Testimony before the U.S.-China Economic and Security Review Commission

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With the U.S. economy on life support lending from the central banks of China and Japan and the White House backtracking on open markets in textiles, steel, and agriculture while proving unable to conclude new free trade deals, it's time for American economists, CEOs, and political leaders to fess up. In its current form and mode of operation, globalization is ultimately unsustainable and is presently undermining long term U.S. welfare and power.

As usually presented in the press and quantified in economic models, globalization presumes a world of private enterprises engaging in free trade through open markets under conditions of transparency and rule of law. Nothing could be further from reality.

In fact, the global economy is bi-polar. One bloc of countries – the United States, the EU, Canada, Mexico, and a few others – run according to a kind of "dirty" free trade model. The others pursue a variety of forms of mercantilism. This reality is obfuscated by the fact that all pretend not only to be playing pure free trade, but that all the others are too.

The result is a world in which there is one net consumer – the United States. All others (even the "dirty" free trade EU) are net sellers, depending on exports directly or indirectly to the U.S. market for all or most of their growth. U.S. annual consumption is now $700 billion more than production. World growth depends entirely on growth in this consumption, which can only be maintained by borrowing from abroad, especially from the above noted banks. Thus the global economic role of the United States is to borrow ever more in order to consume ever more so that the rest of the world can export ever more.

In contrast, the mercantilists suppress consumption (by, for example, limiting consumer credit), compel high savings rates (in some cases by simply deducting from your paycheck), subsidize investment and exports, protect key markets, and manage the dollar exchange rate to keep their goods and services under-priced while those of America remain over-priced on world markets. Although it tends to transfer U.S. production, technology, and investment abroad, American leaders, Republican and Democrat alike, have long acquiesced to these practices because they keep prices and interest rates down while stimulating short term growth through, among other things, home equity financed consumption.

One result of all this is that the United States is now absorbing about 80 percent of all available global savings, a figure suggests the ultimate denouement. When the number hits 100 percent, the music will stop. And because U.S. and world growth depend on ever rising U.S. consumption and borrowing, the number is mathematically almost guaranteed to hit 100 percent. Thus the sustainability of the system has been in question for some time. Recent developments, however, have dramatically sharpened the question.

Three Billion new participants from China, India, and the former Soviet bloc have suddenly entered the global economy in the past ten years. Standard international economic doctrine holds that people in developing countries typically have low skills and that their low wages are offset by low productivity because of lack of technology and capital investment. It is further assumed that they can't easily move abroad and that capital and technology can't easily move to them. Hence, their low wage production poses no threat to high wage developed country workers.

With the advent of the Internet and global air express a new wave of globalization has made most of these assumptions are no longer valid. Capital moves instantly around the world at the click of a mouse. Technology goes where it finds smart people and financial incentives. And people move quite easily and almost instantly in the virtual world of call centers and business processing offshore.

On top of this is a unique aspect of these three billion new participants. While on average they are poor and unskilled, because there are so many, a large number of them (perhaps equal to the population of the United States) have the unexpected combination of the highest skill levels with the lowest wages. The new globalization puts them all effectively in the next cubicle, and their ticket to the good life is to combine these low cost skills with the mobile technology, capital, and virtual workplace to produce more U.S. bound exports financed by more U.S. borrowing from China and Japan.

In theory, of course, as these new participants sell more, their wages will rise and they will consume more, including more U.S. made goods and services. So everyone will win. But that's where the problem is. It hasn't yet happened that way. Japan and the Asian tigers have not become net consumers as they have gotten rich. Just as the U.S. structure of consumption is hard wired so is the mercantilist structure of export led growth.

While necessary, dollar devaluation, federal budget deficit reduction, and other conventional nostrums are insufficient solutions because they are based on invalid assumptions. Without dramatic commitment to fundamental change the global economy will go over the cliff. Before it does so we need to rethink our understanding and operation of globalization.

Today a third wave of globalization is washing over the world. Riding its crest, the two giants of Asia—China and India—are coming back into their own after six hundred years of impoverishment and servitude. The key elements of this new wave are the negation of time and distance and the rapid transfer of technology from advanced to developing countries. The already struggling machinery of the American-led globalization of the Cold War will be battered and strained further, perhaps beyond repair, by the impact of the 3 billion new capitalists. The new wave will dramatically change corporate strategy, the balance of power, and the everyday lives of billions of people, from the elite “masters of the universe” to ordinary citizens in America and abroad. It will empower individuals as never before and bring into action talents and players long ignored. One of its defining characteristics is that it will be less driven by countries or corporations and more driven by real people. It will unleash unprecedented creativity, advancement of knowledge, and economic development. But at the same time, it will tend to undermine safety net systems and penalize the unskilled. Nondiscriminatory and already less American and less first world, it will challenge the livelihoods of heretofore secure professionals in Europe, the United States, and Japan. Indeed, it will challenge all the conventional economic wisdom as it shifts wealth and power to Asia.

For example, take immigration. Historically America has attracted immigrants in search of opportunity and work. More recently this has also been true of Europe and even, to a lesser extent, of Japan. Now, however, the flow is going the other way. Some of the work is emigrating to seek the workers, and former immigrants are going home where opportunities now seem better. China has become the location of choice for global manufacturing, while India is becoming the destination for software development and services.

These new players are creating new markets and ways of doing business as well as substantial and badly needed centers of demand in the global economy. China has just displaced America as Japan’s biggest trading partner and is supplying the demand for possible Japanese growth. Its enormous appetite for food and primary resources is also spurring development from Indonesia to Brazil. At the same time, the new wave is rapidly raising demand for scarce water, accelerating desertification, and poisoning both the water and the air with pollution. On top of that is the question of energy. The entire world will become more dependent than ever on Persian Gulf oil suppliers, even as the price of oil ratchets ever upward. Both energy and environmental issues will challenge not only the United States but also China and India and the rest of the world.

As these developments shift the basic structure of the global economy, they are calling into question assumptions that have long dominated global economic policies. Business executives, economists, and political leaders have resisted rethinking them even when they seemed seriously out of whack with realities. These issues remind me of the flaws in the Titanic, since the global system could founder on them, absent new thinking more compatible with the realities of the new wave of globalization:

- The U.S. trade deficit is now over $600 billion, or about 6 percent of GDP annually. As a result, the United States has swung from being a major creditor nation to having the biggest debt—now nearing $3 trillion. These unprecedented amounts, however, have been dismissed as potential problems. They have even been called signs of strength by some who claim they just mean the U.S. economy is growing faster than others. This growth also supposedly makes it easy to finance them because foreigners will want to invest in the fast-growing U.S. economy. More recently, however, leaders like Federal Reserve chairman Alan Greenspan and former chairman Paul Volcker have begun to express concern that the deficits may be unsustainable, while the headlines included in the Prologue testify to the concern of foreign leaders. The United States now needs a fix of over $2 billion a day of foreign money coming in. Without new thinking, there may be a day when it doesn't come.

