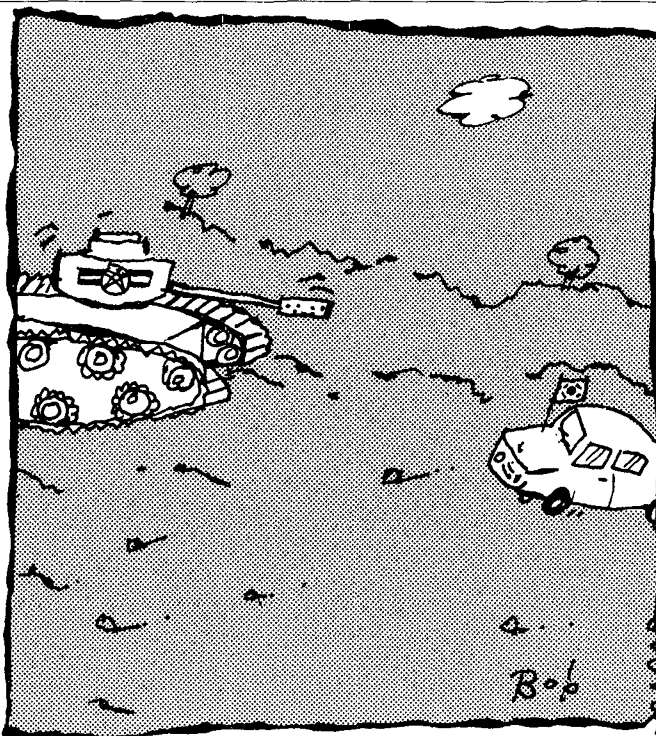
PROTECTION RACKET

BY MARTIN MORSE WOOSTER



BOB ECKSTEIN

Now that the Berlin Wall has fallen and communism has retreated, there seem to be very few dragons left for the United States to slay. True, Saddam "Beast of Baghdad" Hussein has some potential as a villain. But many commentators have decided that, with the Soviets down for the count, the chief threats to America will be economic, not military.

From Anthony Harrigan on the right to Kevin Phillips and Robert Kuttner on the left come shrill claims that Japan and Europe are about to gang up on us, turning the United States into an economic colony of Tokyo and Bonn. Indeed, some frantic commentators (such as John Judis) have concluded that anyone who is opposed to protectionism must be in the pay of the Japanese government.

It is amusing to see liberals searching for Japanese influence with a fervor equal to that of their counterparts on the right, who once held a contest to find the swarthy paymaster in the ill-fitting Bulgarian suit whom everyone knew was doling out gold rubles to the Institute of Policy Studies from a faded Gladstone bag. Both the left and the right falsely assume that anyone who disagrees with them must have been paid off by malign forces.

To suggest that overseas multinationals are as much of a threat to America as the dictators of the past is to argue that a salesman is the moral equivalent of a tyrant. How many divisions do the Japanese car companies command? Yet a rising number of pundits are rattling their sabers and calling for economic war.

Some commentators observe the rise of "geoeconomics" without endorsing protectionist schemes. "Everyone, it appears, now agrees that the methods of commerce are displacing military methods," contends Edward N. Luttwak of the Center for Strategic and International Studies in the summer issue of *The National Interest.*

Other observers are more bellicose. Perhaps the noisiest is a mandarin named Ronald A. Morse, who told Ian Buruma of *The Spectator* that "Japan, a nation without principles or values, cannot lead the world." Not only is Japan a "predator," Morse said, but "if you defect to the Soviet Union you can get shot, but if you defect to Mitsubishi you can get rich."

But, as Buruma notes, while the chief export of the Soviet Union until recently was the arms race, foreign corporations have made inroads into the American economy not by guile or conquest but by selling well-made goods at reasonable prices. "Is a Japanese company that provides jobs in America and good, cheap products to boot, good or bad for the national interest?" Buruma asks.

In a hard-hitting column in the July 16 *Business Week*, Princeton economist Alan S. Blinder adds that our trade deficit with Japan equals 1 percent of the U.S. gross national product: Even if that deficit were closed through protectionist action, Blinder argues, low American unemployment rates ensure that "there would not be more American jobs if our trade were balanced—there would just be different jobs."

Neither Buruma nor Blinder analyze why so many pundits and terrified CEOs fret so much about foreign competition, but there are several explanations. First, there is the fundamental law of public-choice economics, the rule that advocates of government largess usually fight harder for their subsidies than foes of such spending battle for reductions, because each consumer of government pork stands to gain more from a benefit than a taxpayer or consumer would stand to gain if the entitlement were eliminated. Unionized auto workers who make $40,000 a year from protected jobs are far more effective than the millions of consumers who would save $1,300 on a new Japanese car (according to a 1984 Federal Trade Commission study) if import quotas did not exist and foreign car makers were free to compete.

