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WARREN BROOKES

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# Protectionist hara-kiri?

The turbulent storms ripping though world financial and currency markets these last few weeks have nothing to do with the mild inflation up-tick we have just seen.

They have everything to do with the growing perception that the demagogues in Congress have successfully and skillfully lured the Reagan administration into a potentially irreversible trade war with Japan — a trade war which could easily trigger worldwide economic recession, just as it did in 1929.

Unfortunately, that perception is bolstered by mounting evidence the administration's chief protectionist, Commerce Secretary Malcolm Baldrige, now has the friendly ear and solid support of White House Chief of Staff Howard Baker.

Until Mr. Baker's arrival, Mr. Baldrige was largely muzzled or ignored for what he genuinely is: a special pleader for big business. But during the last few weeks Mr. Baldrige's muzzle has been removed and he has been sicked on our trading partners.

One newspaper headline captured it all, "Baldrige lands in China," suggesting a suicidal battle the United States is sure to lose, as every new sanction will be countered by a retaliatory sanction and world trade as a whole will decline.

We tend to forget that the United States now exports close to $220 billion in goods to world markets, and nearly $30 billion to Japan. As we retaliate against their imports they will stop our exports, in a game of international chicken, in which all economies will crash, and the first to suffer will be the American farmers, who since July have finally seen their exports rise again.

The hypocrisy of our current trade war with Japan was evident last week as the Commerce Department continued, as part of its "competitiveness" package, to ask Congress to reform our domestic antitrust laws to abolish, among other things, "predatory pricing" as a consideration, all the while raging at Japan for "dumping" computer chips, which is exactly the same thing.

At the same time, the U.S. computer industry last week reported its best quarter of sales and earnings in three years, reflecting, among other things the lower world price of chips.

Meanwhile, on Capitol Hill, the Democrats are enjoying this swamp into which they have drawn a weakened president. Even as this nation outperforms all others (including Japan) in new job and business creation; and even as evidence grows that the trade deficit is beginning to subside, they have managed to use massive disinformation about virtually every sector of the economy to stampede the increasingly timid at 1600 Pennsylvania Avenue.

While Howard Baker has brought great stability and political competence to the White House, he has also carried with him the traditional Republican baggage of protectionism and defensive thinking, along with his own doubts of the president's policies.

He has also brought along the chief architect of the Republicans' no-issues, don't-make-any-waves campaign to lose the Senate last fall, Tom Griscom, who is Mr. Baker's new White House communications director. This reflects a new willingness to respond to every feint and jab from Capitol Hill, as well as a lack of confidence in the high ground of Reagan's free market thinking.

Last week, one of the last solid free market economists in the administration, Budget Director James Miller, was publicly rebuked when he suggested, quite rightly, that the Federal Reserve should not overreact to premature inflation fears at a time when the greatest danger is worldwide deflation.

Sensing all this disarray, Rep. Richard Gephardt, the political ambulance-chaser, rides high on the Hill as the architect of one of the worst pieces of trade legislation ever, and as cosponsor of the most dreadfully fascist farm bill in U.S. history.

Mr. Gephardt is orchestrating a nationwide "fear-in" for his own political purposes, namely to scare both Congress and the president into doing dumb things so he can win radical caucus support in Iowa.

But when and if the dirty deeds are done, the Republicans will have become the main scapegoats for the economic disaster that will surely follow. If they don't understand that this is exactly what the politically astute, but otherwise intellectually defunct, Democrats have in mind as their surest route back to permanent national power, they deserve the outcome. But, for what?

By almost every measure you want, this nation's economy is *not* suffering from its trade deficit: In the last 12 months, total jobs are up by a whopping 2,561,000, as the United States breaks its own employment ratio record, month after month, while protectionist Japan and Europe have both been *losing* jobs.

Even our manufacturing jobs are down just an insignificant 0.3 percent, or 65,000, far less than in Japan and Europe, and they remain close to the consistent level of 19.2 million of the past 15 years.

Manufacturing as a share of gross national product is higher today than it was 20 years ago. Since 1980, U.S. manufacturing productivity has been rising at the fastest rate since the 1960s, and because of a lower dollar, our worldwide labor costs are now level with our biggest and toughest competitors, including Japan.

Even imports, as a share of GNP, are no higher now than they were in 1980 (9 percent). And, most of our decline in exports is with the debtor nations, for whom a trade war would be disaster.

If Ronald Reagan wants a place in history other than that accorded to Herbert Hoover, he will wake up this morning, smell the coffee, call off his yapping protectionist puppies, and tell them the way to bring Japan into line is to start making bilateral free-trade deals with all of Japan's key competitors, especially South Korea, Taiwan, Singapore, and Hong Kong, building further on the Kemp-Gramm plan for a Western Hemisphere Common Market with Canada, Mexico, and the Caribbean.

Such a positive approach would expand instead of contract world trade and at the same time, force Japan's responsive attention without shooting our own nation in its collective foot, or bringing the world economy down in flames around us.

