

# AMERICA AND THE WORLD ECONOMY

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The United States, like all countries, is part of a world economy fraught with danger and rich in potential. Foreign competition can drive wages down, force factories to close, push companies out of business. Foreign markets and investments can create jobs, raise incomes, and boost profits. The contradiction between the attractions of international markets and the threat of international competition is central to most debates over international economic policy. In the United States, this contradiction has often given rise to bitter battles. Americans who have little direct or indirect contact with the world economy are indifferent to it, and therefore want to see political energies put into domestic policy; those with links to world trade and payments are passionate about its significance for our own economy.

The characteristics of supporters and opponents of greater integration of the United States into the world economy have changed over the centuries. Those drawn toward overseas markets, sources of supply or capital, or investment opportunities have advocated greater economic openness—whether they were cotton plantation owners, multinational corporations, or international banks. Those faced by foreign competition have favored relative closure—whether they were domestic manufacturers, affected workers, or dairy farmers.

The issues, too, have changed. When the United States was an underdeveloped debtor country, most debate was over whether and how the country should honor its debts to foreigners. As it became the world's leading creditor, the debate shifted to how the country should treat its debtors. As it regained its position as the world's largest debtor, controversy erupted over the causes and implications of the renewed reliance on foreign capital. Attachment to the gold or silver standard, free trade or protection, international economic engagement or isolation, have all motivated great conflict at one time or another. Battles over the country's position within the world economy have run like a red thread through the development

of the American political economy. The twentieth century is no exception.

## HISTORICAL BACKGROUND

For nearly the first century of its existence, the United States exported raw materials to Europe, especially cotton to England, and imported manufactured goods from Europe. In the years before the Civil War, the principal political division over foreign economic policy was between the export-led cotton South, on the one hand, and the industrializing Northeast, on the other. Southern agriculturalists wanted access to foreign markets and foreign goods; northern manufacturers wanted protection from foreign products. The tariff pendulum swung back and forth for decades.

From the first days of the Civil War until well into the twentieth century, the United States imposed high tariffs on a wide range of manufactured imports. As industry grew up behind high tariff walls, however, agriculture and mining were unprotected and indeed relied heavily on exports. Even after the Civil War, political battles over the tariff tended to pit the agrarian and mining South and West against the industrial Northeast and Midwest.

A second great divide of the era, known then as the Money Question, also had major international components. In the nineteenth century, America's leading commercial and financial interests were tightly tied to world trade and payments. The import-export business was central to America's ports and to the shipping, insurance, and trade they managed. The country's leading financiers were heavily involved in attracting foreign capital for investment in the United States, which was the world's leading borrower throughout the century. As international trade and investment were organized around the gold standard, all those involved in managing the nation's foreign commerce and finance supported American adherence to gold.

However, businessmen and farmers in the interior had little use for the gold standard. They were primarily concerned with the declining prices of their products and the high cost of borrowing, both of which were in some measure a result of the dollar's tie to gold. Farm prices, set on world markets, were falling; interest rates, set in London, were high. To use today's terms, farmers wanted a devaluation of the dollar to raise the dollar price of the wheat and cotton they produced; borrowers wanted a floating dollar that would unlink American from British interest rates. Whether as greenbackers, silverites, or Populists, farmers and others resented economic conditions they believed were imposed from abroad.

Both tariffs and gold were at the center of American politics from the Civil War until the 1896 presidential election decided the matter. In that year, a coalition of pro tariff Midwesterners and pro gold Northeasterners led by Republican William McKinley squared off against anti tariff, anti gold farmers and miners in the South and West enthused by the populism of Democrat William Jennings Bryan. McKinley's victory marked the triumph of a combination of protectionism and financial conservatism.

### EXPANSION AND EMPIRE

With gold and protection firmly ensconced, America's business leaders turned their attention to other problems. Foremost among these was the need to secure export markets for the country's burgeoning industrial output. By the 1890s, indeed, the United States was far and away the world's leading manufacturing nation, and despite continued demands for protection many American industries were internationally competitive. Satisfaction was tempered, however, by the experience of depressed business conditions between 1893 and 1897. In its wake many business and political leaders regarded future prosperity as at least in part dependent upon overseas sales of American manufactures and importation of inexpensive foreign raw materials to fuel American industry.

Heightened business interest in the rest of the world coincided with the rise of the "Power School" of American diplomatic thinkers, led by Elihu Root, Henry Cabot Lodge, and Theodore Roosevelt. For them, with the frontier closed and the country industrialized, the next step for the United States was to establish itself as a major diplomatic power. This required a larger military, especially a navy, and the definition and protection of spheres of military and economic influence. Economic and diplomatic con-

cerns came together in the last years of the nineteenth century.

As in other industrial countries at the time, U.S. manufacturers of certain products were obsessed with the prospects of opening new markets, or getting into existing ones, abroad. In the American context, most attention turned to Asia and Latin America because European markets were primarily satisfied by European production, especially as trade protection in Europe increased. Much of the rest of the world was divided into colonial empires, which tended to have explicit or implicit preferential trading and investment ties with their mother countries. The race for China, however, was still in progress, and American businessmen stood a chance of procuring a share of the world's most populous market. In an attempt to secure America's place, Secretary of State John Hay issued a series of open door notes in 1899 and 1900, asserting the right of all nations to Chinese trade and investment opportunities. For a decade thereafter, until the Chinese empire collapsed into revolution, American businessmen and policymakers tried to force their way into railroad projects, financial consortia, and other commercial endeavors, with mixed success. But the United States had established its economic position in Asia, and its Philippine colony helped reinforce its claim to status as both a diplomatic and an economic power.

The Spanish-American War of 1898 projected American military might into areas of economic interest to American businesses. The peace treaty gave the Philippines, Puerto Rico, and Guam to the United States; Cuba became a de facto American protectorate; and Hawaii was annexed during the war. The new Asian possessions helped establish the nation's claim to be one among the many imperial players there. The Caribbean outposts served as beachheads in making the region an American sphere of influence.

Even as American diplomats and financiers argued for an open door in China, they had plans to reserve the Caribbean basin for the United States. The nations surrounding the Caribbean, and the islands in it, had long attracted the intrigue of European powers. With some exceptions, their intrinsic economic importance was slight, but they could affect strategic control of shipping in the area—especially if a transisthmian canal, under discussion for decades, were built.

As soon as the Spanish-American War ended, the McKinley administration began plans for an American canal in Central America. Diplomatic obstacles from the British were overcome, and the reti-

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cence of the Colombian government was sidestepped by the American-encouraged secession of the Colombian province of Panama. By 1904 the Panama Canal was being built. At the end of the year, the American president enunciated the Roosevelt Corollary to the Monroe Doctrine, asserting American rights to intervene in the Western Hemisphere in the event of "chronic wrongdoing, or an impotence which results in a general loosening of the ties of civilized society."

