DOCUMENTI

IAI

DECLINING AMERICAN LEADERSHIP IN THE WORLD ECONOMY

by Stephen D. Krasner

Paper prepared for the conference "International Political Economy in a Tripolar World", Hakone, Japan, January 12-13, 1991

ISTITUTO AFFARI INTERNAZIONALI

DECLINING AMERICAN LEADERSHIP IN THE WORLD ECONOMY*

Stephen D. Krasner
Department of Political Science
Stanford University
October 1990

Paper prepared for a conference on International Political Economy in a Tripolar World, Hakone, Japan, January 12-13, 1991.

* Some parts of the sections of this paper headed "American Power" and "Systemic Outcomes" appeared in Michael Webb and Stephen D. Krasner "Hegemonic Stability Theory: An Empirical Assessment," Review of International Studies (1989). Professor Webb was not involved in the preparation of this paper and bears no responsibility for its analysis or conclusions.

TWO PERSPECTIVE: LIBERALISM AND REALISM

For the last twenty or more years, international relations scholarship in the United States has been dominated by two competing research programs -- liberalism and realism. Each of these programs has had many specific variations. The adherents of each perspective have disagreed with each other as well as with those holding the other view. Each of these broad perspectives, however, share basic assumptions about the nature of actors, the character of the international system, and the prospects for cooperation. For liberalism there are a multiplicity of actors, cooperation is likely if not foreordained because these actors pursue absolute not relative goals; they function in a mixed motive not a zero sum world. Order can emerge from the self interested behavior of individuals although, under conditions of market failures, international institutions might be necessary to facilitate cooperation.[1] For liberalism, the decline of American power presents some, but not central, problems for maintaining international cooperation.

---

1. One of the most compelling empirical verifications for a liberal perspective is offered by Paul R. Milgrom, Douglass C. North, and Barry R. Weingast, "The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs," Economics and Politics 2 (March 1990) which argues that traders in early modern Europe were able to develop an international regime, the Law Merchant, which facilitated commercial transactions. This regime emerged out of the self interested behavior of traders and did not involve political authority which was, in any event, too weak and fragmented at that period to provide protection and security for long distance trade.

Realism, in contrast, sees states as the dominant actors in the system. Cooperation is problematic because states function in a world which is, at least in large part, zero sum. Order has to be imposed, usually by a dominant states, although, at times, by several states working together. For realism, the decline of American power suggests that it will be more difficult to secure cooperation in the future than it has been in the past.

a. Liberalism

Liberalism, sees a world with many different kinds of actors including states, multinational corporations, international organizations, terrorists, the Catholic church, ethnic groups, and private transnational groups ranging from Greenpeace to the IRA. These actors have different interests. In some cases, most visibly international terrorists, their objectives are disruptive of what most would consider international cooperation and order. Most of these actors, however, have objectives that are, at the very least, compatible with an orderly global environment. In the case of economic actors, their ability to secure preferred outcomes is increasingly intertwined with their counterparts and partners in other states. Interdependence has increased and while this increase may not have altered the underlying preference functions of economic actors, it has altered the way in which they go about achieving their goals. In an interdependent world self interest pushes actors towards higher levels of international cooperation. Liberalism can only see the developments of the last few years as positive, even an occasion for celebration. The Soviet Empire has collapsed. Even the Soviet Union has made some steps toward market allocation and the legitimation of civil society. Democracy has triumphed in Eastern Europe against what would have seemed insuperable constraints only three or four years ago. The multiplicity of actors in the international system has increased and their interests have become more compatible.

The relative decline of the United States, not so dramatic in any event, is not particularly consequential from a liberal perspective. The postwar order is understood more as a product of mutual interests, bargaining, and cross cutting cleavages than as a result of imposition by the United States.[2] While leadership may be consequential overweening power is not.

Liberals have hardly been pollyannas. Cooperation is not a foregone conclusion. Many situations in international politics are viewed an analogous to the Prison's Dilemma payoff matrix. Individual utility maximizing behavior can lead to pareto sub-optimal outcomes. For instance, in international trade the ideal policy for a single country is not to engage in free trade but rater to impose an optimal tariff, but if other countries retaliate, then everyone will be worse off. There is an endemic

---

2. The logic of liberalism at the international level is analogous to the logic of pluralism in the analysis of American politics. A multiplicity of interests can lead to stable and accepted outcomes provided that there are cross cutting cleavages. The classic statement of this argument remains Robert Dahl, Who Governs? (New Haven: Yale University Press, 1961).

temptation to cheat because even if a pareto optimal outcome is achieved, it will not be a Nash equilibrium; that is, each actor could achieve a higher level of utility, at least in the short run, by defecting rather than cooperating.

It may also be difficult to achieve optimal outcomes because of public goods problems. Purely individual self interested behavior will not lead to an optimal supply of public goods because each individual actor will undercontribute, or not contribute at all, hoping to benefit from the contributions of others.[3] The importance of public goods in the international system, goods that are characterized by both jointness of consumption and non excludability has almost certainly been exaggerated.[4] It is, for instance, not evident how public goods problems can arise in the area of international trade, where it is always possible to devise regimes that can exclude some actors. For instance, the benefits of GATT agreements were always only available to GATT members and, in the case of the non-tariff barrier codes negotiated during the Tokyo Round, the benefits were only available to the signatories of the codes not to all members of the GATT.[5] Nevertheless, public goods problems

---

3. The problem that public goods presented for pluralist analysis was forcefully presented in Mancur Olsen, The Logic of Collective Action (Cambridge: Harvard University Press, 1965).

4. Duncan Snidal, "Public Goods, Property Rights, and Political Organization," International Studies Quarterly 23 (1979).

5. See Stephen Krasner, "The Tokyo Round: Particularistic Interests and Prospects for Stability in the Global Trading System," International Studies Quarterly 23 (1979) and Joseph

can arise, especially in the financial and monetary areas where stability and the widespread acceptability of one or more reserve currencies profits a good with joint consumption from which it is very difficult to exclude anyone.[6]

For liberals, problems of market failure, which occur when pareto optimal outcomes are not, at the same time, Nash equilibria, such as the provision of public goods or the presence of Prisoner's Dilemma payoff structures, demand explicit agreement among actors. For cooperation to be enduring under circumstances where there is a temptation to cheat, it is necessary to establish international institutions. These institutions raise the probability of enduring cooperation by increasing the amount of information. With more information it is easier to monitor the behavior of actors, and, if actors know that their behavior can be effectively monitored, the temptation to cheat is reduced. Institutions can establish clear rules about acceptable behavior, reducing the likelihood of misperception. Even small amounts of misperception can unravel

---

Grieco, Cooperation Among Nations: Europe, America, and Non-Tariff Barriers to Trade (Ithaca: Cornell University Press, 1990).

6. The Soviet Union for instance was effectively excluded from the international trading regime organized around GATT, but the Soviets did, in indirect ways, benefit from the global financial regime based on the American dollar. One of the explanations for the development of the Euro-dollar market is that it grew out of Soviet deposits in western banks in the 1950s and 1960s. For one exposition see Michael Webb, International Coordination of Macro-Economic Policies, 1945-1989, Unpub. Ph.D dissertation, Stanford University (Stanford California: 1990).

cooperation, that is, lead to mutual defection in Prisoner's Dilemma situations where actors are playing a tit for tat strategy.[7]

An entire research program organized around the concept of cooperation has been spawned by the assumption that many situations in international relations, and especially international economic relations, are characterized by the fact that pareto optimal outcomes are not Nash equilibria.[8] From this analytic perspective, the decline of the United States is consequential only for the provision of public goods where the existence of a single dominant actor can provide, if not an optimal, at least a reasonable amount of the public good. The dominant actor provides the public good because it is in its interest to do so regardless of the behavior of other actors. Free riding, as we shall see, is a concern shared by both realist

---

7. For a discussion of the consequences for a breakdown in agreement given even a very limited amount of misperception see George W. Downs et al, "Arms Races and Cooperation," World Politics 38 (1985).

