Policy Analysis

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Executive Summary

Secretary of State Warren Christopher has stated that his foremost priority is the economic security of the United States. To that end, the administration is making aggressive efforts to open foreign markets and thereby create U.S. jobs.

There are three major problems with the administration's policy. First, it is based on a misunderstanding of international trade. As long as the overall economy is growing, a trade deficit is not a problem. Second, the administration has focused its policy on Japan but fails to appreciate the difficulties affecting the Japanese economy. Putting pressure on Japan at a moment of economic weakness risks creating a reservoir of anti-American sentiment.

Third, an obsession with economic security risks repeating the unfortunate developments of the late 19th century. Then as now, rapid technological change fostered economic insecurity among those who lacked the skills to keep up. In an attempt to counteract that trend, governments adopted mercantilist policies, which exacerbated economic rivalries, especially between Germany and Britain. Those rivalries spilled over into the political and military arena and ultimately led to World War I.

Although history does not repeat itself exactly, using political and economic muscle to create an international playing field tilted toward the United States, which the secretaries of both the Treasury and Commerce have admitted is their policy, is extremely risky. Other countries will respond in kind, and global tensions will increase. The administration should abandon its neomercantilist policies and renounce the concept of economic security.

Introduction

The Clinton administration has been looking for a new principle around which to formulate a foreign policy. Believing that military threats have greatly diminished since the end of the Cold War, administration officials have focused on threats to what they call economic security. "In the post-Cold War world, our national security is inseparable from our economic security," Secretary of State Warren Christopher told the Senate Foreign Relations Committee on November 4, 1993, emphasizing "the new centrality of economic policy in our foreign policy."[1] Indeed, he has said that economic security is his foremost priority, ahead of the fate of the former Soviet Union or nuclear proliferation.[2]

The threat to American economic security allegedly arises from the unfair trade practices of U.S. allies, which the United States indulged in the past because of the overriding priority of allied unity in the Cold War. As former Treasury secretary Lloyd Bentsen has put it, "For four decades, we accepted protectionism elsewhere as the price of stability and winning the Cold War. But that day is over."[3] With the demise of the Soviet Union, the United States is now free to deal with the threat posed by protectionism, and it must do so for the sake of its economy. "This is not tough for being tough," stresses trade negotiator Mickey Kantor. "This is tough on behalf of American jobs and the American economy."[4]

By framing the argument in that manner, the administration makes opponents of its position appear to be unpatriotic. After all, what American can be opposed to measures that promote American jobs and the American economy? The danger, however, is that the measures the administration has been taking may not achieve that objective--indeed, the administration's actions may have exactly the opposite effect. There are three fundamental problems with the policies designed to enhance U.S. economic security: first, the administration's understanding of economics, and especially of trade; second, the administration's appreciation of the current international economic situation, especially where Japan is concerned; and third, the administration's assessment of the international political environment.

Two Types of Capitalism

The history of mankind reflects the history of economic growth and economic institutions. Primitive economic systems were based on self-sufficiency (e.g., hunter-gatherers who provided for themselves and those close to them). Economics proper came into being with the development of exchange, which is founded on the division of labor. Ultimately, the need to make exchange easier led to the creation of money, which in turn made it easier to measure the accumulation of surpluses for investment. Capitalism arose with 1the creation of institutions to facilitate the investment of surpluses.

Mercantilism

Over time two types of capitalism have emerged. The first, typically called mercantilism, gives "first rank to the goal of national power and adopting regulation of economic life as the preferred means of ensuring the desired increase of wealth."[5] Accordingly, the state should determine how surpluses are invested. Two arguments are used to justify that position. The more traditional argument is that the power of the state must be enhanced because of the constant demands of war. In the blunt formulation of Jean-Baptiste Colbert, Louis XIV's chief minister and perhaps the foremost exponent of mercantilism, "Trade is the source of public finance, and public finance is the vital nerve of war."[6]

The second argument is that the state's knowledge is superior to that of people acting on their own. That argument, typically associated with communism, has been somewhat discredited by the collapse of the Soviet Union but has found new life in "revisionist" interpretations of Japan's economic growth. "Research and development is necessary for the future and it is a gamble," Naohiro Amaya, a former vice minister of Japan's Ministry of International Trade and Industry, has argued. "Businessmen are risk averse. They hesitate to take the gamble on research and development. Therefore, if the invisible hand cannot drive the enterprise to research and development, the visible hand must."[7]

Those two views are quite complementary. As James Fallows, Washington editor of the Atlantic Monthly, has pointed out, "In the Anglo-American model, the basic reason to have an economy is to raise the individual consumer's standard of living. In the Asian model it is to increase the collective national strength. . . . This is, in Western terms, a `military' view of economics."[8]

It is especially disturbing that Fallows and other revisionists who assert that Japan has developed a different and superior form of capitalism are inspired by the "German school" of 19th-century economists led by Friedrich List, an imperialist whose work provided part of the intellectual foundation for Nazism.[9] List explicitly based his economic nationalism on the need of the state to prepare for war. Indeed, he condemned free trade precisely because it takes "no account of the effects of war upon the foreign trade of nations.[10] The revisionists condemn free traders for their alleged indifference to history, but it is the revisionists who are evidently unaware that, historically, a military view of economics has led to war.