American concern to secure the Caribbean was only indirectly economic in motivation. Certainly Mexico was commercially significant, and Cuba and Venezuela had potential, but the region as a whole was no financial prize. However, constant European intervention in an area close to the United States was threatening—especially in 1914 with the Canal in place—and the Caribbean basin might be a stepping stone to the economically much more important South American republics. The principal American goal, then, was to supplant the Europeans in the area surrounding the Caribbean.

Although the chronologies and details varied, the typical Caribbean application of what was called Dollar Diplomacy used a combination of financial and military means. Typically, American investors bought out European financial and commercial interests, while the U.S. government encouraged new American investments and trade, especially government loans. The threat or reality of American military force helped stabilize local politics. By the 1920s, the United States owned Puerto Rico, the Virgin Islands, and the Canal Zone, exercised significant rights over Cuba, and had intervened militarily in the Dominican Republic, Haiti, Honduras, and Nicaragua. The Caribbean was an American lake (see map 13 in the article "World Regions" in this volume).

The era of frequent American military intervention in Central America and the Caribbean lasted until the early 1930s. It is almost certainly the case that the proximate causes of intervention were primarily military and political rather than economic. Nonetheless, American resident investors in the region did sometimes encourage their home country to send troops. More generally, strategic concerns about the Caribbean basin had economic dimensions: most policymakers and businessmen believed that American economic interests were linked to American diplomatic influence. They saw hegemony in the Caribbean as crucial to a broader role in the world.

American involvement in the Caribbean and Asia was not universally supported. Some Americans

found cause for moral indignation in America's pursuit of quasi-colonial goals. Others simply felt that attention paid to foreign matters detracted from resolving problems at home. Foremost among the latter were many former supporters of the populist movement, whose anti-imperialism was more isolationist than internationalist. Nonetheless, it was difficult even for those who opposed intervention in principle to avoid it in practice, as Woodrow Wilson and the Democrats—including Secretary of State William Jennings Bryan—found when they took office in 1913. Conditions in the Caribbean area were so unsettled that the temptation to try, as Wilson put it, to "teach the South American Republics to elect good men" was sometimes irresistible, and Wilson oversaw a real upsurge in "gunboat diplomacy" during his two terms.

Other economic policies also evolved in the years before World War I. Exports, especially to Latin America, grew in importance, and the government paid increasing attention to helping American firms supplant European ones in competition for third markets. As the nation's trade expanded, interest in reducing American tariffs grew: exporters worried about retaliation, and more domestic producers wanted access to inexpensive imports.

The movement for "tariff reform," principally a reduction in import barriers, gathered support in the early years of the century. The 1909 Payne-Aldrich Tariff, enacted by the traditionally high-tariff Republicans, undertook a modest reduction in duties. After the Democrats swept the 1912 elections, they implemented their low-tariff ideas in the form of the 1913 Underwood tariff, which brought trade barriers down to their lowest levels since the Civil War.

By the eve of World War I, the country's economic growth had brought about important changes in its international economic relations. Manufactured and semimanufactured products went from only one-fifth of total exports in 1890 to one-half in 1914, while non-European markets similarly increased their importance from one-fifth to one-half of American exports in the same time period. From a major international borrower, the United States had become an overseas lender and investor. By 1914, American corporations had about \$2.5 billion in foreign direct investments ranging from plantations and oil fields to manufacturing plants. Americans had also lent a billion dollars to foreigners, a turnaround from the country's longstanding reliance on foreign borrowing of its own. While total American foreign investments of about \$3.5 billion in 1914 were small by European standards—the United Kingdom's overseas assets

were approximately six times this size—they demonstrated the ability of American firms to compete in the international economy.

### WORLD WAR I AND ITS AFTERMATH

The Great War drew the United States into the world economy with a vengeance. The country emerged from the war in a position of unchallenged international economic leadership, both because of the devastation of Europe and because of the extraordinary growth of the U.S. economy in wartime. However, America's politics and policies lagged behind its economic evolution, as resistance to international involvement persisted.

Almost as soon as the war broke out, American farms and factories began supplying the Allies (the Central Powers were effectively blockaded by the British Navy). Armaments exports went from \$40 million in 1914 to \$1.3 billion in 1916, while total exports went from \$2.4 billion to \$5.5 billion. Initially, the Europeans paid for their purchases by selling off their investments in the United States, but soon funds ran out. At that point, after some wavering about the implications of lending to only one side (and the resignation of Secretary of State William Jennings Bryan in protest), the government allowed private bankers to advance the Allies the money necessary to buy what they needed in the United States. By the time of U.S. entry, Americans had lent \$2.6 billion, primarily to the French and British. J. P. Morgan and Company was the principal manager of the credits and served as purchasing agent for the Allies. After the United States declared war on the Central Powers, private investors were replaced by \$9.6 billion in government-to-government loans from America to Europe.

As American economic ties with Europe grew, so too did trade and investment interests in Latin America and other developing regions. European competitors were retired from the scene, preoccupied with events at home. In many instances, they were forced to sell off investments in developing countries to pay for raw materials, food, and war matériel. American businesses stepped quickly into the vacuum, supplanting European manufacturers, lenders, and investors throughout the developing world—even in some European colonies.

By about 1924, wartime conditions were over, and the United States was firmly ensconced as the world's principal trader, lender, and investor. However, American political commitment to the rest of the world was far less substantial than its economic

interests. Almost as soon as American troops arrived home, public sentiment retreated from overseas affairs, and those with foreign economic concerns lost political influence. American signature of the Versailles Treaty and participation in the League of Nations, based on Woodrow Wilson's hopes and ideals, were defeated by domestic political resistance to overseas involvement.

With the war over, the American body politic separated into "internationalists," "isolationists," and a large number who were apathetic toward the whole subject. The former wanted the nation to play a leading role in world political and economic affairs: to sign the Treaty, join the League, reduce trade barriers, and cooperate with other economic powers. Support for internationalism was especially strong among those heavily involved in the world economy, such as northeastern banks and corporations and southern producers of export crops. Isolationism was particularly powerful in the more insular Midwest, where many industrial and agricultural producers depended primarily on the domestic market and feared foreign competition. They preferred diplomatic disengagement and trade protection, in order to resolve domestic economic problems.

Wilson and his internationalist allies lost the battle for the League of Nations, and the mostly isolationist Republicans swept the 1920 election. With isolationism ascendant, official participation in international economic organizations was largely ruled out. Congress would not agree to any substantial American involvement in the sorts of cooperative agreements that Wilson and his supporters had envisioned.

In trade policy, too, the movement toward commercial liberalization undertaken before World War I was reversed after the war. With Republicans back in control of the White House and Congress, American tariffs were raised in 1921 and 1922. Many business and political leaders expressed a desire to restrict American lending and investment abroad. Even as American producers, traders, and investors came to dominate the world economy, U.S. government involvement in international economic affairs was strictly limited.

### THE INTERWAR YEARS

The conflict between America's central position in the world economy and its reluctance to play a corresponding diplomatic role defined much of the interwar period. The ambivalence of American policy contributed to instability of the world economy in

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the 1920s, and exacerbated the impact of the Great Depression in the 1930s.

