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The Betrayal of American Prosperity: Free Market Delusions, America's Decline, and How We Must Compete in the Post-Dollar Era

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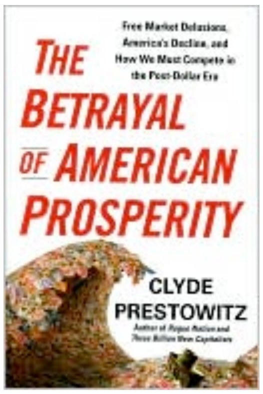

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Introduction

JOANNE MYERS: Good morning. I'm Joanne Myers, Director of Public Affairs Programs, and on behalf of the Carnegie Council, I'd like to thank you all for joining us. Today our speaker is Clyde Prestowitz. It wasn't so long ago that we had the good fortune to listen to Mr. Prestowitz when he discussed two of his earlier critically acclaimed books, *Rogue Nation* and *Three Billion New Capitalists*.

We are delighted to welcome him back, this time to talk about his just published book, whose title says it all: *The Betrayal of American Prosperity: Free Market Delusions, America's Decline, and How We Must Compete in the Post-Dollar Era*.

Today, even as the United States tackles the immediate economic crisis, some say that our long-term economic competitiveness and ability to deal with global challenges is being undermined. Therefore, it wasn't entirely surprising when President Obama, in releasing the National Security Strategy report late last week, emphatically declared that the United States must revitalize its economic, moral, and innovative strength if it is to continue to lead the world.

He went on to say that just as we did after World War II, the United States today must shape an international order and system of global institutions that reflect a 21st-century reality in which America's greatness is not readily assured.

In *The Betrayal of American Prosperity*, our speaker forcefully echoes similar views, especially the idea that America's economic strength has eroded over the past 50 years and needs to be restored.

Mr. Prestowitz explains that in the years between 1800 and 1950, America became the richest country the world had ever seen. By promoting new technology, investing in production and key industries, and massive infrastructure projects, like the transcontinental railroad, America developed an economic strategy that set out to build a partnership between business and government. It was a time when business was the business of America. Sadly, in his view that this is no longer the case.

He writes that we have largely turned our backs on this approach and have subordinated our economic development to geopolitical priorities which are rapidly chipping away at the base of our prosperity and national security.

In shifting our economy from a manufacturing society to one of consumption, Mr. Prestowitz argues, we have been left with a crumbling market share, disappearing jobs, stagnant wages, and lost technological edge, which is simply a terrible deal that doesn't have to be this way.

As President Reagan's chief trade negotiator and founder of Economic Strategy Institute, Mr. Prestowitz knows a great deal more about trade and trade negotiations than most of us. Accordingly, when he writes about our nation's perilous economic position, the growing U.S. trade deficit, and the decline of American manufacturing, he understands only too well why our trade policies are seriously flawed and what we must do to correct this situation. He is deeply troubled by how American political leaders from both parties have sold America out.

Under the circumstances, you may be asking yourself whether America's economic vitality has deteriorated so much that it cannot be restored to compete effectively against a rising China or India. Or are there ways to recover our competitiveness?

For the answer, please join me in giving a warm welcome to our guest, Clyde Prestowitz. Thank you for joining us.

Remarks

CLYDE PRESTOWITZ: Thank you very much. It's really a pleasure and an honor to be back at Carnegie. This is a great place to kick off a book.

I have to say that I admire you. You have what the French call courage. Anybody who can get up at this hour of the morning and come to listen to a speaker talk about a book on economics—that's really impressive. I thank you very much.

I went to Washington in the fall of 1981. I had gotten a call from then-Secretary of Commerce Malcolm Baldrige. I was then working as head of global marketing at American Can Company, nearby here in Greenwich, Connecticut. Mac asked me if I would come down to Washington to help out with the trade negotiations, particularly negotiations with Japan, since I had lived, studied and done a lot of work in Japan, presumably I knew something about Japan.

I told Baldrige, "Okay, I'll give you a year. I'll take a year leave of absence and I'll come down to help you solve this problem."

I showed up in September of 1981, walked into Baldrige's office the first day on the job, and essentially I said, "Okay, Mac, here I am. What's my job?"

Baldrige said, "Clyde, your job is to reduce the trade deficit."

