The Trans-Pacific Partnership (TPP) Violates Free-Trade Principles

By

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The Trans-Pacific Partnership (TPP) violates fundamental free-trade principles and should be rejected by those who advocate for honest free trade.

Free Trade Principles:

The essence of free trade is that trading partners should be able to trade lawful goods and services in fully informed voluntary transactions without hindrance or subsidy.

When Adam Smith in his seminal *The Wealth of Nations* circa 1776 and classical economist David Ricardo in his *On the Principles of Political Economy and Taxation* circa 1817 posited the benefits of comparative advantage and free trade, the understanding was that "*exports will pay for imports*": that one was trading value for value, i.e., work for work. [Emphasis added] What could be unfair about that?

The overriding benefit of free trade is that it facilitates the division of labor and improves the standard of living of all concerned.

How is it that the principles put forth by Smith and Ricardo, which appear to be timeless and made perfect sense for nearly 200 years, are now decimating U.S. manufacturing and other industries?

Free-trade and fiat, a.k.a. make-believe, money are incompatible:

When Smith and Ricardo were advocating for free trade, the world's monetary system was based on gold and silver coin, not legal tender irredeemable paper-ticket-electronic money, the kind of money we have now.

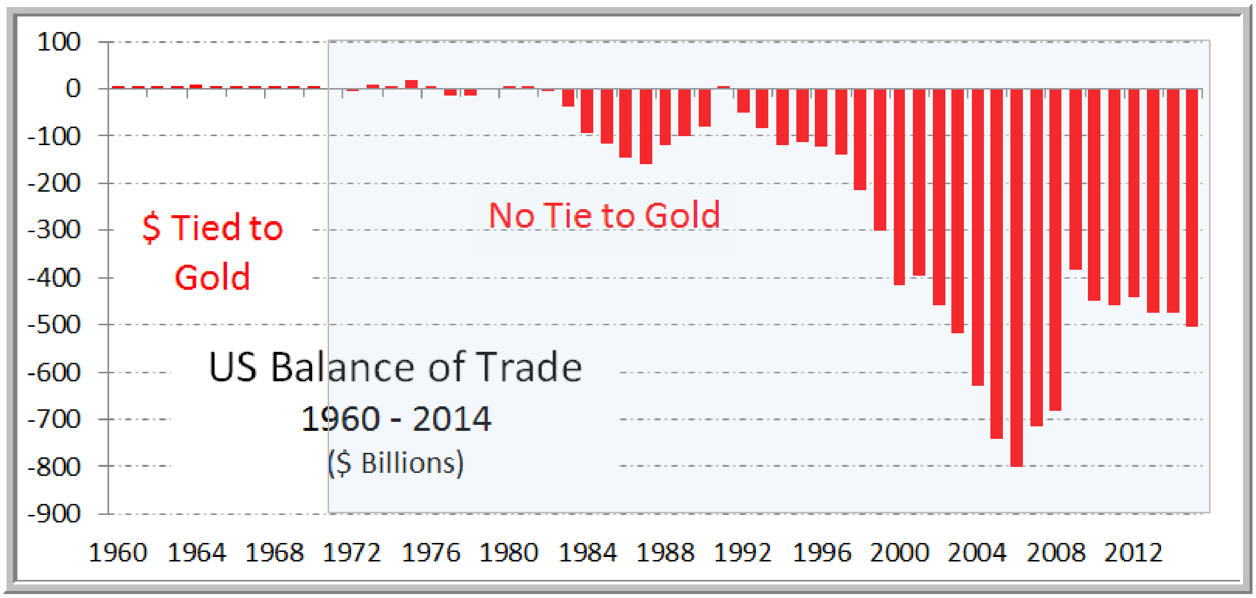
Two plots below show the resulting trade deficits and cumulative trade deficit after gold was completely removed from the U.S. monetary system in 1971. At that time, the U.S. substituted a make-believe-money, a.k.a., a fiat, monetary system. We no longer have free trade as contemplated by Adam Smith and David Ricardo, because we are not trading work-for-work or value-for-value. How much more work does it take to print a $100 bill as compared to a $1 bill?

