global context. I find myself wondering to what extent the reforms Roberts would like to see instituted are feasible without there being some way to control multinational businesses. Without an enforceable set of international rules, offshore tax havens, constant relocation to secure ever cheaper labor, and profiteering by the few will continue to be the norm.

As Roberts makes clear, laissez faire economics favors the wealthy, who have been effective in installing political and economic policies that benefit themselves and harm others. Before changes can be made, perhaps of a Polanyian sort, the scope and seriousness of the problem needs to be made clear. Roberts’ book is a great tool of education. While The Failure of Laissez Faire Capitalism is replete with redundancies, the net effect of the repetitions is to underscore the seriousness of the problems and the need for reform. This is a powerful book that deserves wide distribution and discussion.

An Appreciative Response to Walter Gulick

Paul Craig Roberts

Keywords: Keynes, Polanyi, globalism, offshoring, short-term profits, regulation capture, economic stimulus.

ABSTRACT

Gulick’s description and analysis of my The Failure of Laissez Faire Capitalism is largely on target, but in this response I point out several of his misperceptions and elaborate on several points made in my book. For instance, I note that Polanyi’s monetary prescription for stimulating the economy is no longer relevant when so many US jobs have moved offshore. Polanyi’s interest in achieving full employment has been replaced by Federal Reserve policies that keep risk-taking banks solvent.

I appreciate Walter Gulick’s excellent review of my book, The Failure of Laissez Faire Capitalism. I would like to take the opportunity that his review presents to clear up some misinterpretations and misperceptions.

It might look on the surface as if “Polanyi’s advocacy of printing money—a lot of it—is exactly what the Federal Reserve Board is doing currently.” However, the differences between Polanyi’s policy prescription and the Fed’s current policy are vast. Indeed, there are no similarities.

On the simplest level, in Polanyi’s policy the central bank does not print money with which to buy the Treasury’s bond issues. There are no bonds. The Treasury itself prints money in lieu of borrowing, just as President Lincoln printed Greenbacks to finance the war to prevent secession.

On the policy level, Polanyi was addressing a situation in which government policy had inadvertently shrunk the supply of money. In the UK it was the government’s decision to return the British pound to pre-war (WWI) parity with gold. Too much new money had been issued for the pound to have pre-war parity and the result of shrinking the money supply to restore parity collapsed employment. In the US the failure of the Federal Reserve to sufficiently expand the supply of money to offset the shrinkage caused by bank failure collapsed employment. (There was no FDIC, so when a bank failed the money supply shrank by the amount of the bank’s deposits).

Polanyi uniquely interpreted J.M. Keynes to mean that the government could use a deficit in its budget to raise the level of overall spending or aggregate demand by printing the money to cover that part of government expenditures that was in excess of tax revenues.

Tradition & Discovery: The Polanyi Society Periodical, 40:2
Keynesians, particularly the American ones, interpreted Keynes to mean that the government would cover its deficit by borrowing. As Keynesians thought the problem was an excess of savings over investment, the borrowing would not raise the interest rate and depress economic activity. In the Keynesian view, there was no role for monetary policy and no need to create new money. Fiscal policy was sufficient.

Milton Friedman later made it clear that both taxation and borrowing from the public reduce private sector spending. For fiscal policy to be effective, it must be accommodated by monetary expansion.

There are other important differences between Polanyi’s policy and the Fed’s current policy. Polanyi’s policy was keyed toward restoring full employment. The Fed’s policy is keyed toward protecting the balance sheets of banks.

“Too big to fail.” The Fed says that its low interest rate policy is for the purpose of stimulating the economy while admitting that it can do little to do so. This is public cover for a policy of supporting bond prices. All debt instruments move together. By driving up the price of Treasury debt, the Fed drives up the prices of the debt-related derivatives on the books of the banks, thus preserving the banks’ solvency.

As I make clear in my book, there is a fundamental difference between the effectiveness of stimulative economic policy in pre-jobs-offshoring times and today. In Polanyi’s time the jobs were still there. All that was needed was a large enough money supply to support full employment. Plants were shuttered, but the work had not been moved to another country. However, today the jobs are moved offshore. As the jobs are moved abroad, stimulative policy cannot put people back into jobs that no longer exist.

Gulick suggests that my solution for bringing offshored jobs back to the US is open to the criticism that it “pays insufficient attention to the global context of business.” Corporations, Gulick suggests, would argue that my proposal “would put them at a competitive disadvantage” and cause them to move their headquarters abroad. Here are a number of interrelated confusions.

Globalism is the context of my book. I point out that globalism, far from being the beneficial expansion of free trade that its advocates pretend, is a mechanism for dispossessing First World labor and for destroying the self-sufficiency of Third World societies by turning their agriculture into monocultures. Globalism is nothing but a process for looting.

I demonstrate that jobs offshoring has nothing whatsoever to do with free trade or with trade of any kind. Jobs offshoring is not the result of comparative advantage or competitive pressures. Jobs offshoring is nothing but labor arbitrage across national borders.

Jobs offshoring was not a response to international competition. It was produced by three factors: (1) the collapse of the Soviet Union which changed the attitudes of India and China to foreign capital, (2) the rise of the high speed Internet that permits tradable professional skills to be distantly performed, and (3) Wall Street’s success in changing business ethics.

The Soviet collapse resulted in vast under-utilized labor supplies in India and China becoming available to First World capital. The low cost of living and the large excess supplies of labor mean that labor can be paid less than its contribution to output. This difference is captured by the offshoring corporations as profit. Offshoring jobs transferred what had been American wages into profits which are distributed as performance bonuses to executives and to shareholders as capital gains.