However, the American private sector remained central to the world economy in the 1920s. American foreign direct investment reached \$7.9 billion in 1929, while foreign loans outstanding topped \$8.1 billion. The European economies, along with those of many developing countries, were fueled by American capital and access to the enormous American market.

Private American bankers and businessmen themselves were heavily involved in designing and implementing a series of stabilization programs in Europe. The most famous of these were the Dawes and Young plans in Germany, put in place in 1924 and 1929 respectively, but similar schemes were developed elsewhere. The general pattern involved a loan from American private bankers, typically led by Morgan and Company, as well as from central bankers in Britain and France. The loans normally carried with them promises from borrowing governments to implement a series of economic reforms, such as reducing budget deficits and inflation. In some instances, foreign supervisors were appointed to monitor compliance with the terms of the loans. Although such foreign control grated on nationalist sensibilities, in return for good behavior countries could expect access to the capital and lucrative markets of North America and Western Europe.

As important as American private businesses may have been to European reconstruction, their support was often undermined by the indifference or hostility of the United States government. To be sure, some in the government were sympathetic to demands that the United States become more active. Officials from the State Department, the Treasury, and the Federal Reserve sometimes assisted behind the scenes as American bankers or businessmen worked out stabilization loans.

However, American economic policy was often at cross-purposes with the activities of American businesses abroad. Perhaps the thorniest issue of the era was the war debts and reparations tangle. The U.S. government was owed about \$10 billion by the Allies, lent during and right after the war. The Allies (principally France, Britain, and Belgium) were in turn owed billions in reparations by the defeated Germans. Both sets of debts tended to dampen economic recovery and to fuel nationalist resentments. Internationalists on both sides of the Atlantic felt the logical solution was for the U.S. to cancel or substantially reduce the war debts, thus allowing the Allies to cancel or substantially reduce reparations

demands. But American isolationists would not hear of forgiving debts owed to American taxpayers simply to placate the passions of unreasonable Europeans, and so the issue festered.

Refusal by the United States to contemplate war-debt reduction exacerbated conflict in Europe. High American tariffs impeded exports to the United States, making it more difficult for Europeans to earn the dollars to service their debts. American unwillingness to join the League and other international organizations weakened attempts to forge cooperative monetary, trade, and investment relationships.

American economic policymakers found themselves torn. On the one hand, they recognized that U.S. policies had a profound impact on the world economy and that world economic trends could in turn affect the American economy. This gave them ample reason to take into account the international impact of what was done within America's borders. On the other hand, most Americans were indifferent or hostile to anything that smacked of subordinating American economic interests to global considerations. This made it difficult for policymakers to balance the demands of the world's largest economy with domestic concerns.

In monetary policy, for example, the new Federal Reserve System (Fed) was continually torn between foreign and domestic pressures. Low interest rates in the United States might stimulate the U.S. economy, but they also led foreigners to sell dollars, which endangered the dollar's position at the center of the international monetary system. Higher American interest rates stabilized the dollar, but dampened American economic growth. Throughout the 1920s, the Fed was driven back and forth between demands for a tight monetary policy to maintain the dollar as the anchor of the international economy and demands for a looser monetary policy to encourage American growth.

The inconstancy of American economic policy almost certainly exacerbated the Great Depression. Between 1928 and 1933, the Fed was buffeted by conflicting demands. When it lowered interest rates to stimulate the U.S. economy, the dollar came under attack. When it raised interest rates to defend the dollar (or to stanch speculation on Wall Street) it dampened recovery at home, and drained funds from foreigners in desperate need of new loans.

On another front, as the Depression hit, the United States substantially raised trade barriers. The Smoot-Hawley tariff of 1930 raised the average tariff on dutiable imports to its highest level in American

history. Increased American protectionism may have contributed to retaliation from other countries and to a world trade war that brought international commerce, too, nearly to a standstill.

When the Roosevelt administration took office in March 1933 both the world and the American economies were in dire straits. Britain had gone off the gold standard to devalue the pound sterling and was refocusing its international economic activities on its Empire. Trade wars were breaking out among the world's commercial leaders, exacerbated by rounds of competitive currency devaluations. Most of the countries to which American bankers had extended loans had defaulted on their payments. All over the world, the global crisis was helping bring to power nationalists who blamed foreigners for their peoples' tribulations.

The situation in the United States was as bad as, or worse than, that abroad. In his first few months in office, Roosevelt chose to downplay international initiatives and concentrate on the domestic economy. In July 1933, despite his traditional association with internationalism, Roosevelt broke up an international economic conference in London, arguing for the primacy of national policies. A few months later, the new administration began devaluing the dollar to make American goods more competitive on world markets. Whatever hopes the internationalists may have had were dashed.

But Roosevelt soon began showing interest in additional international cooperation. Secretary of State Cordell Hull was indeed a strong free trader, and in June 1934 Congress responded to Hull's demands to pass a Reciprocal Trade Agreements Act that allowed the president to negotiate tariff reductions with other countries. While the actual impact of the Act is controversial, it took trade policy one step away from Congress, and may have imparted a less protectionist orientation to it. Meanwhile, the dollar had stabilized and the administration began working with the British and French on international monetary cooperation. These negotiations culminated in the Tripartite Agreement of 1936, which brought the dollar, the pound, and the franc back onto a gold exchange standard.

While most attention centered on relations with other industrial countries, American interests in the developing world, especially Latin America, grew apace. Originally, defaults by Latin American debtors were the cause of considerable tension. However, the era of gunboat diplomacy was over, and a new age, dubbed by Roosevelt that of the Good Neighbor, had begun. By the late 1920s, indeed, the experience

of the Mexican Revolution and the maturation of American economic interests in Latin America had led to a rethinking of traditional U.S. policy. Intervention appeared far less effective in such large, relatively advanced countries as Mexico or Brazil than it had been in Haiti or the Dominican Republic. The typical American economic interest in the region was no longer a banana plantation but an automobile plant or a private loan, and these were much harder to protect with the Marines. Meanwhile, European competition had diminished greatly.

When Latin American governments, and those of a few other developing countries, defaulted on their debts in the 1930s, the U.S. government essentially stepped aside. It did try to facilitate renegotiations, and to ensure that markets were opened to American exporters and investors. When the Mexican government nationalized American oil properties in 1938, the United States protested vigorously. But military intervention in the Third World was no longer considered a routine option.

By the late 1930s, halting moves toward renewed international economic cooperation were overtaken by diplomatic crises in Europe and Asia. Even before the shooting began, American planners began thinking about the sort of world they might like to build after the war. In leading circles, internationalism appeared vindicated by the disasters of the 1930s. Internationalist businessmen and policymakers resolved not to repeat the mistakes of American retrenchment after World War I.