Market-Based Capitalism

The second type of capitalism is based on the market (i.e., on the people separately, rather than the government collectively, directing economic activity). To be sure, the state has a right and even an obligation to control economic activity that directly affects national security. As Adam Smith acknowledged, "It will generally be advantageous to lay some burden upon foreign, for the encouragement of domestic industry . . . when some particular industry is necessary for the defense of the country." In a market economy, however, the purpose of the economy is not to prepare the state for war but to provide for the satisfaction of the desires and needs of the people as consumers. "Consumption is the sole end and purpose of all production," Smith insisted, "and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer."[11]

Unlike traditional mercantilists and their contemporary counterparts--Communists and Japanese "revisionists"--Smith and his followers believe that the economy is simply too complex to be successfully directed by the government over the long term.[12] Recognition of that point led to the repudiation of a command economy in Russia. Even during the Gorbachev era, some officials began to question that essential tenet of communism. As Alexander Yakovlev, one of Gorbachev's closest advisers, acknowledged in 1988,

Let us put the question in the following way: have we other reliable means of identifying all the countless requirements which actually exist in society? From the largest to the smallest ones? Are we able to take into account their extremely mobile dynamics? And even if we somehow identify these requirements without the market, shall we be in a position to manage to meet them from a single center? Up till now, all such attempts have ended in failure.

Today we know--and this I emphasize--we know from experience the answers to all these questions. And they are very simple answers. It is not that it is simply technically impracticable to practice such totalitarian bureaucracy, but that human flaws in the command system cannot be compensated for by even the most sophisticated computers. Such approaches should be rejected in principle.[13]

Although the Clinton administration has supported the principles of free trade and the market economy, a closer examination of its arguments indicates that it is guided to a large degree by mercantilist assumptions. For example, although President Clinton fought hard for the North American Free Trade Agreement, he did so primarily because he believed it would "create American jobs, and a lot of them," not because it would benefit American consumers.[14] The administration's focus on expanding exports and its obsession with the U.S. trade deficit with Japan are also characteristic of mercantilist thinking.

Mercantilism's Erroneous Emphasis on Balance of Trade

Balance of trade is so central that it deserves elaboration, since it was one of the major inspirations for Smith's Wealth of Nations. "There is no commercial country in Europe of which the approaching ruin has not frequently been foretold by the pretended doctors of this [mercantile] system, from an unfavorable balance of trade," he wrote. "After all the anxiety, however, which they have excited about this, after all the vain attempts of almost all trading nations to turn that balance in their own favor and against their neighbors, it does not appear that any one nation in Europe has been in any respect impoverished by this cause."[15]

Smith went on to distinguish the balance of trade from "the balance of the annual produce and consumption," which "necessarily occasions the prosperity and decay of every nation. . . . A nation may import to a greater value than it exports for half a century, perhaps, together . . . and yet its real wealth, the exchangeable value of the annual produce of its lands and labor, may, during the same period, have been increasing in a much greater proportion."[16]

Two points need to be made. First, the statistics on international trade can be misleading. For example, U.S. exports tend to be undercounted because customs agents understandably are more interested in accurately counting imports, on which they collect duties. Thus, Canada shows more imports from the United States than the United States shows exports to Canada. There is also the problem of how the trade balance is calculated--it makes a difference whether the Japanese-American trade balance is valued in dollars or yen or by volume. Similarly, the trade balance will differ depending on how trade is defined. The National Academy of Sciences suggests totaling companies' sales based on ownership, instead of the current practice of defining imports and exports depending on whether countries receive or ship goods. Using companies' sales, Commerce Department economists determined that the United States would have had an overall trade surplus of goods and services of $164 billion in 1991, instead of a $28 billion deficit. Even if profits are substituted for sales of U.S. companies abroad, on the theory that it is the profits that benefit domestic workers, the $28 billion deficit still turns into a $24 billion surplus.[17] Newsweek estimated that the United States was running a trade surplus in the first quarter of 1992 if uncounted services were added to merchandise.[18]

Second, a positive balance of trade is not necessarily a sign of economic health. For the first nine months of 1993, for example, Russia had a trade surplus of $14.3 billion, but no reasonable person would suggest trading the U.S. economy for Russia's.[19]

In short, the idea that trade surpluses enhance employment is a fallacy, a point stressed by 19th-century American economist Condy Raguet. "When foreign commodities are imported, they are not paid for, or they are paid for," he explained. "If they are not paid for, they are a clear gain to the country. . . . No one would think it other than a public gain if it were to rain dollars . . . provided they did not fall on the people and break their heads. Nor could any one consider it other than advantageous to us, if the British or the French should pour into the country whole cargoes of their fabrics, and give them to us for nothing."[20]

Unfortunately, our trade partners are not that foolish. "Hence it may be taken as an incontrovertible truth, that, with the exception of the comparatively small amount which insolvent merchants owe to foreigners, the nation pays for every thing it imports from abroad." Since "the value given is precisely equal to the value received," for otherwise we would be getting something for nothing, "foreign goods cannot possibly be consumed without giving employment to domestic industry equal in value to the foreign industry employed in their production."[21] In other words, the only reason to export is to earn money in order to import, either now or in the future. The Japanese, through their hard work, have earned a lot of dollars. If they do not spend those dollars, they have given away their Toyotas and VCRs for free.