As more fully explained below, because our monetary system is *prima facie* bogus, it is a misrepresentation to call the current incarnation of globalization and the proposed TPP free trade.

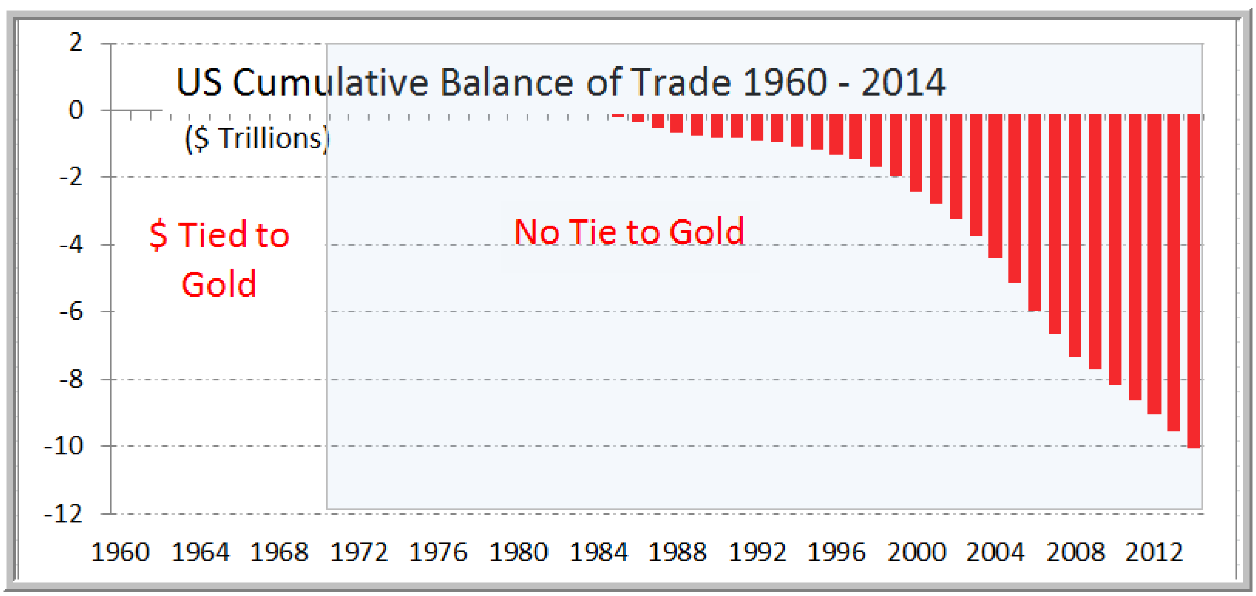
Specifically, it contradicts Ricardo's dictum that "*exports will pay for imports*." Sending electronic blips or legal tender irredeemable paper-ticket money abroad are not exports.

With honest free trade, when one imports tangible items, intellectual property or services from abroad, one needs to export tangible items, intellectual property or services in return. Otherwise, there is no real trade.

The transfer of what are now called "dollars," either as numbers printed on a piece of paper or an electronic blip from a computer, do not complete the trade until they are exchanged for tangible items, intellectual property or services.



Plot 1: United States Balance of Trade, 1960 – 2014 ($ Billions)
Source: U.S. Bureau of Economic Analysis



Plot 2: United States Cumulative Balance of Trade, 1960 – 2014 ($ Trillions)
Source: U.S. Bureau of Economic Analysis

Some claim that our now make-believe-money sent abroad comes back to the U.S. to be invested in U.S. Government bonds and securities denominated in dollars. So what? That, again, does not constitute trade. But what about when foreigners purchase, dismantle and ship entire factories back home? Something is generally wrong with this transaction genre.

No one in their right mind would trade capital goods for consumer goods. The analogy is a workman trading his tools for Nike running shoes. Where would he be without his tools when the running shoes wear out?