### BRETTON WOODS AND EUROPEAN RECONSTRUCTION

Even before the United States entered World War II, it made clear to its eventual allies that it had war goals with important international economic components. The Atlantic Charter of August 1941 committed the United States and Great Britain to some form of freer trade after the war, much to the chagrin of British supporters of the Imperial Preference System, a series of trade barriers around the British empire. Pressures on the Allies to abandon barriers to American trade and investment continued with the Lend-Lease agreements.

The implementation of postwar plans began in earnest at an Allied conference in Bretton Woods, New Hampshire, in July 1944. The negotiations were dominated by Harry Dexter White, of the U.S. Treasury, and John Maynard Keynes, of the British Treasury. They proposed two new organizations. The

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International Bank for Reconstruction and Development (World Bank) would make long-term loans to encourage the growth of war-ravaged regions and developing countries. The International Monetary Fund (IMF) would supervise a reconstituted and modified gold exchange standard. Parallel negotiations produced a plan for an International Trade Organization (ITO) that would lead members toward reduced trade barriers and freer trade.

None of the three organizations evolved exactly as anticipated. The ITO ran into opposition within the United States, from both sides of the trade issue. Protectionists feared it would force more trade liberalization than they wanted; free traders believed it would be more forgiving of trade barriers than they wanted. By 1950 the ITO was dead, and a provisional organization arose in its stead, the General Agreement on Tariffs and Trade (GATT).

The IMF was supposed to oversee a quick return to a functioning international monetary order of relatively fixed exchange rates. Instead, most European governments kept their currencies inconvertible—restricting their use in international trade and payments—until 1958. In the interim, the world moved onto a modified dollar standard. The American currency was tied to gold at \$35 per ounce; other currencies could tie to the dollar. But in the unsettled conditions of postwar Europe, the IMF had little to do.

Nor did the World Bank play its expected role in financing European reconstruction. The needs were too great for World Bank resources, and the organization soon turned toward the developing world, where it began to act as a large-scale development bank. It was to lend to countries in the Third World so that they could build infrastructural and other projects that the private sector might not otherwise be willing to finance; in return it would demand both a general respect for the property of foreign investors, and specific economic policies deemed appropriate.

Important as they later became, the three Bretton Woods organizations—GATT, IMF, and the World Bank—were practically dormant for a decade after World War II. Postwar reconstruction was dominated, not by the careful plans of the Bretton Woods negotiators, but by the geopolitical turmoil of the new Cold War.

Inside the United States, despite the turn toward more international engagement in the Roosevelt administration, the end of the war raised the possibility of a return to traditional isolationism. The Republicans swept the 1946 midterm elections, controlled

the House and Senate, and were widely expected to take the presidency in 1948. And the Republican party continued to have a large isolationist wing, led by Ohio senator Robert Taft, that was wary of global economic and political commitments.

The Truman administration needed the support of the Republicans for its postwar policies, but appeals to Wilsonian globalism were ineffectual. In a series of debates between 1946 and 1949, Truman and his foreign policymakers were able to win over enough Republicans to create a centrist consensus that dominated American foreign policy for decades thereafter.

The masterstroke was to tie the administration's international economic proposals together with its attempts to oppose the spread of communism in Europe and Asia. While many Republicans had little use for freer trade or the IMF, they were militant in their concern about an expansion of the Soviet sphere of influence. Truman, Secretary of State George Marshall, and his assistant Dean Acheson convinced Republican Arthur Vandenberg, chair of the Senate Foreign Relations Committee, that American international economic engagement was inseparable from the fight against communism. On this basis, reworked versions of the American postwar plans were acceptable to a Republican Congress.

In 1946, the United States loaned \$3.75 billion to the United Kingdom in return for a series of British commitments to move toward opening its empire to foreign (including American) economic interests. In 1947, the Truman Doctrine and the Marshall Plan committed the United States to billions more dollars in aid to its European allies in return for their standing fast against the Soviet Union.

In addition to the strategic alliance formalized with the creation of NATO in 1949, American assistance in postwar reconstruction also carried economic strings. The United States insisted on a liberalization of international economic ties, and on a cooperative relationship among its European allies. It encouraged the formation of the European Coal and Steel Community in 1950, and its evolution into the European Economic Community (Common Market). These initiatives were almost certainly good for the countries involved, but American support was motivated less by this than by the hope that greater economic openness would benefit U.S. interests, and that prosperity in Europe would strengthen pro-American, anti-Soviet governments.

The melding of economic internationalism and geopolitical goals was not without difficulties. At times the two worked at cross-purposes, as with

American attitudes toward the trade policies of its European and Japanese allies. On economic grounds, the United States wanted the Europeans and Japanese to open their markets to American products. But America's allies argued that too rapid a liberalization of trade would cause economic dislocation that might lead to social and political unrest, and that this unrest could feed into pro-Soviet or neutralist political movements. Faced with a choice between freer trade and more unstable allies, American economic policymakers often had to content themselves with an uneasy compromise.

The Common Market itself was aimed in part at restricting the access of American goods to the markets of its member states. American support for the EEC was predicated on the calculation that, even on purely economic grounds, a stable pro-American Europe partly closed to American exports was better than an unstable anti-American Europe forced open to trade. And in any event, while trade barriers could keep out American goods, they did not keep out American corporations. In fact, European protection tended to suck American firms into European operations, as they jumped trade barriers to gain access to the continent's markets.

A similar conflict between economic principles and geopolitical concerns affected American colonial policy in the 1950s. On the one hand, the United States had long demanded access to the markets and resources of the colonial empires and, if possible, independence for the colonies. This dovetailed with concerns that colonialism played into the hands of the Soviet Union, by setting colonial populations against the leading capitalist powers in independence movements that the Soviets supported. On the other hand, America's colonialist allies argued that their empires were crucial economic assets, and that rapid decolonization would weaken socioeconomic and political structures in metropolitan Europe. Again, American policymakers found themselves torn between one set of desires, to encourage a breakup of the European empires, and another, not to weaken unduly its European allies.

Contradictory or not, the American-led international regime that emerged from the early postwar years had some clearly defined characteristics. It was organized around the so-called Bretton Woods institutions: IMF, the World Bank, and GATT. These three symbolized the contours of the Bretton Woods system: trade liberalization, international monetary relations centered around a gold-backed dollar, and multilateral lending to the developing world. While none of these three was truly in place until about

1958, they were the goal toward which U.S. (and Western) policy was striving.

### THE HEYDAY OF BRETTON WOODS

The year 1958 is usually regarded as the start of the full-fledged Bretton Woods system. In December of that year, the currencies of most European countries returned to convertibility, making them available for international trade and investment. The gold dollar-based international monetary system, monitored by the IMF, was in place. Five GATT negotiating rounds had reduced tariffs substantially among Western industrialized nations. In 1957, six European countries had signed the Treaty of Rome establishing the EEC, and trade barriers were dropping rapidly among the Common Market Six. The World Bank's lending programs were beginning to direct substantial amounts of money to Latin America and the newly independent countries of Asia and Africa.