What Under Secretary of the Treasury Lawrence H. Summers calls "export activism" to create jobs seems odd along side efforts by the Federal Reserve to slow down the economy: it is like pressing on the accelerator and the brake of a car simultaneously.[22] Moreover, given the weakness of the Japanese economy, "export activism" threatens to be counterproductive, for if it contributes to the extension of Japan's prolonged recession, it could create a crisis with damaging effects in the United States.

The Current Economic Crisis

In the 1980s a number of books and articles appeared arguing that Japan was practicing a different, and superior, form of capitalism that represented a direct threat to the United States. "The American Century is over," Clyde V. Prestowitz Jr., a former U.S. trade negotiator, proclaimed in 1989. "Japan has, as I predicted it would, become the undisputed world economic champion with all the geopolitical power that implies."[23]

Indeed, 1989 represented the high point of Japan's admittedly mercantilist policies. Alarmed by the runaway increase in asset values, the Japanese central bank began to raise interest rates, hoping to gently deflate the speculative "bubble." The bank had waited too long; consequently Japan has suffered its worst postwar recession, which has cut the value of its stock market to approximately half of what it was four years ago. More ominous, company earnings have suffered an even greater decline, leaving the stock market more overvalued, on a price-earnings basis, than it was when the downturn began.[24] Japanese property prices, which one financial analyst has called the biggest financial bubble in the history of the world, also have been falling dramatically.[25] Bill Sterling, manager of international economics at Merrill Lynch, estimates that Japan's real estate market has suffered a paper loss in excess of $10 trillion. "An event of that magnitude, in what's arguably the world's largest asset class, can't help but have realworld consequences."[26]

Revisionists downplay the importance of those developments, and President Clinton reportedly agrees that the media are exaggerating Japan's economic problems.[27] But the Japanese are admitting the seriousness of their situation. "We have had two years of no growth, and it's becoming clear that what we are enduring is not merely a cyclical slump," says Fumio Sato, president of Toshiba. Similarly, a Japanese government report maintains that "if we are to develop a convincing blueprint for the Japanese economy of the 21st century, we must abandon existing economic policies, management styles, and ideas about living standards, and embark upon structural reforms of historical magnitude."[28]

Rethinking Japan's "Distinctive Capitalism"

According to the revisionists, Japan has a distinctive form of capitalism with three notable qualities: emphasis on expanding market share, targeting of critical industries, and low cost of capital. Those qualities are supposed to have given Japan a competitive advantage, but all of them have now been brought into question.

Market Share vs. Profits. MIT professor Lester Thurow argued that it was wrong for the United States to ignore the supposedly predatory pricing of Japanese manufacturers. "This argument ignores what happens when an American industry is driven out of business" by those efforts to expand market share. "The Japanese business firm is not in the business of making permanent gifts to Americans. When competition is gone, prices rise."[29]

But if that were happening, Japanese firms should by now be showing the benefit of higher prices in their income statements. Instead, they were forced to lower their prices as new competitors entered the market.[30] Moreover, as Thurow himself admits, American firms are far more profitable than Japanese ones. He explains that by distinguishing "societies espousing market-share maximization" from "societies based on profit maximization." Making allowances for the size of the home market and Japan's shorter history as a wealthy country, Japanese firms are larger than American ones because the Japanese emphasize market share; American firms are more profitable because they emphasize profits.[31]

That explanation makes little sense. As Thurow acknowledged, expanding market share is not an end in itself; it is simply an attempt to obtain higher profits later. If the higher profits do not materialize, there is clearly something wrong with the approach. The Japanese themselves now admit the problem, conceding that after three years of declining profits, Japanese companies must improve profit- ability rather than focus on expanding market share.[32] That is likely to be a permanent adjustment because of the growing dependence of Japanese corporations on foreign financing. "The international capital markets will provide funds, but they will demand that Japanese companies make an internationally competitive return on investment. That will maintain the pressure for improved profitability," notes Charles Leadbeater of the Financial Times.[33]

Government Industrial Power vs. the Market. Just as Japan's emphasis on market share has proved counterproductive, so has its targeting of critical industries. "In Japan, industrial policy is the starting point," Prestowitz contended in 1989. "Their policy is not to pick winners but, rather, to identify and back the winners the market has already picked, to ensure that Japan rides with the winners."[34]

When Prestowitz wrote those words, it was commonly assumed that Japan's industrial policy had allowed it to surpass the United States in semiconductors, the foundation of the new information technology.[35] Events since then, however, provide quite a different picture. "Despite their dominance of the memory-chip business, Japan's semi- conductor firms are being left behind in the race to master the next generation of devices," the Economist observed in April 1992.[36] Government-coordinated industrial policy turned out to have limits. Although the Japanese government had been successful in helping Japanese companies to catch up with American companies in established technologies, it proved much less adept at charting new paths.[37] A recent assessment in the Asian Wall Street Journal is especially negative. "Japanese companies are now among the industrialized world's laggards," concludes Shoaib Raza Naqvi, an employee of a Tokyo electronics manufacturer. "Technological obsolescence threatens computer and chip makers, electronics manufacturers, software developers, and telecommunications companies."[38]

