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The United States in the World Economy: Problem or Solution?

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Washington University in St Louis

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A border was once defined as the line separating two groups, each of which believes that civilization ends at that line. Somehow that reminds me of the current state of U.S.-European economic relations. It is fascinating to participate, as I recently have, in a discussion on the other side of the Atlantic on the role of the United States in the international economy. It is so different from the discussion of the same subject on this side of the ocean. I would like to share with you some of the insights that I obtained.

View One: The Angelic U.S.

As you might suspect, we Americans tend to see our nation as the embodiment of fairness and idealism in an otherwise nasty and selfish world. In that view—which I label the angelic U.S.—our strong recovery is the engine that is pulling Europe and the rest of the world out of recession. Our triple-digit (in billions) trade deficit reflects the tremendous market potential which, in our naivete, we are permitting other countries to take excessive advantage of.

In this angelic view of the U.S., Western Europe talks about government aid to developing nations, while the United States acts—

Dr. Weidenbaum is Mallinckrodt Distinguished University Professor and Director of the Center for the Study of American Business at Washington University in St. Louis. This speech was given at a luncheon sponsored by the Center on December 10, 1984. It is based on Dr. Weidenbaum's keynote address to the International Conference on Economic Policy sponsored by the Austrian Society for Foreign Policy and International Relations and the *Zentralsparkasse und Kommerzialbank*.

providing, via open trade, opportunities for these nations to earn the foreign exchange they so badly need. America invests a growing percentage of its national wealth in the nuclear umbrella that protects the entire free world. At the same time, other nations increase investment in their own productive capacity, which enables them to compete with aging American industry. And, of course, the angelic view maintains that the United States is an island of free trade in a world of subsidy and protectionism.

View Two: The U.S. As Devil

That is not quite the picture that I get on the other side of the Atlantic. There, the United States emerges more in the role of, shall I say to provide a vivid contrast, the devil. Our friends overseas remind us of the evils arising from our loose and irresponsible fiscal policy, how those 200 billion dollar budget deficits have pushed up interest rates, and how the resultant superstrong dollar is bedeviling the economies of every other nation. All this supposedly forces our European friends to a painful action; in order to limit the outflow of capital to the United States, they must maintain high interest rates in the face of high unemployment, all at the expense of their own social needs.

In this second or devilish incarnation, rather than being a firm apostle of free trade, the United States is seen as the hypocritical nation that maintains a firm "Buy-American" policy while berating the trade barriers erected by other governments. While focusing on its massive trade deficit with Japan, the U.S. conveniently overlooks the large trade surplus it ran with the European community over the past decade (although not in the most recent past).

Also, the United States, it is recalled, tried to force an embargo of the Soviet pipeline while selling the Russians our surplus grain. Speaking of the Russians, I am told that the Americans—especially Reagan Administration spokesmen—delight in irritating the Soviet Union. The Americans, in that view, conveniently overlook Western Europe's proximity and our own great distance from what Ronald Reagan calls the "evil empire."

View Three: A Composite Picture

I readily plead guilty, of course, to considerable exaggeration in each of the two views I have just presented. Yet there is a strong factual, albeit incomplete, basis for each of the two views. Clearly, the attitudes on the two sides of the Atlantic are very different. Still, the two views are held tenaciously, and often by people with considerable knowledge and experience.

The nature of the problem was illustrated to me recently when I debated the subject of trade deficits with an executive of one of our own large manufacturing companies. He vividly demonstrated the "flood" of imports into the United States with the help of an unusual set of props. He had brought with him items from his own home which were imported from overseas. It was an extensive collection of foreign products which had successfully penetrated our domestic market.

My response, I must candidly report, did not go over nearly as well. I lamely referred to all the American exports that were probably in the homes of his counterparts in London, Paris, Rome, and Frankfurt. But the audience had great difficulty in visualizing my point in the absence of physical examples that they could see, smell, and touch. That, of course, is the difficulty in developing an objective view of these complicated matters. We must go beyond the factors that we know from our own experiences.

But let us try to develop a more balanced view of the international role of the American economy. Such a balanced view will show that the United States is neither angel nor devil, but that it is—I say candidly—part of each. To be sure, I am reminded of the cynical comment, that if you stand in the middle of the road, as I am trying to do, you are most likely to be hit by the passing traffic. But nevertheless, let us persevere.

Fundamental Changes in the U.S. Economy

In their preoccupation with budget deficits, many observers, both at home and abroad, have overlooked fundamental changes that have been occurring in the U.S. economic environment. Many of these developments have an impact in Western Europe and other parts of the world. At any rate, this seems an opportune time to review these changes as Ronald Reagan—the architect of many of them—nears his second term.

The Merger Movement

For example, since January 1981, there has been a new and more positive governmental attitude toward mergers between large corporations. Those who favor this development say that it is a more modern and enlightened government position. Those who do not share this positive view label the government's willingness to go along with these combinations as permissive. The important point is that, during the past four years, there has been an unprecedented wave of mergers in the United States which did not require any special laws from Congress.

The international implication of the stepped-up merger movement may not be welcomed overseas with great enthusiasm. But this is a far more benign response to import competition than traditional protectionist measures.

