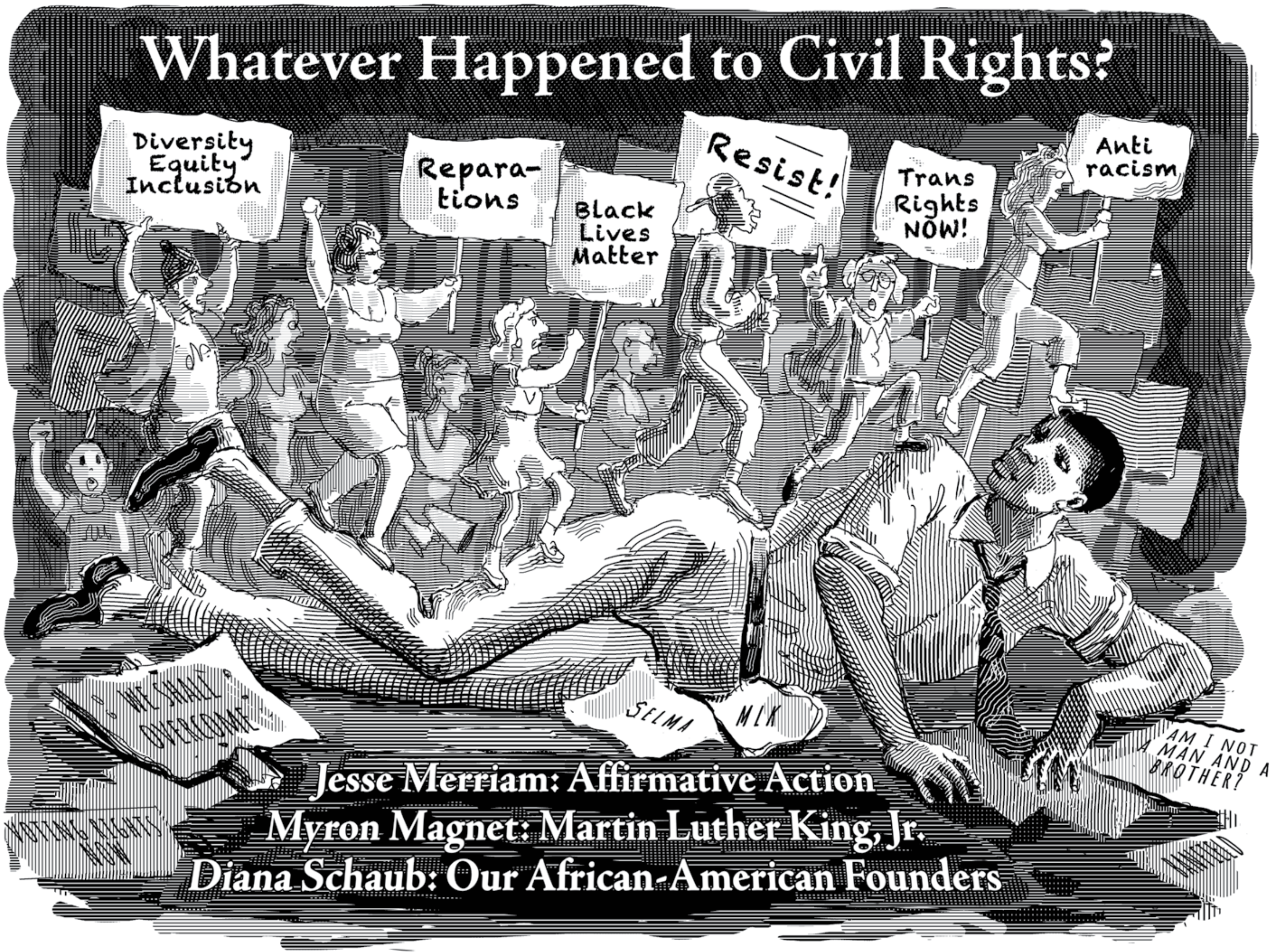
VOLUME XXIII, NUMBER 2, SPRING 2023

CLAREMONT
REVIEW OF BOOKS

A Journal of Political Thought and Statesmanship

Whatever Happened to Civil Rights?