In short, the assumption that the government had a more long-term view than the market, supposedly one of Japan's advantages, turned out to be erroneous. Not only did Japanese policy inhibit flexibility, it led to wasteful government expenditures in support of new technologies that proved faulty (e.g., the "fifth-generation" computer and high-definition television). The distinction between market and industrial policy is not between short- and long-term horizons, as is commonly thought. Rather, the difference is between investing your own money and investing other people's money, or what may be termed accountability for risk. Market systems assume that people investing their own money will be more careful, and therefore they will not continue to throw good money after bad, a problem that is not addressed when people are free to spend someone else's money with little if any accountability. The market is not always correct in its decisions--nothing is--but it is, as Yakovlev conceded, "the only reliable anti-waste mechanism."[39]

Low-Cost Capital: Blessing or Curse? The low cost of capital, which is the result of financing methods that Karel von Wolferen has called "arguably the single most important factor in creating the new type of international competitiveness," has also backfired.[40] After the Japanese government agreed in 1985 to increase the value of the yen to reduce the country's trade surplus, it attempted to offset the deflationary impact of that decision by lowering interest rates, which led to an increase in the value of financial assets--the "bubble."[41] As Wolferen correctly notes, Japanese companies were able to use their inflated assets as collateral to obtain additional financing for "practically nothing."[42] But far from being a benefit, the low cost of capital masked the underlying deterioration of the earning power--that is, the competitiveness--of Japanese companies. "In the economic expansion from 1987, improved financial balances shrouded an ongoing decline in the earning capacities of core divisions," the Bank of Japan concluded in December 1992. "However, financial divisions are not likely to contribute to profit to any great extent and thus it is crucial that enterprises again revamp their earning capacity."[43]

Japan's Hidden Unemployment. To improve their earning capacities, however, Japanese companies have to get their costs under control, and that means addressing the question of excess staffing. Although Japan's low official unemployment rate--3 percent in September 1994--has been a source of domestic pride and foreign envy, former minister of trade and industry Hiroshi Kumagi has admitted that that number is misleading and conceals a lot of in-house unemployment.[44] He has also admitted that unemployment would have to rise as a consequence of restructuring.[45] Indeed, as early as 1988 the Economist reported that the Japanese unemployment rate could be as high as 6 percent by American standards.[46] Having failed to address the problem during a period of prosperity, Japan must now deal with it during a time of deep recession, when as much as 16 percent of the Japanese labor force is classified as redundant by Japanese government studies.[47] The situation is potentially so serious that a Ministry of International Trade and Industry official, writing in a personal capacity, recently concluded that "the destruction of Japan's industrial foundation will cause unemployment to rise, damaging the fabric of Japanese society."[48]

A Japanese Banking Crisis? Japan's industrial and employment problems are aggravated by financial difficulties. The deflationary problems of the increasing value of the yen are compounded by the precarious situation of Japan's banks, which loaned money recklessly during the "bubble." "Japan's banks are in crisis," the Wall Street Journal warned in August 1992. "Continued trouble in the bank- ing system could strangle Japan's economic recovery."[49] The situation continues to be serious. Japan's banks "are stuck with non-performing loans that conservatively amount to 5-10 percent of the Y390 trillion (U.S. $3.4 trillion) total," the Far Eastern Economic Review reported in 1993, adding that "problem loans are mounting."[50] Although the capital adequacy ratios of Japan's banks are officially more than 10 percent, well above the Basle accord minimum of 8 percent, a recent report in the Economist suggests that that is due to accounting gimmicks.[51] Some Japanese economic commentators have begun warning of runs on the banks and "financial panic" if the Bank of Japan does not provide "massive infusions of funds."[52] In spite of those warnings, however, the governors of the Bank of Japan and the Finance Ministry recently announced that they do not have an obligation to prevent all bank failures.[53]

The problem of the banks' capital ratios is compounded by their dependence on the value of their equity holdings. To cover their loan losses, banks have been selling equities.[54] The pressure to sell, however, has the effect of lowering the value of equities, which makes it more difficult for the banks to maintain their capital ratios at the required level. In apparent response to internal pressures to boost asset levels (as well as external pressures to increase imports), the government has enacted some stimulus packages, which seem to have been helpful in boosting the Japanese stock market above the lows seen in 1992. Subsequently, there have been calls for providing additional stimulus, but it is doubtful the government can provide much more because, contrary to the popular impression, it is already running a sizable deficit. As the Finance Ministry pointed out in early 1994, if Japan calculated its budget the way the United States does, its deficit would be 5.5 percent of gross domestic product, compared to 3.6 percent for the United States.[55] "Many economists have purposely ignored this," charges an editorial writer for Sankei Shimbun, "but the fact is that Japan's fiscal balance is worse than either the U.S.'s or Germany's. Japan has been engaged in deficit finance since 1965 and now has more than Y200 trillion ($1.9 trillion) in outstanding debt to pay down, equivalent to more than 40 percent of GDP. Local governments are in more or less the same situation."[56]

Risking a Trade War?