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# Lowering the protectionist boom

## Gephardt pushes all the 'hot buttons'

The Reagan administration is about to discover the real danger of their phony trade war with Japan: The Nippon-bashing jingos in Congress are going to escalate it into a real kamikaze attack in reverse, and in the process risk worldwide depression.

The leader of this protectionist frenzy is Rep. Richard "Smoot" (as in the Smoot-Hawley tariff that started the Great Depression) Gephardt, presidential candidate and full-time boy demogogue who has been flitting opportunistically from one political "hot button" to another, searching for a way to fan the wispy smoke of discontent into a full-fledged prairie fire of support.

Mr. Gephardt told The Wall Street Journal editors last Wednesday he had the votes, including 22 Republicans, to force his own draconian trade-retaliation amendment through the House.

His amendment would force the president to "take whatever steps are necessary to reduce trade surpluses" with Japan and others by 10 percent a year, including the imposition of quotas and tariffs, not just on a few items, but across the board.

Aside from the fact that this measure violates the General Agreement on Tariffs and Trade, it would immediately start a disastrous international trade war which could cost 25-30 percent of Americans their jobs, easily, just the way his foolish Harkin-Gephardt farm bill could cost more than 2 million agricultural jobs.

If the administration's tiny tariff action affecting less than $300 million or 0.3 of 1 percent of U.S.-Japan total trade could spook the stock market by 90 points, think what a full fledged "Smoot" Gephardt-style trade war could do.

This is why Mr. Gephardt's dreadful bill is opposed by every responsible Democrat, not only by presidential front-runner Gary Hart but by most key Democrats on the Hill, including both House Majority Leader Tom Foley, and Ways and Means Chairman Dan Rostenkowski. The big exception, of course, is "Speaker Wrong" (House Speaker James Wright) who seems never to have seen any tariff, subsidy, tax or special interest he didn't love.

What is really shocking, though, is that Mr. Gephardt's bill is also secretly supported by top leadership in President Reagan's own Commerce Department.

This surprising fact was inadvertently signaled during CNN's "Cross Fire" show last Thursday, when Commerce Secretary Malcolm Baldrige's former assistant secretary for international development, Clyde Prestowitz, was asked by Rob-

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ert Novak: "How do you feel about the Gephardt amendment?"

Mr. Prestowitz said quickly, "It's all right as far as it goes," and then quickly added that "it doesn't go far enough." Under further questioning, it was clear that Mr. Prestowitz favored broad-scale measures "to correct the imbalance of trade."

Yet this will not really surprise anyone who has watched Mr. Prestowitz's former boss, Mr. Baldrige, who along with two successive Commerce trade honchos, Lionel Ollmer and Bruce Smart, have been big business's chief advocates for protection.

Unfortunately, they have been remarkably successful, because the Reagan administration, by its own proud admission, has granted more "trade relief" to industry than any other in recent history, from new quotas on textiles and apparel against the Pacific Rim, to tougher "target prices" for the steel industry, to "voluntary export restraints" for the U.S. auto industry, not to mention trashing the U.S. dollar by 40 percent in world currency markets.

The fact that in spite of all this, our trade deficit continues high is proof that protectionism is not only dangerous, it is counterproductive to real world economic growth, because it only depresses total trade, imports and jobs.

The best proof of this is to look at the dreadful relative economic performance of the protectionist European nations and Japan, who have been the main targets of our "dollar attack."

In every case, their surpluses with us are now larger, and their economies (and thus import demand) are now weaker in job growth, industrial growth, and unemployment than they were a year ago.

Germany, for example, is running a trade surplus with us of more than $14 billion. Yet its unemployment is now 9 percent — in U.S. terms more than 20 percent — while both its employment growth and production growth are a fraction of ours. The same holds for France and even, currently, for Japan. Indeed, the last time the United States ran a trade surplus was during the deep recession year of 1975.

Ironically, during 1986, when our total trade deficit was supposed to have been $166 billion, the U.S. manufacturing economy lost only 65,000 jobs — 0.3 percent — by far the smallest loss of any major industrial nation.

**U.S. ECONOMY VS. TRADE-SURPLUS NATIONS**

**(As of February-March 1987)**

| | Current Trade Surplus with U.S.* (billions $) | 1986-87 Industrial production | '86-87 Total Jobs | '86-87 Mfg. Jobs | Latest Unemployment | Latest Employment Ratio |
|---|---|---|---|---|---|---|
| United States | — | 1.6% | 2.5% | -0.3% | 6.6% | 61.1% |
| Japan | $59.9 | 0.6 | -0.6 | -0.8 | 3.0 | 60.5 |
| West Germany | 14.1 | 0.3 | 0.7 | -0.4 | 9.0 | 50.5 |
| France | 3.0 | -2.0 | -1.1 | -2.4 | 11.0 | 52.7 |
| United Kingdom | 4.3 | 1.1 | 1.3 | -0.6 | 11.1 | 54.6 |

*Last five months annualized.

Sources: Economist - U.S. Census of Foreign Trade - Bureau of Labor Statistics.