8. The most important of these analyses is Robert O. Keohane. After Hegemony: Cooperation and Discord in the World Political Economy (Princeton: Princeton University Press, 1984). See also Kenneth Oye, ed. Cooperation Under Anarchy (Princeton: Princeton University Press, 1985), Charles Lipson, "International Cooperation in Economic and Security Affairs," World Politics 37 (October 1984), and Robert Axelrod, The Evolution of Cooperation (New York: Basic, 1984). I have recently offered a critique of these arguments in "Global Communications and National Power," World Politics forthcoming (April 1991).

and liberal analysts.[9] For Prisoner's dilemma type issues, however,, which have dominated the cooperation research program, the relative decline of American power is, in essence, only tangentially relevant. The fact that relative power might have structured the payoff matrix in the first place is hidden in the ontological givens (the existence of the actors and the values in the cells) of this analytic perspective.[10] A more powerful state may provide leadership, it may suggest rules that would make cooperation easier, but this is relevant primarily because it offers a salient solution.

b. Realism

The analysis presented in this paper is based upon the second perspective that has dominated research in international political economy -- realism. For realism states are the dominant actors in the international system. Many, if not all concerns of states involve relative rather than absolute objectives. They are inherently zero sum because one actor's gain is another's loss. Even when states are involved in mixed motive games, conflict and power are omnipresent concerns. Statesmen are always attentive to issues related to their

---

9. There is no more graphic example of this problem than the present deployment of troops on the Saudi peninsula where the United States has provided almost all of the manpower; newspaper reports suggest that Saudi Arabia itself has hardly even mobilized.

10. This argument is developed in Krasner "Global Communications and National Power," especially the concluding section.

autonomy and freedom of action.[11] Anarchy matters because the world is a dangerous place. Order does not emerge from bargaining among relative equals. The South Bronx, not the Ginza or the Via Veneto, represents the state of nature.

For realism, the decline of American power is a concern, not just for the United States, but for international order as well. The stability and success of the postwar international economic system, for the advanced market economies countries and for many less developed countries as well, was predicated upon the behavior of the United States.

The United States was fundamentally concerned not with enhancing its own relative economic standing, but rather with what American leaders saw as a cosmic struggle with communism. Freed of the normal constraints imposed on states because of its extraordinarily dominant position in the international system, the United States could pursue very ambitious security and milieu goals. Its fundamental objective was to halt and ultimately to reverse communism. The communist regime of the Soviet Union was not only seen as a security threat to Western Europe, but also as an ideological threat to the core of American beliefs. This core is built upon the notion of Lockean individualism. The political system which reflects this commitment is democracy; the economic system is capitalism. Communism in its post world war Stalinist

---

11. The problem of autonomy is strongly emphasized by Joseph Grieco, Cooperation Among Nations.

manifestation was antithetical to both democracy and capitalism.[12]

The United States adopted extraordinarily ambitious policies to contain communism as it existed on the Eurasian land mass and to oppose any manifestation of communism, imagined or real, which presented itself in other areas. Troops were quasi permanently stationed in Western Europe, Japan, Korea, and other overseas military bases, despite the fact that developments in these areas never presented a threat to the territorial integrity of the United States.[13] The United States fought major wars in Korea and Vietnam even though it had no important economic interests in either of these countries when war broke it. It sent troops to other countries including the Dominican Republic and Grenada when they appeared to be threatened by communist takeovers. It

---

12. The basic text for the centrality of liberalism in American life is Louis Hartz, The Liberal Tradition in America (New York: Harcourt Brace, 1955). For a dissenting view see J. G. A. Pocock, The Machiavellian Moment (Princeton: Princeton University Press, 1975). Pocock argues that republican virtue not Lockean liberalism is at the core of American political commitments. No one who has visited Washington, a truly monumental capital city can doubt that Pocock's analysis speaks to some aspects of American life. Nevertheless, over time it has been Jackson not Jefferson who seems to have triumphed. It is not easy to find signs of Republican virtue even the patrician George Bush much less that quintessential manifestation of Southern California Ronald Reagan. Jimmy Carter actually did manifest Republican virtue and we know all too well what happened to him.

13. Indeed, the security of the United States, the ability to deter a nuclear attack, depended entirely on the arsenal of nuclear weapons which could provide a stable second strike deterrence. Almost all of these weapons were on planes or missiles within the United States, or on American submarines.

participated covertly in the overthrow of left wing leaders in Chile, Guatemala, and Iran.[14]

American foreign economic policy was only, then, one aspect of a much larger agenda. The basic objective of American foreign economic policy in the early postwar years was to built up the economies of its allies. The lesson of the 1930s was that economic weakness could lead to political instability, and political instability to authoritarian regimes. The United States wanted an economically strong Western Europe and Japan because it wanted to halt the spread of communism and because it wanted reliable allies. Given the proclivity of American leaders to assess reliability in terms of the second image, that is, the domestic characteristics of states, the promotion of democracy and capitalism was far more important than any realpolitik considerations of the balance of power.[15] Such ambitious policies were only possible because of the overweening power of the United States.

AMERICAN CAPABILITIES

---

14. If the United States does actually fight a war with Iraq, it will be a departure from past policies in which the real or imagined presence of a communist regime was the precipitating factor for armed intervention.

15. The concept of the second image is developed in Kenneth Waltz, Man, The State, and War (New York: Columbia University Press, 1964). The first image refers to the belief that foreign policy is determined by individual character, the third image that it is determined by the distribution of power in the international system.

Operationalizing power has never been an easy task for realists; if it were there would be many fewer wars since statesmen would agree on winners and losers, and relative costs. Power capabilities are not necessarily fungible. Nuclear weapons may deter an attack, but they cannot lower oil prices. A state may deploy its underlying resources in an number of different ways. Over the medium or long term basic resources can be reallocated from say, military activity to finance, but in the short term such commitments are more or less fixed. In contrast, however, to most circumstances, the position of the United States in the postwar period is relatively easy to present. The United States emerged from the second world war with extraordinary resources across a very wide range of issue areas. It has by far the largest GNP. It was the only states that possessed nuclear weapons. Although its army was partly demobilized after the war, it had an extremely powerful blue water navy. It held far more international financial reserves than any other state and was the only significant source of international capital. Its industries held the lead in cutting edge technologies. The relative position of the United States declined from the late 1940s until about 1970. Since 1970, as measured by a number of indicators, its underlying relative capabilities have remained relatively stable. The one major exception is oil.