Jesse Merriam: Affirmative Action
Myron Magnet: Martin Luther King, Jr.
Diana Schaub: Our African-American Founders

Adam Candeub:
Immigrants' Cultural Baggage

Philip Pilkington:
The Next American Economy

Daniel J. Mahoney:
Eric Voegelin

William Voegeli:
Crime Marches On

Wilfred M. McClay:
America's Heartland

Michael J. Lewis:
Buildings that Hold Up

Christopher Caldwell:
Ungovernable France

Glenn Ellmers:
Michael Zuckert's Lincoln

Scott Yenor:
The First Ladies of Country Music

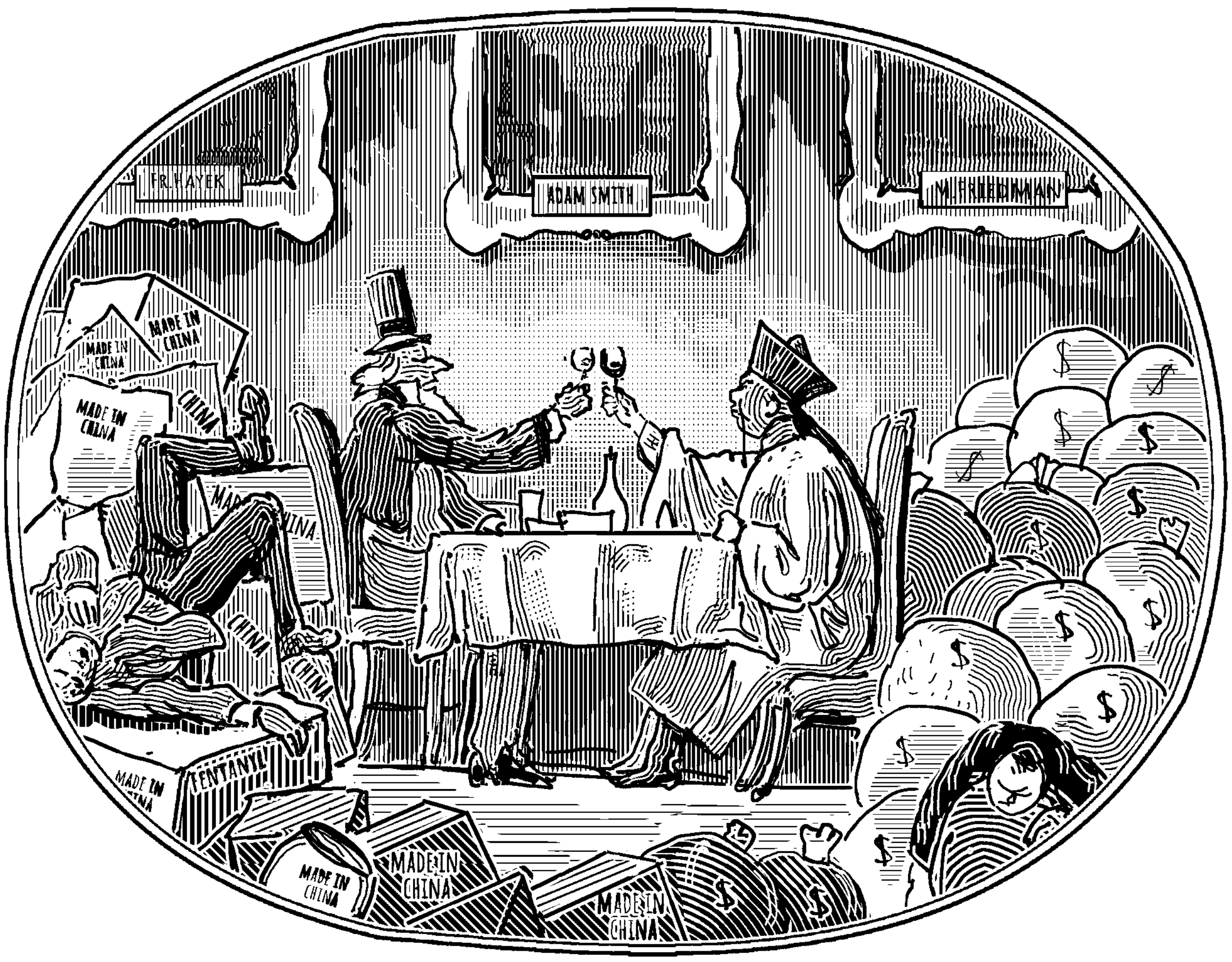
$9.95US $14.95CAN

A Publication of the Claremont Institute
PRICE: $9.95
IN CANADA: $14.95

Book Review by Philip Pilkington

Protecting the Free Market

The Next American Economy: Nation, State, and Markets in an Uncertain World, by Samuel Gregg. Encounter Books, 336 pages, $30.99



It is no secret that in the United States defenders of free markets have gotten flabby in recent years, chugging along on too much think tank money and too little opposition. Samuel Gregg has done a great service in writing a book defending free markets in the face of criticism by those, especially on the right, who favor industrial policy and even a degree of protectionism. As the Distinguished Fellow in Political Economy at the American Institute for Economic Research with affiliations at the Acton Institute and the Heritage Foundation, he is a formidable advocate who has written several previous well-received books on economics and ethics.

Yet for all that, *The Next American Economy* turns out to be too one-sided, highlighting, for example, the failure of government loans extended to the green energy company Solyndra but ignoring the same loans given to the highly successful automotive company Tesla. One could just as easily play this rhetorical game with lightly regulated markets, using the recent bankruptcy of the cryptocurrency company FTX to damn all financial markets. But only those already convinced that markets are bad would swallow such an analysis.