Now, in 1981, the trade deficit was $27 billion annually. Everybody said, impossible; not sustainable; couldn't go on. The trade deficit with Japan was about half of that, about $13 billion, and everybody said the same thing: We've got to solve this trade deficit with Japan.

In fact, if you read the papers today about U.S. trade with China, and if you just took out "China" and wrote in "Japan," it's the same story. In fact, I think, actually, the papers take those old stories and just put "China" in.

I said, "Okay, great. What do I get paid?"

Baldrige gave me a number. I've forgotten what it was, but I remember it was a lot less than my wife and kids had become accustomed to. I mentioned this to Baldrige.

He said, "Ah, Clyde, don't worry. I'm a businessman, too. I understand entrepreneurial drive. I'll make you a deal. I'll pay you a bonus—10 percent of the amount by which you reduce the trade deficit."

Five years later, the trade deficit was $150 billion, I owed Baldrige $15 billion, and I had to start writing books, so I hope you all buy about 300.

Today the trade deficit is about $700 billion. We have a $50 billion monthly trade deficit, $55 billion monthly trade deficit—double the annual deficit when I showed up in 1981.

I have a feeling that I'm standing back and watching a disaster about to happen. In terms of loud and quiet disasters, we have a very loud disaster going on in the Gulf of Mexico. It really is a catastrophe, in my view. It's easy to understand but it's not easy to respond to. Nobody seems to really know how to fix it. But at least you can see it and you can understand the efforts being made to deal with it.

What I'm watching is a quiet disaster, but in a way it's a much more fundamental disaster. Let me put it in terms that were well articulated by the 1936 finance minister of Japan, Korekiyo Takahashi.

Takahashi said that the consequences of an economic defeat are far more difficult to reverse than those of a military defeat. I have been watching for 30 years the economic defeat of the United States. It has been a slow defeat, but a steady erosion of American leadership in industry, technology and of the U.S. wealth-producing capacity.

We have had a high standard of living and many people flourished in the 1990s and in the last decade of bubbles. That's precisely the point. We kept telling ourselves in the 1990s and in the "aughties" that we were doing great.

We had great economic growth, the longest expansion of the U.S. economy in history in the 1990s. We told ourselves we had the world's highest per-capita GDP and that we were leading the world in productivity gains and so forth.

What we didn't watch was that we were also leading the world in piling up debt. We were living beyond our means.

We're still living beyond our means. We consume more than we produce. We spend more than we earn. In fact, the irony of the present recovery, to the extent that it is a recovery, is that we're repeating that scenario. So we really haven't addressed the underlying dynamics that drove it in the first place. So, in many respects, the U.S. economy in the last 20 years has been and still is a Potemkin village.

Just to dramatize that a little bit, think about things that you run into. If you go to Korea, you know that the cell phones in Korea really work. They work so well that I was on a train in Korea not too long ago and we were going through the mountains and through the tunnels, and the guy across from me was talking on his cell phone. I was tired, jet-lagged and I really hate cell phone chatter. This was really a bad time. I had this great urge to grab the phone and stuff it down his throat. But I resisted. I said, "Clyde, control yourself, because this is really interesting." Why interesting? Because we're going through tunnels and around mountains, and he never loses the call. In the long tunnels he doesn't lose the call. I thought, "Wow."

I was in Cairo not too long ago.I had a free afternoon, so I got a car and driver and went out to the pyramids. You are allowed to climb halfway up the Great Pyramid of Cheops. So I did, and while I was there I had this inspiration. I thought, "I wonder if I could call my wife on my cell phone." My wife was in Maui. So I dialed the phone—straight through, clear as a bell. It was like she was on the other pyramid. I thought, "Wow, this is fantastic."

I go home. I'm at Dulles Airport in Washington and try to call my wife. Impossible.

Take the Internet. I just got Verizon FiOS service. I got the highest speed that FiOS will give you. I think it's about 8 megabits per second. I get really irritated, particularly these days, because I have this book out, and so I'm going to Amazon and other book places to check what's happening with my book. You try to flip the pages, but there's always a pause. There's a pause because, at 8 megabits per second, it doesn't flip so fast.

If I were in Korea, Japan, France or Germany, it would flip three or four times faster than it does in the United States. We have the slowest broadband Internet. We call it "high-speed." The Koreans laugh at us. The Koreans call our broadband Internet, "snail mail."