Table 1 presents data on US aggregate economic activity relative to major competitor countries from 1953 to 1988. These measures are the best single indicator of overall power capabilities, even if they do not reveal how these capabilities have been deployed. The data reveal that the relative size of the US economy did fall sharply between the early 1950s and the mid 1970s. However, the relative aggregate size of the US economy has remained stable since the mid 1970s. The US share of total OECD GDP has remained between 35 and 38 percent even when calculated at current prices and current exchange rates which have fluctuated sharply. Its size relative to some major OECD countries has increased while its size relative to Japan has declined moderately. Since 1975, the gap between the US and the much smaller USSR has increased significantly. Current estimates now suggest that earlier approximations of Soviet GNP were, in fact, too high. Measurement of the Soviet GNP is notoriously difficult because it is necessary to establish shadow prices for goods produced in a non market economy. In sum, although the relative position of the United States has declined since the second world war, it still remains the largest economy in the world by a large margin; in 1988 the gross national product of the United States was still more than one and a half that of Japan, its nearest rival.[16]

---

16. Figures from World Bank, World Bank Atlas, 1988, pp. 7 and 9.

TABLE 1

US output compared to output of major competitors, in percent

	1953	1960	1970	1975	1980	1986	1988
1. US output as % of output in:							
USSR	316[a]	201	180	172	184	187[b]	
OECD	57.7	53.4	47.2	38.1	34.5	38.4	34.5
UK	791	714	554	558	604	641	516
W.Germany	839	712	487	494	492	538	401
Japan	1719	1161	345	315	290	278	169
2. US output per capita as % of:							
USSR	420[a]	238	214	205	214	217[b]	
UK	251	207	150	145	149	151	
W.Germany	257	219	144	141	133	136	
Japan	929	601	175	162	148	140	

Notes: Comparisons with USSR (all years) are made at purchasing power parities. Comparisons with OECD countries for aggregate GDP are made at current prices and current exchange rates. Comparisons OECD and US per capita income are made at purchasing power parities. US-USSR comparisons are based on GNP; US-OECD comparisons are based on GDP.

[a]1951 [b]1984

Sources: US-USSR comparisons 1960-1984 from CIA, Handbook of Economic Statistics, 1985; US-USSR comparison for 1951 from Krasner, 1976, p. 346. US-OECD comparisons 1960-1986 based on OECD, National Accounts 1960-1988. Volume I: Main Aggregates (1990), Table 13, and National Accounts 1960-1986, p. 145. US-OECD comparisons 1953 calculated from UN, Yearbook of National Account Statistics 1965.

Table 1 also presents data on US output per capita relative to that in major competitor countries. Per capita output is not a direct measure of power; a small state with high per capita output would almost certainly not have much influence in the international system. Per capita output is, however, an indicator of technological capability and factor mobility, variables that are consequential for the ability of a state to redeploy its resource to either resist a foreign threat or to increase it leverage on another actor. A similar pattern to that in aggregate size is evident. The US lead over other countries fell sharply in the 1950s and 1960s, but has remained relatively stable since the early 1970s. Only Japan has continued to catch up to the US.

Table 2 presents comparative data on real growth rates, one very rough indicator of where power capabilities might be headed in the future. US growth rates were slower than those of its main competitors and slower than the developed market economy countries as a group during the 1950s, 1960s, and early 1970s. Since the mid-1970s, US growth rates have matched or exceeded those of its main competitors, with the exception of Japan, and that of the developed market economy countries as a group. Recent US growth rates may be a sign of weakness, however, since they have been underwritten by massive fiscal deficits financed by borrowing from abroad.

TABLE 2

Average Annual Economic Growth Rates, in percent

	1953-60	1961-70	1971-75	1976-80	1981-84	1985-87
US	2.6	3.8	2.2	3.3	2.5	3.7
USSR	5.7[a]	5.1	3.7	2.7	2.7	n.a.
DME total[b]	3.6	4.8	2.9	3.4	2.1	2.8
Japan	7.9	11.7	4.4	5.0	3.8	3.5
W.Germany	8.5	4.5	2.1	3.4	1.0	1.7

[a]1951-60

[b]all industrialized countries as classified by IMF

Sources: USSR data from CIA, Handbook of Economic Statistics 1985 (for 1980-84) and CIA, USSR: Measures of Economic Growth and Development 1950-1980 (1982) (for 1951-79). All other data calculated from International Monetary Fund, International Financial Statistics, various issues.

Line 1 of Table 3 shows that the US has accounted for a larger proportion of international trade than any other country throughout the postwar period. The US share fell sharply in the late 1940s and 1950s, and then more or less stabilized between 24 and 28 percent. The composition of its share has, however, changed dramatically. In the 1950s, the US share of world exports was greater than its share of world imports as it ran large trade surpluses; in the 1980s, the US share of world imports was greater than its share of world exports. In 1987, the United States accounted for 10.2 percent of world exports and 16.4 percent of world imports. While the United States was by far the largest importer (Germany was second with 8.9 percent) it was second to Germany (11.8 to 10.2 percent) with regard to share of world exports.

The power implications of trends in the US share of world trade are mixed. A declining share of world exports is conventionally interpreted as a sign of eroding competitiveness. On the other hand, the rising US share of world imports implies that the US market is becoming a more important market for foreign exporters, a potential source of leverage.

As Albert Hirschman so elegantly demonstrated in National Power and the Structure of Foreign Trade[17] the basic relationship between trade and power is determined by the relative opportunity cost of change. The larger, more diverse, and more flexible an economy, the easier it is to adjust. The smaller, more concentrated and more rigid an economy, the more difficult it is to adjust to changing external conditions. Hence, a large, diverse, and developed country like the United States is less subject to external economic pressures than other states and more able to make credible threats because the cost of implementing these threats is relatively low. If relative opportunity costs of change are used as a measure of power capabilities then the position of the United States remains formidable.

Line 2a of Table 3 shows that the US share of world monetary reserves fell sharply between 1950 and 1970, has remained at around 13-17 percent during the mid 1980s and then fell to under

---

17. Berkeley: University of California Press, 1945.

10 percent in 1988. Japan passed the United States as the country with the largest international reserves in 1987, the first time that the U.S. had not ranked first in the postwar period. Low reserves have not constrained the United States as severely as they would other countries. The United States is the only country that is able to create money that foreigners are willing to hold because of its near-universal use as the world's primary reserve and transactions currency, and it is the only country that is able to borrow substantial amounts from foreigners in its own currency.[18]

The American position is, however, not as comfortable as it was before 1970 when the dollar was essentially the world's only transactions and reserve currency and the US held much larger reserves than anyone else. While the United States is probably still the world's most secure large parking space for capital, it is not the only garage in town, and the freedom of action of American central bankers has been constrained by the need to attract foreign capital to finance the US budget deficit.

---

18. Susan Strange "The Persistent Myth of Lost Hegemony," International Organization 41 (1987), pp. 568-69.

TABLE 3

US shares of world trade, international investment, and world monetary reserves, in percent

	1948	1955	1960	1970	1975	1980	1986	1988
1.a) US share of world exports plus imports	33.2	28.3	26.8	25.8	24.0	23.6	27.9	
b) closest competitor's share	23.7	19.4	17.0	20.1	18.6	18.9	20.2	
	UK	UK	UK	Ger	Ger	Ger	Ger	
2.a) US share of world monetary reserves	50.1	42.4	32.3	15.5	13.1	17.6	14.0	9.7
b) closest competitor's share	7.1	5.6	11.7	14.6	12.9	10.8	10.6	12.6
	UK	Ger	Ger	Ger	Ger	Ger	Ger	Jap

Notes: Data excludes countries which are not member of the IMF (i.e., the Soviet bloc and Taiwan, which has accumulated enormous reserves in the 1980s).
Sources: Lines 1a and 1b from: UN, Yearbook of International Trade Statistics 1960 and 1970-71; UN, 1984 International Trade Statistics Yearbook; GATT, International Trade 1986/87.
Lines 2a and 2b: IMF, International Financial Statistics Yearbooks 1987 and 1989.

In some specific issue areas, however, the power capabilities of the United States have declined more dramatically. As a major debtor rather than creditor it has less ability to influence the policies of borrowers even if it can still hold its lenders hostage. Japan has effectively challenged American global economic dominance of many high technology sectors. The Soviets have achieved parity in the area of nuclear weapons.