The fifteen years from 1958 to 1973 were the high point of the postwar international economic order. With European and Japanese reconstruction complete, the world economy grew more rapidly than ever. World trade grew even more than world production, as economies became increasingly open to foreign products. International investment expanded, especially in the form of foreign direct investment (FDI) by multinational corporations. And, after thirty years of dormancy, international lending picked up as well; by 1973 global financial markets held over \$160 billion.

The United States was the centerpiece of the Bretton Woods system. In fact, a major source of the global prosperity of the era was the world's access to American markets, American capital, and the American dollar. All of these in turn relied on U.S. commitments to international economic openness.

American support for trade liberalization remained strong, for American industry dominated most markets. Under U.S. leadership, the most ambitious round of GATT negotiations began in 1962 and ran until 1967. The Kennedy Round, as it came to be called, brought about a reduction in nonagricultural tariffs among the industrial nations of over 35 percent in weighted average terms.

American firms also led the charge toward the era of the multinational corporation (MNC). In one sense, such international investment was not new, for European companies had often looked for overseas opportunities in the nineteenth century. But the MNC as it emerged in the 1950s and 1960s, largely as an American phenomenon, was different. First,

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most new MNCs were in manufacturing rather than plantation agriculture or mining. Second, most MNCs had integrated global management: they operated simultaneously in many regions and countries, and were capable of shifting funds and operations from one part of the world to another with great ease. And finally, MNCs tended to provide fierce and often unwanted competition for local companies.

Direct investment became, in fact, a more important way than trade for U.S. firms to tap into markets abroad. American corporations were able to take advantage of their substantial edge in technology, marketing, and management expertise in many industries, not to speak of the spread of American consumption patterns to much of the rest of the world.

Expansion into Europe was the first step for most American multinationals. The creation of the EEC gave U.S. firms great incentives to locate production facilities in Europe. The process of bringing many European nations together made the Common Market an essential target for American producers. Since this was associated with maintaining moderate barriers to imports from outside the EEC, U.S. firms often found themselves faced with the choice between losing a lucrative market and locating branch factories inside the Common Market. The result was a rush of American companies to get inside the EEC.

Foreign lending by U.S. banks followed soon after the upsurge in foreign direct investment. American bankers, scared off international operations by the defaults and other upheavals of the 1930s, concentrated on domestic business until the mid-1960s. But as the corporate customers of American banks went abroad in ever increasing numbers, major banks were drawn after them. By the 1960s, many U.S. banks had built branch networks in Europe and were lending large amounts there. Even the Third World was looking more attractive, especially as the World Bank had showed that some developing countries might be creditworthy. Cautiously at first, but with growing enthusiasm, American bankers looked to make loans to the apparently more reliable of the less-developed countries, especially in Latin America.

Despite the general prosperity of the Bretton Woods era, there were plenty of sources of friction, even within the United States. Trade liberalization was relatively easy at the outset, as American firms faced little foreign competition. But over time new competitors grew up, especially in Europe and Japan, and U.S. producers began to lose markets to imports. The result was a gradual increase in protectionist sentiment. This was most striking in the labor movement. In the postwar period, American labor had

been largely supportive of free trade, which appeared to bring about the creation of jobs in the country's export industries. As imports chipped away at domestic manufacturing, though, the AFL-CIO rethought its position. In the late 1960s, most labor unions came to feel that trade protection was necessary to preserve high-wage jobs in U.S. industry, and by 1970 the AFL-CIO was consistently protectionist.

Foreign direct investment (FDI) by multinational corporations, lucrative as it may have been for many American firms, was also a source of controversy. Many workers resented the increasingly common pattern in which an American company would reduce production in the United States, only to open a new factory in Europe or Latin America. Labor unions, and regions losing industrial employment, complained about "runaway shops" and called for government measures to keep companies at home.

American FDI was far more controversial abroad than inside the United States. The first wave of concern was in Europe, where fear of an invasion of the continent by American MNCs reached a peak in the late 1960s. The rapid spread of American corporations inside the EEC gave rise to protests that American MNCs were taking Europeans' own markets away from them.

Concern about MNCs was also increasingly common in the developing world. Here the general irritation at the competition represented by foreign, especially American, multinationals was compounded by the sense that MNCs were large and experienced enough to evade developing-country regulations. Some also feared the political influence of foreign corporations that could be extremely large as compared to the size of the national economy. When developing countries attempted to control or even nationalize foreign corporations, they resented the support given by home governments, especially the United States, to their firms.

Developing-country apprehension about MNCs was part of a rising tide of political and economic nationalism throughout the Third World. By the late 1960s, decolonization had run its course, and the former colonies—along with long-independent developing nations—turned their attention to economic independence. The Cuban Revolution of 1959 crystallized many of developing countries' hopes, and America's fears. In its aftermath, the United States tried a combination of positive and negative incentives to shore up its supporters in the developing world.

Foremost among attempts by the United States to counter the rise of anti-American sentiment in

the Third World was the Kennedy administration's Alliance for Progress, originally touted as a sort of Marshall Plan for Latin America. But these plans were soon frustrated by realities in the United States and Latin America itself. The tens of billions of dollars originally envisioned for the Alliance to channel to Latin American development never materialized. There was entrenched opposition within the region to the sort of reformist policies the United States proposed, especially land reform.

More generally, U.S. policy in the Third World was often frustrated by contradictions among modern capitalism, strivings for democracy, and solid anti-communism. Democrats were frequently lacking in firm anti-Soviet credentials, while local anti-Soviets were generally either undemocratic, or hostile to economic modernization, or both. Over the course of the 1960s and early 1970s, Alliance for Progress or not, a wave of authoritarianism swept Latin America, and American policymakers were generally resigned to supporting dictatorial regimes so long as they were anti-Cuban. The American record in the South, then, was mixed. The United States continued to be admired for its living standards, and the economic impact of trade and investment ties with the United States was welcome. However, in much of Africa, Asia, and Latin America, corporations based in the United States and the American government tended to be associated with tolerance for authoritarianism and maintenance of an economic order widely seen as inequitable.

Economic problems among the industrialized countries were less ideological, but more important in the long run. While trade relations and FDI remained somewhat controversial in the 1960s, the focus of most concern was macroeconomic. American domestic policies were increasingly at odds with the central role of the United States dollar in the international monetary system, and American unwillingness to adjust its policies to accommodate its European and Japanese partners was the source of great conflict.

The core of the problem was the contradiction between the dollar's international role and its status as the currency of a country overwhelmingly concerned with its domestic economic affairs. This issue had not arisen with the international monetary system that prevailed before World War I, based as it was on the pound sterling, for the British economy relied heavily on world trade and investment. Nineteenth-century Britain was typically willing to sacrifice some domestic economic goals in the interest of stability on international markets for goods and

capital, for its domestic prosperity depended on its international ties. This was not the case for the United States, which could—and did—often ignore the international impact of its domestic economic policies.