Gregg also argues early in his book that trade deficits do not matter. Anyone who has any experience with, say, emerging market debt crises will tell you that trade deficits do indeed matter a great deal. When a country imports more than it exports, it runs a trade deficit—or, more specifically, a current account deficit—racking up debt with its partner countries. If financial markets decide that they are no longer willing to accept this debt, the result can be a crash of the country's currency and very high inflation. This is what happened with the Asian Tigers crisis in 1997-98, during which Indonesian GDP fell nearly 15% and inflation peaked at close to 85%. Which is why current account balances are constantly monitored by practitioners.

Gregg dismisses trade deficits in five short paragraphs together with one long quote from Adam Smith around which his argument is centered. Smith's point, however, is that it is by no means clear that running, say, a trade surplus is a good thing because by doing so a country is effectively sending goods it could be consuming itself to another country. Gregg seems to be employing Smith in order to fend off economists who point to problems associated with America's large trade deficit. But his approach might lead to downright dangerous policy prescriptions, as one can see by examining the instant case of the U.S. trade deficit.

In 2021 the United States ran a current account deficit of around 3.6% of GDP. Although this didn't match the previous high of 6.5% of GDP seen in 2006, it remains the second largest current account on record. This means that in 2021 the United States borrowed the equivalent of 3.6% of GDP from its trade partners, which is added to the total stock of foreign claims often measured by the net international investment position (NIIP). At the end of the third quarter of 2022, America's NIIP stood at -$16.71 trillion, or roughly 72% of GDP. America is a country with a vast foreign debt load.