Chart by Dolores Motichka / The Washington Times

This should be a reminder to the Commerce protectionists that the main reason for the U.S. trade deficit today is not soaring imports, whose percentage of our gross national product has actually *declined*, from 9.2 percent in 1980 to 8.6 percent in 1986, but the falling imports by both the developed, and developing nations of the world, who have either been assaulted by the plunging dollar, or squeezed into austerity by the International Monetary Fund.

Since a trade war will only exacerbate this situation, the net effect will be to make our whole economy worse, not better. We expect "Smoot" Gephardt not to understand this, but Mr. Baldrige and his Commerce Department should know better.

Unfortunately, they don't, judging by the fact that they routinely "hype" the trade-deficit figure, only to correct it downward some months later. Indeed, within 24 hours of the delayed publication of February's $15 billion figure, Mr. Baldrige was forced to issue a revised figure of $13.8 billion, because Congress in 1980 decided to force Commerce to release, first, the inflated deficit between the full cost *including freight (CIF)* of imports and the "free alongside ship" (FAS) value of exports, not counting overseas shipment costs.

This automatically hypes the trade deficit by about $1.2 billion each month over real value exchange.

In addition to this built-in bias, over the last 13 months, eight monthly trade deficits have since been revised downward an average of nearly $2 billion a month, while those in five months have been revised upward an average of $1.5 billion, for a net 13-month downward revision of nearly $8.4 billion. At the same time as the supposedly shocking $15 billion number came out, the January figure was revised *down* by more than $2.5 billion.

While this may not seem like much, it demonstrates a clear statistical bias in the Commerce Department to make the trade deficit seem even worse than it is, a bias which may reflect the bureaucracy's willingness to help Mr. Baldrige wage war for more protectionism against administration free-traders.

Their cause has also been abetted by Allen Lenz, the economist responsible for U.S. trade data, who has argued repeatedly that the only thing that matters in trade is manufacturing — and that the huge $20-30 billion surplus in U.S. service-sector exports is inconsequential. For a nation whose service sector is expanding rapidly (even as our manufacturing share of GNP continues steady and strong), this deliberately distorts our real trade picture.

Last winter the Office of Technology Assessment in Congress argued that Commerce also fails to measure as much as $40-60 billion of exports of all kinds of U.S. services, from financial, accounting, management, construction, education, research and technology, consulting, medical care, and so forth, further hyping the deficit.

The Commerce Department hotly denied this charge, but within a week of its denial the Canadian government published a report which showed that its trade surplus with the United States was not the $22 billion Commerce reported, but only $11 billion, in part beause of Commerce's failure to account fully for service exports.

Since the monthly merchandise trade deficit report by definition excludes the service sector, it deliberately overstates that deficit by as much as $2 billion as a device to sell protection for U.S. industry to congressional crazies.

It is time for Mr. Baldrige's department either to get on board with a supposedly free trade administration, or simply publish its true colors as "Smoot" Gephardt's biggest fans

LOS ANGELES TIMES April 8, 1987

# Time Out in the Chip War

## Pushing Japan Further Could Turn Into Reciprocal Ugliness

By ROBERT J. SAMUELSON

Japan-bashing has now taken on the aura of official U.S. policy. It's a perilous gambit, an invitation to bitter and mutually harmful conflicts.

Our illusion is that we can somehow compel the Japanese to do what is right for them and for us. We rationalize the stridency of our rhetoric and actions as necessary evils for a greater good. The Japanese, we say, react only to pressure. This is true up to a point. But because they believe—sometimes correctly, sometimes not—that our demands are selfish and unreasonable, they may miss the larger message. Change is mainly necessary for their own good, not ours.

The occasion of this policy change illustrates the dangers. Semiconductor "chips" are the tiny components of computers, communications equipment, television sets and most electronics. In 1986 the United States and Japan agreed that Japan would encourage more imports of U.S. chips while also stopping the "dumping" of Japanese chips at unfair prices around the world. Now the United States says that Japan has not complied with the agreement. Therefore we're threatening to slap a 100% tariff on $300 million worth of Japanese electronic imports.

In the chip war, almost everything is the opposite of what it seems. We see ourselves as the wronged victim of a broken agreement. In fact, Japan was forced to sign a bad agreement that probably was unenforceable and doomed to fail. We view our chip industry as being strangled by Japan's. In fact, the American industry is still the world's largest, and its problems stem mainly from overcapacity. Japan's high-technology industries, including semiconductors, could be badly hurt by the rising yen.

Nor did Japan alone cause its large trade surplus. Much of the recent increase stemmed from fast U.S. economic growth, which spurred our imports. But none of this exonerates the Japanese. Their illusion is the mirror image of ours: They blame their growing economic problems on a deliberate U.S. policy to raise the value of the yen. It's up about 40% against the dollar since early 1985, making Japanese exports less competitive and threatening the export-led growth of the Japanese economy. Since early 1986 the physical volume of Japan's exports has fallen.

The Japanese theory is fantasy. It's true that on any given day an offhand comment by, say, Treasury Secretary James A. Baker III may drive up the yen. But the basic pressure propelling it upward has been Japan's huge trade surplus, $83 billion in 1986. Its traders earn so many dollars, which must then be sold for yen, that the dollar is inevitably pushed down and the yen up. Higher Japanese demand for dollars to make overseas investments only partly offsets the upward pressures.

