

The Economy in Perspective

'Tis our true policy to steer clear of permanent alliances with any portion of the foreign world.

—George Washington, in his Farewell Address

Even as U.S. military forces combat terrorism in Afghanistan, Secretary of State Colin Powell prepares to travel to the Middle East. Fears of a widening conflict have been sending oil prices higher in recent weeks, and an escalation of violence in the region could add more uncertainty to energy markets. As developments shift daily, it is clear that that oil and Middle East politics continue to bedevil U.S. economic interests.

Back at home, President Bush recently imposed tariffs on a variety of steel products exported to the United States, levying the highest duties against European countries. As anticipated, the European Union is considering various retaliatory options. Some political analysts conjecture that President Bush imposed the steel tariffs to convince Congress that in his drive to negotiate future trade agreements, he would be mindful of the dislocations these pacts sometimes impose on U.S. industries. If true, this one-step backward, two-steps forward approach to bargaining illustrates that the complexity inherent in trade negotiations lies as much with domestic politics as foreign.

There is no questioning the importance of international trade and finance to the U.S. economy. During the past 10 years, exports from—and imports to—the United States roughly doubled, while the overall economy grew 35%. Over the same period, the United States imported foreign savings at prodigious rates, enabling both households and businesses simultaneously to consume and invest vigorously. The broadening and deepening of international financial markets facilitated the global movement of capital, which correspondingly facilitated the movement of goods and services. These effects are merely two sides of the same coin.

Import competition can displace U.S. companies and employees and, at the same time, U.S. exports can displace foreign producers and employees. In the short term, adjustments can be difficult for nations; in the long term, some industries and

regions expand while others shrink. U.S. manufacturers list China, Japan, and Mexico among their strongest competitors. China has become an economic dynamo and it increasingly occupies the attention of U.S. trade negotiators and business interests.

A decade after Japan's asset bubble burst, its economy remains moribund and its banking system impaired. Clearly, Japan still faces considerable internal adjustments, yet the United States continues to run a significant trade deficit with that country, and the dollar/yen exchange rate remains a strain on trade relations. U.S. trade deficits with both Japan and China heighten the domestic political pressures associated with expanding foreign trade.

Finally, consider the case of Mexico. In the last five years alone, U.S.–Mexico trade flows have expanded about 50% in each direction, with imports from Mexico somewhat stronger than U.S. exports to her. Consequently, Mexico joins the list of nations sending capital to the United States and amassing claims on future U.S. output, claims that already stand at \$2 trillion globally.

Even as our founding fathers sought financial assistance from France and the Netherlands to finance the Revolutionary War, they warned against becoming enmeshed in foreign intrigues. At the turn of the twentieth century, Americans still harbored a deep suspicion of foreign alliances. It was one thing to fight for democracy, protecting U.S. lives and property through "gunboat diplomacy," but quite another to rule an empire, as Great Britain, Russia, or Germany did.

At the dawn of the twenty-first century, all pretenses of innocence have been abandoned. For better or worse, preserving the American way of life today seems to require the United States to be fully engaged in world affairs economically, politically, and militarily. If George Washington expressed a measure of caution, Thomas Babington, Lord Macaulay, sounded a note of realism when he wrote, "Free trade, one of the greatest blessings which a government can confer on a people, is in almost every country unpopular."