

## ECONOMIC NEWS UPDATE

Irwin Stelzer

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### **The Unstimulating Effect of “Buy American”**

Congress continues to include “Buy American” provisions in the stimulus package, albeit in watered-down version. This has set off alarm bells in the free trade community. With reason. During his presidential campaign Barack Obama made it clear that he is unhappy with the way the world trading system works -- draining factories and jobs from America. And not because American workers are inefficient, or lazy. Rather, it is because the system is somehow rigged against America, with its free-floating currency and open markets. So he thinks. Or thought. In recent days he said he wants to avoid any steps that would “signal

protectionism. That is a potential source of trade wars that we can’t afford at a time when trade is sinking all over the globe.” Whether he can persuade congress to delete the Buy American provisions contained in the version of the stimulus bill now wending its way through congress is not clear -- he is not in complete control of his own party, and Majority Leader Harry Reid is an ardent fan of “Buy American”.

Meanwhile, free traders are scrambling for their dog-eared copies of Adam Smith’s “Wealth of Nations”, and reading to their protectionist friends the great Scot’s explanation of the enriching

nature of free trade to all parties engaging in it. "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage." To which those who are upset by the costs of freer trade respond by citing Smith's defense of retaliation when it "will procure the repeal of ...prohibitions" imposed by other nations.

Such "prohibitions" on the free movement of goods and services abound. The EU restricts imports of American chickens and beef, so America wants to levy a tariff on Italian water. France prevents foreigners from taking over any of its "national champions" (including a yogurt maker), and in the current crisis President Sarkozy has told his country's leading manufacturers to confine layoffs to plants located in other countries. (Iowa Senator Charles Grassley took a similar position when he urged Microsoft CEO Steve Ballmer to confine the firm's 5,000 layoffs to foreign workers). In a display of Gaul, French trade minister Anne-Marie Idrac told the Davos

attendees that she finds it "extremely preoccupying that one of the first acts of the Obama administration could be a measure [Buy American] that is clearly protectionist and a distortion of competition".

Russia welcomes the inflow of foreign capital, which it then confiscates, cooperates with the OPEC oil cartel to restrict output, is attempting to set up a similar organization to control natural gas prices, and raises tariffs on whatever products Vladimir Putin decides to protect. Mexico bars American capital from investing in its oil industry. American administrations have at times imposed "voluntary" quotas on the importation of autos, steel, shoes and other goods. Most important to US politicians, China manipulates its currency so as to keep its value down and its powerful import machine humming.

Which is why a rumor circulating in Washington is so interesting. Recall: Treasury Secretary Tim Geithner, during the course of his confirmation hearings, told the senate that he wants to crack down on China's manipulation of the yuan. Tough talk, especially his use of the word that the Chinese hate -- "manipulation".

But rumor has it that Geithner informed the Chinese that in order to assure his confirmation he would be using the m-word. And just last week, Geithner safely installed at the Treasury, President Obama hinted that he is unenthusiastic about precipitating a trade war. Perhaps the new administration has decided that a trade war would destroy as many jobs as it would create, and that there are better ways to dampen protectionist pressures.

There is an emerging consensus among the policy wonks with access to the President and his advisors that a trade war can be avoided if several new policies are adopted. The first would be to find some way to compensate the innocent bystanders, those workers who have lost their jobs to foreign competition, much of it from the over one-billion workers in China and India who have in recent years entered the international labor force. The various programs now in place are too complicated, too restrictive, to provide enough relief, and the tax laws too tilted in favor of investing overseas rather than in America, say the Obama team. Some method must be found to share the gains of the

winners -- consumers who profit from the low prices Wal-Mart can charge for its imported goods -- with the losers. That has nothing to do with the efficiencies of free trade, but with politicians' notions of what constitutes an equitable sharing of its benefits that might dampen congressional enthusiasm for protectionism.

Then, something must be done to persuade protectionist-leaning legislators and their trade union masters that China can be brought into the international trading system as a full and fair partner. That won't be easy. The country's communist leaders have built their economy around the jobs created by exports; domestic demand is too limited to absorb all of the job-seekers in China, which now include the 20 million rural Chinese thrown out of work in coastal manufacturing centers and heading home -- potential participants in the increasing incidents of "social unrest" (aka riots) that has the regime worried. The nation's rulers will be willing to bring their currency more in line with its market value only if pressured to do so. And America, in debt to China to the tune of billions of dollars, with more IOUs to sell when the

stimulus spending cuts in, is not well positioned to apply that pressure. Waiting in the wings is New York Democratic senator Chuck Schumer, who wants to levy a tariff of 27% on Chinese products to offset the regime's currency manipulation. And soon to come is the administration's report to congress, in which it must announce whether China is indeed deliberately manipulating its currency. Geithner has to write that report, and it won't be easy for him to get around his earlier testimony unless he can wring some at least cosmetic concessions from his friends in China.

But this administration knows that in the end its success will be measured by its ability to create jobs to replace the 3.6 million lost in the current recession. Best done before the 2010 congressional elections, but definitely in time to produce a down tick in the 7.6% unemployment rate and to affect the presidential battle in 2012. If that means living with the long-run inefficiencies created by trade barriers, so be it. Observers here are now convinced by Obama's flaccid performance during the crafting of the stimulus package that the

President will not or cannot stand up to a congress that is dominated by members of his party who are ideologically on his left, and for whom the displeasure of the trade unions can mean early retirement, and a return to deserved obscurity.

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