- Behind the trade deficit lies the zero savings of American households, the federal budget deficit, and the excessive savings rates and mercantilism of a number of other countries. None of these phenomena are sustainable.

- Can, and should, the dollar last as the world's currency? Heretofore there have been no real alternatives; but with the advent of the euro and discussion of an Asian currency unit, that situation is changing. The special role of the dollar as the world's money removes all financial discipline from the United States and enables currency manipulation by other countries. This is the key Titanic-like flaw in the current system. It cannot last. But how and when to change are crucial questions not presently being addressed.

- Does manufacturing matter? In the United States, manufacturing has declined from 23 percent of GDP in the 1980s to 12.7 percent today. Europe and Japan have also seen a decline but smaller than in the United States. The conventional wisdom holds that the structure of an economy, what it makes, and the services it provides are not terribly important and should not be the subject of government policy. According to this view, linkages between industries and technologies are unimportant, and technology development is independent of manufacturing and production. This view also seems to be at odds with the realities of the third wave of globalization. Beyond that is the question of balancing the trade deficit, which is mostly in manufactured goods. But the United States does not have enough physical manufacturing capacity to export its way to anything approaching a trade balance even if the dollar goes to zero value. Services exports can surely rise, but it is unlikely they can completely fill in the gap. Without some development in manufacturing, therefore, the only way out of the trade deficit is a significant cut in consumption. Thus the question, Does manufacturing matter?

- Economists have held it as an article of faith that high-tech manufacturing and services are done in advanced countries, while routine, low-value work is done in developing countries. But China has more semiconductor plants under construction or about to go into operation than America has. All mobile phone makers have moved most or much of their R&D to China. Nor does India limit itself to mundane software development; it also works at the cutting edge. As for services work, radiology, heart and joint replacement surgery, and pharmaceutical development are regularly outsourced to India. U.S. and European companies emphasize that they do a lot of high-tech work in China and India because they can't get it done as well at home.

- It has long been assumed that as manufacturing jobs disappeared, the service industries would provide secure, high-paying jobs to compensate for the loss of manufacturing. That view, however, is pre-Internet and pre–third wave. It may not be sustainable in the world of 3 billion new capitalists all online.

- The view that the uniquely inventive U.S. economy will always maintain economic leadership by doing the next new thing no longer necessarily holds. U.S. spending on research and development has declined in critical areas, and its technology infrastructure is deteriorating. Other countries are graduating more scientists and engineers, while America graduates fewer and fewer. Most important, the leading U.S. venture capitalists and technology firms are taking R&D and new start-up company development to Asia as fast as possible.

- The MBA and the American business model have had great influence on how business is done worldwide. The success of U.S. business has been largely attributed to its management and its focus on shareholders as opposed to stakeholders. Yet much of the U.S. business success has been due to government support and fortunate circumstances. The change in circumstances and the rise of strong non-American companies with different concepts of their purpose and objectives may require a whole new way of thinking about business.

- Although Western, particularly U.S., business leaders tend to disdain intervention in their affairs by their own governments, they frequently curry favor with authoritarian foreign governments. This practice may make them more subject to the policies of foreign governments than their own. Ironically this situation has been fostered by Western government officials who disdain the whole notion of an economic strategy. None of this thinking may be sustainable in the wake of the third wave of globalization.

- The level playing field concept is much loved by Western political leaders who are quick to call Asian countries trade cheaters while insisting that Western workers can compete with any on “a level playing field.” But the truth is they can’t. Advanced country workers with the same skills as Chinese or Indian workers will not be able to compete unless they are willing to accept Indian or Chinese wages. Moreover, in a peculiar way, the playing field will tilt toward the two new giants of the global economy. The potential size of their markets, their endless supply of low-cost labor, the unique combination of many highly skilled but low-paid professionals, and the investment incentives offered by their governments will constitute an irresistible package that will attract investment away not only from the first world but from other developing countries as well. China, for example, could be a real problem for Mexico. The only sensible response is massive investment in education and up-skilling of the workforce. Only those who have capabilities no one else has or can work better than anyone else will be secure.

- Americans are likely to find themselves increasingly uncompetitive as individuals. They have never understood the extent to which their high standard of living has been the result of good luck rather than personal virtuosity. In the new world of no time and no distance where education will be at a premium, the poor quality of U.S. secondary education will be even more of a disadvantage than it is now. American students now rank near the bottom of all the comparative international tests. To have any chance of competing on a level playing field, the United States will have to find a way to reverse that situation.

- Unless China and India go totally off the rails, they will become the world's largest economies in the middle of this century. The European Union is already the world's largest economic unit and will remain larger than the United States indefinitely. Despite U.S. military might, the balance of international influence and power is already shifting. As the National Intelligence Council says, the international power situation is more fluid now than at any time in the past half century. The challenge for the United States will be to play its currently powerful cards to shape a new balance of power favorable to its interests in a future when it will be relatively much weaker. Will its pride allow it to recognize that reality?

But these are all subsets of a much larger question. Today's global economy is the most integrated and it offers greater potential opportunities than ever. Yet, in many respects it resembles the Titanic, a magnificent machine with serious and largely unrecognized internal flaws heading at full speed for icebergs, armed with knowledge and assumptions significantly at odds with reality.

At a recent conference in New Delhi concerning the future development of India and China, I was the only American on the program—or in the audience. Nevertheless, the economic discussion was couched in terms of dollars. Charts and tables relating to Indian or Chinese GDP growth rates, export and import volumes, foreign reserve holdings, and other variables were all denominated in dollars. Even when I had the bad luck to run short of Indian rupees in the middle of the conference, the coffee service gladly took my dollars. Nor was this surprising. Wherever I have traveled for the past forty years, people always and everywhere have readily accepted dollars. Few of the conference participants considered that the Indian and Chinese economic developments they were discussing could serve as catalysts for the end of the dollar era.

Yet that possibility was made clear to me on the return trip, when I stopped in Frankfurt for lunch with some German friends. The conversation turned to how inexpensive things are in the United States these days. When I mentioned the price of a new house in Washington, one of my friends became a bit confused and asked what that would be "in real money," by which he meant euros. It was a perfect reversal of the classic American tourist's question to anyone spouting prices in currency other than dollars. It was also a brutally insightful commentary on a developing financial shift of truly global proportions. Over the past four years, the chronic U.S. trade deficit has reached unprecedented levels, and the dollar has begun to weaken as a consequence. Of course, this has happened before and the dollar has not lost its global primacy despite a cumulative decline of 70 percent over the past fifty years. But this time it is different.