Most dramatically for global economic performance, the United States no longer has, as it did before 1970, surplus crude oil production capacity that could be used to offset production cutbacks by third world oil exporting states. After the 1967 middle east war some oil exporting states did attempt to impose production cutbacks. They were, however, frustrated by increases in exports from the western hemisphere, including the United States. The dramatic oil prices increases of 1973-74 and 1979-80 and almost certainly those of 1990 as well had or will have major economic consequences for the world economy. These price hikes ushered in a period of lower productivity growth because of the need to adjust to higher oil prices. Prices increases also had inflationary conseqeunces.

The international oil market, like international financial markets, touches all countries. Energy is a sufficiently important sector of the economy that price changes in this one commodity can have significant consequences. It is not just to oppose what President Bush so often terms "naked aggression" (what would clothed aggression be?) that the United States has dispatched 300,000 troops to the Arabian peninsula.

In sum, American power has declined since the peak immediately after the conclusion of the second world war. This is hardly surprising. Western Europe and Japan were destined to recover from the devastation of the war, even if it was difficult to predict that they would recover so well.[19] This decline in relative American capability was most pronounced before 1970. Some major indicators of capabilities, especially share of world gross national product have remained fairly stable since then. The United States still remains by far the world's largest and most diverse economy.

Nevertheless, the recovery of Europe and Japan and other shifts in relative capabilities have eroded the relative position of the United States even if it remains exceptionally formidable.[20] The United States has moved from being a net creditor to a major net debtor, making American financial markets sensitive to external developments and constraining the freedom of action of the Federal Reserve Bank. The United States was able to run a very large government deficit during the early and mid 1980s without very high real interest rates (they were high enough anyway) only because of substantial flows of Japanese capital. Japan has challenged the pre-eminence of the United States in many high technology industries. Most pointedly, the United States lost control of the world oil market shortly after 1970 when it moved from being a net exporter to a new importer of

---

19. Kenneth Organski and Jacek Kugler have argued that states which are defeated in war ultimately return to a trend line of level and growth of GNP established by their prewar experience. See A.F.K. Organski and Jacek Kugler, The War Ledger (Chicago: University of Chicago Press, 1980).

20. Bruce Russett,"The Mysterious Case of Vanishing Hegemony; Or, Is Mark Twain Really Dead?" International Organization 39 (1985).

oil and was therefore no longer able to offset production cutbacks imposed by Middle East producers after the 1973 war, cutbacks that had a devastating immediate effect on growth and inflation in the rest of the world, and a long term effect on growth and Third World debt. The inability of the United States to effectively regulate world oil markets may now lead to a major war over raw materials supplies for the first time since Japan attacked Pearl Harbor and British colonies in Asia.

AMERICAN POLICIES

For realism, the best explanation for foreign policy is the relative power capabilities of a particular state. The erosion, although hardly the collapse, of American power suggests that American policies should have changed as well. As the international environment became more constraining, realism would predict that American leaders would focus more on specific interests and less on general milieu objectives. This element of a realist analysis is confirmed by the empirical data on American foreign policy.

In the immediate postwar period American leaders pursued a number of objectives largely related to milieu goals as opposed to the narrow economic or political interests of the United States.[21] They wanted to introduce democratic political

---

21. The most restrictive understanding of narrow interests is that a country pursues relative rather than absolute objectives; that is, its fundamental concern is its own standing vis a vis other countries not the level of absolute gain secured through a particular policy. A somewhat more expansive understanding of

structures in Germany and Japan. They wanted to dismantle European colonial powers. They wanted to prevent economic breakdown in Europe and Japan.

As the Cold War developed after 1946, American policy became more singularly focussed on the Soviet and communist threat. For both ideological and strategic reasons, American leaders were deeply antipathetic to communist regimes. They saw such regimes menacing the values which underlay the American polity -- democracy and private property -- values which they wanted to encourage in the rest of the world. The extraordinary material resources of the United States, its GNP was about six times larger than that of the United Kingdom and three times larger than that of the Soviet Union at the end of the war, made it possible to adopt very generous economic policies toward allies that were designed to promote general political and strategic goals, not to further American economic interests narrowly defined. At the same time, American leaders attempted to exclude the Soviet bloc from the global economic system and impede its economic and military progress.

a. The Soviet Bloc

American foreign economic policy toward the Soviet bloc has been motivated by political and strategic considerations at the

---

narrow interests would be that a country pursues its own objectives with little concern for the ramifications of its policies on other countries (except insofar as there is strategic interaction) or the global system as a whole (except insofar as there is feedback from the system).

expense of economic interests. The Soviet Union and Eastern Europe were never included in the liberal economic regime that the United States sought to encourage in the non-communist world. The prevailing view in the United States before the late 1980s was that trade was a one way street that would benefit the Soviets disproportionately, that the Soviets were very effective at retooling western technology for military purposes, and that economic relations could be linked to political behavior. American leaders viewed East-West trade as essentially political.

The United States followed a policy of restricting trade in non-agricultural products, adopted a broad definition of security, and promulgated a comprehensive set of laws governing the transfer of non-military technology. Economic relations have persistently been linked with political objectives whether they be holding out carrots to encourage detente or economic reform within the Soviet Union, or using a stick to impose punishment for the invasion of Afghanistan.[22] A 1982 State Department document noted that:

> Our economic or trade relations with the Communist world, and particularly with the countries of the Warsaw Pact, have a different dimension from our economic relations

---

22. Gary K. Bertsch, "American Politics and Trade with the USSR," in Bruce Parrott, ed., Trade, Technology, and Soviet-American Relations (Bloomington, Indiana University Press, 1985), p. 274; Angela E. Stent, "East-West Economic Relations and the Western Alliance," in Parrott, ed., pp. 286-87; Gordon B. Smith, "The Politics of East-West Trade," in Smith, ed., The Politics of East-West Trade, (Boulder: Westview, 1985), p. 2.

> elsewhere. Economic relationships with these countries cannot be divorced from our broad political-security objectives. U.S. economic policies must support the overriding foreign policy goal of deterring Soviet adventurism, redressing the military balance between the West and the Warsaw Pact, and strengthening the Western Alliance.[23]

The United States persistently advocated policies that were more stringent than those acceptable to its allies. Canada, the United Kingdom, France, West Germany, and Japan called for major reductions in the list of items that were restricted by CoCom (the allied committee which coordinates policies regarding the transfer of goods and technology to the Soviet bloc). The United States has been much more willing than its allies to use economic sanctions for foreign policy as opposed to strictly national security reasons; that is, to show displeasure with Soviet foreign policy behavior rather than to impede the Soviet acquisition of goods or technology with military applications. Allies have objected to American laws that make claims to extraterritorial controls by regulating the reexport of American products, foreign products that contain American components or technology, or the activities of subsidiaries of American multinational corporations. In the most celebrated recent case, involving

---

23. Quoted in Stent, p. 287.

American efforts to stop European sales for the construction of a natural case pipeline from Siberia to Western Europe, the United States was forced to back down.[24]

A study by the National Academy of Sciences concluded that national security export controls had cost the United States about $9 billion per year in lost sales, which meant a loss of about 900,000 jobs. Applying the standard multiplier would raise the economic costs to the United States to $17 billion annually. No one in the United States, or in allied countries, would argue that all of these costs were incurred without any impact on the Soviet Union. Controls did impede Soviet efforts to secure militarily relevant technology and goods. An extremely generous interpretation of the consequences of these policies is that they materially contributed to the collapse of communism in Eastern Europe; a more reserved judgment would be that communism collapsed under its own weight.