Second, advocates of government expansion always like to inflate the harm an "enemy" might cause. When Robert Kuttner creates scary myths about foreign capitalists as justification for a Mussoliniesque industrial policy, he is using the same tactics William Bennett uses to defend the war on drugs or the Pentagon employs to justify the defense budget.

As *Newsweek* reporter Bill Powell observes in the August *Business Month*, most commentators simply refer to "the

Japanese" when they should be referring to individual Japanese managers. For example, few know who the president of Honda of America is, even though Honda now makes and sells more cars in the United States than Chrysler does. Japan's success in America, Powell says, is due not to the Buddhist work ethic or low wages but simply to basic skills "that ought to be familiar to U.S. managers: motivating employees, balancing production lines, working closely with suppliers."

In an accompanying article, *Business Month* staff writer Alex Prud'homme interviews five heads of the American branches of Japanese corporations. Far from being drones or America-haters, most of these CEOs like America, and some of them prefer the United States to Japan. Most of the CEOs Prud'homme interviewed displayed the sort of old-fashioned reticence that was characteristic of business leaders in the days before some decided that self-promotion was more important than making good products.

Prud'homme did meet one fireball, however: Toyota of America CEO Yukiyasu "You can call me Yuki" Togo. Togo, who says his goal in life is to "sell like hell," practices what he preaches; he once shaved his head and spent two weeks in a Buddhist monastery in Thailand in order to convince anti-Japanese Thais to buy Toyotas. Togo, "who seemed to be powered by a small nuclear reactor," says that his countrymen frequently accuse him of being an American, a label he likes.

Not all protectionists are anti-Japanese. Institute of Policy Studies fellow Richard Barnet, for example, contends that the real enemies of America are not the Japanese, but multinational corporations. Capitalism, Barnet tells the readers of the July 16 *New Yorker*, is the only "global-economic faith" in the world. (Did the IPS staffers wear black the day socialism died?) But corporations, Barnet was shocked to learn, don't necessarily do what governments tell them to do. They shift factories to the Third World! They ally with foreign competitors! The "great global corporations," Barnet says, "are becoming less and less accountable to the people whose lives they change." Because multinationals are, in Barnet's eyes, maleficent, they should be "restrained" (in a way Barnet never makes clear) by the state.

Barnet has been campaigning against multinationals since most REASON readers were in high school, but he has never been able to show why they are wicked. Corporations, Barnet says, "make the key decisions—about what people eat and drink, what they read and hear." But he gives no indication of how these multinationals are able to force people to buy their products. Moreover, we live in an age where economic power is both concentrating and diffusing. Large corporations are becoming larger, but their size makes them more sluggish and more vulnerable to entrepreneurial initiative.

Health food companies succeed by providing tastier alternatives to major brands; dozens of microbreweries produce the fine beer that large American breweries do not choose to make; and the market offers dozens of alternatives to the magazines published by international conglomerates. If global megacorporations successfully control American choices in reading matter, why has the *Utne Reader* captured nearly 200,000 subscribers? Although he is not, strictly speaking, a protectionist, Barnet's arguments have to be refuted because they draw on common fears that protectionists exploit in their crusade against "foreign" corporations.

Two other articles provide additional intellectual ammunition for the free trader. In the winter 1990 *International Organization*, Harvard scholars Dennis J. Encarnation and Mark Mason examine the history of foreign investment in the Japanese economy. They conclude that nearly all the gains American corporations have made in the Japanese market have come about because of pressure from business, not government.

In the late 1950s, for example, IBM was the first major American corporation to capture a large share of a Japanese market, but it insisted that the U.S. government stay away from the negotiations. When DuPont built its first Japanese plant, its chief negotiator "openly complained that the staff of the U.S. Embassy remained patently unhelpful (if not harmful)" during the negotiations. In this light, those who advocate a greater government role in U.S.–Japanese trade negotiations should ask why the government can "help" now when it did little good and some harm during the past 40 years.

The best piece to appear about trade so far in 1990 is an article by American Enterprise Institute fellow Irwin M. Stelzer in the July *Commentary*. Stelzer offers a primer on all the arguments protectionists bring up, convincingly showing that protectionism does not create jobs or ensure the successful birth of "infant industries." Stelzer is particularly good at explaining the statistical problems with calculations of the U.S. foreign debt. While American corporations bought most of their foreign holdings years ago, Stelzer argues, their foreign counterparts have acquired American properties more recently. Because corporations value these holdings on their books at the price they paid for them, the nation's net foreign debt seems higher than it actually is.