For Japan, the mechanics of exchange rates poses a merciless choice: Either Japan narrows its trade surplus by increasing imports and economic growth (higher growth also would raise imports), or the yen automatically climbs further and cuts the trade surplus through lower exports. Ironically, high-technology exports, led by computers, might suffer the most. In these markets, Japanese companies have little if any advantage over U.S. companies. By contrast, their hold on the car market is stronger. In 1986 nearly 40% of Japan's $59-billion trade surplus with the United States stemmed from automobiles, trucks and parts.

The best policy for both countries is faster economic growth and more openness to imports. But we cannot dictate to Japan how to change its economy and society. Our exports to Japan (and those of other countries, too) are held down by trade barriers that often involve custom as much as official policy. The amount of our export loss is unclear: Estimates range from a few billion dollars to nearly $20 billion. But these restrictions cannot be ended by negotiation. They are too numerous and complicated; any agreements easily could be frustrated by the Japanese.

The barriers will fall only when the Japanese decide that it's in their interests to make them fall. Many changes would be wrenching. For example, ending the huge protection afforded to Japan's farmers would expand food imports. Similarly, the Japanese will spur greater economic growth only when they decide that their interests require it. They resent foreign suggestions about how to alter their tax and spending policies. So do we. These matters engage national sovereignty, and can't be settled diplomatically.

It is said that we can force Japan to change by being tough on vital trade matters, such as chips. Well, maybe. The danger, though, is that these individual conflicts will obscure the larger issues. The talks develop their own momentum and emotions. In chips, for example, U.S. companies had legitimate complaints about fair access to Japan's market. But they used this problem to coerce Japan into a global price-fixing agreement, which is described deceptively as a remedy to "dumping."

Low chip prices mainly reflect vast global excess production capacity. Chip demand (mostly for computers) fell far short of forecasts. In 1986 the U.S. industry utilized only 57% of its capacity. When supply exceeds demand, prices fall. In Japan, chip prices are lower than in the United States. But we insist on higher Japanese export prices—to all countries, not just to us. We say that prices should equal full production costs. True, that's one definition of dumping. But the artificial gap between Japan's low domestic prices and higher export prices inspires cheating that the government says can't easily be policed.

The complaint rings true. Price controls rarely work. So both countries feel that they have been had, and in a sense they have. Our best policy is to be patient while the rising yen elucidates Japan's predicament to the Japanese. Instead, the chip dispute may become a prototype. It vents our nationalistic frustrations and makes it appear that politicians are "doing something." It implies a series of narrow disagreements, with both sides believing that the other is making unreasonable demands and acting in bad faith. Japan offers grudging concessions, but there are few basic changes and much ill will.

Our Japan-bashing may become their America-bashing.

*Robert J. Samuelson writes on economic issues from Washington.*

WARREN BROOKES 253P

# Shifting gears on textiles

Last month, the Southeast textile barons once again snapped their fingers and their congressional minions of both parties jumped to attention and introduced still another textile quota bill aimed at protecting the supposedly "hard-pressed industry."

But, just a week after South Carolina Sens. Strom Thurmond, a Republican, and Ernest "Fritz" Hollings, a Democrat, teamed up on this "modified quota bill," *The Wall Street Journal* told us just how "hard-pressed" this industry really is:

The five major textile companies increased their net profits on continuing operations in the fourth quarter of 1986 by a whopping 116 percent over 1985, and their net income was up 94 percent. (See table.) Small wonder their stock rose more than 30 percent last year, one of the best performances.

The five companies split up net income of almost $78 million, up from $40.3 million in the like quarter the previous year. One-time union-buster J.P. Stevens led the way with a 204 percent increase, from $6.7 million to $20.5 million.

And why not? Sales were up solidly in an industry that now runs at almost 94 percent of capacity, 14 points above the nation, in which employment actually *rose* from 705,000 to 725,000. With productivity rising in this industry at a nearly 4 percent annual clip, this means 1986 real output rose about 5-6 percent.

As a matter of fact, the industry raised its wages from $274.57 a week to $296.49, a very strong 8 percent increase. This is more than triple the 2.6 percent national weekly wage increase for all industrial workers, as the index of total hours worked rose sharply from 77.3 to 83.9, a 7.5 percent increase year over year, compared with only 1.1 percent for all manufacturing industries.

Two reasons for these happy results are tough new quotas against Korea, Hong Kong, and Taiwan arranged by U.S. Trade Representative Clayton Yuetter last July; and a massive rise in the Japanese yen which has helped push down imports substantially.

Last summer, clothing imports were running nearly $2 billion a month. But over the last four months they have dropped back to $1.6 billion, according to the Commerce Department.

Textile imports have fallen from $845 million a month last summer to around $700 million a month now, so the trends in imports on both clothing and apparel are no longer up.

Compare this with the bleatings from Dewey Trogdon, president of the American Textile Manufacturers Institute, who claims "textile imports grew 19 percent last year while the domestic market expanded by only 1 percent," and who argues that "only legislation can prevent a takeover of the domestic textile and apparel market by foreign producers."