According to the Clinton administration, the biggest problem confronting the international economy is Japan's trade surplus, which signifies serious asymmetry in the world economy.[57] To deal with that problem, the administration is using a variety of coercive measures including, despite its denials, an effort to increase the value of the yen. "Currency speculators have driven up the value of the yen, assuming that the United States would deliberately drive it up somewhat later," Thomas L. Friedman wrote in the New York Times in April 1994. "This, in turn, has caused a howl of complaints from Japanese businessmen. . . . As American officials see it, that is the best kind of pressure. It comes from Japan and is directed at the real pressure points. They want to let it percolate more."[58] The Wall Street Journal also reported that "throughout the spring [of 1994], administration officials--usually speaking anonymously--continued to portray a weak dollar as a way to pressure Japan to open its markets to foreign products."[59]

That strategy is playing with fire. Not only does it undermine the U.S. recovery by adding to pressures on the Federal Reserve to increase interest rates to offset the inflationary effects of the declining dollar, it threatens to push the Japanese economy off the edge of a cliff. "The risks of a lasting deflation are probably now greater in Japan than they have been in any big industrial country since the Great Depression of the 1930s," Gerard Baker pointed out in the Financial Times last April. Although Japan has "the lowest nominal interest rates in the world . . . the real deflationary pressures at work in the economy mean that policy is tightening by default."[60]

To counter the deflationary trend, the administration has encouraged macroeconomic stimulus in Japan and other industrialized countries, but its advice has been confused and contradictory. David Aaron, head of the U.S. mission to the Organization for Economic Cooperation and Development, wrote to that institution's director general in January 1994, that "there is substantial room to reduce short-term interest rates to stimulate aggregate demand".[61] Yet as Summers cautioned at the same time, "Lower short-term interest rates that were associated with higher long-term inteest rates could actually be counterproductive. So it's a difficult job managing monetary policy in Europe."[62] Indeed, in a significant disagreement with the United States, Europeans wonder whether stimulus is the answer to their unemployment problems. "Instead of resorting to fiscal and monetary panaceas that have long been obsolete, policy makers should concentrate on removing actual impediments to growth," argues Otmar Issing, the Bundesbank's chief economist. "We now have to pay for our failure to tackle the structural problems in `good' years."[63]

The difference of opinion about how to deal with European unemployment is aggravated by growing confrontation over U.S. trade policy. Although U.S. officials insist that their efforts to open the Japanese market are designed to benefit everybody, other U.S. allies are distrustful. "We don't support the U.S. opening up the Japanese market in a unilateral and retaliatory way," warned Australian trade minister Bob McMullan.[64] Washington's approach is "misguided and misleading," echoed Peter Sutherland, director-general of the General Agreement on Tariffs and Trade, contending that a new outbreak of bilateral trade tensions was putting the achievements of the Uruguay Round to the test even before they become fully operational.[65] Such criticism has drawn a sharp response from the administration. "Europeans are always delighted when they can hold our coats and we go out to get our noses bloodied," Mickey Kantor has charged. "We don't look for criticism from those who sit on the sidelines and don't get in the game."[66]

The question, however, is how the game would look if everybody played it the way the United States is now doing. The administration addresses that question only to dismiss it. "We may have confrontations or fights, but that's natural," argues Kantor. "It doesn't mean you have to have a trade war. That's silly."[67]

Kantor is playing high-stakes poker. Although Summers insists that the administration's objective is to open markets rather than provoke protectionism, U.S. policy seems to be having the opposite effect.[68] Even countries that have benefited from U.S. efforts to open markets are concerned about the way the administration has gone about it. "The U.S. approach is not consistent with multilateral trade rules," worries South Korea's assistant trade minister Chang Sokan. "We are concerned that this unusual approach could be used by the U.S. to attack any country."[69] The State Department's top Asia official evidently shares those concerns. "A series of American measures, threatened or employed, risk corroding our positive image in the region, giving ammunition to those charging we are an international nanny, if not bully," Assistant Secretary Winston Lord wrote Secretary Christopher in the spring of 1994. "Without proper course adjustments, we could subvert our influence and our interests."[70]

Nevertheless, other administration officials suggest that they are prepared for that kind of confrontation, confident they will prevail in the end. "There's more willingness to risk a short-term cost for a long-term gain," a senior official told Business Week.[71] In a world witnessing an explosion of nationalist sentiment, that position assumes not only that the administration's coercive tactics will lead to freer trade but that economic confrontation will not spill over into the political arena--a questionable assumption. Host Koehler, state secretary at the German Finance Ministry, warns, "The mixed signals [coming from the United States] help those in Europe who say we have to define our own interests--and that means a bloc. I am very concerned that Europe, especially certain countries in Europe, is seeking a solution in a defensive strategy of trade barriers to protect jobs and social systems."[72]

