower that "80 percent of the population would have voted for the Communist Ho Chi Minh" over Emperor Bao Dai.

Ensuing events led to American entry into what became the Vietnam War. America's reasons for entering the war were

- Moral - The communists were godless, and they enslaved their own people, denying them freedom.
- Geopolitical - The Domino theory: Stop the spread of communism.

This undertaking did not end favorably for the United States, with the capture of Saigon by the North Vietnamese army in April 1975. The war exacted a huge human cost in terms of fatalities. The lesson that it was hoped we learned was: Different countries have different values, beliefs, and societal arrangements than we do. When governmental arrangements grow out of internal forces in a country, we should accept them and not try to bring about "regime change" even if these countries have a different concept of freedom than we do, and we do not approve of their values.

So it is not going to be productive for our relationship with China for Navarro, Autry, and others to tell them they need to "reform" their systems to bring them in line with our concepts of freedom. The Chinese might tell us that they do not want a political system like ours where election campaigns have become so expensive that wealthy corporations can, by financing campaigns, effectively "hire" candidates with views to their liking.

<u>"Regime Change" in Iraq</u>

Our war in Iraq has similarities to the Vietnam War. Saddam Hussein rose to power in Iraq from internal forces in that country. He was not installed in office by foreign powers. However, we did not approve of him or Iraq's form of government. George Bush's reasons for invading Iraq were:

- Moral - Saddam Hussein was a ruthless dictator who enslaved his own people, denying them freedom.
- Geopolitical - Stop the spread of weapons of mass destruction -- which were never found -- and stop the spread of terrorism by taking away their training grounds. In fact, the terrorists just found somewhere else to train.

Like the Vietnam war, the Iraq war did not end favorably for the United States, given our moral and geopolitical goals.

Death By China: Confronting the Dragon--A Global Call To Action
by Peter Navarro and Greg Autry

<u>In summary</u>, *Death By China* by Peter Navarro and Greg Autry provides some useful insights and information, but I believe its orientation and perspective are wrong and would, if followed, be counterproductive. <u>You should read it with caution.</u>

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HUFF POST BUSINESS

U.S. Trade Deficit Widens To $53.1 Billion, Highest Level Since 2008

By MARTIN CRUTSINGER 08/11/11

WASHINGTON -- American producers sold fewer industrial engines, electric generators and farm products to the rest of the world in June, pushing the trade deficit to the highest level since 2008 and dealing another blow to an already struggling economy.

The deficit rose 4.4 percent to $53.1 billion in June, the largest imbalance since October 2008, the Commerce Department reported Thursday. Imports fell 0.8 percent to $223.9 billion as crude oil prices fell for the first time in nine months. Exports dropped 2.3 percent to $170.9 billion, the biggest decline in more than two years.

The drop in exports, the second in a row, was a blow to hopes that rising overseas demand will boost the fortunes of American manufacturers in the face of a slump in spending by U.S. consumers. The concern now is that a global slowdown will hobble a U.S. economy that is in danger of stalling out.

The deficit through June is running at an annual rate of $576.6 billion, 15.3 percent higher than the 2010 imbalance. A higher trade deficit subtracts from overall economic growth because it means consumers are purchasing more foreign-made goods and fewer products made by U.S. workers.

The big rise in June's deficit came as a surprise to economists who had been forecasting an improved deficit based on their belief that oil prices would fall, lowering imports, while exports would recover from a May decline which had been the first setback after 10 monthly gains.

Instead, exports tumbled by the largest amount since a 5.1 percent plunge in January 2009 as the global economy was in the grips of a deep recession.

The weak June trade report was the latest in a string of disappointing economic statistics raising concerns that the U.S. economy could be in danger of toppling into another recession. The economy slowed to an annual rate of just 0.8 percent in the first six months of the year, the slowest period of growth since the recession officially ended two years ago. In June, consumers cut spending for the first time in 20 months and saved more while wages were barely growing and unemployment remained above 9 percent.

The deficit with China shot up by 6.8 percent $26.7 billion in June, the highest since September 2010. The deficit with the European Union rose 12.2 percent to $9.8 billion, the worst imbalance since July 2008. The deficit with Japan climbed 53 percent to $4 billion. Imports with Japan had been reduced in previous months following the March natural disasters which disrupted production at Japanese auto plants and other factories. As Japanese factories have resumed more normal operations, shipments to the United States have been rebounding.

Oil imports fell 4.3 percent in June to $38.2 billion as the average price of a barrel of crude oil fell to $106, down from $108.70 in May. It marked the first decline in crude prices in nine months.