Thus far, the hoped-for remedy for underpriced imports for many U.S. manufacturing companies has been to move their operations to foreign shores, e.g., China. Whole industries, e.g., shoe manufacturing, microwave ovens, televisions, textiles, and a good part of other industries, e.g., machine tools, furniture, garments, etc. have moved offshore.

Millions of good-paying manufacturing jobs have been lost. The skill sets associated with those jobs have been also been lost. In addition to the unfathomable hardship on the affected workers, their families and their communities, in many cases there are national security issues at stake.

<u>How free-trade became perverted</u>:

Prior to August 1971, so-called "dollars" sent to foreigners in exchange for their goods and services were, by a United States Senate ratified treaty, the *Bretton Woods Agreement*, redeemable for gold at the rate of $35 for an ounce of gold.

Arguably these "dollars" were receipts for gold with the counterparty being the United States Treasury. Foreigners trusted the United States Government to honor its promises. Those promises were not honored.

Here is the progression of how the promises defaulted:

<table>
<tr><td>This is silver money. It is in fact and in law a one dollar coin as provided for by the Coinage Act of 1792. It is in conformity with the dollar referred to in the 7th Amendment to the Constitution.</td><td>
</td></tr>
<tr><td>This is not a dollar. It is a promise to pay a dollar. (The words under Washington's image read: "Will Pay To The Bearer On Demand ONE DOLLAR")</td><td>
</td></tr>
<tr><td>This is a broken promise to pay a dollar. (The phrase under Washington's image "ONE DOLLAR" is a misrepresentation. This is neither in fact nor in law a dollar. Even though it says NOTE, it is not a promissory note.)</td><td>
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</table>

What we are now “paying” for our imports and what the TPP if passed will further legitimatize are not in conformity with free-trade principles.

Moreover, broken promises to pay money cannot retain purchasing power. The history of legal tender irredeemable paper-ticket-electronic money is that its purchasing power always approaches the cost of producing paper money: near zero. For electronic blips it is zero!

Foreigners who exported to the U.S. tangible items, intellectual property and services will end up with an empty bag. Some suggest that U.S. consumers have benefited from paying less for foreign-originated goods and services. In addition, cheaper goods from overseas reduced pricing power for domestic producers, thereby benefiting consumers even more. In the near term, this is true.

In fact U.S. consumers have been inadvertent parties to transactions that will be seen to have cheated foreigners. Importantly, by allowing this system to continue, U.S. consumers will pay a very high price: savers and pensioners will be wiped out.

For myriad reasons, this must be fixed. Domestic manufacturers have been the early victims of this system. Not being mindful of how our monetary system has been transformed—there is not a university in the country that teaches anything about this, and almost all of the key concepts have been removed from textbooks—as the empirical evidence has demonstrated, not beyond a reasonable doubt, but beyond doubt, quotas, tariffs, anti-dumping regulations, lawsuits and the like have not, and will not, do the job.

This is <u>not</u> a matter of monetary <u>policy</u>, as the National Association of Manufacturers found out about twelve years ago when Paul O’Neill was our Secretary of the Treasury. At that time, the NAM sponsored The Sound Dollar Committee. Its only remit was to convince Treasury to coerce foreign nations to stop alleged currency manipulation.

It was, and remains, beyond Treasury’s ability to do that. The fact of the matter is that our current monetary system is unstable, unauthorized (by the *Constitution*), and dishonest. There is nothing manufacturers or Labor can to do that will deliver relief within this system.

The cumulative trade deficit today, about $10 trillion [no typo], would not have been possible if we had an honest monetary system, one that is in compliance with the *Constitution*. Imagine what would have been, and would be, the employment level, standard of living, pension funding levels, etc. if we had produced an *additional* $10 trillion worth of goods and services over the period. It would be a different world.

Notice on *Chart 2* how there was virtually <u>no cumulative trade deficit</u> prior to President Nixon unilaterally abrogating the *Bretton Woods Agreement*. After the treaty was defaulted—Nixon called it “closing the gold window”, “temporarily,” he said—the cumulative trade deficit accelerated to a heretofore unimaginable amount.