You can see that the dynamism, the competence, the leadership that the United States used to have has eroded dramatically in many areas. So how did we get here?

First, we got rich. I won't belabor that part of the book, but I think the history of how America got rich is extremely important. We have a mythology about this, that it was all entrepreneurial pioneers just doing their thing. The free market ran, and those entrepreneurial tough-minded pioneers drove the development of the country.

Now, I don't want to put the tough-minded pioneers down and I don't want to put the entrepreneurs down, because we did have great entrepreneurs, and we did have tough-minded pioneers. But you know what? They worked with a government that was focused on developing the American economy.

The United States government worked on developing the American economy between 1815 and 1950, in pretty much the same way that the Chinese government is now focusing on developing the Chinese economy. They had a catch-up strategy. Our forefathers wanted to catch up to and beat the British, who were then the world leader in industry and technology. To do that, they had industrial policies.

We had protection of our markets. We stole technology and didn't protect the intellectual property of the Brits or other Europeans. But the main point is that the focus, the highest priority of the U.S. government, was economic development. They had an economic strategy, and it worked.

I'll just give you one vignette. This is just a great story, I think.

In 1919, Woodrow Wilson is at Versailles negotiating the peace at the end of the First World War. He discovers that the Brits are reading his telegraph traffic. You know that today, because the United States was the origin of the Internet, the structure of the global Internet is still America-centered. A lot of Internet traffic that goes, let's say, from Asia to Europe goes through the United States. It's not meant for the United States; it just goes through the United States because that's the way the circuits and the lines were built.

In 1919, the telegraph, the radio telegraph, was kind of the analogue of today's Internet, and Britain was the hub. So a lot of international telegraph traffic went through London, even though it might not be destined for London. British Marconi was the dominant global radio telegraphy company, and through cooperation between British Marconi and the British government, they read everybody's telegraph traffic.

Wilson didn't like it. He thought that was unfair. So he called his secretary of the Navy, a young guy named Franklin Delano Roosevelt, and he says, "Frank, this is unacceptable. The Brits are reading my traffic. We need to stop this. We need a company that can beat British Marconi. Frank, form a company."

So Roosevelt calls in the heads of AT&T, Westinghouse, General Electric, and United Fruit, and says to them, "Gentlemen, you are going to be shareholders with the U.S. Navy in a new corporation. The U.S. Navy will hold 50 percent. You will share the other 50 percent. We're going to build a radio telegraphy company to beat British Marconi."

Does anybody know the name of that company? RCA, Radio Corporation of America. Within three years, Radio Corporation of America had bested in market share British Marconi.

That's an industrial policy. That's picking winners. RCA was a great winner for the United States for a very long time. It had a sad end—in fact, it's now a Chinese company—but it had a great run.

China did exactly what the United States did. We were kind of the model for the Chinese.

Having gotten rich, in 1950, and having emerged as the top country in the world, we changed our policies and our strategies in many respects. We changed them for good reasons. But in the course of changing our strategy and our policies, we began to forget some of the lessons that we had learned in the previous 150 years. We began to adopt bad habits, and we ultimately have embraced false gods, false doctrines.

I want to say this very strongly, so let me put it in strong terms that I know you will all understand. This audience well remembers we had a doctrine, the domino theory, the notion that if Vietnam went communist, all Southeast Asia—nay, all of Asia—nay, the whole world—would go communist. And so we had to draw the line in Vietnam and stop the communists.

Now, in retrospect, we all know this was a silly doctrine. We all know it was superficial and it wasn't thought out. We all know that it had serious flaws. In fact, it was stupid.

But our elite—as David Halberstam said in his great book, *The Best and the Brightest*—the best and brightest in the United States embraced that doctrine. You couldn't get tenure in a university if you didn't embrace that doctrine. You didn't get a high position in government if you didn't embrace that doctrine. You didn't get on an editorial page if you didn't embrace that doctrine. It was an orthodoxy. And it was only after we killed 58,000 kids that somebody said, "Hey, this is stupid."

We have done similarly in embracing false economic doctrines. I mention six false doctrines in my book. I'll run through them quickly, but I don't want to elaborate on every one of them, because if I did, you wouldn't have any time to ask me any questions. I want to elaborate on two or three.