Rather, the President appointed a new Attorney General, a new Chairman of the Federal Trade Commission, and a new head of the antitrust division. This favorable attitude on the part of the antitrust agencies toward large mergers will, to a substantial degree, continue beyond the Reagan Administration. I say that because it is becoming clear that U.S. companies increasingly compete in global markets and domestic antitrust enforcement inevitably has to respond to economic reality.

The international implication of this stepped-up merger movement may not be welcomed overseas with great enthusiasm. The long-term result could very well be enhanced competitiveness on the part of many American companies. But I tell them that this is a far more benign response to import competition than traditional protectionist measures.

Labor-Management Relations

Another key area of the American economy that has been ignored because of the preoccupation with budget deficits is labor-management relations. One of the most important labor events in the United States in the past decade was the President's breaking the illegal strike by the air traffic controllers. Firing the controllers was a decisive move that signaled a fundamental turn in American labor-management relations.

I believe it was the main reason that the postal unions did not seriously consider going on strike. But the repercussions of the President's action extended to the private sector as well. There was a strong and clear signal that the government would no longer get involved in disputes between companies and their unions—and certainly not on the side of the unions. In many past administrations, the federal government put pressure on management to settle promptly with unions. The result was escalating wage settlements. Our high-cost steel industry is a cogent example of the dangers of such past government intervention.

Since 1981, we have seen a remarkable decline in union demands. The slower rise of labor costs, of course, has helped reduce inflationary pressures. It has also enhanced productivity and, hence, increased the competitiveness of American industry. Moreover, lower inflation rates have also reduced the ratcheting effects of cost of living adjustments on American wage rates. Thus, we see important feedback effects at work here, the economic adjustment mechanism operating at its best.

International competition has also begun to exert profound effects on U.S. wages, especially in autos and steel. Currently, both labor and management in these and other import-threatened industries find it in their mutual interest to seek short-term relief through quotas, euphemistically called voluntary export restraints. They are becoming increasingly aware, however, of the need to moderate wage increases and foster productivity growth in order to improve the long-term health of their industries—and thus respond constructively to the pressures of worldwide competition.

Uneven Trade Policies

Of course, most of our trading partners are not very sympathetic with our efforts to protect American industry. The track record of the Reagan Administration in this area is, at best, uneven. The Administration said "no" to pleas to extend quotas on non-rubber footwear but it has supported limits on automobile imports as well as efforts to restrict textile imports.

It would help to clear the air in international trade discussions if the United States were to acknowledge that all of our actions are not on the side of the angels. We have created many obstacles to inhibit imports into the United States.

Although our average tariff rates are low, high tariffs are levied on selective items. Tariffs on textiles average 20 percent. "Buy American" statutes give preference to domestic producers in government procurement. The Jones Act prohibits foreign ships from engaging in commerce between American ports. This law, of course, effectively bars all competition in U.S. domestic marine transport.

The recent effort to further protect the domestic steel industry furnishes another example of the way in which U.S. trade policy produces self-inflicted wounds. Recently, Arthur Denzau at our Center for the Study of American Business analyzed the effects of steel quotas on America's steel-using industry; he points out the fallacy of thinking that these measures "save" jobs. Dr. Denzau estimates that the 26,000 jobs saved in the steel industry would reduce employment in steel-using sectors, which are also subject to global competition, by 93,000 jobs—for a net *loss* of 67,000 jobs.

All in all, it would help if the United States were to reduce its self-righteousness in dealing with trade matters, and also if other nations would take our pleas for open trade more seriously.

Although the United States is more protectionist than it likes to admit, it is useful to point out to other countries the great extent to which our trade restrictions are a two-edged sword. Embargoes on grain and soybeans curtailed our exports and increased our trade deficit. So do restraints on high-tech trade. All in all, it would help if the United States were to reduce its self-righteousness in dealing with trade matters, and also if other nations would take our pleas for open trade more seriously. As I see it, the United States' role in world trade is ambivalent—neither angel nor devil.

Impact of Triple Digit Deficits

In developing a more evenhanded approach to assessing the United States in the world economy, we should remind ourselves that those truly outrageous budget deficits have helped to generate a strong recovery in the American economy. That has led simultaneously to important desirable results in the international economy—such as providing a growing market for Western Europe and the developing countries—and many undesirable results as well—high interest rates, appreciation of the dollar, and extraordinary inflows of capital into the U.S.

There are two derivative notions that we can develop from this general point. One is that the pluses and the minuses go together. In the absence of the huge budget deficits and their ramifications, I doubt that those substantial trade deficits would have developed. The second point is that U.S. policies and practices are not the sole source of the difficulties facing other nations.

For example, the fall in the value of the franc that followed the 1981 election victory of M. Mitterand surely did not result from any U.S. action. Rather, such adverse consequences resulted from the financial markets' correct anticipation of the economically troublesome policies that Mitterand would introduce in his first year in office.

I readily agree that we would all be better off if our budget deficits were half their size. And I also would be happier if I would awake tomorrow young and handsome. I assign equal probabilities to the two cases. Having urged, from the outset, policies that would have reduced those deficits, I do not now have to apologize for them. Rather, I merely try to realistically acknowledge their likely continuation and explain their varied impacts.

