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An Auto Bailout Would Be Terrible for Free Trade:

Does anyone really expect other countries to ignore our subsidies?

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Congress is now considering a federal bailout for America's Big Three automobile companies. Many want to grant them at least $25 billion from the $700 billion Troubled Asset Relief Program on top of $25 billion in low-interest loans approved earlier this year.

But these figures represent only a fraction of what the total cost of the bailout could be. In a global economy, a federal bailout of the automotive industry could cost Americans jobs as well as foreign markets to trade in. There are at least three important ways an industry bailout could damage America's engagement in the global economy and hurt U.S. companies, workers and taxpayers.

The first global cost of a bailout could be less foreign direct investment (FDI) coming into the United States. On Sunday, President-elect Barack Obama asked, "What does a sustainable U.S. auto industry look like?"

Well, it looks a lot like the automotive industry run by "foreign" car companies that insource jobs into the U.S. In 2006 these foreign auto makers (multinational auto or auto-parts companies that are headquartered outside of the U.S.) employed 402,800 Americans. The average annual compensation for these employees was $63,538.

At the head of the line of sustainable auto companies stands Toyota. In its 2008 fiscal year, it earned a remarkable $17.1 billion world-wide and assembled 1.66 million motor vehicles in North America. Toyota has production facilities in seven states and R&D facilities in three others. Honda, another sustainable auto company, operates in five states and earned $6 billion in net income in 2008. In contrast, General Motors lost $38.7 billion last year.

Across all industries in 2006, insourcing companies registered $2.8 trillion in U.S. sales while employing 5.3 million Americans and paying them $364 billion in compensation. But as the world has grown smaller, today the U.S. faces increasingly stiff competition to attract and retain insourcing companies. Indeed, the U.S. share of global FDI inflows has already fallen. From 2003-2005 the U.S. received 16% of global FDI. That's down from 31.5% it received in 1988-1990.

Will fewer companies look to insource into America if the federal government is willing to bail out their domestic competitors?

The answer is an obvious yes. Ironically, proponents of a bailout say saving Detroit is necessary to protect the U.S. manufacturing base. But too many such bailouts could erode the number of manufacturers willing to invest here.

The bailout's second global cost could hit U.S.-headquartered companies that run multinational businesses. In total, these companies employ more than 22 million Americans and account for a remarkable 75.8% of all private-sector R&D in the U.S. Their success depends on their ability to access foreign customers. They do this

two ways. They export goods from their U.S. parent companies. And they sell goods locally through foreign affiliates. These foreign affiliates are built by direct investment of American companies in other countries. In 2006, U.S. parent companies exported $495.1 billion to foreign markets. That same year their majority-owned affiliates earned over $4.1 trillion in sales -- $8.33 for every $1 in exports.

This access to foreign markets has been good for America. But it won't necessarily continue. The policy environment abroad is growing more protectionist. Multilateral efforts to liberalize trade in the Doha Development Round died in July with no prospects for restarting. Even more worrisome are rising FDI barriers. In 2005 and 2006, the United Nations reported a record number of new FDI restrictions around the world -- even in major recipient countries such as China, Germany and Japan.

Will a U.S.-government bailout go ignored by policy makers abroad?

No. A bailout will likely entrench and expand protectionist practices across the globe, and thus erode the foreign sales and competitiveness of U.S. multinationals. And that would reduce these companies' U.S. employment, R&D and related activities. That would be bad for America.

Rising trade barriers would also hurt the Big Three, all of which are multinational corporations that depend on foreign markets. In 2007, GM produced more motor vehicles outside North America than in -- 5.02 million, or 54% of its world-wide total. That year in China, the world's second-largest and fastest-growing automobile market by volume, GM continued to lead in market share and became the first global auto maker to surpass the one-million mark in single-year unit sales in China.

The bailout's third global cost could fall on the U.S. dollar. For 32 years the U.S. has run trade deficits and offset it with sales of U.S. assets to foreign buyers. A critical foundation of foreign-investor confidence in U.S. assets has been transparent competition in our product markets -- competition that spurs economic growth and rising average standards of living. To keep that up, it is important to address concerns related to allowing foreign companies to compete on U.S. soil, not by bailing out struggling companies but by taking care of workers who are dislocated in the give-and-take of a competitive market.

Will a federal bailout that politicizes American markets bolster foreign-investor demand for U.S. assets?

Not likely. Instead, America runs the risk of creating the kind of "political-risk premium" that investors have long placed on other countries -- and that would reduce demand for U.S. assets and thereby the value of the U.S. dollar.

Reduced foreign demand for U.S. assets would be troubling at any time. Its prospect is especially troubling now, when the federal government's fiscal 2009 deficit is widely forecast to reach something near or exceeding $1 trillion -- up from $456 billion last year. With net saving still near zero for U.S. households and falling profits for U.S. companies, financing that deficit will require attracting foreign capital.

This week Congress is weighing the cost of the bailout. Let us hope that lawmakers realize that the true cost of such a bailout is far larger than any check the U.S. Treasury will have to write in the coming months.

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