But the strongest refutation of protectionism is a practical one. Why, one should ask, are foreign corporations bad? Is Baskin-Robbins ice cream less tasty because it has been owned by the British conglomerate Allied-Lyons? Are Doubleday books less readable now that they are owned by West Germany's Bertlesmann? If companies produce goods people want, they will succeed; if they produce goods no one wants, they will fail. Even the Japanese can fail spectacularly in the American market. Remember the Infiniti?

When buying goods, the rule should be "buy what you like," not "buy American." Wrapping a product in the Stars and Stripes is a very easy way to hide a multitude of sins.

Martin Morse Wooster is the Washington editor of REASON.

SHARPEN UP THE SHEARS

BY TOM MILLER

On January 10, 1989, shortly before unveiling the Bush administration's plan for bailing out the bankrupt Federal Savings and Loan Insurance Corp. (and the hundreds of insolvent savings and loan institutions FSLIC "insured"), Treasury Secretary Nicholas Brady told congressional leaders that "curtailing deposit insurance is not an option and will not be considered."

Since then, cost estimates for the total S&L bailout have ballooned—to well over $2,000 for every U.S. taxpayer—with no end in sight. Federal Deposit Insurance Corp. chairman L. William Seidman has warned Congress that the deposit-insurance fund for banks is "under great stress" as well. Not only are taxpayers being billed for the mistakes of the past, they remain on the hook for future loan losses by banks and thrifts. Until the current structure of unlimited, flat-rate deposit insurance for all comers is changed, taxpayers will remain vulnerable.

While the dare-to-be-cautious Bush administration prepares to release its reform recommendations after the November elections, other policymakers and financial analysts are stepping forward with calls for taxpayer protection and marketplace discipline. Within the financial industry, William Randall, chief executive of First Interstate Bank of Arizona, has proposed cutting back deposit-insurance coverage levels to somewhere between $50,000 and $75,000. (An estimated 98 percent of all deposit accounts have balances of $20,000 or less.)

Regional Federal Reserve Banks in Cleveland and Minneapolis have offered "coinsurance" plans. This approach would reduce the maximum size of deposits receiving 100-percent coverage (to $10,000 under the Minneapolis plan and $25,000 in Cleveland's version). Higher balances would receive 90-percent coverage under the Minneapolis proposal. The Cleveland plan would establish a sliding scale of 90-percent, 80-percent, and 70-percent coverage.

On Capitol Hill, House Banking Committee Chairman Henry Gonzalez (D-Tex.) has indicated that he intends to protect taxpayers from the risky lending encouraged by the deposit-insurance system. During a February 14 hearing, he called deposit insurance "government guarantees for the most affluent of society" and urged consideration of private insurance, "particularly for high-risk activities and for extended coverage beyond that provided by the federal insurance funds." Sen. Alan Dixon (D-Ill.), who heads the Senate Banking Subcommittee on Consumer and Regulatory Affairs, has advanced a proposal to generate "risk-based" insurance premiums by having the FDIC "reinsure" a small share of its portfolio in the private insurance market.

Perhaps the most popular deposit-insurance reform among lawmakers would limit coverage to $100,000 per person, instead of per account. Under the current system, a depositor can obtain virtually unlimited insurance by maintaining multiple accounts at different institutions. Even Treasury Secretary Brady has hinted that "if you were going to start any place, that would be a place to start."

These proposals would force sophisticated investors and large depositors to monitor the health of their banks and S&Ls. Financially shaky banks will find it difficult and expensive to attract new funds or retain old accounts. This in turn would force regulators to intervene more promptly and head off further losses in insolvent operations.

These reform proposals all focus on tightening the explicit limits on deposit insurance. But one of the biggest obstacles to reform is the informal "too big to fail" policy, which provides de facto coverage for virtually *all* deposits, whether officially insured or not. Although the law does not mandate protection for unsecured creditors or for deposits over $100,000, the FDIC has a long history of bailing out nearly everyone. Changing this approach is a necessary condition for successful reform. All the other reform ideas will come to nought so long as the too-big-to-fail policy remains in place.

Instead of simply closing a bank and paying off insured depositors (which would impose losses on uninsured large depositors and unsecured creditors), the FDIC prefers to arrange for another ostensibly healthy bank to accept all of the deposits of a failed bank and purchase some of its assets. It then negotiates a cash payment to cover the difference between the two.

In the 1980s, the FDIC briefly experimented with "modified payoffs" that imposed losses on uninsured deposits. But it abandoned the practice when Continental