In today's global economy, one net consumer—the United States—is accumulating a huge trade deficit by buying more than it produces at an ever-accelerating rate. While it imported $600 billion more than it produced in 2004, it will import an excess of nearly $700 billion in 2005. The money to pay for this excess has to be borrowed from the rest of the world. So far that has been no problem because the rest of the world saves by consuming less than it produces, and then lends the savings to the United States so that we Americans can import the excess production of the other members of the global community. These U.S. imports create export-led growth for the rest of the world while adding to the growing U.S. trade deficit. Thus Americans borrow and buy more and more while the rest of the world saves and produces more and more. It then lends more and more to the Americans so they can spend more and more on imports from abroad.

This has been going on for a long time, and for a good reason. It suits all the players fine. The Americans get to live beyond their means, and they love it. The best part is that because individual Americans are not borrowing the money, they get to believe they are actually earning their high standard of living. The non-Americans also like it. The extra American demand enables them to invest more and grow faster than they otherwise could, particularly in what they consider key industries. It also allows them to earn a reserve of dollars that can cushion shocks and provide leverage in global financial negotiations. So everyone is happy. If the Americans could guarantee to buy more than they produce at an ever-accelerating pace indefinitely, while the rest of the world guaranteed to keep lending to America at the same pace, everyone would remain happy. Unfortunately, neither side can make those guarantees.

Here's why. American consumers have been buying so much on their credit cards and home equity lines that U.S. household debt is now at an all-time high of 120 percent of household income.[1] Once the credit cards and home equity lines are maxed out, the kids all have part-time jobs, and mom and dad both work full-time, it is just not possible to consume more unless earnings start rising more rapidly. But earnings can't rise. The lack of domestic savings is holding investment down, and the rapid move toward outsourcing and offshoring, along with technology-driven productivity gains, is restraining all but executive wages and salaries. And an aging population with lots of retirees means less consumption and less growth over time. Finally, the United States is already absorbing a large portion of the world's internationally available savings. At current rising debt rates, there simply may not be enough global savings to fund the American need.

There are also pressures on the other side of the equation. The great pools of world savings are in Asia, particularly China and Japan. But the aging of Japan's population has already cut savings rates from 15 percent to 6.4 percent.[2] In China, which is also aging, popular pressure to realize the fruits of economic growth through more consumption is also likely to cut savings rates. This is broadly true for the rest of East and Southeast Asia as well. More immediately, however, many foreigners are growing uneasy about the long-term value of the American IOUs they have been piling up. Foreigners effectively lend money to the United States in several ways. Private investors, for instance, might buy U.S. stocks and bonds or real estate or locate new factories and offices on U.S. territory. All of which brings foreign money flowing into the U.S. coffers. Foreign central banks also invest in the United States by acquiring Treasury bonds or buying the dollar in an effort to prop its value up when foreign exchange forces are tending to push it down. During the dot.com bubble of the late 1990s, the vast bulk of foreign money flowing into the United States belonged to private actors rushing to invest in the new El Dorado. In those years, however, the United States needed only $100 billion–$200 billion to balance its deficits.

Recently that amount has grown to nearly $700 billion annually, even as the crash of the U.S. stock markets and a recession have driven many private foreign investors out of the market. They were replaced by their countries' central banks, which are now sitting on enormous piles of U.S. Treasuries, dollars, and other assets. Twenty years ago, America was the world's biggest creditor. Now the world's central banks are choking on close to a net $1.5 trillion of American IOUs and increasingly wondering if Americans are really going to make good on them. They especially wonder this when they consider two developments. One is the rapid offshoring of U.S. manufacturing, software, and services, and the other is the likely continued decline of U.S. savings, as the federal budget deficit widens under the impact of rising social security and health insurance obligations. Both will make the current account deficit get much bigger before it gets smaller.

How did we get into this pickle? Of the many factors, primary have been America's misuse of the dollar, our falling savings rate, our soaring trade deficit, and the myth of free trade, along with the excessively high savings rates, production, and exports of other countries. Let's start with the abuse of America's privileged role as the issuer of the world's money—the dollar.

When President Nixon announced the end of the dollar's link to gold and created today's dollar standard, he effectively made the global financial system dependent on America's good behavior. With no necessity to make good on its obligations in a world with no alternative reserve currency, America was literally licensed to print international money. It could exchange green pieces of paper bearing pictures of presidents for whatever it wished to buy. Do America's gas guzzlers need more oil? Print greenbacks and send 'em to the Saudis. Are American kids in love with everything made in Japan or China? Just run off some of those presidential pictures and send them along. America could have anything it wanted without having to consider the value of what it was getting against the value of what it was giving because—except in a very abstract way and over a very long term—it wasn't giving anything of value.

With no potential discipline or real obligations involved, America's international trade accounts became accounting artifacts. When I was a student in the 1960s, the monthly trade and balance of payments statistics were prominently reported, and France's periodic demands for more gold from Fort Knox were hotly debated. After the Nixon shock, however, this all got relegated to page 42, and America stopped worrying about international trade. Other countries had to count their reserves and find ways to earn dollars in order to procure necessities from international suppliers. But not the Americans. They just ran their printing presses and bought whatever they wanted. If they happened to buy more than they produced, what difference did it make? In fact, it was actually good to buy more than you produced because the world needed an engine of growth, in view of the fact that the Asians saved too much and consumed too little.

America's emphasis—with the memory of the Great Depression still fresh—on consumption as the driver of economic growth after World War II has a twin—a declining national savings rate. From 1947 to 1973, America's national savings—the combination of household, corporate, and government budget surpluses and deficits—fluctuated between about 8 to 15 percent of GDP. Since 1980, however, everything has gone south. What lies behind this trend is both difficult and easy to explain.

The difficult part is personal savings. Over the past twenty-five years it has steadily declined, from nearly 10 percent of GDP in 1979 to almost nothing today. One factor, clearly, has been the heavy promotion of consumption. As a teenager in the late 1950s, I never received an unsolicited credit card in the mail. When my children were teenagers in the late 1980s, they were each getting two or three a month. In 1968 outstanding consumer credit (calculated in year 2000 dollars) was $119 billion. By June 2000 it had soared to nearly $1.5 trillion. In 1970 only 16 percent of households had a bank type of credit card. By 1998 that figure had climbed to nearly 70 percent.[3] So aggressive are the credit card companies that they use data-mining techniques to identify people with high debt balances on their present cards in order to ply them with additional card offers. I can remember when most retail stores were closed on Sundays. For my children, that is unimaginable.

