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The Establishment Rethinks Globalization

by WILLIAM GREIDER

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The church of global free trade, which rules American politics with infallible pretensions, may have finally met its Martin Luther. An unlikely dissenter has come forward with a revised understanding of globalization that argues for thorough reformation. This man knows the global trading system from the inside because he is a respected veteran of multinational business. His ideas contain an explosive message: that what established authorities teach Americans about global trade is simply wrong--disastrously wrong for the United States.

Martin Luther was a rebellious priest challenging the dictates of a corrupt church hierarchy. Ralph Gomory, on the other hand, is a gentle-spoken technologist, trained as a mathematician and largely apolitical. He does not set out to overthrow the establishment but to correct its deeper fallacies. For many years Gomory was a senior vice president at IBM. He helped manage IBM's expanding global presence as jobs and high-tech production were being dispersed around the world.

The experience still haunts him. He decided, in retirement, that he would dig deeper into the contradictions. Now president of the Alfred P. Sloan Foundation, he knew something was missing in the "pure trade theory" taught by economists. If free trade is a win-win proposition, Gomory asked himself, then why did America keep losing?

The explanations he has developed sound like pure heresy to devout free traders. But oddly enough, Gomory's analysis is a good fit with what many ordinary workers and uncredentialed critics (myself included) have been arguing for some years. An important difference is that Gomory's critique is thoroughly grounded in the orthodox terms and logic of conventional economics. That makes it much harder to dismiss. Given his career at IBM, nobody is going to call Ralph Gomory a "protectionist."

He did not nail his "theses" to the door of the Harvard economics department. Instead, he wrote a slender book--*Global Trade and Conflicting National Interests*--in collaboration with respected economist William Baumol, former president of the American Economic Association. Published seven years ago, the book languished in academic obscurity and until recently was ignored by Washington policy circles.

I asked Gomory if his former colleagues from the corporate world quarrel with his provocative message. "Most of them have never heard it," he said. "It's a pretty new message." He has discussed his reform ideas with some CEOs, "who said, Well, maybe we could do that. Others couldn't have disagreed more strongly."

Now Gomory is attempting to re-educate the politicians in Congress. He has gained greater visibility lately because he has been joined by a group of similarly concerned corporate executives called the Horizon Project. Its leader, Leo Hindery, former CEO of the largest US cable company and a player in Democratic politics, shares Gomory's foreboding about the destructive impact of globalization on American prosperity. Huge losses are ahead--10 million jobs or more--and Hindery fears time is running out on reform.

"We want to be a counter to the Hamilton Project," Hindery explains. "They have a sense of stasis that is more benign than I have. I don't think this is all going to work out." The Hamilton policy group was launched last year by former Treasury Secretary Robert Rubin to make sure the laissez-faire trade doctrine known as Rubinomics continues to dominate the Democratic Party. "We're never going to have the status of Bob Rubin," Hindery concedes. "But we're not chopped liver either. We have respectable business careers. You can't tell Ralph Gomory that he is 'smoke and mirrors,' because he wrote the book."

Gomory's critique has great political potential because it provides what the opponents of corporate-led globalization have generally lacked: a comprehensive intellectual platform for arguing that the US approach to globalization must be transformed to defend the national interest. Still, it will take politicians of courage to embrace his ideas and act on them. Gomory's political solutions are as heretical as his economic analysis.

At IBM back in the 1980s, Gomory watched in awe as Japan and other Asian nations captured high-tech industrial sectors in which US companies held commanding advantage. IBM invented the disk drive, then dropped out of the disk-drive business, unable to compete profitably. Gomory marveled at Singapore, a tiny city-state, as it lured American manufacturers with low-wage labor, capital subsidies and tax breaks. The US companies turned Singapore into a global center for semiconductor production.

"It was an unforgettable transformation," Gomory remembers. "And it was pretty frightening.

"The offer that many Asian countries will give to American companies is essentially this: 'Come over here and enhance our GDP. If you are here our people will be building disk

drives, for example, instead of something less productive. In return, we'll help you with the investment, with taxes, maybe even with wages. We'll make sure you make a profit.' This works for both sides: the American company gets profits, the host country gets GDP. However, there is another effect beyond the benefits for those two parties--high-value-added jobs leave the U.S."

China and India, he observes, are now doing this on a large scale. Microsoft and Google opened rival research centers in Beijing. Intel announced a new, \$2.5 billion semiconductor plant that will make it one of China's largest foreign investors. China's industrial transformation is no longer about making shirts and shoes, as some free-trade cheerleaders still seem to believe. It is about capturing the most advanced processes and products.

The multinationals' overseas deployment of capital and technology, Gomory explains, is the core of how some very poor developing nations are able to ratchet up their technological prowess, take over advanced industrial sectors and rapidly expand their share in global trade--all with the help of US companies and finance, as they roam the world in search of better returns.