What are the false doctrines?

One of them is consumerism. The United States, for good reasons, in the postwar period, focused on consumption as the driver of the economy.

The good reasons were that at the end of the war—remember, our wartime leaders had also lived through the Depression—their great fear after the war was that we would relapse back into depression once the stimulus of wartime production stopped.

They had 15 million men and women coming back to be demobilized, looking for jobs; and clearly exporting was not going to be an option because the big export markets were in ruins in Europe and in Asia. So the only option was domestic growth. We focused on stimulating domestic growth, with the G.I. Bill and many other measures which made sense at the time.

But they became engrained and they developed their own political power. You can just watch consumption as a percentage of U.S. GDP: in the 1950s, 58 percent—just about the same as Europe is today, about the same as Japan is today; in the 1960s, about 63 percent of GDP; in the 1970s, about 65 percent of GDP; in the 1980s, about 68 percent of GDP; today, we are 72 percent of GDP.

So we have a constant rise in consumption as a percentage of GDP, and as the driver of economic growth. Because we forgot about exports in the postwar period, we have never focused on trade or exports as a driver of growth in the past 50 years, and so it hasn't been a driver of growth.

The second false doctrine is what I call the oil addiction, the cheap energy addiction. For most of its history, the United States has been blessed with cheap energy—initially, water and coal and timber, and then oil, first discovered in the United States.

We have become not only accustomed but addicted to cheap energy, to the extent that we fouled the whole Gulf of Mexico in the search for cheap energy. We defend any oilfield, wherever it is. No matter what corrupt regime owns it, we defend it. We protect the sea lanes. We spend, actually, an enormous amount of money to get cheap energy. This is a great drag on our economic growth.

A third false doctrine is what I call the geopolitical imperative—geopolitics, playing the great game, moving troops around, negotiating weapons agreements and nuclear-free-zone agreements. The great game of global politics is the highest priority and, in fact, the highest thrill of our political establishment. To play that game, they subordinate our economic interests.

I'll just give you one example. In November President Obama was in China, and he held a press conference jointly with President Hu Jintao. In the press conference—I listened to it—President Obama said that America would assist China in its development of a commercial jet airliner.

When I heard that, I kind of shook my head. I thought, "We don't really have much that we can sell to the Chinese. One of the things that we can sell the Chinese is commercial jetliners. Why are we helping the Chinese do this?"

My thinking was conditioned by the fact that I had been at a dinner in China several years previously with some high-ranking officials who had made a strong point of saying that China would not need to import airplanes in the future because China could make its own airplanes. In fact, China could make anything, they said.

So here was the president saying he's going to assist the Chinese to accelerate their development of a commercial jetliner, and the logical extension of that is, so that the Chinese won't have to import airplanes from the United States.

Why is Obama saying something like this? He's not a stupid person. He's a very bright guy. Why is he saying that? I'm sure his speechwriters wrote it, and I don't think he thought about that line a lot. But his speechwriters have a kneejerk mentality. For years the United States has done this. In order to achieve geopolitical ends, we have made technological economic concessions.

In this case, Obama wants China to help him out with North Korea, sanctions on Iran, and with global climate change. Of course, he also needs the Chinese to fund the U.S. current account deficit. So to get their help with those things he says, "Well, I'll give them a jetliner."

Just pair up Hu Jintao and Obama. Obama gets up in the morning and the first thing he gets is his daily brief from the CIA as to all the trouble spots—what has happened in Afghanistan, who shot whom in Iraq, what the Iranians are really doing with their atomic weapons, how many Israeli commandos descended on the flotilla of ships. All of the hotspot news Obama gets first thing in the morning.

What Obama does not get in the morning is how many miles of high-speed rail track we have laid today, how many new research and development centers have been placed in the United States today. Obama wouldn't have a clue. And this is not a put-down of Obama. Neither would George Bush have had a clue, or Bill Clinton. It's not what presidents in the United States do.

But I bet you that when Hu Jintao gets up in the morning, he is pretty well informed on how many miles of high-speed track have been laid in China and how many new semiconductor fabs have been invested in in China and how many more solar panel plants are going up in China. He is focused on economic development. He has an economic strategy. Obama doesn't. Obama's strategy is not to have a strategy. It's just to let the unfettered, free market run.