To help pad these already sumptuous profits, their friends in Congress propose to set a global textile import quota allowing imports to grow no more than 1 percent a year — and compensating foreign producers who comply with lower tariffs.

This approach, attacking all foreign producers, not just those of the Pacific Rim who were the targets of last year's aborted Jenkins bill (which failed to survive the president's veto), is supposed to be "less protectionist." But Ambassador Yuetter has already signaled his opposition to further concessions to this industry, saying: "There is no way we will agree to import levels that are squeezed to that degree."

The sole purpose of such a squeeze is not to save or promote U.S. jobs, but to allow U.S. producers to push up their prices and profits. The best proof of this is that clothing inflation has shot up from minus 2 percent a year ago to plus 3 percent this year, stimulated by the combination of the new quotas and the weaker dollar, showing up in a 116 percent surge in profits.

Fortunately, House Energy and Commerce Chairman John Dingell Jr., Democrat of Michigan, a key "gatekeeper" for trade legislation in the House, told us recently: "I don't plan to move a textile bill this year, at least not until after we complete work on an overall trade bill. I just don't see much support for another fight this year on this issue."

One reason may be the fact that the three major textile states are still showing such solid economic performances. North Carolina's total payroll employment rose nearly 3 percent last year, and it currently sports an unemployment rate of 5.1 percent, well below the national average. And South Carolina's unemployment fell from 6.4 to 5.6 percent last year, while its total payroll employment rose 50 percent *faster* than the nation, as did Georgia's, with 5.7 percent unemployment.

So Mr. Dingell is right on putting off a textile bill. There is not the slightest reason to add to the already massive $25 billion a year which consumers now pay for import "protection" of this industry.

## Our 'Depressed' Textile Industry?

Fourth-quarter net income in millions of dollars

| | 4th Qtr. 1985 | 4th Qtr. 1986 | % CHANGE |
|---|---|---|---|
| Burlington Mills | $ 8.444 | $10.037 | UP 18.9% |
| Fieldcrest Cannon | 6.874 | 10.700 | UP 55.7% |
| J.P. Stevens | 6.732 | 20.461 | UP 203.9% |
| West Point Pepperell | 11.460 | 20.949 | UP 82.8% |
| Springs Industries | 6.762 | 15.822 | UP 134.0% |
| TOTALS | 40.272 | 77.969 | UP 93.6% |

Source: Wall Street Journal, Dow Jones

The Washington Times

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# Uncle Sam's Supermoney

The worldwide supremacy of the dollar is a symbol of strength and a source of grief

You've probably never heard of it. It's called CHIPS, for Clearing House Interbank Payments System. On a typical day, CHIPS's computers help transfer $425 billion among banks around the world. Dollars become data entries moving between New York, London, Tokyo and dozens of other cities. The dollars pay trade bills, finance foreign investments and settle international debts. The dollar remains, as CHIPS vividly demonstrates, the world's supercurrency.

It's fashionable to blame the decline of U.S. technological and business superiority for our foreign economic problems. Actually, the dollar's supercurrency status is far more important. It lies at the core of huge U.S. trade deficits, today's lopsided (and wobbly) global economic recovery and the Third World debt crisis. Our supercurrency is a mixed blessing. It allows us to buy imports with our own money, but a strong world demand for the dollar props up its value and hurts our exports. Paradoxically, our problems reflect U.S. economic strength as much as weakness.

Consider what's happened. Since 1982 the United States has spent abroad—mainly by importing and traveling overseas—about $420 billion more than we've sold. Our dollars were accepted by foreigners and reinvested in high-yielding dollar securities. Would an equivalent surplus of French francs, British pounds or Japanese yen have been similarly reinvested? It's doubtful. Foreigners' dollar holdings are the simplest cause of the unbalanced world recovery. The export earnings of our trading partners didn't automatically increase their imports. Japan, West Germany and Taiwan run huge trade surpluses while we run a massive deficit.

This vote of confidence in the dollar confounds longstanding obituaries of its supercurrency status. Someday the forecasts may be proven correct. Our economic superiority has declined, and other currencies—the German mark, the Japanese yen, the Swiss franc—matter. But they still pale beside the dollar. It is used to price most internationally traded raw materials and to pay for many of them, most importantly oil. It comprises about two-thirds of countries' foreign-exchange reserves. Half or more of all international bank and bond loans are in dollars.

Indeed, its importance may have increased. The dollar has accommodated itself easily to an era of electronic fund transfer and increasing cross-border investments. Since CHIPS's start in 1970, its average daily volume has multiplied more than 140 times. The dollar's versatile uses, the size of our economy (more than twice as large as Japan's and four times larger than West Germany's) and our political stability give dollar investments special appeal. In 1986 Japanese investors bought at least $65 billion worth of dollar bonds, according to Salomon Brothers.