The Gomory-Baumol book describes this as "a divergence of interests" between multinational firms and their home country. "This overseas investment decision may then prove to be very good for that multinational firm," they write. "But there remains the question: Is the decision good for its own country?" In many cases, yes. If the firm is locating low-skilled industrial production in a very poor country, Americans get cheaper goods, trade expands for both sides and the result is "mutual gain." But the trading partners enter a "zone of conflict" if the poor nation develops greater capabilities and assumes the production of more advanced goods. Then, the authors explain, "the newly developing partner *becomes harmful* to the more industrialized country." The firm's self-interested success "can constitute an actual loss of national income for the company's home country."

American multinationals, as principal actors in this transfer of wealth-generating productive capacity, are distinctively free to make the decisions for themselves without interference from government. They want profit and future consumer markets. Their home country wants to maintain a highly productive high-wage economy. Without recognizing it, the two are pulling in opposite directions--the "divergence of interests" most US politicians ignore, evidently believing church doctrine over visible reality.

The Gomory-Baumol book explains the dynamics with charts and equations for economists to study. For the rest of us, it is easier to follow Gomory's personal explanation of changing fortunes among trading nations. "What made America much wealthier than the Asian nations in the first place?" Gomory asks. "We invested alongside our workers. Our workers dug ditches with backhoes. The workers in underdeveloped countries dug ditches with shovels. We had great big plants with a few people in them, which is the same thing. We knew how, through technology and investment, to make our

workers highly productive. It wasn't that they went to better schools, then or now, and I don't know how much schooling it takes to run a backhoe.

"The situation today is that the companies have discovered that using modern technology they can do all that overseas and pay less for labor and then import product and services back into the United States. So what we're doing now is competing shovel to shovel. The people in many countries are being equipped with as good a shovel or backhoe as our people have. Very often we are helping them make the transition. We're making it person-to-person competition, which it never was before and which we cannot win. Because their people will be paid a third, a quarter of what our people are paid. And it's unreasonable to think you can educate our people so well that they can produce four times as much in the United States."

As this shift of productive assets progresses, the downward pressure on US wages will thus continue and intensify. Free-trade believers insist US workers can defend themselves by getting better educated, but Gomory suggests these believers simply don't understand the economics. "Better education can only help," he explains. "The question is where do you put your technology and knowledge and investment? These other countries understand that. They have understood the following divergence: What countries want and what companies want are different."

The implication is this: If nothing changes in how globalization currently works, Americans will be increasingly exposed to downward pressure on incomes and living standards. "Yes," says Gomory. "There are many ways to look at it, all of which reach the same conclusion."

I ask Gomory what he would say to those who believe this is a just outcome: Americans become less rich, others in the world become less poor. That might be "a reasonable personal choice," he agrees. "But that isn't what the people in this country are being told. No one has said to us: 'You're probably a little too rich and these other folks are a little too poor. Why don't we even it out?' Instead, what we usually hear is: 'It's going to be good for everyone. In the long run we're going to get richer with globalization.'"

Gomory and Baumol are elaborating a fundamental point sure to make many economists (and political leaders) sputter and choke. Contrary to dogma, the losses from trade are not confined to the "localized pain" felt by displaced workers who lose jobs and wages. In time, the accumulating loss of a country's productive base can injure the broader national interest--that is, everyone's economic well-being.

"Our objective," Baumol told a policy conference last summer, "is to show how outsourcing can indeed reduce the share of benefits of trade, not only for those who lose their jobs and suffer a direct reduction in wages but can wind up making the average American worse off than he or she would have been."

The conventional win-win assurances, they explain, are facile generalizations that ignore the complexity of the trading system--the myriad differences in country-to-country

relationships and the vast realm of government actions and policy interventions designed to shape the outcomes. "Many of our 'dismal science' colleagues speak unguardedly as though they believe free trade cannot fail, no matter what," Baumol said.

Some nations, in other words, do indeed become "losers." Gomory fears the United States is now one of them--starting to go downhill. When he and Baumol wrote their book, they figured US trade relations with China and India produced "mutual gain" for both ends. The United States got cheaper goods, China and India got jobs and a start at industrialization. But the rapid improvements in those two nations during the past decade, Gomory thinks, are putting the United States in the bind where their gain becomes our loss.

Essentially, the terms of trade have changed as more and more value-added production has shifted from the United States to its poorer trading partners. America, he explains, becomes increasingly dependent, buying from abroad more and more of what its citizens consume and producing relatively less at home. US incomes stagnate as the high-wage jobs disappear and US exports become a smaller share of the world total.

The persistent offshoring of domestic production is leading to a perverse consequence: The United States finds itself paying more for imports. The production that originally moved offshore to get low-wage labor and cheaper goods is now claiming a larger and larger share of national income, as the growing trade deficits literally subtract from US domestic growth. "All the stuff you were already importing from them becomes more expensive," Gomory explains. "That's why you can start going downhill--because you pay more for what you were previously getting." Put another way, one hour of US work no longer buys as many hours of Chinese work as it once did. China can suppress its domestic wages to keep selling more of its stuff, but that does not alter the fundamental imbalance in productive strength.