A problem with this is that if you have two countries and one country has a strategy and the other country doesn't, in effect, the country without a strategy adopts the strategy of the country with the strategy. In effect, the United States is increasingly being run by Chinese strategy, without really kind of knowing it.

One other point I should make is what I call market fundamentalism.

Over the past 30 years the ideology or the doctrine of market fundamentalism became kind of a dominant doctrine, particularly here in the New York financial markets. But the notion was started, much earlier. It began at the University of Chicago in the 1960s, 1970s, with the development of rational expectations theory.

But it was really pushed when President Reagan came into office, on the basis of the slogan that government is the problem, and if you just let the free market run, the free market will self-adjust; it will optimize productivity and welfare; there won't be any bubbles; there won't be any recessions. Just let the free market go. Get the government out of it.

We know the end of that. We saw it dramatically in the crash of Wall Street, but we are seeing it in many other respects, even in the Gulf of Mexico. When you get the regulation out, sometimes bad things happen.

But I think this doctrine of market fundamentalism has been undermined recently by the Wall Street crash and by other developments.

So let me get to the heart of the matter here, which is free trade—and I'll link this—free trade and global corporations. Part of the free trade, an important part, is the dominance of the dollar as the world's global money. These three things are all linked.

Let me pose a question to the audience. How many of you are free-traders?

Normally every hand goes up. Then, when every hand goes up, I say to the audience, "when I say free trade, I bet that you think I mean reciprocal free trade. My market is open, your market is open, and we trade with each other on the same terms."

That's not what economists mean when they say free trade, and it's not what American officials mean when they say free trade.

What economists mean—and, inadvertently, what U.S. officials mean—when they say free trade is unilateral free trade. Herb Stein, the former chairman of the Council of Economic Advisers, once explained this to me. He said, "Clyde, listen. Even if the Japanese put rocks in their harbors and close their airports so that no American goods can get there and no American businessmen can get there—even if they do that, we're better off leaving our market fully open to Japanese imports."

He was operating on the basis of the notion that free trade is always a win-win solution and that it's even a win if the other guy is not a free-trader.

Herb had a rationale to back this up. His rationale was the work of David Ricardo, the 19th-century elaborator of the concept of comparative advantage, and Heckscher and Ohlin, the Swedish economists who elaborated and further developed his work, and of neoclassical economics as it is taught today in every American university.

The basis of this thought goes back to Ricardo's classical example, which was the trade of British textiles for Portuguese wine. Ricardo worked it out that even if Portugal could produce both textiles and wine more efficiently than Britain, because Portugal produced textiles only a little bit more efficiently than Britain, but produced wine a lot more efficiently than Britain, the Brits would do the textiles and the Portuguese would do the wine, and they would trade, and both sides would be better off.

Ricardo's model is correct. The mathematics are correct, if you accept the assumptions. The assumptions of that model—there are a lot of them, but I'll just give you three assumptions of that mode:

- There is full employment and full utilization of resources. Every factory is running at full speed. Every worker is employed. Every truck is being used.
- The second assumption is that you have full factor mobility, meaning that if, for some reason or other, winemaking becomes less—maybe you're making too much wine, and you don't need those workers. So the wine press workers can instantly, without cost, become computer software programmers.
- Another assumption of that model is that there are no international capital flows. There is no foreign direct investment anywhere.

In fact, Ricardo understood this. People don't read Ricardo. But Ricardo said himself in his first treatise, if the British textile makers could put their factories in Portugal, they would, and they would be better off putting their factories in Portugal. But, he said, the British textile makers wouldn't do that. Why wouldn't they do that? Two reasons.

- One, because they were patriotic. They wanted to support Britain.
- Two, it was risky to put their capital in Portugal. What can happen to your capital? So they would keep it at home.

That may have been true in 1817, but clearly it's not true in 2010. But that's the assumption of the model.

Another big assumption of the model is no cross-border flows of technology. You don't put an Intel plant in China. You don't put an Applied Materials photovoltaic cell research and development center in China. That's not in the model, guys.

So this model is really very restrictive. It's not wrong; it's right, given its assumptions. But its assumptions are so narrow in today's world, and so inapplicable in most of the trade that we do, that it really is a useless model. But that is the basis on which our trade policy is determined.