The administration presents its confrontational policy as a reaction to American domestic opinion, which it contends will not otherwise continue to support free trade. "It will be impossible for the United States to maintain consumer interests by keeping its market open if we do not work to ensure that other markets are kept open as well," Summers has argued.[73] The administration assumes that other governments will not adopt a similarly confrontational policy because it would not be rational for them to do so, but that assumption underestimates the political pressures in other countries where unemployment is higher than it is in our own.[74] OECD secretary general Jean-Claude Paye, for example, concedes that protectionism is "stupid," yet Paye admits he would not rule out protectionism as a last resort to prevent a social explosion.[75]

Ultimately, the administration's policy reflects a naive complacency about the international political situation in the aftermath of the Cold War. "Our goal in this era is to expand democracy and take advantage of the democratic tide running in the world," National Security Adviser Anthony Lake explained in October 1993.[76] That optimistic agenda might have been justifiable a few years ago, but it was unrealistic by the fall of 1993.[77] "Right-wing extremism has taken over from communism as the greatest threat to democracy in the eyes of many Western politicians," Ian Mather, the European's diplomatic editor, wrote in September 1993. "Virulent nationalism once more rears its head in post-Cold War Europe."[78] Echoing that view, Dominique Moisy, deputy director of the French Institute of International Relations, warns that "if economic recession deepens to the point of threatening the stability of democratic regimes, Europeans may, however slowly and painfully, resign themselves to the inevitability of war."[79] Such pessimism is not unfounded. Since the Cold War there has been a substantial increase in armed conflicts in Europe.[80] Given the present situation, the political assumptions underlying and the consequences of the administration's emphasis on economic security must be carefully examined.

The International Political Environment

"We live in a curious time," President Clinton mused when he visited Moscow in January 1994. "Modern revolutions are transforming life for the better--revolutions in communications, in technology, and in many other areas. And yet the oldest of society's demons plague us still--the hatreds of people for one another based on their race, their ethnic group, their religion, even the piece of ground they happen to have been born on."[81]

The president is right, of course, but this situation is nothing new. During the late 19th century the world was experiencing a technological revolution as steel, refrigeated steam ships, electricity, chemicals, telephones, the internal combustion engine, and automobiles transformed daily life.[82] But that rapid economic change led to a decline in free trade as governments responded to domestic pressures to protect home markets from foreign competition. "The Great Depression [of 1873-96] ended the long era of economic liberalism," notes economic historian Eric Hobsbawm. "Starting with Germany and Italy (textiles) in the late 1870s, protective tariffs became a permanent part of the international economic scene."[83]

Thus, the politicization of international economics intensified as industrialization and the depression turned trading partners into economic rivals; the gains of one country's economy were perceived as a threat to the others. "Not only firms but nations competed. Henceforth the flesh of British readers was made to creep by journalistic exposes of German economic invasion," Hobsbawm explains. The rivalry was exacerbated by a surge of imperialist expansion as the leading European powers sought to obtain protected markets for their production, hoping to carve out territories that would give national business a substantial advantage, if not a monopoly. "In a sense, this was an extension of the protectionism which gained ground almost everywhere after 1879," Hobsbawm writes. "To this extent the `new imperialism' was the natural by-product of an international economy based on the rivalry of several competing industrial economies, intensified by the economic pressures of the 1880s."[84]

The Perilous Consequences of an Economic Security Strategy

Although the parallel is not exact, the Clinton administration's emphasis on numerical criteria for measuring progress in its trade negotiations with Japan is disturbingly close in its logic to the motivation behind the depression-era imperialist expansion of the 19th century, when "fair trade" was sought over free trade.[85] Similar sentiments are widespread today. "The United States had large trade deficits with other countries such as Canada which did not engender the same feeling as the deficit with Japan," Prestowitz has acknowledged. "The strong emotions engendered by the unequal balance of trade with Japan stemmed from a feeling that Japan wasn't playing fairly."[86]

Significantly, the aversion to "unfair" trade prompted identical responses in the 19th and 20th centuries. "The weapon with which they [the nations] all fight is admission to their own markets," Lord Salisbury argued in 1892. "You must be prepared, if need be, to inflict upon the nations which injure you the penalty which is in your hands, that of refusing them access to your markets."[87] That viewpoint is echoed by President Clinton. "Our administration is now developing a comprehensive trade policy," he announced in February 1993. "It will say to our trading partners that we value their business, but none of us should expect something for nothing. We will continue to welcome foreign products and services into our markets, but insist that our products and services be able to enter theirs on equal terms."[88]

Economic Nationalism, Popular War

Perhaps most disturbing is that Europe 100 years ago was also characterized by growing democratic influences, but those influences did not result in what we commonly think of as democracy today. "Instead of controversies about political freedom, the fight for economic security became the focus of public discord," Hans Rosenberg pointed out in his study of the 19th-century great depression in eastern Europe, stressing that the consequences were "the advance of the Leviathan state, the growing dependence of economic agencies on state aid, and the intensification of nationalism."[89] Hobsbawm agrees that "when the masses entered the political stage pursuing their own concerns, they were hostile to all that bourgeois liberalism stood for. . . . In the period from 1880 to 1914 nationalism took a dramatic leap forward."[90] We all know what happened in 1914, but we often forget that the outbreak of World War I was widely welcomed. In Paris "anti-war demonstrations were literally swallowed up by the vaster, more Dionysian frenzy of the patriotic mobs screaming and chanting on the boulevards," wrote Edmond Taylor, while in Berlin "the approach of war was greeted with a collective fervor not matched anywhere else."[91]