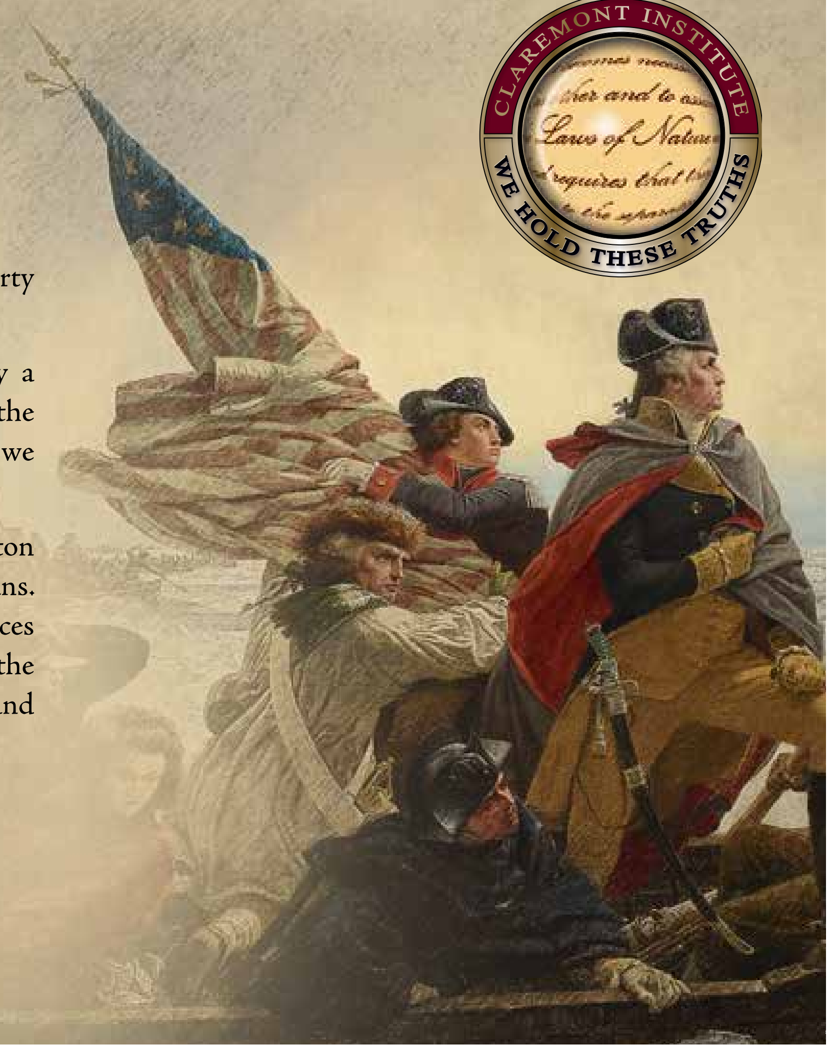
How does the United States maintain this debt? Simply put, by ensuring that there is adequate demand for American assets abroad—most notably Treasury bonds and dollar currency reserves. This in itself is a problem insofar as large swaths of the American economy are owned by foreigners. But even beyond the ownership problem, such a system introduces serious vulnerabilities into the American economy. At the margin, the demand for American assets is driven by the status of the U.S. dollar as the global reserve currency, which ensures that foreign governments are willing to accept and hoard American paper assets in exchange for goods and services.

But what happens if this situation changes? If the demand for these paper assets dries up, the U.S. dollar will decline in value, the price of imports will rise, inflation will increase, and American living standards will decline—especially for those with lower incomes. In an article for the journal *American Affairs* ("The End of the Dollar Hegemony?," March 2022), I calculated that a 10% depreciation of the dollar would lower living standards by around 3.5%, a 30% decline would lower them over 10%, and a 50% decline would lower them over 17%. How far would the dollar fall if it stopped being the global reserve currency? There is simply no way to know.