Our trade policy is based on the notion that these assumptions hold and that unilateral free trade is good for the United States. That assumption rationalizes it when President Obama tells the Chinese he'll help them build a jetliner, because, according to the economic rationale, it doesn't matter; it will all work, based on the win-win model.

The truth is that trade can be—when I say trade, I want to change the model here. What we have today is not trade. We have globalization. Globalization involves investment, cross-border flows of capital, technology and people. Globalization does not accord with any of the assumptions of free trade, as we have been taught it in the university.

Under globalization, you have economies of scale. In the classic model, there are no economies of scale. The classic model has constant returns to scale. So you don't have any companies like General Motors, Intel or U.S. Steel.

In the real world the key to wealth production is economies of scale. You want industries—the more industries you have that have economies of scale, the more productive and wealthy you will be. And that's what you want. But our leaders don't know that. So they don't try to maintain those industries or to respond to strategies that attack those kinds of industries.

What that means is that under globalization, the model is not necessarily win-win. It may be zero-sum, win-lose. He wins, I lose; I win, he loses. For example, if the United States is providing assistance for China to develop a jetliner, once China is in the jetliner business, that is going to diminish the market share of other jetliner producers, the major one of which happens to be mainly in the United States. So this is not necessarily a win-win proposition for the United States.

The second point I want to get to is the role of the dollar.

Americans have some pride in the notion that the dollar is the world's money. As President Reagan used to say—as, in fact, every president and secretary of the Treasury has said since I can remember; Bob Rubin used to repeat this endlessly—a strong dollar is good for the American economy. Don Regan, in the Reagan Administration believed that a strong dollar represents the strength of the American economy.

I was sitting in the room when Don said that. "Who says the dollar is overvalued? The market is clear every day."

Well, sure, the market is clear every day, because the Chinese, Singaporeans and the Japanese are buying and selling in the market.Why are they buying dollars? Because they are setting the price of American goods.

They buy dollars to keep the dollar strong. That makes American export prices and domestic prices high, which keeps their products cheap, which subsidizes their exports into the U.S. market. So, sure, the market is clear. But the markets are fixed to clear at a certain price. China is doing this all the time. The yuan is 6.178 yuan to the dollar and China makes sure it stays there every day by buying billions of dollars every day to keep the dollar at that price.

The difficulty is that being the world's money not only allows other countries to manipulate the value of the dollar, and therefore the price of American goods versus the price of others, but it also allows the Americans to be irresponsible.

As long as the world will accept dollars, we don't have to worry about deficits. We don't have to worry about trade deficits or federal budget deficits or personal deficits. We just keep printing dollars. It allows you to live beyond your means. It feels good, until the reckoning comes.

I wish I could tell you when the reckoning is coming. Every time I think it's coming, something like the collapse of the euro strengthens the dollar, and people say, "Ah, Prestowitz, you're just crying wolf. Prestowitz, you've been saying this for 15 years." But you know what? The wolf did come, didn't it?

The wolf is coming on the dollar at some point. I don't know when or how exactly. Nobody anticipated the collapse of the euro, did they? Nobody anticipated the collapse of Wall Street, did they? Nobody anticipated the 1997-1998 Asian financial crisis.

I laugh—you go to Davos [World Economic Forum] in January. Everybody is paying a lot of money to go there. Everybody is saying that they are going there to find out the trends.

I was in Davos in 1997, and the theme of the meeting was "Southeast Asia, the most dynamic part of the global economy." Nobody at Davos in January 1997 talked about the Thai baht. Nobody thought Thailand had a bubble that might collapse. But it did. Nobody in Davos in January 2007 talked about Wall Street collapsing.

The conventional wisdom has this great tendency to be powerful and wrong. That's where we are. We are being governed by conventional wisdom.

Let me get to my third part here, which is the global corporation. We think of companies, like General Electric, like Ford, Intel, and Apple, as American companies. The CEOs of these companies are on the advisory boards that advise the U.S. trade representative, the secretary of commerce, and the president on exports and international trade.

The truth is that these companies are not really American companies. They don't have a concern about the welfare of America. They are concerned about the welfare of their companies. But these are global companies. They have big constituencies in China, Japan, Europe, and in Latin America. They can't treat the Indian employees discriminatorily in comparison to their American employees.