This shop-till-you-drop mentality did not evolve unaided. For a long time, the interest on credit card debt was tax deductible because the government thought shop-till-you-drop was good for the economy. Even when the feds eliminated the deduction, they provided for tax deductibility on home equity loans, meaning you could keep shopping as long as you owned a house. And don't forget President Bush's stirring injunction to the nation following 9/11. After declaring "war on terrorism," he urged Americans to support the effort by shopping to keep the economy going. The same year, Alan Greenspan, director of the Federal Reserve system and the nation's top economist, slashed interest rates virtually to zero after the collapse of the dot.com bubble in an effort to hold up consumer spending by encouraging home equity loan–based buying. Over the past fifty years, "saving" has almost become a bad word. Hardly anyone wants you to do it.

But the rise of consumerism only partly explains the decline of saving. There has also been a tightening squeeze on the average family's finances. After more than doubling from $21,201 to $43,219 (2003 dollars) between 1947 and 1973, median family income went nowhere for the next twenty-two years, rising only to $48,679 in 1995.[4] It jumped to $54,191 in 2000 but then dropped back to $52,864 in 2002.[5] Had the 1947–1973 trajectory held, median family income would now be approaching $100,000. Even more revealing, over 80 percent of households in my youth in the early 1950s only had one earner. Today over 70 percent have two.[6] One could argue that the real per capita standard of living has declined. Of course, I must quickly acknowledge that today's houses are bigger than yesterday's, and families now drive two or three cars in place of one and shop online instead of driving to the mall on Saturday. Moreover, the imported clothing, toys, and PCs they buy are very inexpensive and have given families a kind of income boost through lower prices. Michael Cox, of the Dallas Federal Reserve Bank, has written that if you calculate retail costs not in the familiar constant dollars but in the amount of average-wage work time needed to earn something, most consumer goods have grown significantly cheaper over the past generation. Cox argues that the material possessions of Americans at the poverty line in 2000 roughly equaled those of middle-income Americans in 1971.[7] So perhaps "decline" is too strong a word. Still, the average American family has been under increasing pressure to find ways to pay for the average lifestyle. One way to do that has been to save less.

The part of the falling national savings rate that is easy to explain is the government portion. The Reagan tax cuts of the early 1980s did not generate enough economic growth to offset the revenue loss arising from lower tax rates. As a consequence, the federal budget deficit soared to an unprecedented 6 percent of GDP and further accelerated the decline in the national savings rate arising from the fall in private saving.[8] America was spending far more than it was earning, and conventional analysts began to warn that government borrowing might soak up all the savings necessary to fund private investment, causing a spike in interest rates.

It never happened, because all that American buying included lots of imports that put billions of dollars in the hands of foreigners, especially of Japanese, who seemed to be making everything at the time. With global trade now denominated mainly in dollars decoupled from gold, the foreigners had no alternative but to accept and hold those green presidential pictures in return for all the Hondas, Walkmans, and Airbuses they were selling us. But rather than just look at the handsome pictures, they used them to buy U.S. Treasury bonds. This funded the burgeoning budget deficit and kept interest rates under control. Americans could have their cake and eat it too. Deficits, whether fiscal or trade, didn't seem to matter for the United States. By implication, neither did savings because, in lieu of its own, America could soak up the savings of the rest of the world. How good could life get?

Actually there were a few clouds in this picture. Social security was looking as if it would run out of money, and the federal budget deficit projection was getting so big that all the savings in the world might not be enough to offset it. So Reagan eventually raised taxes, and Bush I and then Clinton raised them even more. That, along with the 1990s dot.com bubble that produced rising tax revenue, put the federal budget in surplus and offset the continuing fall in private savings to keep total national savings at least in positive territory. Mind you, this was not enough to fund America's investment needs. The country was still borrowing like crazy, accepting those green pictures back in return for Treasury bonds or shares in U.S. companies and golf courses.

Then came the election of Bush II in 2000, and new tax cuts at the moment when private savings were collapsing completely. The budget deficit set new records in each following year, and America's national savings evaporated. In 2004 the Congressional Budget Office and several other public and private groups calculated a U.S. financial shortfall of $2.3 trillion over the next ten years.10 But official Washington was not worried. As Vice President Dick Cheney said, "Reagan proved deficits don't matter."

Cheney actually had a point. What's the big deal about national savings? So we consume more than we produce, run a trade deficit, and have no savings to fund further investment. But our economy grows and stimulates growth in the rest of the world. Saving is a virtue but not an end in itself. It simply provides investment capital for the real objective: growth and higher living standards. If you can get the capital without saving, that would seem pretty close to paradise. This is where American conservatives like Cheney think they are. They firmly believe that American democracy holds the secret to superior economic performance. Conservatives know that America's investment needs have long outstripped its now nonexistent savings. But they fully expect that foreigners will cover the gap indefinitely, both because they have no alternative to keeping their reserves in dollars and because they believe the U.S. economy will always yield the best return.

Recent history has seemed to justify this view. After raising concerns about declining competitiveness in the 1980s and recession in the early 1990s, the U.S. economy turned around to produce the longest boom in its history. It seemed to far outstrip the Japanese and European economies in both growth and productivity. On top of that, the Silicon Valley phenomenon, with its stock options, and the boiling NASDAQ market, were making everyone rich. Of course, foreign investors were putting their money in the United States. And who said Americans had no savings? Look at their capital gains in the stock market and at the skyrocketing equity in their homes. If you counted savings properly, it was argued by conservative economists, Americans were the world champions.

Then the market crashed, destroying $8 trillion of value. This is one reason market gains on paper don't count as savings. There were other flaws in the argument as well. Much of the growth was phony. The United States had experienced one of history's great investment bubbles, comparable to the South Seas bubble in the early eighteenth century, the Tulip bubble in the 1630s, and the Japanese bubble of the 1980s. The growth of such bubbles and their collapse are not usually considered signs of robust economic health.

Another apparent justification has been productivity growth. Productivity is the single most important thing in economics. It's the difference between a rich economy and a poor one. If I can produce twice as much as you in the same amount of time, I am going to be a lot richer than you. During the golden age of 1947–1973, productivity grew faster than it ever had, at about 2.8 percent annually. That's why real income more than doubled. For the next twenty years, however, productivity growth languished at about 1.5 percent and real income hardly moved. Then there was a huge jump to 2.5 percent annual productivity growth in the late 1990s, and everyone became euphoric about the new economy and its magnetism for foreign capital.

Still, it’s not entirely clear that this jump was real. By creating huge excess investment, bubbles generate high rates of production, and factories running at 100 percent of capacity are always more productive than those limping along at 70 percent. The argument has been made that the huge infusion of IT equipment and processes that accompanied the bubble was a major factor in the jump in U.S. productivity, and it contains some truth. Although productivity growth fell off somewhat in the recession of 2001–2002, it has remained good over the past several years. U.S. analysts, comparing this to the approximately 1.5 percent rates of Europe and Japan, have not hesitated to attribute foreign capital flows to America to its apparently superior productivity.