The United States, however, had great difficulty weighing costs and benefits. The institutional structure that governed American economic relations with the Eastern block was designed to give greater weight to security as opposed to economic considerations. Especially under the Reagan administration, the Department of Defense was the most important bureaucratic

---

24. National Academy of Sciences, Committee on Science, Engineering and Public Policy, Panel on the Impact of National Security Controls on International Technology Transfer, Balancing the National Interest: U.S. National Security Export Controls and Global Economic Competition (Washington: National Academy Press, 1987), pp.98-99, 145.

actor. There was no effective mechanism for removing items from the controlled list, even after they had become readily available on world markets. US export controls increased the incentive for foreign competitors to develop their own capabilities. They also made foreign firms nervous about the future availability of American components.[25]

In sum, American economic policies toward the communist bloc were driven by security not economic considerations. The United States took the toughest stand among the western industrialized countries with regard to economic transactions with Eastern Europe. It sought to exclude the Soviet Union from the benefits of international trade even if this imposed disproportionate costs on the American economy.

b. The Western Bloc

The United States has had similar difficulties in assessing trade-offs involving relations with its allies. Here the assumption has been that there are no fundamental strategic or political conflicts. American leaders presumed that all good things go together; that they could accomplish all of their core objectives -- the promotion of economic development in the non-communist world, economic growth for the United States, and increasing utility for American consumers -- by pursuing a policy of liberal internationalism. The possibility

---

25. National Academy of Sciences, Balancing the National Interest, pp. 121,130.

that promoting prosperity for the Western bloc as a whole could impede American growth, weaken the relative position of the United States, damage particular American industries, and even threaten the ability of the United States to effectively assume global leadership has not been seriously confronted by American policymakers. In recent years American policy has begun to change in the face of increased external pressures, but there is, as yet, no articulated alternative to the guiding philosophy of liberal internationalism, even as the principles and norms of this approach are violated by an increasing number of specific American policies.

i. Postwar Altruism and Diffuse Reciprocity

By the winter of 1946-1947 American policymakers had concluded that the wartime alliance with the Soviet Union had collapsed. They responded with a massive effort to use economic resources to inoculate western Europe, Japan, and ultimately the third world against Leninist regimes and Soviet enticements.

The Marshall Plan provided large amounts of capital and foreign exchange which was designed to encourage productive investment in Europe, and to facilitate European cooperation. The United States did not oppose the imposition of tariffs and quotas by European states. It supported the creation of the European Common Market even though a common external tariff would inevitably have some trade diverting impact on the United States. After the unsuccessful effort to establish convertibility for the pound in 1946, Europeans were allowed, even encouraged, to continue monetary policies that discriminated against the American dollar. Many European currencies were massively devalued in 1949. While these devaluations were initiated by Europeans, they were supported by the United States. The European Payments Union, which was strongly supported by the United States, facilitated trade for transactions that were not dollar denominated. The United States assisted the creation of the European Payments Union by contributing dollars that provided surplus countries with the confidence that they would not be left holding the bag if the payments scheme failed.[26]

American policies toward Japan paralleled those applied in Europe. Japan was seen as the key to Asian economic and political development. American leaders wanted to reintegrate the Japanese economy with the rest of Asia, excepting, of course, China, once the communists had defeated the Kuomintang.

In the immediate postwar period the United States focussed on political reform, attempting to extirpate the individuals and institutional structures associated with Japanese militarism and aggression. The occupation regime did not consider economic development as part of its mandate. Heavy

---

26. Thomas L. Ilgen, Autonomy and Interdependence: U.S.-Western European Monetary and Trade Relations, 1958-1984 (Totowa, N.J.: Rowman and Allanheld, 1985), p. 12; and Michael Webb, International Coordination of Macro-Economic Policies, 1945-1989.

industry was discouraged. American policymakers saw Japan attaining a level of development comparable to the rest of Asia.[27]

But in 1947 and 1948 the fear of communist expansion became the major concern of American leaders. The emphasis of policy toward Japan switched from political reform to economic recovery. The Japanese economy was in desperate shape after the war. By the middle of 1946 trade was less than 5 percent of prewar levels. Inflation had reached 700 percent. The financial system was in a shambles. In January 1948, the United States formally reversed course and committed itself to the economic reconstruction of Japan. American policymakers set targets for Japanese industrial production and unilaterally ended the reparations program. Efforts to dismantle the zaibatsu were abandoned as was most of the political reform program. Individuals jailed as war criminals were released. Protests from Britain, Australia, and other Asian countries were brushed aside.[28]

American leaders were deeply concerned with the dollar gap, with the inability of Japan to earn enough hard currency to sustain economic development. They were skeptical of Japan's ability to develop a viable export market in the United

---

27. William S. Borden, The Pacific Alliance: United States Foreign Economic Policy and Japanese Trade Recovery, 1947-1955 (Madison: University of Wisconsin Press, 1984), pp. 62-68.

28. Borden, The Pacific Alliance, pp. 77-84. Pat Choate, Agents of Influence (New York: Knopf,1990), 178-79.

States. They, therefore, encouraged Japanese trade with the rest of Asia. They also supported higher levels of foreign aid, but were stymied by resistance in Congress.

The Korean war afforded leaders in the executive branch the opportunity to substantially increase the transfer of economic resources to Japan. The United States pumped up the Japanese economy through the purchase of war materials. The increase in raw materials prices which accompanied the war provided other Asian countries with more hard currencies which could be used to purchase industrial goods from Japan. Japanese heavy industries, in particular, benefitted from the wartime boom. In 1953 American military procurement in Japan was equal to 70 percent of Japanese commercial exports. By the mid 1950s military procurement of some $4 billion and foreign aid of $2 billion covered Japan's dollar gap.[29] Japanese restrictions on American exports and direct foreign investment were tolerated. The United State pressed for Japanese admission to GATT and opened the American market, albeit with some concessions to domestic interest groups, especially textiles.

Through the 1950s, the openhanded policy followed by the United States including foreign aid, military aid, and access to the American market did promote all of America's basic objectives -- prosperity for the non-communist world, economic

---

29. Borden, The Pacific Alliance, pp.145-47, 167-68, 220.

growth for the United States, and consumer utility. American actions contributed to European and Japanese recovery and communist movements were suppressed or unable to secure a dominant positions in any major government. Finally, the high value of the dollar increased consumer utility by lowering the dollar price of imported products. All good things would, indeed, go together if the United States followed an open trading policy based on diffuse reciprocity.

ii. Declining Power and Particularistic Interests

American leaders, both public and private, have continued to enunciate principles which defend a liberal open international economic order. In the early 1980s, in an exceptional show of bipartisanship, former presidents Ford and Carter jointly issued a declaration warning about the dangers of protectionism. The Reagan administration enshrined the free market. In the summer of 1986 all of America's Nobel prize winners in economics publicly endorsed a free trade. The United States took the lead in the new round of multilateral trade negotiations designed to extend the scope of GATT coverage to services.

However, while the general principles and commitments of American policymakers have not changed, both external and internal pressures have led to the adoption of new policies that are based more on specific than diffuse reciprocity. American foreign economic policy has not been characterized by the replacement of one set of principles by another but rather by the accretion of one set of practices on top of other earlier practices that might have been based on a very different set of principles and norms.[30] As early as the mid 1950s US policymakers employed sector specific approaches. The motivation of executive branch policymakers in the United States was to preempt what they feared would be even more restrictive action initiated by Congress. They frequently resorted to voluntary export restraint (VERs) agreements as the least damaging form of protectionism. "Voluntary" restraints did not formally violate GATT rules. VERs gave the rents accruing from restricted access to foreign producers rather than to the US Treasury, an indication that the primary concern of American leaders was to preserve, as best they could in the face of domestic protectionist pressures, an open global system, rather than to maximize returns to the United States.