Nor is this a problem that will only be faced in some far-off future. After the Russian invasion of Ukraine in February 2022, the Biden Administration froze all of Russia's foreign exchange reserves as the world looked on in shock. The message sent to the rest of the world was simple enough: your U.S. dollar reserves and Treasury bonds are only good if you do not cross red lines in your foreign policy set by Washington. The result has been profound, and now everywhere from Saudi Arabia to Israel to China is diversifying out of their U.S. dollar reserves. This doesn't mean that the dollar will cease being the world's reserve currency overnight, but it may well be the beginning of a long period of its decline. After allowing the rest of the world to accumulate enormous claims on America—recall, around 72% of annual GDP—this turn of events puts the U.S. in a position not unlike that of Great Britain after World War II.

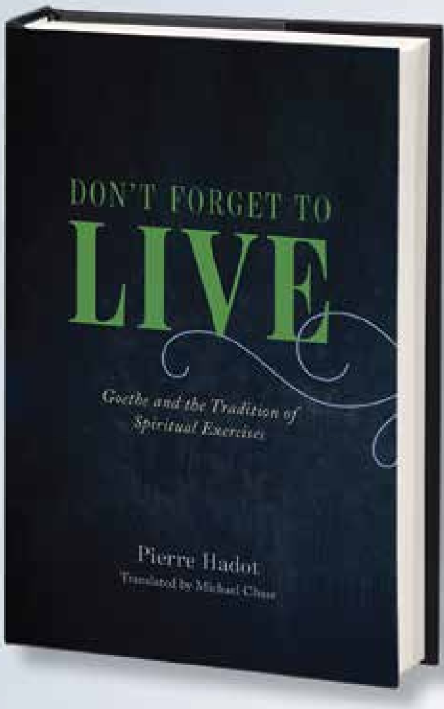
America's trade deficit exposes the pitfalls of Gregg's approach. In thrall to simple models and attractive theories, he advocates throwing caution to the wind and doubling down on policies that have vastly weakened the United States economically. Over the past three decades free trade has been an enormous boon to the developing world. Millions, if not billions, of people have been lifted out of poverty. But just because free trade is in the general interest of mankind doesn't mean that it is in the particular interest of the United States, or of any other single country for that matter.

The only thing worse than pursuing an ideologically driven policy that weakens your country through unfettered trade with poorer, lower-wage countries, is an ideologically driven policy that seeks to tear your now dependent economy away violently from its major trade partners. *The Next American Economy* contains much discussion of the relationship between free trade and national security, especially as it relates to China, and it is here that Gregg's otherwise zealous defense of free trade crumbles. He had the opportunity to warn that, by engaging in aggressive levels of protectionism that are out of



New from

CHICAGO



Don't Forget to Live

Goethe and the Tradition of Spiritual Exercises

Pierre Hadot

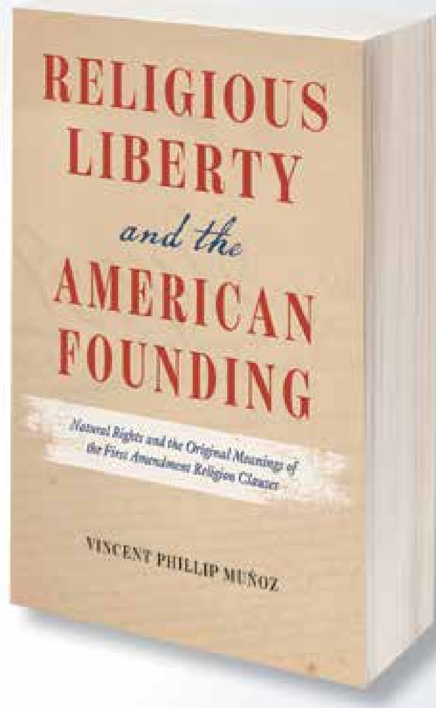
Translated by Michael Chase

With a Foreword by Arnold I. Davidson and Daniele Lorenzini

"Reading Hadot sparks enormous joy."—*Charlie Hebdo,* on the French edition

"It is the culmination of Hadot's long-term concern with 'philosophy as a way of life' and constitutes a significant expansion and deepening of this theme."—John Dillon, Trinity College Dublin