Yet the way productivity is calculated and the effect of offshoring make it very hard to get an accurate accounting. For example, U.S. productivity calculations are done by a method known as hedonic scoring. Here’s the deal. Last year you bought a laptop with a one-gigabit hard drive and a Pentium 3 microprocessor for $2,000. This year you got one for your wife, but it had a two-gigabit hard drive and a Pentium 5 chip, and it cost $1,000. Did computer production fall in the United States or did it double? Measured by price, it fell in half; but measured by computer power, it doubled. The U.S. government, using hedonic scoring, says it doubled. (It’s actually more complicated than that, but you get the idea.) For sure, it didn’t fall by half, but is your wife really using all that extra power? Maybe it didn’t double either. After all, when you buy your new Cadillac with 400 horsepower to replace an old one that only had 200, you don’t consider that you got two cars in place of one. Anyway, the key is that other countries don’t use hedonic scoring, so it’s not entirely clear how our productivity compares to theirs.

Then there’s the effect of offshoring. When companies close factories and move production offshore, they close the worst plants first. Remember that productivity is the amount produced per worker per hour. When the unproductive plant closes, output per worker rises. That’s very good, but what of the workers from the plant that closed? Unless they get new jobs that pay as well as and with the same productivity as the old jobs, they become a drag on the economy.

Offshoring adds another complication as well. When my tax accountant moved his back office to Bangalore, it didn’t mean he was doing more tax returns. Rather, as he explained to me, by laying off his back office staff and outsourcing the work to India, he would save a huge amount of money. How would this play out in U.S. productivity accounting? Here’s how it seems to work. Say my accountant sells $1,000 of tax returns. He pays nine back office employees a total of $500 to crunch the numbers and pockets $500 in profit for himself. Thus, before the switch to Bangalore, the U.S. economy gets to add $1,000 to GDP, and productivity is $100 per person employed. After the switch, the nine American back office workers have become fifteen Indian workers. The cost of doing the work in India is $100, which has to be deducted from the $1,000 gain to U.S. GDP. Thus the number of people required to do the work has increased, but as far as U.S. accounting is concerned, there is only one, my accountant. He is now making a profit of $900; and because he is now the only worker in the firm, productivity has gone to $900 per worker. U.S. GDP has decreased, and the number of people required to do the job has increased. But because most of those people are not in the United States, American productivity has taken an enormous jump. You see how slippery all this can become.

In truth, superior U.S. performance presently explains little of the foreign capital flow. The money now coming into the United States is largely not funding private investment. Rather, it is going into treasury bonds that fund budget deficits and excess U.S. consumption. When you borrow to invest, you expect to eventually pay off your loan and make a return. But when you borrow to throw a big party, you can expect only bigger credit card payments down the road, along with less money available for investment. That's where the United States is right now.

The fault, however, doesn't lie entirely with the Americans. In their efforts to achieve rapid economic growth, first Japan, then the Asian tigers like South Korea and Singapore, and now China have all contributed to the American problem. In *The Wealth of Nations,* Adam Smith argued that the objective of economic activity is consumption. While this may be true for the Asian economies in some long-term sense, their development models all involve the suppression of consumption, along with a heavy emphasis on saving, investment, and production. In Singapore, for example, the government mandates large contributions to a pension fund. In Japan, consumer credit is limited even today. Asian savings rates, at 30 percent to over 50 percent of GDP, are higher than Western rates have ever been except in wartime, which is perhaps not surprising given that industrial development is seen in Asia as a key element of national security and of avoidance of Western dominance. For similar reasons, savings have frequently been channeled not by the invisible hands of bureaucrats. They push investments in industries they think will grow faster and enjoy higher productivity gains than others or that will raise the general level of industrial technology and prevent undesirable strategic dependence. Whether the strategy is economic or geopolitical, it is not aimed at satisfying consumers today.

We have already seen a number of examples of this. The semiconductor industry has been a favorite, with Japan, Taiwan, South Korea, and now China all promoting its development through special financial incentives and regulatory policies. These countries are prepared, in effect, to buy semiconductor plants because those plants are seen as universities-cum-research centers that will bring quick technology transfer. Sometimes there is another factor. In capital-intensive industries with only a few competitors, dominant companies can become quasi-monopolies earning high profits and paying high wages. Sometimes policymakers aim to ensure that their country includes companies that dominate these industries.

Thus, while competition and market forces operate, they are subject to intervention. Nor are the Asians the only ones to use these techniques. Americans and Europeans invented them; RCA and Airbus are good examples. But in the past fifty years they have been used more extensively and consistently in Asia than elsewhere.

High productivity usually requires economies of scale that in turn require mass production. The high Asian savings rates and the drive for mass production mean these countries always produce more than they consume. Their high savings rates mean they cannot sustain their own production and would all go into recession or depression if they suddenly had to depend on their internal demand. In short, they save and produce too much.

There is a solution to this problem—exports. "Export-led growth model" is the phrase coined to describe the Asian approach to economic development. The model has a number of variations. For example, Singapore and China have welcomed foreign direct investment, while Japan, Taiwan, and South Korea have resisted it. But there is a common feature: if you are a country that produces more than it consumes and depends on exports for growth, you don't want a lot of imports. You might want to import raw materials or commodities you don't make, but imports of what you do make, or of products in industries you are trying to build, interfere with your growth. Thus there is a constant temptation to protect, particularly in "strategic" areas. In practice, this temptation has been yielded to in different ways. The Japanese market has long been notoriously difficult to penetrate, while Hong Kong and Singapore are pretty easy, and China is surprisingly open. However, one characteristic common to all the key Asian economies except Hong Kong (which is essentially dollarized) is managed currencies. They are either pegged to the dollar, like China's yuan, or the object of frequent central bank intervention in the currency markets to conduct a "dirty float." Either way, they usually keep their currencies undervalued versus the dollar.

International economics employs a simple accounting equation to explain the causes and dynamics of the U.S. trade (more accurately, current account) deficit:

Exports – Imports (the trade balance) = Private Savings +
Government Budget Surplus (or deficit) – Domestic Investment

A trade surplus means the sum of private savings and government surpluses or deficits is greater than domestic investment. A trade deficit means the opposite. Over the past twenty-five years, nearly all the discussion of this equation has been based on the assumption that the action is from right to left. In other words, low private savings and government budget deficits have driven the American trade deficits.

Nonetheless, because the formula is an equation, the causality can run from left to right as well. An excess of imports over exports could be causing a reduction in private savings and/or an increase in the U.S. government budget deficit. This is the effect of protectionism, pegged currencies, and "dirty floats." Companies producing in the United States sell less than they otherwise would, workers earn less, the government collects less in taxes. The result is a shortage of savings relative to investment and an ever larger trade deficit. Just as foreign governments suppress their domestic consumption, so they also help suppress U.S. savings. This is the elephant in the corner that is rarely discussed in polite company.