The problem was dormant until about 1966. At that point, the Johnson administration undertook a combination of increased outlays for the Vietnam War abroad, and increased social spending on the War on Poverty at home, and was loath to finance both wars by increasing taxes. The result was a rise in inflation inside the United States from an average of 1.2 percent a year between 1960 and 1964 to 3.8 percent between 1965 and 1969, reaching 6.1 percent in 1969. This level of inflation was modest by standards of the 1970s, but it exceeded that of many of the country's trading partners; between 1965 and 1969, American prices rose 23 percent while German prices rose 12 percent.

American inflation created international monetary problems because it meant that world trade and payments were denominated in a currency, the U.S. dollar, that was losing real value. Traders and investors were willing to hold dollars, and to use them internationally, inasmuch as they had faith in their value. But as the dollar's real value declined, firms and individuals had less reason to accept or hold on to the American currency. This left the international economy with a less stable key currency at its center. As faith in the dollar declined, wary investors redeemed the American currency for more reliable gold. The United States soon faced a drain on its gold reserves that could not continue indefinitely.

Two simple resolutions of the problem were available. The United States could have changed its domestic economic policies to strengthen confidence in the dollar. This, however, would have implied tax increases, government spending reductions, and other politically unpopular austerity measures. Especially given the concern of the Johnson and Nixon administrations about the weakness of popular support for their domestic and foreign policies, this was an unappealing choice. Alternately, the United States could devalue the dollar so that its nominal value would more accurately reflect its true worth. But this would have called into question the very structure of the Bretton Woods system, based as it was on a dollar whose value was supposed to be fixed in terms of gold. And undermining the role of the dollar might contribute to a broader erosion of Western confidence in American international leadership, already at a low point due to the Vietnam War.

Faced with one alternative with major domestic

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political costs, and another alternative with major international political costs, successive American administrations temporized. Because foreign investment and lending by American corporations and banks increased the world supply of dollars and put downward pressure on the value of the dollar, starting in 1963 the U.S. government restricted the degree to which American firms could directly export capital. These capital controls were meant, among other things, to partially segregate American monetary conditions from international confidence in the dollar, and vice versa—thereby postponing attempts to bring the two into line.

At the same time as it tried domestic measures to prop up the dollar, the United States pursued parallel international initiatives. American monetary authorities cajoled other governments into restricting opportunities for foreigners to exchange dollars for gold. A separate private market for gold was established, in which the precious metal's price was allowed to rise, while governments agreed to continue to pay the Bretton Woods price of \$35 an ounce. Central banks committed themselves to lend each other money in case of pressure on one of their currencies, thus staving off devaluations. In this way, the immediate pressures on the dollar, and on the international monetary system, were mitigated.

The years from 1958 to 1973 were in many ways a golden age of modern economic growth. World output and trade grew at extremely rapid rates, and the American economy led the way. International markets became ever more linked in an environment of generalized and increasing prosperity, and again the United States was in the forefront of attempts to reduce barriers to trade, investment, and financial flows. Prices were relatively stable, and the dollar-based monetary order seemed reliable. Despite the strains on the system, the world economy did remarkably well until the early 1970s.

### THE COLLAPSE OF BRETTON WOODS AND THE OIL SHOCKS

During the 1970s, the world economy encountered serious difficulties. The United States was both an important source of international economic tension and significantly affected by broader trends. Some of the problems were the outgrowth of cross-cutting pressures on the Bretton Woods system that had built up over the previous fifteen years; others represented the rise of new economic issues.

The international monetary difficulties that accumulated over the course of the 1960s came to a

head in 1971. At the root of the problem was the erosion of confidence in the dollar caused by relatively high rates of inflation in the United States. Despite stop-gap measures, it was increasingly clear that the United States would either have to undertake serious domestic austerity measures, or devalue the dollar.

This longstanding dilemma was joined by two further developments that complicated America's international economic role. The first was the rise of Europe and Japan as economic powers more or less on a par with the United States. The American economy had so dominated the world economy after World War II that many in the United States came to regard this as the normal course of things. But European integration had, by the early 1970s, created a unit roughly equivalent to the United States in economic importance. And while the Japanese economy remained substantially smaller than the American, its products, banks, and corporations were increasingly able to compete with American products, banks, and corporations. As Europe and Japan grew in economic influence, the ability of the United States to manage the world economy single-handedly eroded noticeably.

A second development whose significance became clear only in the 1970s was the growing level of international economic integration, and especially the growing importance of the global economy for the American economy. This interdependence offered great gains to many Americans, but it also imposed some new constraints on American economic and political activities. From the 1930s until the 1970s, despite gradual trade liberalization and increasing international investment, most economies remained relatively closed to the rest of the world. Even the United States remained nearly oblivious to external economic trends.

By the 1970s, national economies were increasingly tied together. Trade had grown enormously, even for the United States: manufactured imports went from just 4 percent of total American manufacturing output in 1960 to 16 percent by 1974. Investment links were massive and growing, too, as the multinational corporation became a global phenomenon. Even the United States saw a major influx of European and Japanese MNCs. And the principal national financial markets were ever more closely drawn together, so that financial conditions in the United States directly and immediately reflected conditions elsewhere. Higher levels of international economic integration generally, and of the United States into the international economy specifically, height-

ened the contradictions of American economic policy.

The first pillar of the Bretton Woods system to give way was the gold dollar-based international monetary regime. As world financial markets grew in size and sophistication, massive capital flows in response to uncertainty about the U.S. economy made it impossible for the Nixon administration to ignore pressures on the dollar. Unwilling to subject the American electorate to economic austerity in the year before a presidential election, on 15 August 1971 Nixon took the dollar off gold and devalued it. For a couple of years, the leading economic powers attempted to hold together some semblance of the Bretton Woods system of fixed exchange rates, but by the middle of 1973 most such efforts were abandoned. From that point on, the world's major currencies fluctuated in value against each other according to the dictates of currency markets.

In the United States, the collapse of Bretton Woods meant, among other things, that the strictures of the gold-dollar standard were loosened. This opened the way for higher rates of inflation, as successive administrations attempted to deal with mounting domestic and international economic problems. In 1974 consumer prices rose by more than 12 percent.

To make matters more complex, the unraveling of the postwar order was accompanied by attempts on the part of developing countries to secure a better deal for their products. A series of commodity cartels were formed, mostly by Third World nations, to try to raise world prices for everything from bauxite to bananas. The most spectacularly successful of these cartels was the Organization of Petroleum Exporting Countries (OPEC), which was able to quadruple the world price of oil in 1973–1974 and triple it again in 1979.

At the same time, another group of developing nations was industrializing very rapidly. These newly industrializing countries (NICs), largely in Latin America and East Asia, were manufacturing products that had previously been the private preserve of the developed North: steel, automobiles, pharmaceuticals, even airplanes. Many of them were developing sophisticated industries with money they had borrowed from American, European, and Japanese banks. The NICs' economic dynamism might otherwise have been welcomed by the developed countries, and indeed it was by many, but it also meant an upsurge in competition from regions with low wages and the ability to undercut many American producers.