Recent legislation shows more movement toward specific reciprocity, bilateralism rather than general multilateralism, and a greater concern with specific American interests rather than the stability of the global economic system as a whole. The Caribbean Basin Initiative of 1983 gave Caribbean countries preferential access to the American market, again a violations of most favored nation principles.[31] The Trade and Tariff Act

30. Judith Goldstein, Ideas, Interests, and American Trade Policy, Unpub. manuscript, Stanford University, October, 1990.

31. C. Michael Aho and Jonathan David Aronson, Trade Talks: America Better Listen (New York: Council on Foreign

of 1984 gave the president the right to negotiate bilateral free trade agreements, a movement away from generalized most favored nation treatment. Agreements have been concluded with Israel and, much more significantly, with Canada. The United States and Mexico are actively exploring a free trade agreement raising the promise or specter of a North American trading bloc.

The Omnibus Trade and Competitiveness Act of 1988 created a number of mechanisms that could, if they were vigorously pursued by the executive branch, provide the United States with greater leverage to alter the behavior of foreign trading partners. Most importantly, the Super 301 provision of the Act provides for expedited action against countries that are judged to be engaged in unfair trading practices. Such practices can, under the provisions of the Act, be technically legal, but if they violate the spirit of international trade agreements the president is authorized to retaliate. Retaliation can be targeted against a specific country and can take a very wide range of forms. Super 301 is an instrument for coercive bargaining on the part of the United States. It has been used as leverage to get other countries to change their policies. To date only one Super 301 action has actually been formally taken.[32]

Relations, 1985), p. 126.

32. Goldstein (1990), Chapter 2, pp. 47-52.

In general, American-Japanese relations offer the best evidence for the practical significance of specific reciprocity. There is a long history of sector specific arrangements involving the United States and Japan. In 1955 the United States successfully secured Japanese acquiescence to an arrangement that limited the sale of Japanese cotton textiles in the United States. This accord ultimately evolved into the MultiFibre Agreement.[33] Other agreements involving major products such as steel and automobiles were concluded in subsequent years.

In the early 1980s the United States and Japan began a series of negotiations known as MOSS (Market Opening Sector Specific) negotiations. These discussions dealt with several specific commodities including telecommunications equipment, electronic devices, wood and paper products, and medical equipment and pharmaceuticals. The United States focussed its attention on procedural issues such as technical standards, certification requirements, access to MITI advisory committees, and the patent application processing. But in some cases the United States also pressed for explicit market shares, an objective much more consistent with a policy of specific reciprocity.[34]

---

33. For an explication of developments in the textile sector see Vinod Aggarwal, Liberal Protectionism (Berkeley: University of California Press, 1985)

34. A listing of the issues dealt with in the MOSS negotiations can be found in Japan Economic Institute, JEI

The MOSS negotiations were followed by the Structural Impediments Initiatives (SII). In these negotiations, concluded in June 1990, American negotiators sought more ambitious changes in the way business is done in Japan that are designed to increase American exports and protect American property rights. Japan agreed to reduce the average time needed to issue patents from 37 months to 24 months. Despite the opposition of the Ministry of Finance, the Japanese government agreed to increase public works programs by 63 percent over the next decade. Japan agreed to modify a law that had frustrated the opening of large chain and department stores that are more likely to sell imported goods at discounted prices. Distribution costs in Japan have been so high that exchange rate changes, that have reduced the wholesale costs of foreign goods, have little impact at the

Report No. 2B, January 17, 1986, pp. 3-6. American negotiators have pressed for some target level of purchases in the MOSS telecommunications negotiations. See JEI Report, 21B, June 7, 1985, p. 8. Some specific targets were also informally mentioned in a settlement worked out between Japan and the United States to resolve several anti-dumping suits that had been brought by American firms against Japanese exporters of micro-chips. Both American and Japanese negotiators said that they had discussed a target of 20 percent of the Japanese market for American firms by 1991, but no formal commitments were made. In the mid-1980s American producers accounted for only 8 percent of the Japanese market. See New York Times, August 1, 1986, 27:3. Targets had, however, been mentioned informally in earlier agreements related to semiconductors to no avail. A Commerce Department official who played a major role in negotiations with Japan during the expressed great skepticism about the impact of the 1986 agreement. See the statement of Clyde Prestowitz in Business Week, August 16, 1986, p. 63.

retail level. Japan also agreed to make some changes in the laws and regulation related to keiretsu's, although no timetable was set.[35]

The MOSS negotiations and the Structural Impediments Initiative implicitly recognized that given the variations in institutional arrangements between the United States and Japan, general rules do not provide either mutually satisfactory outcomes or policy guidance. The American market can be penetrated much more easily than the Japanese market because in the United States transactions are more heavily determined by arms length market transactions; long term relationships are less important. In Japan economic activity is more strongly influenced by long standing relationships and commitments among private and public actors. Networks consisting of keiretsu members, MITI, and increasingly members of the Diet are not easily penetrated by foreign corporations.

The growing attentiveness of American policymakers to sector specific concerns involving Japanese products was highlighted by developments in the semiconductor industry in 1986 and 1987. In July of 1986, a bilateral agreement was signed in which Japan agreed to end what the United States claimed was the dumping of semiconductors in the American market, and to open the Japanese market to American products. Had the agreement not been concluded, the United States would

---

35. New York Times, June 29, 1990, p. 1 c.1.

have imposed substantial anti-dumping duties on Japanese semiconductors. In March of 1987, however, President Reagan declared that Japan had not abided by the agreement. A primary focus of American concern was the entry of Japanese products through third countries. Reagan announced that import duties of 100 percent would be imposed on about $300 million worth of Japanese electronics products. This was the first formal use of American trade legislation for retaliation against Japan in the postwar period.[36]

There are other instances as well of policy which is more consistent with specific than diffuse reciprocity. In March of 1987, after protests from American government officials notably Secretary of Commerce Baldridge and Secretary of Defense Weinberger, Fujitsu withdrew its effort to take over the Fairchild Semiconductor Corporation. Baldridge and Weinberger expressed concern for national security; however, Fairchild was owned by a French company Schlumberger, so the issue was not simply one of foreign ownership.[37] In the mid and late 1980s the United States pressed Brazil extremely hard to open its computer market. There was continuing pressure on the Common

---

36. New York Times August 1, 1986, 1:5, and March 28, 1987, 1:3. While the symbolic importance of American action does need to be highlighted, it must be recognized that the duties will affect less than one percent of Japanese products entering the United States.

37. New York Times, March 18, 1987, p. 25:1

Market to further open its domestic markets to American agricultural products.[38]

These actions, and others like them, which focus on specific are not evidence that American policymakers have consciously adopted a policy of specific reciprocity. Some actions are rationalized by appealing to national security. Others are caste as efforts to make the system more closely conform to GATT rules. Others are explained as necessary concessions to domestic pressure groups. The sector and country specific policies adopted by the United States have not, however, been informed by any general set of principles. They are ad hoc responses to growing environmental pressures.

The growing American concern with specific interests has not been limited to the area of trade and investment. In the 1980s, American officials pressed other countries to open their telecommunications markets to both American products. A more market oriented regime would undermine the system of national monopolies that has dominated domestic and international markets since the 19th century. American officials were motivated by possible competitive advantages enjoyed by some American firms as a result of new technologies. The United

---

38. John Odell, "International Threats and Internal Politics: Brazil, the European Communist and the United States," Unpub. paper, University of Southern California (August 1990).