It is not discussed because to do so would be to challenge free trade policies that have formed the bedrock of the international economy for over half a century. The mismanagement of the global economy that worsened the Great Depression and helped bring on World War II taught postwar leaders an important lesson. Protectionism not only doesn't work; it can be dangerous. That lesson was the foundation of the postwar economic institutions, of the spread of the liberal trading regime, and of the whole second wave of globalization. The new system, built on free trade principles, succeeded because those principles are essentially sound, and there is great truth in the free trade analysis when its major assumptions are operative. But like generals fighting the last war, economists have too frequently fought the last depression while ignoring important new realities.

The impact of 3 billion new capitalists on the United States, along with America's abuse of the dollar and its soaring public and private debt, has made foreign central bankers and finance ministers very nervous. They are all in a global game of financial chicken. If foreigners dumped a large portion of their dollar holdings, the dollar would fall dramatically and cause a recession or even a depression in the United States. Because the rest of the world lives by selling to the Americans, a U.S. recession could be devastating to the rest of the world's economies. Dumping dollars could precipitate global stock and bond market crashes that would bring huge losses to, among others, those doing the dumping. From this perspective, Americans are holding the world's financiers hostage. On the other hand, should things fall apart, the first player who gets out of dollars will take the smallest loss. Thus any hint of significant dollar dumping is likely to cause a chain reaction—fast.

If you are a finance minister or central bank director, this possibility creates two worries. First, if it looks like things are beginning to fall apart and you don't move, you could wind up losing billions for your country, along with your reputation. Second, Americans owe so much that they are sure to be tempted to inflate the debt away. If they do that while you are steadfastly holding on, you will again lose gobs of money, and your epitaph will not be heroic. So all the players, or nearly all (about which more later), are damned if they do and damned if they don't. So far they haven't, but tomorrow is another day.

Recently everyone's nervousness has been reflected in some interesting moves. As private money abandoned the dollar over the past two years, the European Central Bank followed free market principles and refrained from any intervention in the currency markets. American officials said they wanted a strong dollar, but their body language said weak dollar. Consequently the euro, which had languished during the dot-com boom, gained over 35 percent against the dollar in a two-year period. The Bank of Japan, on the other hand, engaged in massive intervention, buying over 623 billion dollars in 2003 in a largely successful effort to prevent the dollar from falling against the yen.[9] Because the Bank of China keeps the yuan pegged to the dollar by law, it doesn't intervene in the exchange markets as the Japanese do. But its trade surplus means that to hold the peg, the bank has to keep accumulating dollars. While doing so, however, the Chinese have quietly been buying lots of oil. They need the oil, and buying it now with strong dollars is a way to avoid investing in U.S. Treasuries, whose value could plummet in a crisis. The oil producers, in turn, have been taking the dollars from the Chinese and selling them for euros and euro bonds, putting more upward pressure on the euro. The Russians only added fuel to the euro fire when they announced the decision to reverse the dollar-euro ratio of their international reserve holdings. This activity has begun to price European goods out of international markets. As a result, the Europeans are now talking about “stabilizing” the dollar by organizing a joint buying operation with the Japanese. So far the system is still holding together, but it is increasingly shaky.

No one knows for certain what will happen, but clearly the global financial markets could implode very quickly. Former Federal Reserve chairman Paul Volcker says there is a 75 percent chance of a dollar crash within the next five years. There is a market fundamentalist view that prevails in Washington and parts of Wall Street, that markets are self-correcting and best left alone—a dangerous siren song. Far from being self-correcting, markets tend to excess. They overshoot. Anyone with any experience of markets knows this. When markets are going down, all the weaknesses get concentrated, and you need intervention at the right time to stop things from getting out of control. If the dollar started to melt down, the results could be really nasty. A 1930s-style global depression is not out of the question.[10]

The lack of an alternative to the dollar is the only reason it hasn’t taken a big fall already. But now those alternatives are emerging. The euro, though not a perfect substitute, is becoming more attractive. Besides the Russians, others are also sneaking into euros, which is why it has recently strengthened so much.[11] In Asia there is serious discussion of creating an Asian currency unit, or Acu, in imitation of the European Ecu, which preceded the euro.[12]

In the end, it is very simple: the global economy is highly distorted. Americans consume too much and save nothing and the rest of the world, especially Asia, consumes too little and saves too much. There are three ways for this situation to work itself out. Americans could consume less and save and invest more. The fastest way to do this would be to cut the federal budget deficit. There are two problems. If Americans take all the adjustment, it would entail a big reduction of GDP. Since no political leader could survive that, it is not going to happen voluntarily. Nor is the federal deficit likely to be cut. If anything, it will increase as the baby boomers retire and cause a dramatic rise in social security and Medicare payments. The second option would be for Asia and the rest of the world to cut saving and increase consumption. That will undoubtedly occur over the long run, but in the short run it would slow up the growth that is the raison d’être of these regimes, especially China’s. Moreover, if it did occur, the reduction of the flow of Asian savings to U.S. financial markets would cause the dollar to fall.

That is, of course, the third and by far most likely event. When and how it might occur no one knows. Most analysts would like to see a smooth, gradual decline of 30–50 percent from present dollar values. How things develop will be significantly determined by China. To many Western economists China’s policies seem foolishly mercantilist. But China’s accumulation of dollar reserves has given it great negotiating leverage against the United States, and its policies induce rapid industrial development and technology transfer. So China might decide to prop the dollar up for a long time, as will, almost certainly, Japan. Europe might even join in to avoid the pain of the rising euro. But there is always the unexpected. Vladimir Putin is increasingly unhappy with the United States. Could he show his dissatisfaction by dumping dollars? What about OPEC? There are surely a number of members who have no love of the United States and might jump at an opportunity to dethrone the dollar. Remember also that before the Asian financial crisis of 1997, no one anticipated the damage hedge funds could cause. Recently a little bond market maneuver by Citibank caused a scary ripple in the European markets. There's no guarantee that something like that won't trigger a dramatic dollar crisis, and if it does, it won't just be another decline. It will be the end of the dollar's dominant role as the world's money.

Although America has not yet caught on, its relative economic superiority and power are rapidly slipping away. Far from leading the world on a global march to freedom, the United States could find itself hard pressed to maintain a reasonable standard of living and defend its vital interests. While America still has the best cards, it will have to hold on to them—and learn to play them a lot better. Unfortunately, the hand and the position of play have deteriorated since I first wrote about these issues nearly twenty years ago in *Trading Places: How We Allowed Japan to Take the Lead*. Maintaining a unipolar, hegemonic leadership is out of the question. It is no longer possible nor desirable for the long-term welfare of Americans. But there is much America can and should do to mitigate the impact of wage competition, maintain the promise of opportunity at the heart of the American Dream, provide for a continually rising standard of living more equally distributed, and continue to influence the course of global affairs.