CLOTH $25.00



Religious Liberty and the American Founding

Natural Rights and the Original Meanings of the First Amendment Religion Clauses

Vincent Phillip Muñoz

"Muñoz's superb new book is an indispensable guide to the issue that will soon replace abortion as the most important point of contention in our constitutional law."—*Claremont Review of Books*

PAPER $30.00

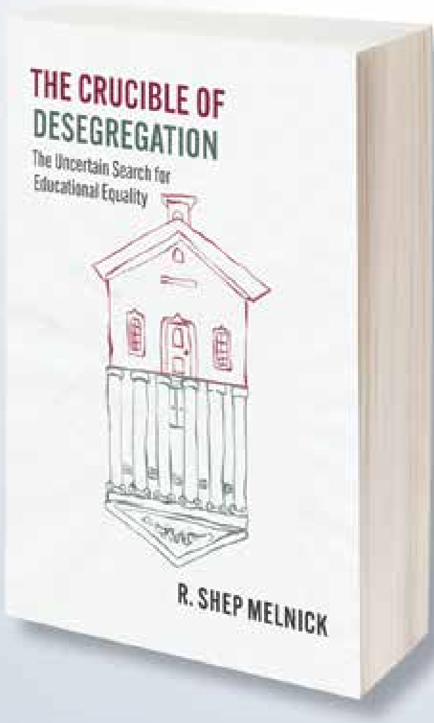
The Crucible of Desegregation

The Uncertain Search for Educational Equality

R. Shep Melnick

"This meticulously researched, elegantly written, scrupulously fair-minded account achieves the rare feat of reshaping our understanding of one of the epochal constitutional and social issues of our time."—David Kirp, University of California-Berkeley

PAPER $35.00



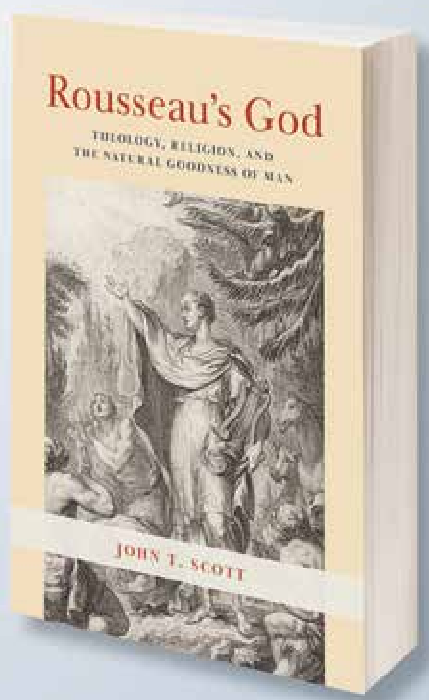
Rousseau's God

Theology, Religion, and the Natural Goodness of Man

John T. Scott

"Scott succeeds in reconstructing the entire complex edifice of Rousseau's theology and relating it to the broader and even more complex context of Rousseau's thought as a whole. This is a remarkable achievement and a major contribution to understanding Rousseau."—Clifford Orwin, University of Toronto

PAPER $32.50



The UNIVERSITY OF CHICAGO PRESS www.press.uchicago.edu proportion to the problem at hand, the U.S. economy might be heading over the waterfall. But instead, he's caved to the China panic that has currently engulfed Washington, digging up quotes from early free trade proponents—both economists and politicians—to show that they were perfectly willing to violate their faith when there was an enemy visible on the horizon.

Gregg lays out this new "free market protectionism" in four axioms. The first is for adherents to "be more measured when stating what free trade can and cannot do for America." That is, free trade advocates should stop making promises that trade liberalization will lead to the democratization of authoritarian regimes like China. This axiom is simply a recognition of reality. The second axiom is that American supporters of the free market "should focus their fellow Americans' minds on how trade openness serves *America* economically and politically as a nation" (emphasis in the original). The fact that this even needs to be stated shows how far free traders have drifted from common sense in recent decades.