States had already dramatically increased access to its own market as a result of the break-up of ATT.[39]

In international monetary policy the United States has moved from a set of policies in the 1960s that were dominated by a concern for global stability to a set of policies that are focussed on much more narrow considerations. In the early 1960s the Kennedy administration was willing to impose deflationary pressures on the American economy to preserve the international value of the dollar. Rather than pushing for devaluation during the mid 1960s, American policy makers engaged in a number of devices that were designed to finance rather than change the American deficit.

When, however, the United States trade balance, as opposed to just the current account balance fell into deficit in 1971, the Nixon administration acted decisively to bring down the value of the dollar. In August of 1971, American policymakers suspended the gold convertibility of the dollar and imposed an almost across the board 10 percent import surcharge. After two years of negotiations the advanced industrialized countries were unable to reach any agreement on new exchange rate values and the system de facto moved to flexible exchange rates. Without passing judgment on the benefits of the new regimes, American policy during this period was driven more by specific

---

39. Krasner, "National Power and Global Communication."

self interested concerns than had been the case during the 1950s and 1960s.[40]

The principles and norms espoused by American central decision makers have not changed in any fundamental way. While, however, the rhetoric has remained constant, specific policies have increasingly diverged from the notions of diffuse reciprocity, openness, and non-discrimination. Various pressures, sometimes from domestic groups, sometimes from the international system, have compelled policymakers to adopt practices that are increasingly concerned with specific, well defined American interests than was the case in the immediate postwar period. American leaders have become less concerned with broad milieu goals and more with the absolute, if not the relative, well being of the United States.

The relationship between the relative position of the United States and American policy provides general support for a realist perspective. As the relative position of the United States has declined, American policy has become more oriented toward specific American interests and less concerned with general milieu goals. These changes, however, are relative; they say nothing about the absolute level of American commitment to the stability of the global order. Moreover, this relationship between American power and American policy

---

40. Joanne Gowa, Closing the Gold Window: Domestic Politics and the End of Bretton Woods (Ithaca: Cornell University Press, 1983).

does not provide any direct evidence about developments in the international economic system.

SYSTEMIC OUTCOMES

The following section examines developments in the actual pattern of behavior in the international economy; that is, the movement of goods and services across international boundaries. While the picture is sometimes mixed, oil being the great example of an issue area where the decline in American power is palpably related to disruptions and instability in global markets, on the whole international transactions of many kinds have continued to grow more quickly than domestic transactions. While the commitment of the United States to the stability of the global order may have flagged, that order itself appears to be robust.

a. International Financial Flows

Lines 1 and 2 of Table 4 show that international flows of FDI have remained at high levels throughout the 1970s and 1980s. Flows have been much greater in the 1980s (after a setback around 1982 due to the world recession and the Third World debt problems) than they were in the 1960s. Lines 3 and 4 of Table 4 show that outward and inward stocks of FDI among the developed market economy countries continued to grow strongly in the 1970s and 1980s. Lines 2, 3, and 4 of Table 3 reveal that flows have become more balanced: the US role as a supplier of FDI has declined while its role as a host for FDI has become much more important.

It should be noted, however, that FDI has never accounted for a very high share of total investment in the advanced capitalist countries. In 1970-71 FDI inflows accounted for only 3.5 percent, and FDI outflows only 1.8 percent (unweighted average) of gross fixed capital formation in the developed market economy countries. In 1982-83, FDI inflows accounted for 2.7 percent, and outflows for 2.2 percent, of gross fixed capital formation in these countries.[41]

41. The shares for individual countries varied around these averages (for example, FDI inflows accounted for 0.5 percent, and outflows for 4.1 percent, of gross fixed capital formation in the US in 1970-71, and for 4.1 and 2.6 percent respectively in 1980-81), but the averages do appear to reflect broad trends accurately. See: UN Centre on Transnational Corporations, Trends and Issues in Foreign Direct Investment and Related Flows (1985), pp. 19-20.

TABLE 4

Flows and stocks of Foreign Direct Investment by Developed Market Economy Countries, 1960-1986, in billions of dollars or SDRs[a]

	1960	1967	1975	1980	1982	1984	1986
1. Outflows from DMEs	2.9 ($)	9.1[b] ($)	26.3[c] ($)	40.8 (SDR)	20.7 (SDR)	38.7 (SDR)	78.8 (SDR
2. Inflows into DMEs	2.3 ($)	5.5[b] ($)	14.5[c] ($)	31.0 (SDR)	26.2 (SDR)	36.6 (SDR)	41.1 (SDR
3. Outward stock of FDI from DMEs	n.a.	$106	$259	$458[d]	n.a.	$516[de]	n.a
4. Inward stock of FDI in 5 major DMEs[f]	n.a.	$40	$94	$235	n.a.	$282[e]	n.a

Notes: [a]Before 1971, 1SDR=$1. SDR valuation for more recent data eliminates some of the distortions created by dollar exchange rate fluctuations. SDR values have been used wherever available.
[b]1967-69 annual average [c]1973-75 annual average
[d]Does not include Switzerland, which has substantial holdings of FDI abroad. [e]1983 [f]Canada, West Germany, Japan, UK, US
Source: 1980-86 flows data from IMF, Balance of Payments Statistics Yearbook, Volume 38, Part 2 (1987), p. 68. 1967-69 and 1973-75 flows data, 1967 inward stock data, and 1967-75 outward stock data from UN, Commission on Transnational Corporations, Transnational Corporations in World Development: A Re-examination (1978), p. 238. 1960 flows data from UN, Multinational Corporations in World Development (1973), pp. 144-45. 1975-83 inward stock and 1980-83 outward stock data from OECD, International Investment and Multinational Enterprises: Recent Trends in International Direct Investment (1987), pp. 63-65.

Trends in international banking and international bond financing are clear; most measures indicate that the volume of these flows has increased substantially in the 1970s and 1980s. The growth of these markets had only just begun in the 1960s. Net international bank credit has grown from $12 billion in 1964 to $122 billion in 1972, $810 billion in 1980, $1240 billion in 1983, and $1485 billion in 1985, for a compound annual growth rate of 25.8 percent, far higher than the compound annual growth rate of 10.4 percent for world GDP or the rate of 12.4 percent for international trade in goods and services.[42]

Lending to foreign residents has grown sharply as a percentage of total loans made by banking offices based in the major industrialized countries. In the US, it rose from 2.4 percent in 1962 to 16.8 percent in 1985; in the UK, it rose from 11.3 percent in 1963 to 54.3 percent in 1983; in West Germany, from 2.7 percent in 1962 to 8.5 percent in 1985; and in Japan, from 3.1 percent in 1973 to 7.4 percent in 1985.[43]

Foreign-owned banking institutions have become much more important players in financial markets in the major industrialized countries. Between December 1970 and June 1985,

---

42. World figures exclude Soviet bloc, and all figures are based on current prices and exchange rates (i.e., they are not adjusted for inflation). "Net" international bank credit means net of interbank lending. Source: BIS and IMF data reported by Ralph C. Bryant, International Financial Intermediation (Washington, 1987), p. 22.