The first step is to realize that there is a problem. America needs to recognize that many of the assumptions guiding its economic policy are at odds with the realities of today's global economy. Its performance in a broad range of areas—including saving, education, energy and water conservation, critical infrastructure, R&D investment, and workforce upskilling—is far below the standard of many other nations. America needs to understand that its refusal to have a broad competitiveness policy is, in fact, a policy. And it gives leading U.S. CEOs no choice but to play into the strategies of other countries. This policy, according to its proponents, leaves decisions to the unseen hand of the market. Actually, however, it leaves them to the highly visible hands of lobbyists and foreign policymakers. It is a policy that ultimately leads to impoverishment.

I have been involved in several efforts to identify principles of national competitiveness. The first one is always that a nation's industries cannot remain competitive internationally if the nation's overall economic environment is not competitive. It is impossible, for example, to have successful world-class competitors based in economies characterized by hyperinflation or lack of crucial infrastructure or low educational achievement. The first priority of American leaders—even more important than fighting terror or spreading liberty—should be to ensure long-term U.S. competitiveness. Without it, nothing else will make any difference. The president should establish an independent blue ribbon commission—headed by the chairman of the Federal Reserve or another major figure and including leaders from government, private industry, academia, and the media—to assess and make recommendations for shoring up America's long-term competitive potential.

To preempt the gathering financial crisis and ensure a sounder basis for the third wave of globalization, the United States should take the lead in a global effort to reduce the role of the dollar. It must do so gradually and cautiously. Because the whole system now depends on U.S. consumption and the dirty floating of the dollar, any sudden or unilateral change could precipitate disaster. As a first step, the United States might convene a new Bretton Woods Conference of key global leaders to devise a plan. The U.S. government might announce beforehand the measures it would take to begin balancing the federal budget and creating more savings in the U.S. economy. It could then ask other major countries to come to the meeting with plans for raising consumption and stimulating their own economies. The initial objective of the conference would be to agree on joint implementation of these plans. It must be joint, since action by only one side would be worse than no action at all.

The second step could be to create an international planning commission, perhaps in the IMF, to develop a scheme for eventual adoption of a new international currency. This might involve interim steps like pricing oil and other key commodities in a basket of currencies including the yen, dollar, euro, and renminbi. Mechanisms for continued coordination of fiscal and monetary policy would also have to be developed.

An alternative reserve currency unit already exists in the form of IMF special drawing rights, or SDRs. These were originally created in 1969 to support the Bretton Woods fixed exchange rate system. Al though the collapse of the Bretton Woods system in 1973 and the advent of the current floating exchange rate system obviated the original purpose of the SDRs, they are still used today as the IMF's unit of account, and some countries hold in their reserves SDRs that can be exchanged for IMF member country currencies, just like dollars or gold. The value of the SDR is presently based on a basket of currencies that includes the euro, the yen, the pound sterling, and the dollar, which provides a tie to present market values. Consequently it might provide a vehicle for moving away from today's largely dollar-based system. Or perhaps some other vehicle would be preferable. The point is ultimately to get away from dollar hegemony.

Such a step away from the dollar as the world's money would be a big one for Americans, given our pride in our country and, by extension, the dollar. But in the long run, discretion is the better part of valor. The dollar's present role makes Americans feel good in the short term, but ultimately it will kill us. The way to maximize long-term welfare and power is to reduce the role of the dollar as fast as possible. I don't mean that the dollar should cease being prominent; only that it should not be the only player.

This leads to another vital issue, that of competitiveness. All microeconomic and international trade issues can be covered by the broad term "structural competitiveness," the area no one has charge of in the United States. We need to have someone constantly studying the building blocks of our economy, looking at how they fit together, and how they might be affected by all the regulatory, legislative, and trade and other factors at work. South Korea is far ahead of the United States in the application of Internet and broadband technology because that country's leaders approached regulatory issues from the perspective of how this technology could enhance economic growth and competitiveness. The United States dealt with the regulatory issues primarily as matters of fairness and competition. No one in the United States was charged with getting the most out of this new technology in terms of growth, productivity, and competitiveness. By the same token, no U.S. official is looking at the financial investment incentives being offered by foreign governments to entice U.S. firms or considering counteroffers to keep technology and those jobs in the United States. Nor is any U.S. official calculating the long-term damage to the U.S. economy of manipulated exchange rates or considering how to respond.

In seeking someone with real power to be in charge of this stuff, the office of the vice president might be a good place to lodge the overall responsibility. Below that, how about combining the departments of Commerce, Energy, and Transportation, along with NASA, into one Department of International Industry and Commerce. The vice president would chair a president's council on competitiveness that would include the secretary of this new department, along with the secretaries of Treasury, Defense, Justice, and State and the U.S. Trade Representative. Whatever we do, however we organize it, the main thing is to take the economic nuts and bolts.

In the rules for national competitiveness, the key point is infrastructure, or an ecosystem of competitiveness. Far from being a few venture capital companies or semiconductor producers, Silicon Valley is a densely interwoven network of universities, law firms, venture capitalists, R&D centers, local government officials, major companies, and small start-ups. In some measure, all depend on each other. Being competitive, therefore, requires just as much attention to the key interrelationships as to the single elements themselves. From this perspective, what happens to important end-use markets or to key intellectual property rights or to university research can be critical to the viability of the whole ecosystem and, ultimately, to the nation's ability to remain competitive. The operation of the system is not necessarily linear. In other words, the disappearance of important companies might have as much impact on the number of students enrolled in the university engineering courses as the decline in that number might have on the ability of the companies to remain competitive.

Moreover, the development of these ecosystems is evolutionary, not revolutionary. The full impact of today's developments might not be felt for a decade or more. The fact that this view initially an intuitive one that sprang from our experience in high-tech industries and international trade) has since been confirmed mathematically should demonstrate both the legitimacy and the absolute necessity of the government's concerning itself with these developments. Rather than being protectionist or even tending toward picking winners and losers, such concern is their antithesis and would aim to prevent the protectionism and mercantilism that so frequently distort these competitive ecosystems.

In this context, the United States must respond to interventions in foreign currency markets that distort trade and investment decisions by acting as indirect subsidies. Because such currency policies can nullify and impair the concessions made in WTO agreements and may therefore be in violation of those agreements, the U.S. government must challenge possible violations. The WTO must be persuaded to deal with currency policies that undermine that organization's entire basis.