The US predicament is vividly reflected in the nation's swollen trade deficits, now running at nearly 7 percent of GDP every year. The country consumes more than it produces. It borrows heavily from trading partners, led by China, to pay for its "excess" consumption. This allows America to dodge--temporarily--a reckoning with its weakened condition, that is, falling living standards. But that will eventually occur, when Americans are compelled to reduce their consumption and pay off the overdue bills. Postponement will deepen the ultimate injury because, meanwhile, the trading partners will gain greater industrial capabilities, while US productive strength weakens further.

Americans can choose to blame China or disloyal multinationals, but the problem is grounded in US politics. The solution can be found only in Washington. China and other developing nations are pursuing national self-interest and doing what the system allows. In a way, so are the US multinationals. "I want to stress it's a system problem," Gomory says. "The directors are doing the job they're sworn to do. It's a system that says the companies have to have a sole focus on maximizing profit."

Gomory's proposed solution would change two big things (and many lesser ones). First, the US government must intervene unilaterally to cap the nation's swollen trade deficit and force it to shrink until balanced trade is achieved with our trading partners. The mechanics for doing this are allowed under WTO rules, though the emergency action has never been invoked by a wealthy nation, much less the global system's putative leader. Capping US trade deficits would have wrenching consequences at home and abroad but could force other nations to consider reforms in how the trading system now functions. That could include international rights for workers, which Gomory favors.

Second, government must impose national policy direction on the behavior of US multinationals, directly influencing their investment decisions. Gomory thinks this can be done most effectively through the tax code. A reformed corporate income tax would penalize those firms that keep moving high-wage jobs and value-added production offshore while rewarding those that are investing in redeveloping the home country's economy.

US companies are not only free of national supervision but actively encouraged to offshore production by government policy and tax breaks. Other advanced economies have sophisticated national industrial policies, plus political and cultural pressures, that guide and discipline their multinationals, forcing them to adhere more closely to the national interest.

Neither of Gomory's fundamental policy reforms--balancing trade or imposing discipline on US multinationals--can work without the other. Both have to be done more or less at once. If the government taxed US multinational behavior without also capping imports, the firms would just head out the door. "That won't work," Gomory explains, "because you will say to the companies, 'This is how we're going to measure you.' And the corporations will say, 'Oh, no, you're not. I'm going overseas. I'm going to make my product over there and I'll send it back into the United States.' But if you insist on balanced trade, then the amount that's shipped in has to equal the amount that's shipped out by companies. If no companies do that, then nothing can be shipped in either. If you balance trade, you are going to develop internal companies that work the way you want." Public investment in new technologies and industries, I would add, may not achieve much either, if there is no guarantee that the companies will locate their new production in the United States.

Essentially, Gomory proposes to alter the profit incentives of US multinationals. If the government adds rules of behavior and enforces them through the tax code, companies will be compelled to seek profit in a different way--by adhering to the national interest and terms set by the US government. Other nations do this in various ways. Only the United States imagines the national interest doesn't require it.

In recent months Gomory and Leo Hindery of the Horizon Project have been calling on Congress with these big ideas and getting respectful audiences. The two met with some thirty Democratic senators and Congressional staffers from both parties. Senator Byron

Dorgan, with co-sponsors like Sherrod Brown, Russell Feingold and even Hillary Clinton, has introduced several bills to confront the trade deficits.

Gomory's concept for multinational taxation is a tougher sell amid Washington lobbyists because it goes right to the bottom line of major US corporations. On the other hand, this proposal has stronger intuitive appeal for citizens, who reasonably ask why multinationals are allowed to undercut the national interest when they enjoy all the benefits of being "American" companies.

Hindery's group is advocating Congressional action to arrange a "national summit" on trade, where all these questions can be thrashed out. The political system has never really had an honest, open debate on globalization in the past thirty years. The dogmatic church of free trade--"free trade good, no trade bad"--wouldn't allow it. As more politicians grasp the meaning of Gomory's analysis, they should start demanding equal time for the heretics.

Gomory's vision of reformation actually goes beyond the trading system and America's economic deterioration. He wants to re-create an understanding of the corporation's obligations to society, the social perspective that flourished for a time in the last century but is now nearly extinct. The old idea was that the corporation is a trust, not only for shareholders but for the benefit of the country, the employees and the people who use the product. "That attitude was the attitude I grew up on in IBM," Gomory explains. "That's the way we thought--good for the country, good for the people, good for the shareholders--and I hope we will get back to it.... We should measure corporations by their impact on all their constituencies.

"So in my utopian dream, we decide what we want from the corporations and that's how they make a profit--by doing those things. Failing that, I would settle for the general realization of this divergence and let people argue it out."

Some older CEOs and board members at least listen to him sympathetically. "They have grandchildren," he says. "They wonder too what's going to happen to our grandchildren. You can't get a vote around the corporate board table about, Is this good for the grandchildren? But you can talk to them and they'll worry about it and say, Well, maybe we need to do something."