That should serve as a warning to the Clinton administration, which has proclaimed the enlargement of democracy its primary objective in foreign policy, in part because democracies are generally viewed as more peace loving than other types of regimes.[92] Popular sovereignty is no guarantee of peace, however; as James Madison pointed out, there is such a thing as the war the people want.[93] And as the history of this century demonstrates, such wars can be among the most devastating. "War is waged not only by the armies, but by the nations themselves," a report by the Carnegie Endowment for International Peace stated about the Balkan wars that preceded World War I. "This is why these wars are so sanguinary, why they produce so great a loss in men, and end in the annihilation of the population and the ruin of whole regions."[94]

Although in principle democracy is certainly to be preferred to tyranny, we should be clear about what we mean by democracy. Democracy based on an exclusive definition of the nation and its interests would simply pit nation against nation, inflaming national rivalries and thereby creating conflicts instead of resolving them. That is why economic nationalism, the idea of nations rather than firms as competitors, is so dangerous. As events at the turn of the century demonstrated, once Germany and Britain saw themselves as national economic rivals, that rivalry spilled over into the political and military spheres. Not only was diplomacy affected, leading countries that had not previously perceived each other as enemies to form alliances against each other, but public consciousness was inflamed to such a degree that a terrible war could actually be enthusiastically welcomed by those who would suffer most from it.

To be sure, history does not repeat itself exactly, but recent events should raise questions about the administration's policy of pressuring the Japanese government in an effort to pressure Japanese business. Japan is a democracy in turmoil, buffeted by internal strains that are manifesting themselves not only in political instability but also in a rise in anti-American sentiment. In a poll taken in 1993, almost two-thirds of the Japanese people described U.S.-Japanese relations as "unfriendly," exceeding the previous mark of 55 percent set in May 1987, after the United States imposed trade sanctions on Japan. Much of the bad feeling appears to have been directed at Clinton himself, the New York Times reported, noting that only 6 percent of Japanese described their feelings toward the president as favorable.[95]

The danger in this situation is not a Japanese-American political-military rivalry duplicating the earlier Anglo- German one (although even that might not be unthinkable if the administration truly believes that "continuity in our strategic and security relationship with Japan requires discontinuity in our economic relations").[96] Rather, it is that U.S. economic nationalism will give rise to similar policies in other industrialized democracies that will then victimize not only each other but other countries that previously practiced economic nationalism but are now seeking to integrate themselves into the global economy.

Nowhere is that truer than in the countries of the former Soviet empire. In striking contrast to his secretary of state, President Clinton has identified the future of democracy in Russia as "the major crisis this world has faced since I've been President."[97] It is important, therefore, to understand what Russians and other East Europeans view as crucial to their development as industrialized democracies. "The Americans are talking about expanding aid to Russia," Sergei Y. Glazyev, Russia's foreign trade minister, complained in 1993. "What we demand is a free access of Russian goods to the markets of developed countries."[98] Ivan Szabo, Hungary's finance minister, similarly warned that "unless the countries of our region are allowed to integrate further into the world economy, things could get worse."[99] Unfortunately, those warnings have gone unheeded.[100] "The EU lets us export everything--except those things in which we have a competitive advantage," Radek Sikorski, a former Polish deputy defense minister, recently complained in the Wall Street Journal. "Such attitudes have helped return former Communist parties to power; if you were put out of business by EU regulations, wouldn't you be tempted to vote for those who never had illusions about the West?"[101]

The president is right: the future of democracy in that part of the world cannot be taken for granted. The allies won World War I, but a severe economic depression, intensified by efforts to preserve jobs by practicing economic nationalism, set the stage for a new and even more terrible war. And for all the talk about the enlargement of democracy, it is vital to remember that Adolf Hitler came to power by winning elections; he was the beneficiary of the pain and humiliation of a suffering people. The parallels with our own day are too clear to be ignored. "In a rich country my program would not go down well," Vladimir Zhirinovsky, whose triumph in Russia's parliamentary elections in December 1993 stunned the world, has admitted. "But in a poor, embittered country like Russia, this is my golden hour."[102] And if the Cold War comes back, it may be worse than before because ordinary Russians are beginning to blame the Western democracies for their plight. Already, over half the Russian population believes that the West's economic advice has been designed to weaken rather than benefit Russia.[103] "During the cold war, the bad feeling toward the United States came from the Government," notes a former reporter for Moscow News. "Now it's coming from the grass roots."[104] It was precisely that kind of grassroots animosity that set the stage for World War I.

Political Power or Economic Prosperity?