But our supercurrency doesn't always work to our advantage. It inflicts our economic policies on the rest of the world and, in the process, often causes undesirable side effects. If Italy runs inflationary policies, they affect mainly Italy. Our inflationary policies in the 1970s fostered a worldwide inflationary boom. Dollars were cheap, because U.S. interest rates (after inflation) were low. Developing countries borrowed heavily. Our exporters did well, helped by high demand and—because there were so many of them—a depreciating dollar. The boom inevitably collapsed, leaving behind the Third World debt crisis.

The problem today is the opposite. Reducing inflation in the 1980s meant higher interest rates (again, after inflation). Dollar securities became more appealing, and the dollar appreciated. But the resulting distorted global recovery, burdened by our trade deficits and others' surpluses, is as shaky as the 1970s' inflationary boom. Other countries cannot export an ever-rising part of their production, while our trade deficit cannot perpetually expand. Nor will foreigners accept an infinite number of dollars for their products. The dollar has had to drop, but even its 37 percent decline since early 1985 leaves it higher than in 1980.

**Recession worry:** The threats to the global recovery are obvious. By itself, a dollar depreciation might help the United States, but only at the expense of other countries' exports. If falling exports then tip them into recession, everyone would be worse off. Germany and Japan tell us to avert a downturn by stopping—somehow—the sliding dollar. We tell them to stimulate their economies. After meeting in Paris, the world's major finance ministers recently pledged to do both. Only time will tell whether they can.

To understand these problems is to grasp our dollar dilemma. In the early postwar years, our economic superiority eased the conflict between our export competitiveness and our currency's world role. Other countries were hungry for our products. Unfortunately, this superiority had to slip as other nations rebuilt and assimilated modern technology and management. Meanwhile, the dollar's overseas uses multiplied. The dollar developed a split personality—part domestic money, part international—and the tension between these roles is an unsettling force in the world. Creating too many dollars risks igniting inflation, while too few may cause trade distortions. It's difficult, perhaps impossible, to get the balance right.

Of course, no one should think the dollar causes all the world's woes. It doesn't. In fact, its importance is used by other nations to make us a scapegoat for their problems. Developing countries that borrowed dollars cheaply a decade ago might have used these loans productively. Those that did are faring well, while those that didn't (Mexico, Brazil) are suffering. Germany and Japan preferred a high dollar for parochial reasons. Export-led growth spared them from difficult domestic political decisions to increase growth at home.

But the dollar's global role does place our international problems in a different perspective. We take the dollar's pre-eminence as a point of national pride and attribute our trade troubles to other problems. We deplore "unfair" foreign trade practices that, though real, aren't the main cause of our trade deficit. We fret over a loss of competitiveness that, though genuine, is exaggerated by the dollar's high exchange rate. The more awkward truth is that our supercurrency often frustrates U.S. national interests. We have had a "weak" dollar and a "strong" dollar, and neither has quite suited.

L.A.TIMES: 2-12-87

# Deficits: the Connection That Isn't

## Theory of Budget-Trade Link Is Grossly Misleading

By ROBERT J. SAMUELSON 1b2/53

Ever since enormous federal budget deficits became a reality, the public has been bombarded with false theories about the consequences.

We were initially told that by causing high interest rates the deficits would prevent a recovery from the 1981-82 recession. That was false. Then we were told that they would intensify inflation. That was false. Now we are told that they have caused our large trade deficits. This theory, if not entirely false, is so misleading that it is almost worthless.

The economists who concoct these stories exaggerate what they know, thinking that they have embarked on a vital crusade: deficit reduction. Congress is supposed to be scared into action. But the result is just the opposite. As the budget deficits' adverse effects are discredited, political pressure to deal with them evaporates. Congress doesn't want to cut spending or raise taxes for no apparent gain.

The budget deficits need to be treated candidly—neither sensationalized nor ignored. In many respects the politics of big budget deficits resembles the politics of inflation in the 1960s and '70s. Controlling both involves making difficult short-term choices to avoid larger but ill-defined future problems. We tolerated creeping inflation for nearly two decades, ignoring warnings that it one day might get out of hand. It did, and only the wrenching austerity of the early 1980s stopped the inflationary spiral.

So, too, large budget deficits can be temporarily tolerated. But the longer they last, the greater the danger that they will snowball into a bigger crisis. No one can say precisely what or when. It's this ambiguity that tempts economists and others to advance more dramatic theories tying the deficits to some concrete economic problem. The connection between the budget deficits and the trade deficits is simply the latest example.

The argument is oversimplified, and has perverse side effects. It's being used by Japan and West Germany to resist U.S. pleas to stimulate their economies. The Reagan Administration correctly contends that these countries are draining demand from the world economy with their huge trade surpluses. Faster economic growth and higher imports would help sustain the global recovery. West Germany and Japan wrongly dismiss this view, attributing their trade surpluses mainly to our huge trade and budget deficits.