A tipoff that international trade is not being properly conducted is that the number range “trillions” is reserved for astronomy, not finance.

<u>The Remedy</u>:

The remedy for Labor and for manufacturers to defend against underpriced imports, for manufacturers generally to eliminate trade deficits, and to bring manufacturing back to the U.S. is to reform our monetary <u>*structure*</u>.

Ironically, the NAM was on the right track with its call to rid the world of currency manipulation. Former Chairman of the Board of Governors of the Federal Reserve Paul Volcker supplied the solution. He declared:

> “A global economy requires a global currency.”

A global currency will level the playing field. All trade participants will be trading with the same deck of cards. A monetary system that is stable, honest, and, at least for the U.S., in conformity with the *Constitution*, will provide the basis for expanding free trade as never before.

The challenge is to decide what the global currency should be. Two key issues are: (1) the criteria for the global currency; and, (2) who should decide what the criteria should be.

My view is that there should be three principles guiding criteria selection: (1) full disclosure of all material information about the proposed money; (2) no misrepresentations about the proposed money; and, (3) no one should be forced to use it, i.e., all transactions should be voluntary. It follows that the global currency should not be “legal tender.”

The decision makers should be those who *use* the monetary system for transferring wealth over space and time: (1) those engaged in productive enterprise generally, i.e., producers of goods and nonfinancial services including especially large multi-national corporations; (2) savers, annuitants, pensioners; (3) small countries; (4) Organized Labor, etc.

Those whose primary role is *performing* financial transactions, i.e., financial sector participants along with their “experts,” should not participate, because they have an unacceptable conflict of interests with producers, Labor and almost everyone else.

The financial sector produces no final product. It is only a *facilitator* of financial transactions that are necessary for the production and distribution of goods and services and for transferring wealth over time.

The costs of financial transactions are properly understood as friction. Producers of goods and services along with consumers want a monetary system that will *minimize* financial transaction costs, while the financial sector seeks to increase them.

Up until now, the *structure* of the world’s monetary system has been left to the financial sector. It is understandable, but not acceptable, that financial sector participants have rigged that structure for their own benefit and to the detriment of everyone else.

The conflict is that producers of goods and services, savers, pensioners, Labor, and ordinary people everywhere seek a monetary system that is stable and honest. The financial sector does not want a stable system. Because it pulls so much profit out of the system trading, *it seeks volatility*. Further, as the empirical evidence confirms, provided financial sector participants stay within the bounds of legislation, honesty is a non-issue.

Importantly, when it comes to financial legislation, the financial sector has coopted U.S. lawmakers. For example, as U.S. Senator Dick Durbin, 30 years in the Senate and former Senate Minority Whip, in a candid moment confessed: “The banks own the Congress.” I have the clip, and it is quoted in *Act of Congress: How America's Essential Institution Works, and How It Doesn't* by Robert Kaiser, former managing editor of the *Washington Post*.

After the criteria and recommendations for reforming the monetary system have been determined, those with a stake in the system shall lobby their governments to implement the system. No doubt at this time financial sector participants will weigh in, but at this point all of the relevant considerations will be on the table for all to see. Hopefully politicians will cease allowing financial sector participants special privileges/subsidies and uphold and defend the *Constitution*, as they are all sworn to do.

This is not a call for a return to the so-called gold standard, which this author advocates against (see: Six Reasons Why Promoting the Gold Standard is a Mistake). The answer at least in the U.S. is to reform our monetary structure to be in conformity with the *Constitution*, i.e., the rule of law, something Republicans claim to be in sympathy with.

At the same time, Democrats, who claim to be in sympathy with the inequities that have been inflicted upon workers, should also implement reforming our monetary system.

After a stable and honest monetary system is adopted, real free trade along with all of its concomitant benefits will be universally embraced. Meanwhile, the TPP should be firmly rejected.

Further information about a possible legislative monetary remedy can be found here:

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