Along these lines, I reminded our European friends that the deficits are not viewed in the United States as a means of exporting our domestic difficulties. Rather, the U.S. economy itself suffers from them in many ways. Thus, I called their attention to the fact that the interest-sensitive sectors of our domestic economy have suffered from the financial effects of massive Treasury borrowing. Important examples include housing, agriculture, and durable goods production—in what some now call the "rust belt."

Thus, there are compelling domestic reasons for reducing the deficits. The delay is not due to a lack of recognition of the problem but to insufficient public support for the politically painful steps which would reduce the deficit financing.

Future Changes in the Political Environment

What about the next four years? Despite the current rhetoric, I expect few domestic initiatives by the White House. Budget cuts always loom larger in the December leaks than in the January budget. The President is satisfied that his economic program is working. Taxes have been cut, inflation is lower than almost anyone anticipated, and production, sales, and employment are all continuing to rise. As he would put it, "What more do they want?"

Thus, in his second term, the President's attention can and probably will shift, as it already has in part, to foreign policy matters. The rapid arms buildup will be maintained. Relationships with the Russians will continue to be difficult, but that area will also get greater attention.

In a second term, a President starts thinking about how he will go down in the history books. Trimming government spending may be an important issue today, but it is not likely to create a memorable Presidency. However, if President Reagan succeeds in persuading the Russians that they cannot keep up with the American Joneses (or rather Weinberger), perhaps they will then agree to arms reduction. Whether you believe that eventuality to be likely or not, it is important to understand that the President hopes that such a result will occur. If he can achieve substantial and mutual arms reduction, Ronald Reagan will deserve an important place in history.

Dealing with Deficits

As for those deficits, the proposed constitutional amendment to require an annually balanced federal budget is looked upon by the White House as the major response. In addition, the President's tentative approval of a freeze on civilian spending, except social security, raises some new hope. Given the short-term difficulties of cutting specific budgets, the constitutional approach is regarded as the only satisfactory long-term solution to the fiscal problem facing the nation. But, because of the length of time it would take before such an amendment would be in force, adopting that approach would necessitate little action on the budget deficit during the next four years. A cynic might note that the attractiveness of the balanced budget amendment is that the tough decisions can be postponed until Ronald Reagan's successor takes office.

Spending cuts should precede tax changes. We need a national debate on specific programs within each of the thirteen major spending areas.

I believe that the budget deserves the same attention as is being given to tax reform, and that action on spending cuts should precede tax changes. We need a national debate on specific programs within each of the thirteen major spending areas. We could start by making Dave Stockman's budget proposals as open to the public as the recent Treasury Department tax report.

Tax Reform

We will hear a great deal about tax reform in 1985. President Reagan has vowed not to raise income tax rates. That language provides considerable flexibility. Most likely, the second Reagan Administration will try to move toward a flatter income tax structure. That means broader brackets and lower rates. However, in order to maintain the total flow of revenue to the federal government, it becomes essential to broaden the tax base.

In spite of a good deal of huffing and puffing about budget cuts and tax reforms the budget deficit will not come tumbling down. American fiscal policy will persist in bedeviling other nations' economies.

The basic choice Congress will face in broadening the tax base will be between politically unpopular moves that reduce consumption and economically undesirable changes that reduce investment. Under those circumstances, the prospects for raising the total level of federal revenue via tax reform is surely limited. In short, in spite of a good deal of huffing and puffing about budget cuts and tax reforms, the budget deficit will not come tumbling down. Thus, in the eyes of the rest of the world—both Western economies whose capital flows will continue to be attracted to the U.S. by high interest rates, and debtor nations whose interest payments will continue to strain their economies—American fiscal policy will persist in bedeviling their economies.

Trade Policy

If the Administration's efforts to negotiate import restraints on steel fail, we will have an early test of Ronald Reagan's commitment to free trade. Benefits of protectionism are concentrated by industry and geography while the costs are widely disbursed. And it is this political reality that legislators—who are perpetually running for reelection—must confront.

While the rest of the world may still view U.S. trade policies as hypocritical, the possibilities for greatly increased protectionism are reduced as a result of the November Presidential election. Domestic content legislation for autos is far less likely to be brought up as it would have been if Mr. Mondale had won. Nor are the calls for an industrial policy likely to attract as much support.

Our trading partners should be "relatively" pleased—it could have been worse. Realistically, they should also acknowledge that many of their policies, affecting both basic industry and agriculture, are far more blatantly protectionist.

Final Thoughts

To sum up very briefly, each of the major Western nations faces serious economic problems of primarily domestic origin. If each attempts to deal with them—to get its own house in order—we will have a healthier international economic and financial system. Of course, it is always easier to focus on the actions of foreign devils. But the inevitable protectionist and other interventionist responses only exacerbate the underlying problems.

When I am on this side of the Atlantic Ocean, I invariably find myself opposing those who blame forces overseas for domestic difficulties. Perhaps it is merely an old habit, but I enjoyed taking that position in Western Europe recently, when I was one of those foreign devils.