The U.S. trade deficits mean that as a nation we are spending more than we are producing, and are relying on imports to fill the gap. Blaming this excess national spending on the budget deficits is superficially plausible because, as the following table shows, the two deficits have roughly grown together. (The budget figures reflect the government's fiscal year, from October to September; the trade figures are for the calendar year.)

| | Budget Deficit in billions | Trade Deficit in billions |
|---|---|---|
| 1981 | $78.9 | $39.7 |
| 1982 | $127.9 | $42.6 |
| 1983 | $208.9 | $69.3 |
| 1984 | $185.3 | $123.3 |
| 1985 | $212.3 | $148.5 |
| 1986 | $220.7 | $170.0* |

*estimate

But this argument's flaw is simple: We could produce much more here. Between 1981 and 1983, our trade deficit rose 75%; meanwhile, civilian unemployment averaged 8.8% and factories operated at 75.6% of capacity. Even now there is room for more production. In 1986 unemployment was 7% and factory utilization was 79.5%.

A more sophisticated theory connects the trade and budget deficits via the dollar's high exchange rate, which has made U.S. exports less competitive and imports cheaper. By this logic the big budget deficits—and the expectation that they would continue—pushed up U.S. interest rates in the early 1980s, attracting international investors into dollar securities. As investors sold other currencies and bought dollars, the dollar's exchange rate rose more than 60% between 1980 and 1985.

The trouble with this theory is that the budget deficits were not the main cause of high U.S. interest rates. Most of the rise had occurred by 1982, before big budget deficits, and reflected the Federal Reserve's policy of crushing inflation with tighter credit. The budget deficits may have kept rates up after 1982 and contributed to the trade deficits. But budget deficits are only one of many causes. Others include the Third World debt crisis and slow growth abroad. Both cut demand for U.S. exports.

Being more precise about the budget deficits' effects usually is intellectual arrogance. Economists often pretend to know more than they do. The truth is that as the U.S. economy has become more integrated into the world economy it has become harder to understand. There are new uncertainties and complications. Although economists may grasp general tendencies, detailed predictions are difficult.

In the future the connection between the two deficits may become more important. As the dollar's exchange rate falls, U.S. goods become more competitive and our trade deficit also should fall. Satisfying the spending demands of consumers, businesses and government will be tougher. More of our production will be exported, and imports will slow. Higher production can help, but, if unemployment drops and factory utilization rises, spending pressures could increase inflation or interest rates. Cutting the budget deficit is one obvious way to ease those spending pressures.

That is only one reason for reducing big budget deficits. A government that spends far more than it collects is courting trouble. Potential problems abound: Government may inflate away its debt by printing money, government borrowing may crowd out private investment and big deficits may frustrate spending on vital new needs. The case for cutting the budget deficits does not require sophisticated economic analysis. It's common genre.

10-20

10 - 10-20-30 - ~~5~~ 15 min

5 - 6 - exercise

Up at 5 - 6-30 - dress

6 30 - coffee - ~~[illegible]~~ bread

leave 7:00

mags - home [illegible]

dinner [illegible]

books/mags

notes

11/11 30 - lunch

Friday - [illegible] - [illegible]

Sat. all - I

Sunday - [illegible]

Soc 100

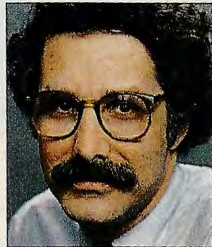
Sunday

Same..

Elmwood



# Corporate Socialism



Those who beg for government protection are also inviting government control

You might not ever have to think about Delaware except for this: although its citizens represent only 0.3 percent of the nation's shareholders, more companies are incorporated there than in any other state. There are 179,000 of them, including 56 percent of the Fortune 500. Delaware may soon enact an antitakeover law, which—given the state's pre-eminent position—would amount to a national antitakeover law.

This is a ghastly idea. Its only purpose is to shield well-paid executives against hostile takeovers. Corporate leaders like to project themselves as defenders of the productive economy against sinister financiers and "raiders." In fact, hostile takeovers promote greater efficiency and productivity. The whole antitakeover exercise smacks of corporate socialism: the marshaling of government powers to protect established businesses against change and challenge.

Executives want to sleep easier at night, and Delaware is eager to please. The corporate franchise tax and other fees provide 16 percent of state revenues. A Supreme Court decision last spring seemed to permit tougher state antitakeover laws. Since then, 13 states have passed new laws, bringing to 27 the number with antitakeover statutes. Delaware officials fear that companies will reincorporate elsewhere if the state doesn't offer greater protection. The local bar association is drafting a proposal, which the legislature may approve in early 1988.

The speed with which these antitakeover laws have passed represents a political triumph for big corporations. They've largely succeeded in portraying hostile takeovers as an economic pestilence. By now, the indictment is familiar. The takeover threat (it's said) forces companies to focus on short-term profits and sacrifice long-term investment or research. Corporate raiders cheat small shareholders by coercing them to sell their stock at low prices.