When President Clinton took office, Martin Walker of the Guardian writes, he "began from the premise that the old world of geo-politics had gone, and was being replaced by geo-economics." Now, however, "the new concept of geoeconomics is starting to crumble in America's hands, and the old menaces of geo-politics are stirring."[105]

It is certainly true that old menaces are stirring, but the distinction between geoeconomics and geopolitics is somewhat artificial, since the mercantilist politics of geoeconomics are inherently associated with geopolitics: both are focused on the problem of power.[106] In the blunt formulation of Jeffrey E. Garten, U.S. under secretary of commerce for international trade, "In today's world, trade is too important to be left to economists who don't think in terms of power."[107] That point of view has drawn a sharp response from Lawrence Summers. "Economic security . . . is a profoundly misguided vision. It fails to recognize the fundamental difference between prosperity and power. Power can be gained only at someone else's expense. Prosperity can be shared."[108]

The president faces a choice. He can pursue a policy of "economic security," but he should recognize that no one will believe he is doing it on behalf of the world community as a whole. Why should they when his own officials disavow that objective? "I'm tired of a level playing field," Lloyd Bentsen acknowledged. "We should tilt the playing field for U.S. businesses."[109] Similarly, Commerce secretary Ron Brown admitted in Beijing last August, "I don't want a level playing field. I want a tilted playing field. I want it tilted towards us."[110]

If we follow such a policy, there will most likely be retaliation. With incredible naivete, Mickey Kantor expressed dismay that the European Union retaliated against American sanctions in 1993. The United States, he said, was "not pleased the European Community has decided . . . it is important for their own internal politics to symbolically impose sanctions as well."[111] If the Clinton administration is going to be tough on behalf of U.S. jobs, why should other governments be less tough? Why should we be amazed that other governments are also responsive to internal politics?[112]

Despite the recent movement toward expanding world trade symbolized by U.S. ratification of GATT, we should recognize that free trade is under attack. Whereas opponents of GATT in the United States viewed freer trade as a threat to American jobs, opponents of free trade in foreign countries see it as "a simple instrument of American power."[113] GATT, the president of the French National Assembly has declared, is like a "thundering God dispensing the lightning of free trade on the bowed heads of the people." Ominously, two-thirds of French citizens polled in 1993 favored limiting imports into Europe.[114]

The reaction of other countries to the Clinton administration's aggressive trade policy has prompted some American exporters to urge restraint. "Boeing executives publicly seem anxious to tone down the President's zeal, fearing a backlash in the lush European market," Business Week reports.[115] Similarly, U.S. semiconductor makers have repudiated the administration's efforts to set numerical targets for exports to Japan. As Pat Weber, executive vice presi dent at Texas Instruments, put it, "We will all be happier with less government involvement."[116]

The administration should revise its assessment of the Japanese economy. Instead of putting pressure on Japan to reduce the bilateral trade deficit, the administration should take no actions that would suggest that the United States is behind growing Japanese unemployment. "Politically and economically, Japan is flat on its back," Investor's Business Daily argued in January 1994. "This is the wrong time to pick a fight with Japan. . . . The Japanese will remember that, when they were facing their worst crisis since the war, we were only interested in getting trade concessions."[117] It is particularly foolish to be aggressive when the U.S. economy is growing so strongly that the Federal Reserve is raising interest rates to slow it down. Eventually, the bilateral trade deficit will take care of itself, since the dollars the Japanese have earned are merely claims on goods and services produced in the United States. Given the strength of the U.S. economy and the dangers of confrontation, we are much better off letting natural processes take their course.

Finally, the administration must reorder its foreign policy priorities. Given the deterioration of the democratic revolution in Russia, the fragmentation of NATO, the danger of nuclear proliferation, and the unraveling of the Middle East peace process, it is bizarre for Secretary Christopher to proclaim that economic security is his foremost priority. It is even more bizarre for an American ambassador to report that "every single individual in my embassy from the political officers to the commercial officers to the defense attache, have [sic] as their primary mission a commercial focus."[118] Political and military officers should be reporting on political and military affairs; that is their job, and it is an important one. Export promotion cannot be allowed to take the place of protection of U.S. national security as the primary focus of our embassies.

The entire concept of economic security needs to be reexamined and repudiated. Indeed, it is striking that one of the foremost proponents of economic security, commerce under secretary Garten, has concluded that "without question, no good is going to come out of this. It would be vastly preferable to have a system where companies are competing on their quality and reputation, not on the subsidized financing they get. We would prefer not to play this game at all."[119]

President Clinton should follow the advice of Summers and choose prosperity over power--and perhaps more important, internationalism over virulent nationalism. In so doing, he would be following in the footsteps of an illustrious predecessor, George Washington. "I cannot avoid reflecting with pleasure on the probable influence that commerce may hereafter have on human matters and society in general," the future president wrote to the Marquis de Lafayette. "On these occasions I consider how mankind may be connected like one great family in fraternal ties."[120] Regrettably, 200 years after he wrote those words, Washington's idealistic vision seems remote, but it is still the right one for the United States. As President Clinton has recognized, "If our new friends are not able to export their goods, they may instead export instability, even against their own will."[121] But if they are going to export, somebody has to be willing to import. The president should, therefore, recognize the implications of his own advice and reject the mercantilist and nationalist assumptions of "economic security."

Notes

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[13] Alexander N. Yakovlev, "The Political Philosophy of Perestroika," in Perestroika 1989, ed. Abel G. Aganbegyan (New York: Charles Scribner's Sons, 1988), p. 66. Emphasis in the original.

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