The combination of rising inflation, the oil-price

shocks, increased competition, and general economic uncertainty was exacerbated by a recession that affected all major countries in 1974–1975. Unemployment rose to levels not seen since the 1930s, and it appeared that the postwar golden age had ended. Unsettled economic conditions tended to inflame conflict both among developed countries and between the developed and developing world.

Inside the United States, the "stagflation" of the 1970s gave rise to increased concern about foreign products. Imported steel, clothing, footwear, and other items confronted American industries with ever stiffer competition. By 1980 manufactured imports were equal to 22 percent of total domestic manufacturing output, one-third higher than 1974 levels. Not surprisingly, protectionist sentiment grew. Some of it met with success as the Carter administration used a variety of tools, from antidumping findings to a steel "trigger price mechanism," to restrict imports.

To some extent, protectionist pressures were reduced by the continued depreciation of the dollar during the late 1970s. The Carter administration regarded a decline in the value of the dollar favorably, as it would make American products more competitive both at home and abroad. Between 1976 and 1980, the dollar dropped by 28 percent against the deutsche mark and 24 percent against the yen. By making German and Japanese goods more expensive in the United States, this dollar depreciation reduced the force of protectionist demands.

However, the dollar depreciation, and the Carter administration's other attempts to stimulate the American economy, led to yet another round of inflation. In 1979 inflation went above 13 percent and continued to rise, exacerbated by the second round of oil price increases.

Surprisingly, in these inauspicious circumstances the seventh, or Tokyo, round of GATT negotiations was relatively successful. Between 1973 and 1979, members of GATT agreed to further tariff reductions, and especially to try to limit the use of nontariff barriers to trade. Such barriers, ranging from quantitative quotas and export restraints to health and safety regulations, had come to replace tariffs as favorite protectionist tools. The United States led the way in trying to rein in the use of nontariff barriers, and the Tokyo Round was a modest success in achieving these and several other goals.

But in essence the 1970s were a period of generalized economic unrest. Consumer prices more than doubled over the decade, and wages did not keep up with prices. Productivity stagnated, growth

slowed, and unemployment rose. Traditional American ambivalence about the international economy grew as domestic problems were exacerbated by growing foreign competition.

### REAGANOMICS AND THE TWIN DEFICITS

The 1980 election of Ronald Reagan to the presidency was in large part due to dissatisfaction with the country's economic performance during the 1970s, and especially under the Carter administration. Reagan undertook a drastic reorientation of American economic policy. Although most of the changes were domestic in focus, they also had important international components.

One of the more prominent economic developments of the 1980s in fact began under Carter with a major shift in monetary policy to attempt to bring inflation under control. In October 1979, Federal Reserve Board chairman Paul Volcker announced a change in central bank operating policy that presaged serious inflation fighting. In the space of a few months, American interest rates began to soar: the prime lending rate went above 20 percent for the first time. One immediate result was two deep recessions between 1980 and 1982. From under 6 percent in 1979, unemployment reached 11 percent by the end of 1982, while capacity utilization in American factories dropped to its lowest levels since the Depression. Inflation, however, fell dramatically from its 1979 peak of over 13 percent to below 4 percent in 1982.

After Reagan took office, the Fed's tight monetary policy was joined by an extremely loose fiscal policy. A combination of tax cuts and increased defense spending led to a budget deficit that passed \$200 billion in 1983. The deficits, despite the expectations of Reagan administration policymakers, persisted throughout the 1980s and into the 1990s. As deficits were financed by borrowing, federal debt more than doubled in inflation-adjusted terms between 1980 and 1992, passing \$4 trillion as George Bush left the White House.

The combination of tight monetary policy and loose fiscal policy led inexorably to a massive inflow of foreign capital into the United States. As American interest rates skyrocketed, foreigners were eager to buy dollar investments. This also reflected the need, on the part of the federal government, to finance its budget deficit: foreigners were willing purchasers of U.S. Treasury securities in a period in which many

other countries seemed less than fully reliable. The flood of capital toward the United States and the dollar bid the price of the dollar up steadily through the early 1980s. From 1980 to 1985 the dollar rose by 50 percent against other currencies.

The strong dollar had mixed effects on the U.S. economy. On the one hand, it allowed Americans to buy foreign products—and to travel—more cheaply. For some, the strength of the dollar was simply a reflection of the strength of the United States, and of faith in its economy. On the other hand, the higher the dollar went the cheaper foreign goods became relative to American products. Beneficial as this might have been to the consumer, it put tremendous pressure on firms in the United States that competed with imports, and those that were trying to export to other markets.

As a result, along with the budget deficit came a growing trade deficit. By the middle 1980s the United States was importing over \$150 billion more than it was exporting. This import surge was perhaps the most prominent public indication of the country's changed international economic position. American consumers who had barely gotten used to Japanese products now found, mostly for the first time, that large portions of what they bought came from such countries as Korea, Taiwan, Brazil, and Mexico. Many American producers who were already having trouble keeping pace with foreign competition in any event were driven to the wall by the rush of imports the strong dollar brought into the American market.

The nation's altered international position was in part an inevitable result of its heavy foreign borrowing. The United States had been a lending nation since the early part of the century, and indeed had been the world's leading lender since the beginning of World War I. But as foreigners rushed to buy high-interest American investments, the tables turned. By 1987 the United States was a net debtor to the rest of the world, and by the end of the Bush presidency the country owed half a trillion dollars more to foreigners than it was owed by them.

A predictable result of these economic trends was a resurgent nationalistic reaction to real or perceived international economic threats. A flurry of protective bills were introduced into Congress, and industries dramatically increased their filing of "antidumping" complaints against foreign competitors.

The most prominent trade barrier of the decade came with the imposition of a "voluntary" restraint agreement on Japanese automobile imports. Under the terms of the 1981 agreement, Japanese producers agreed to limit exports to the United States to about

1.8 million cars and trucks a year. The effect was to raise the price of Japanese (and thus all) cars in the American market. This form of protection was politically viable because its benefits were divided between the American and Japanese automobile industries. As the price of cars in the United States was driven up by supply restrictions, both American and Japanese producers made more per vehicle. This blunted whatever complaints the Japanese might otherwise have raised about American trade protection, and indeed similar "voluntary" restraint agreements proliferated during the 1980s.

The upsurge of protectionism was muted by the economic recovery that began in 1983 and by the decline in the value of the dollar that began in 1985. Both of these reduced the immediacy of protectionist demands, although the size of the nation's trade deficit and tough competition from foreigners continued to inflame the passions of American manufacturers.

By the late 1980s, much of the concern had shifted away from specific competitive pressures toward a broader worry that the country's ability to sustain industrial jobs more generally was being eroded. The ready availability of inexpensive manufactured products from developing countries and Japan appeared to have made obsolete many of the well-paying factory jobs that had been the hallmark of much of the middle-American dream.