There's just enough truth to the indictment to make it seem compelling. Ivan Boesky was just sentenced last week. Some takeover bids are phantom, intended mainly to create speculative opportunities in the stock market. Outlandish trading profits are made. Not surprisingly, corporate raiders and investment bankers are the new villains of popular culture—reviled in novels (Tom Wolfe's "The Bonfire of the Vanities") and movies (Oliver Stone's "Wall Street"). But beyond the imagery, the indictment against hostile takeovers is essentially false. Consider:

- They aren't rampant. In 1986 only 40—a record—were attempted, according to W.T. Grimm & Co.; a mere 15 succeeded. What is rampant is executive anxiety about takeovers. In one survey of 200 large companies, 57 percent said they'd been subject to takeover rumors.
- Hostile takeovers haven't cut total investment or research. Between 1979 and 1986, corporate-financed research and development rose 51 percent, after adjusting for inflation. The increase between 1969 and 1976—when hostile takeovers barely existed—was only 12 percent. Investment, as a share of gross national product, is higher now than in the 1970s.
- There's no evidence that shareholders fare worse in hostile takeovers than in friendly ones—those negotiated by the managers of merging companies. Typically, investors get 25 to 40 percent more than the previous market price.

Still, the corporate rhetoric continues. Listen to H. B. Atwater Jr., chairman of General Mills. He deplores financial "manipulations" and bad "bust-ups." He says hostile takeovers create "no new wealth." He's probably right. But they can improve use of the existing wealth by redirecting wasteful corporate investment. Ironically, General Mills proves the point.

**Useful threat:** General Mills has an "extremely profitable base [business] that subsidized poor diversification," as Michael Porter of the Harvard Business School writes. The company is the second largest cereal maker (Wheaties, Cheerios) and the leader in cake mixes (Betty Crocker). Food profits financed diversification in everything from toys to fashion to furniture. In 1985 Atwater overhauled the company. He sold poorly performing businesses and turned the toy and fashion operations into separate companies, whose stock was distributed to General Mills's shareholders.

The results have been dazzling. The toy and fashion businesses have done better as independent companies. Focusing on fewer businesses, General Mills improved its return on shareholders' equity from 19 to 31 percent. Since 1984 its stock price (including the value of the spun-off companies) has risen about 150 percent. That's more than three times greater than the overall market rise. But suppose Atwater hadn't acted and a raider had? In 1985 someone could have bought General Mills for 50 percent more than its market price and, by doing what the company itself did, profited enormously. Would that be a financial "manipulation" or undesirable "bust-up"?

The economic value of hostile takeovers doesn't lie in the few that occur. It lies in the mere threat, which motivates managers to stay efficient. Just because the pressure operates through the stock market doesn't make it illegitimate. The Delaware antitakeover proposal aims to reduce the threat. Management-approved mergers are exempted. For others, the proposal would make it difficult for investor groups to borrow the money to finance hostile takeovers. Notably, many public pension funds—large stockholders representing millions of retirees—oppose the plan.

What Delaware and shortsighted executives are jeopardizing is a division of labor that's worked well for decades. Congress has left the details of corporate law to the states, as long as states don't use it to settle major issues of national policy. Once that happens—as it is happening here—the question arises: why should Delaware have such power? The logical response is to abolish state corporate charters and replace them with a federal charter.

This step has long been advocated by social activists, but it's fraught with dangers. It would represent a huge politicization of the economy. Through federal charters, corporations could become the target of every passing political and social fad. It would be an economic nightmare. But if business leaders want corporate socialism, that's what they're risking. Those who beg for government protection are also inviting government control.

issue would "look too official"—upstaging the real official magazine company of the Games, Time Inc. Although one set of organizers dropped that suit last month, another has filed a separate lawsuit seeking $1 million in damages. "Sponsors pay a lot of money," said a spokesman for the Olympic organizers. "We're just trying to protect their rights."

The run for the money has produced some twists and turns that would do American figure skater Debi Thomas proud. The Calgary Games have two official beers, for example: Budweiser for the United States, and Labatt's for Canada. Labatt's sold in Canada is permitted to display the Olympic rings, but not Labatt's sold in the United States. Bud can display the Olympic rings in the States but not up north. Gossip alone can throw businesses into turmoil. Rumors began to spread that General Motors cars would get preferential parking at Olympic events after GM anted up for its official status. Some Calgary auto-rental agencies responded by shuffling their fleets and replaced many Fords with GM cars. "What else was I going to do?" one rental manager muttered. "I was getting calls for nothing but GM cars."

**Corporate games:** Early returns show that the official Olympic stamp of approval will be just as profitable this time as it was in 1984. Visa's sales volume rose 17 percent in the third quarter of 1987—in part, says one senior vice president, because of cachet gained from the Olympic association. Eastman Kodak thought enough of Fuji's success at the 1984 Games to outbid the Japanese firm for rights this time. Meanwhile, the donations have already topped $58 million, virtually assuring that the Winter Games will show a profit. With that kind of success, the corporate games seem sure to go on for as long as the Olympics do.

RICHARD MANNING *in Calgary*

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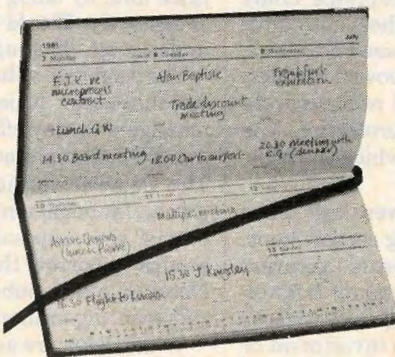

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