I want to make it clear that I'm not really being critical of American CEOs. If I were a CEO, I think I probably would be acting as many of them are. I have interviewed over the last several years almost every high-tech CEO in Silicon Valley. I have asked each CEO a lot of questions, but I have asked each one of them this particular question: "Mr. CEO, you're moving a lot of not only your production, but a lot of your design, a lot of your research and development capacity to Asia, a lot of it to China. You're an American citizen. How do you feel about that?"

The answer, almost invariably, is, "Yeah, it kind of bothers me sometimes, but, hey, I have a fiduciary responsibility to my shareholders. My job is American economic strategy. My job is not U.S. competitiveness. Those guys in Washington are supposed to be handling that. I have to handle the best interests of my company."

What those CEOs mostly don't understand is that if you go to Washington and you have a discussion about American competitiveness, in Washington they are saying, "Well, you know, the CEOs of the companies are supposed to take care of that."

So it's Alphonse and Gaston. It doesn't work.

Two other elements of this:

One, also influencing dramatically the CEOs—in fact, this whole concept of fiduciary responsibility to the shareholders—is a dominant doctrine that has taken hold in the business schools over the last 30 years, the doctrine of shareholder value, the notion that the only, or at least almost the only, mission of the CEO is to raise the price of the stock, to increase the value of the company, and, since that is measured in the short term, pretty much to raise it in the short term.

This is a big change. In 1980, the Business Roundtable had a formal mission statement for CEOs. It said that the job of the CEO was to take care of the customers, suppliers, workers, communities, the nation and the shareholders.

In 1996, the Roundtable changed the mission statement. The mission statement now reads that the job of the CEO is to increase the value to the shareholders. That's it. Nothing about the country, the workers, the consumers, and so forth.

As I said, because the value is measured in the pretty short term, what this leads to is decision making to maximize share prices in the short term, which doesn't necessarily maximize anything in the long term.

Interestingly, in light of our recent experience, the reasoning that underlies this doctrine is that the shareholder is the ultimate so-called residual risk bearer. In other words, if something happens to the corporation, the shareholder is the one who is going to fix it, and is ultimately responsible for cleaning it up and making it work. We have seen in the case of AIG and other Wall Street companies and General Motors and Chrysler that it's not the shareholder who is the ultimate residual risk holder; it's the community. And the government steps in to bail out.

So this whole notion that the CEO's mission is raising the value of shares is based on a really false understanding of the dynamics of the corporation in a free society.

Where this also leads in terms of trade is that we have had a mantra over the past 20, 25 years that goes something like this: Free trade and globalization, will make everybody rich, make all the countries in the world rich. Being rich, they will tend to become democratic. We assume that the free markets create wealth and that wealth creates a bourgeois, and there's a press for freedom, so they will become democratic. Being democratic, then there won't be any more war, because we know, "that democracies don't go to war with each other" [democratic peace theory].

We thought that the transmission belt of these democratic values from the West, particularly from the United States, to the East would be the global corporation.

Irony of ironies, it turns out be the opposite. The CEO of a global corporation is a big political player in Washington. He/She has instant access to anybody, including the president. In fact, the president lines up to meet with the CEO.

In Washington that CEO has lobbyists, lawyers, political action committees, and spends millions of dollars through political campaigns and political donations. They can write or block legislation. They can sue the U.S. government and win. They are big players.

In Beijing, Riyadh, Moscow—even in Singapore—they are deferential. They don't have that clout. They have to kowtow just like everybody else. They kowtow in more luxurious surroundings, but still they have to be careful about their relationships with the top officials. They have to be attuned to the nuances of the phrases that fall from the lips of the top officials. If they are not, bad things can happen. These are not societies of a rule of law.

These CEOs, when they go to China particularly—but other countries as well—from the top down, what they hear when they are talking to officials or to other businessmen in those countries is, "You know, Mr. CEO, you need to have a high image."

What does "high image" mean?

"High image" means you need to prove that you are committed to the future development of China, or whatever the country is. You need to show you're a good friend of China, or whoever the country is. That means you need to put a factory over here and put research and development over there. It means you need to transfer technology. Or what? We have administrative authority here. Things could happen.