Developments in the American economy, especially in the face of the Volcker-Reagan era economic policies, had important effects on the rest of the world. The developing countries that had borrowed heavily in the 1970s were hard hit in the early 1980s by interest-rate increases and recession in the developed world. With their debt at floating interest rates, debtor countries found debt-service payments soaring. Meanwhile, a combination of stagnant demand and protectionism in Europe and North America dampened their ability to sell their products. The result was a wrenching debt crisis in which dozens of developing countries were forced to undertake massive austerity programs to rebuild their shattered finances.

Europe, too, chafed at American policies. High American interest rates drew capital out of Europe, and confronted European governments with the choice either of standing by as money flowed out of their economies at an ever-increasing pace, or of matching American interest rates with similarly high interest rates of their own. Most eventually chose the latter course, thereby imposing recessions on their own economies. In much of the world, complaints multiplied about the unilateralism of the Reagan

administration, its apparent unconcern for the global effects of its domestic policies.

The administration began reassessing its unilateral stance as the problems associated with the strong dollar, import competition, and the debt crisis multiplied. In a major shift in policy, in September 1985 the United States agreed to cooperate with the other major economic powers to encourage a decline in the value of the dollar. This agreement, which did in fact reinforce the dollar's decline back to 1980 levels, marked a tentative step toward more cooperative arrangements between the United States and other leading industrial countries.

In this context, the United States also encouraged the opening of a new round of GATT negotiations. The Uruguay Round, which began in 1987, focused on several thorny issues that had been left unresolved in previous GATT agreements. First was a reduction in barriers to agricultural trade, which had been exempted from earlier GATT rounds. Second was further restrictions on the imaginative nontariff trade barriers many countries had become expert in developing. Third were attempts to elaborate rules on the protection of intellectual property (patents, royalties, and licenses, for example), and on such new arenas as trade in services.

Despite the newfound interest in international cooperation on the part of the Reagan and Bush administrations after 1985, the experience of the late 1970s and early 1980s had driven other industrial countries to look for alternative ways of dealing with their economic problems. Most prominent was the renewed push toward European integration. By 1987 the twelve members of what was now called simply the European Community (EC), and later (1993) the European Union (EU), had resolved to remove all barriers to the movement of goods, people, and capital among themselves by the end of 1992, and to begin a process of monetary integration whose goal was a single currency for the EC.

In parts of East Asia, there were some indications that a Japanese sphere of economic influence was developing. The yen was ever more widely used in regional trade and payments, as many of the region's countries were doing most of their trade with Japan. Japanese investors came to dominate the region, as did Japanese financial institutions. Observers differed on whether this was simply a natural process associated with Japan's economic growth, or reflected purposive Japanese policies that required an American response.

The United States, too, appeared willing to contemplate a renewed regional focus for its economic

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activities. The Bush administration negotiated agreements with Canada and Mexico to remove trade barriers within North America. Complementary agreements with other Latin American countries were also discussed, and the prospects of a Western Hemisphere trade and investment area seemed appealing to many Americans.

This apparent tendency toward further regional integration, whether in Europe, Asia, or North America, was complicated by the collapse of the Soviet Union and Eastern Europe between 1989 and 1991. The emergence of more than a score of new countries eager to build market economies introduced a new element of economic and political uncertainty both in Europe and elsewhere. These formerly centrally planned economies, from Vietnam to Slovenia, were desperate to trade with the West and attract Western investors. Whether their needs can be accommodated by a world economy already strained by the tensions caused by economic integration, heightened competition, and fear of stagnation, remains to be seen.

### INTO THE TWENTY-FIRST CENTURY

As the United States heads toward the next century, it faces daunting economic problems, almost all of which have at least some international dimensions. At the most basic level, the choices open to the United States are analogous to those it has faced throughout its history. At one extreme, Americans can choose to engage themselves fully in a closely integrated world economy. This would mean subjecting the nation to ever greater international competition, but also opening up new economic opportunities for American producers, traders, and investors.

At the other extreme, Americans might react to the international economic threats by turning more resolutely inward, protecting themselves from external competition. This would mean forgoing the benefits of global markets and goods, but also avoiding the costs of foreign competitive pressures that threaten many American industries.

Neither extreme is particularly likely. Too much would be sacrificed if the country moved either toward the world federation feared by nationalists in the United States or toward the Fortress America feared by internationalists on both sides of the Atlantic and Pacific. The most serious issue will probably be the relative significance, and desirability, of regional economic blocs. For some, "blocification" is desirable. A rough division of the world into European, Japanese,

and American spheres of economic influence is superior both to globalized disorder and to provincial country-based nationalism. Each regional power will be able to keep order in its camp, and to cooperate (if warily) with leaders of other camps.

For others, the division of the world into economic blocs is more sinister. Apart from raising the specter of commercial and investment conflict leading to shooting wars, it reduces the scope for economic cooperation among the world's great centers of economic activity. For the United States, the choice may be between secure opportunities in all or parts of the Western Hemisphere, and uncertain opportunities in a much larger world economy. These choices are of varying attractiveness to different economic actors in the United States, of course. Globe-straddling multinational banks and corporations are loath to give up their access to the global economy; uncompetitive manufacturers and farmers shudder at the thought of being exposed to truly global competition.

At a less abstract level, the United States faces economic issues that strongly implicate the rest of the world. The interrelated budget and trade deficits are inherently international. Inasmuch as the nation has financed its spending by borrowing, at some point it will have to generate the resources to service its debt. This will require, among other things, turning the trade deficit into a surplus to use the increased export earnings to pay off the country's foreign debt.

This in turn raises the question of how the international competitiveness of the United States economy can be sustained and enhanced. There are myriad contending positions on this issue. Some analysts focus on the government taking an aggressive stance to force open markets in Japan, Europe, and the developing world. Others want more protection of American producers from imports, or support for American exporters. Still others believe that the answer lies not abroad but at home.

Among those whose attention centers on domestic actions to respond to the global challenge, some want the government to let the market take its course, and to encourage a flourishing of entrepreneurial activity. Many of them believe that excessive government intervention has dampened saving and investment, and that getting the government out of the economy is a prerequisite to getting the United States back to the head of the global economic race. For others, purposive but primarily domestic government policies are key—from a redoubled emphasis on education and innovation to methodical targeting of crucial American industries.

## Part 3 GLOBAL AMERICA

Whatever the direction taken by the American political economy as it heads into the twenty-first century, two things are certain. First, whatever choices the country makes must perforce respond to trends in the global economy. The United States is indeed more closely tied to international markets for goods and capital than it has been at any time in this century; it could not ignore the rest of the world economy even if it wanted to. Second, American

choices will themselves exert a powerful influence over global economic growth and development. While the United States is not quite the economic titan it was for much of the twentieth century, it is still an economic superpower. It remains the world's largest market and its largest producer. What happens inside the United States is as important for the world economy as the world economy is for the future of the United States.

SEE ALSO Foreign Policy (in this volume); Economic Thought; Economic Performance; Economic Policy (all in volume III).

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