In the same way, the U.S. government should actively review the investment incentives other governments are offering to attract major installations from U.S. companies. It is one thing for a factory or an R&D center to be located in a particular place owing to market considerations, but entirely another if the place has been chosen mainly because of tax holidays and other subsidies. The United States should not sit benignly by as perfectly competitive operations are moved overseas in response to such subsidies. We should counter with our own incentives. Some state governments try to do this, but their resources are obviously more limited than those of the federal government. The U.S. government ought to know at least as much about the investment thinking of its companies as the Chinese, Singaporese, and other governments routinely do. Just as foreign economic development boards actively work to promote investment in their jurisdictions, so the U.S. government ought to be working to promote investment in the United States.

A final issue that is of huge importance but little discussed is infrastructure, both physical and institutional. Why are many foreign companies doing their initial public offerings in the United States? Because the U.S. financial markets and corporate governance rules are the most transparent and the best. Still, there is room for improvement, as Enron and other scandals clearly demonstrated. But they are an essential part of what makes New York the financial capital of the world. To be competitive, America needs to keep improving its financial infrastructure while upgrading institutions like the Centers for Disease Control, the National Institutes of Health, and research universities around the country.

The U.S. government also needs to take a hard look at the country's physical infrastructure. People who travel abroad often have a slight feeling of returning to a developing country. While most foreign cities have a fast rail connection from the airport to downtown, most U.S. cities do not. The whole U.S. air traffic system, from the airlines to air traffic control technology, is obviously under stress. In Europe and Japan, rail is fast, comfortable, convenient, and efficient. U.S. rail travel is torture. Among international travelers, the U.S. telephone system has become a bit of a joke. My mobile phone works better in Bombay than in Washington, D.C. Many of our municipal water systems are getting close to one hundred years old, and the blackout of 2003 showed the weaknesses in our electric grid. We cannot be competitive with a second-rate infrastructure. The U.S. government needs to make improvement a top priority.

Although its relative power and influence is in decline, the United States at this moment remains overwhelmingly the most important country on the globe. The unusually fluid international alignments present a once-in-a-lifetime opportunity for the United States to use its still vast power to reset the global table in ways that will favor its interests for a long time to come. Five specific initiatives should be pursued in respect to NAFTA, Japan, the European Union, India, and China.

NAFTA should be turned into an economic and, eventually, a political union along the lines of the EU. It is critically important to all of North America that Mexico succeed. This will require greater integration with Canada and the United States than is possible or likely under NAFTA. Steps should be taken toward the full integration of the three economies and the adoption of the dollar as the official currency in both Mexico and Canada—in order to relieve both of the costs of dollar fluctuations while also creating a more efficient market for all.

The NAFTA countries should invite Japan to join, and Japan should also be invited to adopt the dollar as its currency. Here what may seem like madness has a method. Japan, as we know, holds a lot of dollar assets and worries about their long-term value. Its economy is already highly integrated with the U.S. economy, and it has strong links to Canada and Mexico, with which it recently concluded a free trade agreement. It suffers a heavy cost burden as the result of dollar/yen fluctuations and is under constant uncertainty about the possibility of a protectionist backlash in the U.S. Congress. All these uncertainties and costs could be eliminated if it joined NAFTA and dollarized. In addition, dollarization would enable Japan to negotiate a conversion value for its dollar assets that would guarantee their long-term worth. For the United States, this deal would marry Japan's surpluses with U.S. deficits and create a dollar zone in trade balance with the rest of the world. It would also serve to keep Japan in the U.S. orbit and prevent it from slipping into China's.

Far from trying to divide the EU, the United States should do its best to unite it and encourage its expansion, along with the broad adoption of the euro as an international currency. For example, the United States might encourage the EU to incorporate not only Turkey but Russia as well. A bigger, stronger EU means a partner with somewhat similar values to share global burdens. A widely used euro means a necessary discipline on U.S. finances but also a more widely engaged EU likely to want to cooperate with Washington on global problems. Every effort should be made to develop NATO into a truly bilateral military force that can enable joint power projection on a global basis. Russia in the EU would guarantee Moscow's future democratic development and eliminate it as a potential threat while also relieving EU dependence on Middle Eastern oil. The EU is a natural partner for the United States: we need to promote that partnership and thereby enhance our influence.

India is special to the United States for several reasons. It is the largest democratic country, and the success of its democracy is important to democracy globally. Its business leaders are already well acclimated to U.S. values and practices. Both economies are based on English common law and can integrate quite easily. Done properly, economic integration can help both countries solve enormous problems. For America, the rising costs of health care and aging might be ameliorated. For India, access to critical technology and know-how could be enhanced. In view of India's positive demographics and likely eventual emergence as the world's biggest economy, development of a close relationship with India could extend and enhance American influence and welfare. The United States should foster a special relationship with India by negotiating a free trade agreement and perhaps eventually inviting India into NAFTA as well.

Right now, however, the most important bilateral relationship in the world is that between the United States and China. It will be a difficult and complex relationship for a long time. It is in America's interest for China to succeed. The most dangerous thing for the world of the future would be a failing China. Imagine a China with hundreds of millions of people desperate to escape upheaval and catastrophe, or a rogue China resembling North Korea. To avoid such scenarios, we must work for China's success. But we must do so with our eyes wide open, recognizing the element of competition between the two countries and keeping U.S. interests clearly in mind. It is of particular importance that China cope successfully with its pollution, energy, and water scarcity problems. Here there is great potential for joint R&D and the application of U.S. technologies and techniques. The U.S. government should propose a couple of major joint projects along these lines.

Long ago as a Swarthmore College student, I listened to Scott Paper Company chairman and Swarthmore benefactor Thomas B. McCabe tell the winners of his scholarship that the purpose of elite institutions of higher learning is to train leaders. Leadership, he emphasized, is what it's all about. I have pondered that statement many times in the intervening forty-five years as I have met a number of world leaders and have asked myself what exactly is leadership. It is good to have intelligent leaders, but intelligence is not leadership. Leaders may be in a position of high office, but all those who obtain these positions are not leaders. Just think of the high officials of 1914, blindly plunging the young men of Europe into the blood bath of World War I. Eloquence is a wonderful gift for a leader, but those who eloquently mouth the conventional wisdom are not leaders.

Essentially, a true leader strives to discover the facts, connect the dots, follow where they lead, and determine how best to face the problem they present, and then shape events and persuade people to embrace the results. Six centuries ago, Portugal's Prince Henry (the Navigator) was bold enough to connect certain dots, to think outside the box and so lead our forebears to the Far East and the New World. We too must think outside the box. The fact that we are now riding a new wave of globalization with 3 billion new surfers presents a unique opportunity for a still powerful America to turn from illusions of empire and exercise the ingenious entrepreneurial leadership that has long characterized it. To do so, we must be mindful of Shakespeare's lines in *Julius Caesar:*

> There is a tide in the affairs of men, which taken at the flood leads on to fortune; omitted, all the voyage of their life is bound in shallows and miseries. On such a full sea

are we now afloat, and we must take the current when it serves, or lose our ventures.