What has been happening is that the global corporation becomes a transmission belt for the values of the authoritarian country back into the United States, and those CEOs become lobbyists for the authoritarian countries, and they are advising the U.S. government on its trade policies.

Let me stop there, and we'll open it up.

Questions and Answers

QUESTION: Thank you so much. This, for me, has been the wisest discussion I've heard on the subject.

When they talk about free trade—and as you said, there is the separation of the corporation and the fundamental workers in the country—I never understood how it could be free trade when you have a worker here competing with someone making two dollars a day. That seems like a canard to me.

CLYDE PRESTOWITZ: It can work, broadly speaking. Take an industry like textiles, which is labor-intensive. Divide textiles. We say textiles, but within the textile industry you have the apparel producers and you have the fiber and cloth producers. Fiber and cloth is not labor-intensive. It's capital-and technology-intensive. Apparel is labor-intensive.

So if you are talking about apparel, then the people in China or Indonesia getting paid two or three dollars an hour are clearly going to be able to produce more cheaply than people getting eight, nine, ten dollars an hour in the United States. So apparel should not really be made in the United States, except specialty apparel. It makes sense for that to be produced someplace else.

Where this gets tricky is when you get to the cloth and the fiber. That is capital and technology-intensive. There's no reason why that can't be produced competitively in the United States.

It's easy to envision a system in which the fiber and cloth—some of it at least—is made in the United States and the apparel is made abroad. But what tends to happen is that once the apparel goes, then there is pressure from the country where the apparel is being made to move the fiber and the cloth as well. The pressure is aided by—that country is probably undervaluing its currency and it's offering, probably, very attractive—no taxes for 20 years, free land, capital injections, so that the cost of the capital is greatly reduced. Then what you see is this migration of the fiber and the textiles as well.

To look at another industry, let's say semiconductors. We have told ourselves for a long time—as apparel and shoes and labor-intensive things like that have been moving, we have been telling ourselves for a long time not to worry, because we are going to move to higher ground; we're going to do the high tech. However, Applied Materials just moved their research and development to China. Intel is just moving a major advanced high-tech fabrication facility to China.

Actually, if you think of this picture in your mind, we export right now a lot of semiconductors to China, which are mostly Intel. Once Intel has that factory in China, our exports of semiconductors will decline. But our biggest single export to China, growing rapidly, is wastepaper and scrap metal. We, in effect, are moving our workers from being semiconductor chip makers to being wastepaper pickers. This is not a good direction.

QUESTION: A big thrust of your remarks is that since 1950 all the U.S. government sequentially have lost control. To try to frame this very broadly, are all these different administrations, Democrat and Republican, totally oblivious to all these factors—that is, that all American economic policies have been failures conceptually? Or is it what some others call "Rise of the Rest"?

In other words, it's not so much that the United States policies have been, themselves, totally deficient—maybe they have—but that these other countries—China you mentioned, of course, India, Brazil, Russia, the BRICs—have really come up?

I wonder if you could comment on whether you think American policy has been deficient or whether this is simply kind of that the world has changed under their feet.

CLYDE PRESTOWITZ: It's both. Certainly in 1950, Europe and Asia were still recovering from the war. Clearly they had to recover, and we aided them to get back to the highly productive economies that they were before the war. So there was that factor.

I know that U.S. trade, globalization, and international economic policies for the past, let's say, 60 years have been based on false assumptions and a misunderstanding of the nature of the exchanges, and the nature of the regimes that we have been dealing with. The premise of the World Trade Organization is that all of the members are playing the same game, and because we and the Brits wrote the original GATT [General Agreement on Tariff and Trade], that this and the WTO reflect this Anglo-American, Ricardian doctrine of comparative advantage and free trade.

So the assumptions of the WTO are that China, Singapore, Japan, Israel and Germany are running their economies kind of the same way we are, with a focus on consumption as the main aim of production and with the notion that whatever result the market produces is the right result, the optimal result.

But the fact is that all countries are not playing that game. To demonstrate that, there is no better example, really, than the EU right now. The EU and the euro are in trouble, because the Germans don't play the same game as the Brits or the Greeks or the Spanish. The asymmetry between those two games ultimately doesn't work.

That same asymmetry exists at the international level, and it's not working there either.

JOANNE MYERS: Unfortunately, our time is up. I thank you. That was an extraordinary presentation.