The high speed Internet allows engineering, design, research, indeed any tradable professional skill to be performed offshore with the results sent in via the Internet.
The former business ethic that corporations have responsibilities to customers, employees, communities, and shareholders was reduced by “shareholder advocates” to responsibilities only to shareholders. Corporations were threatened by Wall Street with takeovers if the firms failed to reduce costs and boost profits by moving operations offshore.

A fundamental tenant of economics is that labor is paid according to its productivity. The reason US wages have been high relative to China, for example, is that US labor, working with abundant capital, modern technology, and business know-how, was much more productive. American labor’s higher wage was justified by American labor’s higher output.

However, when China, for example, gains the same technology and business know-how from the location in China of US plants producing for their home markets in the US, Chinese labor becomes just as productive, but the vast overhang of surplus labor on the labor market suppresses wages. The difference between the value labor adds and the wages paid becomes profit.

Jobs offshoring is not traditional foreign investment. Traditional foreign investment is when a company invests abroad in order to sell in the foreign country, not in order to bring the products back to the home market. Traditional foreign investment can result from a variety of purposes or reasons, such as to avoid transportation costs and to avoid import quotas or tariffs.

Taxing corporations according to where they add value to their product is a way of offsetting the profit advantage of using foreign labor to produce for home markets. Gulick’s suggestion that US corporations might respond to such a method of taxation by departing the US and becoming foreign corporations is not feasible. Most corporations are public entities, and they are registered in the US. The only way that this can be changed is if the US corporation is purchased by a foreign company and the purchase meets with shareholder approval.

In other words, companies cannot pick up and move for tax reasons whenever they wish. However, they can move their production for their home markets and do so when the labor cost savings are larger than the transportation and import costs.

There are many external costs associated with jobs offshoring. Careers for Americans are terminated. US GDP and tax base are given to other countries. The offshored production returns as imports, which increase the trade deficit and erode the value of the US dollar. Under the existing system of corporate taxation, jobs offshoring erodes the domestic economy.

In the US, corporate CEOs are usually in that position for a short period. Most rise to it late in their career. It is during these few years as CEO that they can make their fortune. Consequently, they tend to have a short-term outlook and operate to maximize short-term profits, which can be at the expense of the longer term. They gain from jobs offshoring even though the longer run effect is to destroy the US consumer market and growth performance of the US economy.

Gulick writes that my proposal to “break the connection between CEO pay and short-term profit performance requires intrusion into private transactions.” But this intrusion occurred when Congress put a ceiling of $1 million on executive pay that is deductible as a corporate expense unless it is performance based. Supposedly, this was to keep executives from paying themselves large sums that their performance did not justify.

The consequence of this intrusion has been to focus executives on short-term profit maximization. This manifests itself in ways other than jobs offshoring. They skimp on service. They allow corporate infrastructure to deteriorate. Loyal long-term employees are replaced with short-term contract labor.
Nuclear energy plants store used fuel rods in water tanks inside the reactors, leading to such disasters as Fukushima presents.

Gulick suggests that *The Failure of Laissez Faire Capitalism* can be seen as an attempt to begin the process of recovering a liberal economic policy that Polanyi called for. This is true in part. However, the world today and the accumulating problems are far different from those addressed by Polanyi.

Polanyi’s interest in macroeconomic policy (discussed above) was spurred by his fear that the combination of the failure of Western economic policy with the prestige of Soviet central planning would result in the loss in the West of a spontaneous economic order and lead to harmful restraints on a “society of explorers.” Of course, the seventy-year focus on Soviet planning disappeared with the Soviet Union. The type of planning that I suggest is necessary in order to deal with the fact that resources are finite has nothing in common with the practices and goals of Soviet planning. Foresight is not inconsistent with spontaneous order.

As George Stigler observed several decades ago, government regulatory agencies generally end up captured by the industries that they are supposed to regulate. But corporations can pursue their own interests at the expense of the common interest just as effectively as unregulated entities as they can by capturing the regulatory agencies. So it does not follow that we must not plan for resource scarcity because special interests will capture the plan process. As long as any plan is made public and is not secret, it is possible to perceive when the common interest is being subverted. Indeed, this is one of the main functions of a spontaneous order.

Libertarians especially are perplexed by the title of my book. How, they ask, can “crony capitalism” be equated with the failure of laissez faire? What libertarians fail to perceive is that today’s crony capitalism is the direct result of the deregulation and privatization of the past quarter century in the US, UK, France, and elsewhere. It was the removal of regulation that allowed capitalists to become cronies. Regulation makes it more difficult for capitalists to become cronies even when they capture the regulatory agencies, because regulation makes cronyism illegal, which means that they can be prosecuted. This constraint on behavior is missing in a laissez faire environment.

The Age of Globalism is an age of looting. Countries are beginning to turn away from it. In Greece and Spain there are violent protests to the looting and privatization of their public sectors. The BRICS (Brazil, Russia, India, China, and South Africa) are forming as an alternative to the financial imperialism imposed by the US under cover of globalism. South American countries are finding independent voices. The EU and the euro are in partial disarray. As I write, the “superpower” is shutdown, unable to govern itself, much less establish its hegemony over the rest of the world. The economy, undermined by jobs offshoring, cannot produce a revenue base that can support Washington’s commitments. Washington is showing an inclination to bridge the enormous gap between revenues and expenses by cutting social services and income support programs. The result would further collapse the consumer economy and widen the revenue-expenditure gap. Sooner or later the dollar will lose its reserve currency status, and American power will decline with the dollar.

A different world is waiting to be born. It could be worse or it could be better.