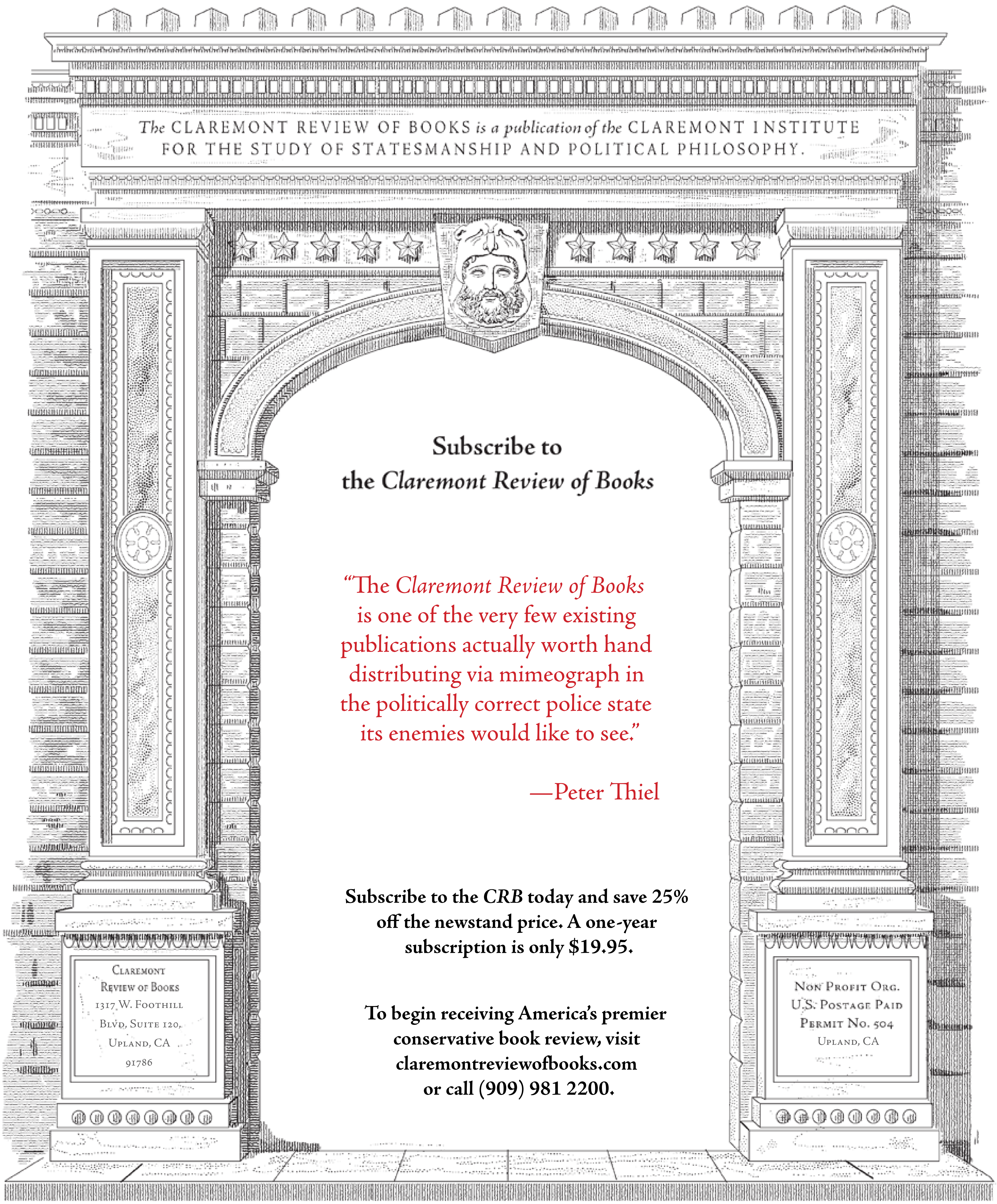
The third axiom is that free market proponents "must distinguish those aspects of trade with other nations which constitute legitimate economic activities from those that don't." Here Gregg is referring to intellectual property theft. The problem with this axiom is that economic models that promote the free market assume that technology is imitable across geographic regions, so if the new free market proponents want to drop this assumption, they need to alter their models—and hence their arguments—accordingly. The fourth axiom is that free marketeers must only advocate policies that "avoid directly bolstering the military and security of regimes deemed hostile to the United States." This axiom gives *carte blanche* to anyone who styles himself a free marketeer to advocate extreme protectionist policies. And because a case can be made that basically any good or service bolsters the military or economic strength of a rival, anything goes. The United States has tried to explain some of its more aggressive protectionist policies in just this way to the arbiters at the World Trade Organization, but the arbiters rejected these arguments and in December 2022 ruled against the U.S.

WHAT GREGG HAS ENDED UP ADVOcating is unlimited free markets at home and, under the strange guise of free market rhetoric, potentially infinite protectionism abroad. A free market autarky may or may not be desirable, but the problem is that American policymakers listened to free traders for years and now the American economy is completely dependent on trade. In 2019 China exported around $191 billion worth of capital goods to the United States, without which American industry would likely crumble. This is not even to mention America's financial dependence on China, which currently holds around $980 billion of U.S. Treasuries and around $1.4 trillion in U.S. dollar reserves. If China dumped all of these holdings on the financial markets at once, the dollar would likely collapse and hyperinflation might follow.

The solution to America's problems is precisely the opposite of what Samuel Gregg advocates. Policymakers should focus on increasing America's competitiveness on the world stage. To do this, we will need a strong industrial policy—the very thing that Gregg spends half his book attacking. To reduce dependence on foreign imports, the U.S. should consider a policy of import substitution through subsidies that bring wage costs between American and Chinese industry more in line. Doing so would obviate the need for the destructive protectionist policies that he ends up promoting against his better judgment. It would also rebuild American industrial capacity directly, rather than sowing the seeds of its destruction—which is what engaging in a trade war with China, America's manufacturer, is almost certain to achieve.

Free market economists love island analogies. They often reach for tropes about Robinson Crusoe to illustrate incentives, trade-offs, and individualistic utilitarian rationality. *The Next American Economy* shows that advocates of the free market are perfectly content to fall back on these island fantasies if given the choice between protectionism abroad or government intervention at home. Ultimately, the modern-day free market advocate is far more attracted to Henry David Thoreau's libertarianism than to Adam Smith's and David Hume's sensible proposals for global trade. It is more of the latter, not the former, that the next American economy is in desperate need of today.

Philip Pilkington, a macroeconomist and investment professional, is the author of The Reformation in Economics: A Deconstruction and Reconstruction of Economic Theory *(Palgrave Macmillan).*


The CLAREMONT REVIEW OF BOOKS is a publication of the CLAREMONT INSTITUTE
FOR THE STUDY OF STATESMANSHIP AND POLITICAL PHILOSOPHY.
Subscribe to
the *Claremont Review of Books*
"The *Claremont Review of Books* is one of the very few existing publications actually worth hand distributing via mimeograph in the politically correct police state its enemies would like to see."
—Peter Thiel
Subscribe to the *CRB* today and save 25% off the newstand price. A one-year subscription is only $19.95.
To begin receiving America's premier conservative book review, visit claremontreviewofbooks.com or call (909) 981 2200.
Claremont Review of Books
1317 W. Foothill Blvd, Suite 120,
Upland, CA
91786
Non Profit Org.
U.S. Postage Paid
Permit No. 504
Upland, CA