43. Calculated from Bryant, International Financial Intermediation, Tables 3-7, 3-9, 3-10, and 3-12.

the percentage of total bank assets (i.e., loans) held by foreign-owned banks rose from 5.8 percent to 12.0 percent in the US, from 37.5 to 62.6 percent in the UK, from 1.3 to 3.6 percent in Japan, from 1.4 to 2.4 percent in Germany, from 12.3 percent to 18.2 percent in France, and from 0.0 to 6.3 percent in Canada.[44] Finally, international placements of bonds have increased at an enormous rate; whereas issues and placements of bonds in foreign markets and in the Eurobond market amounted to $3.3 billion in 1965, in 1986 their value was $227 billion.[45]

b. International Trade

There has also been no significant change in the rate of growth of international trade compared with global economic output despite the relative decline of the United States and the changes in its policies. International trade has grown faster than world output continuously throughout the period since 1945, as shown in Table 5.

---

44. BIS, Recent Innovations in International Banking (April 1986), p. 152.

45. IMF, International Capital Markets: Developments and Prospects (1981), p. 52 and (1988), p. 73.

TABLE 5

Average annual growth rates in world trade (exports) and world output, 1948-87, in percent (calculated using constant prices)

	1948-53	1953-60	1960-70	1970-80	1980-87	1986	1987
world exports	6.3	8.7	8.5	5	3	4	5
world output	5.3	6.1	6	4	2.5	3	3

Source: GATT, International Trade, 1959, 1963, and 1987-88.

Table 6 presents data on long-term trends in trade proportions for the seven largest developed market economy countries. Caution should be used in making comparisons across periods, since the coverage and reliability of the statistics varies. Trade proportions increased dramatically in the postwar period. For several major industrialized states, they reached their highest levels in 1980 and have fallen somewhat since. The falls have, nonetheless been relatively modest with the exception of Japan were trade fell from 30 to 20 percent of national output.

TABLE 6

International trade (exports plus imports[a]) as a proportion of national output[b], 1840s to 1987[c], in percent

	1840s	1880s	pre-WWI	1920s	1952	1960	1970	1980	1985	1987
US	15	13	12	12	9.8	9.5	11.2	24.5	20.4	21.7
UK	26	49	52	38	51.3	43.9	46.1	52.2	57.0	53.4
Japan	na	13	33	41	23.2	21.6	20.3	30.7	29.1	21.6
FRG					29.4	44.0	40.1	57.1	65.8	57.5
France	18	29	54	51	28.6	27.9	32.2	44.3	47.2	41.6
Italy		26	34	30	23.2	29.6	35.0	43.8	43.3	36.3
Canada	na	30	36	50	41.5	36.2	44.0	54.7	53.8	51.1

Notes: [a]Goods and services, except goods only for UK (1920s), Germany and France (1840s, 1880s, pre-WWI, 1920s), and Canada (1880s).
[b]GDP for all countries 1952-87 and for Japan, earlier years. GNP for US, UK, Italy, and Canada for earlier years. Physical product for France, earlier years, and net total uses for Germany, earlier years.
[c]For years prior to WWII, we have selected the years closest to the date indicated for which data was available in Kuznets. Exact years covered can be obtained from the authors.
Sources: For 1920s and earlier data, Simon Kuznets, "Quantitative Aspects of the Economic Growth of Nations: X. Level and Structure of Foreign Trade: Long-Term Trends", Economic Development and Cultural Change 15(2)(Part II) (January 1967), Table 4 and Appendix Table 1. For 1952-70 data, OECD, National Accounts Statistics. 1951-1980. Volume I: Main Aggregates (1982). For 1980-87 data, OECD, Quarterly National Accounts No. 1 1988.

c. Economic Growth and Inflation Rates

While various measures of international economic transactions -- trade, finance, investment -- are either growing or only marginally declining, the performance of national economies has been more problematic. Overall economic performance has declined since 1970: growth rates are slower, and unemployment and inflation are higher as shown in the following table.

TABLE 7

	Average Annual Growth of GDP			Average Annual Rate of Inflation		
	1960-70	1970-79	1980-87	1960-70	1970-79	1980-87
Low Income Countries excl. China and India	4.3	3.8	1.7	3.0	10.9	13.3
Middle Income excl Oil Exporters	6.1	5.5	2.8	3.0	13.3	62.3
Ind Market Economy	5.1	3.2	2.6	4.3	9.4	5.2

Sources: World Bank, World Development Report, 1981 and 1989 Tables 1 and 2.

Growth rates for poor, middle income, and developed market economy countries have all declined since the 1960s. With the exception of the industrialized countries, inflation rates have also grown steadily since the 1960s. Public debt service has increased dramatically from 7.1 percent of the export of goods and services for low income countries in 1970 to 21.9 percent in

1987, and from 11.7 percent for middle income countries to 23.9 percent.[46]

Some of these negative aspects of international economic performance are associated with the declining power of the United States. While Arab exporting states tried and failed to impose a production cutback and embargo after the 1967 Middle East War they succeeded after the 1973 War because in the interim the United States had become a net importer of crude oil: it no longer had the spare capacity to counter even a modest production cutback. Oil prices quadrupled during the first crisis in 1973-74, then fell during most of the 1970s, only to double again as a result of the second crisis precipitated by the Iran-Iraq war. Prices fell during the 1980s, but the Iraqi invasion of Kuwait led to another doubling of prices.

The Third World debt crisis began partly as a result of the exceptional incentives that international banks had to recycle petro-dollars. The funds flowing into these banks grew so precipitously as a result of the revenues generated for petroleum exporting states that the banks almost pushed oil importing Third World states into higher levels of borrowing despite the fact that high rates of inflation in the mid 1970s made real interest rates negative for some loans. When real global interest rates rose in the late many Third World countries found themselves in a debt squeeze which contributed to economic downturns more severe

---

46. World Bank, World Development Report 1989, Table 24.

than anything they had experienced in the 1930s. Debt service ratios (debt payments as a percentage of the export of goods and services) for non-oil developing countries increased from 11.5 percent in 1974 to 22.3 percent in 1982 and remained at about the same level through the late 1980s.[47] Mexico experienced a growth rate of only 0.5 percent for the period 1980-87 compared with 6.5 percent for the period 1965-80; Argentina had a negative growth rate of -0.3 percent for the period 1980-87 compared with a positive rate of 3.3 percent for the period 1965-80.[48]

The decline in productivity among the industrialized countries as a whole is also related to the increase in oil prices. Around 1974-75 productivity measures in the United States and other advanced industrialized countries fell sharply. They persisted at significantly lower levels during the rest of the 1970s. Although productivity increased again in the 1980s it did not regain the levels of increase in average annual output per man-hour that had been experienced in the period from 1960-73.[49]

---

47. IMF, World Economic Outlook 1982, p. 173, October, 1986, p. 110.

48. Figures from World Bank, World Development Report 1989, Table 2.

49. Zvi Griliches, "Productivity Puzzles and R & D: Another Nonexplanation," Journal of Economic Perspectives 2 (1988), Table 1.

There are one two serious possible explanations for this decline. One is a reduction in R and D expenditures. This is not convincing because although some expenditures fell in the United States, they did not fall in other countries; yet the rate of productivity growth declined in all industrialized countries. The second explanation is the direct and macro-economic consequences of rising energy prices. Higher prices forced many companies to scrap some capacity and to alter their allocation of factors. Higher oil prices led to a fall in real wealth, a decline in aggregate demand because of government attempts to control rising inflation, and, for the United States, a decline in exports and rise in imports because of rising dollar exchange rates. These macro-economic changes reduced the rate of growth of productivity. Hence, higher oil prices not only resulted in a slowdown in the rate of growth of the world economy but also contributed to what has been a long term decline in the rate of productivity growth.[50]

In sum, the empirical record on the relationship between declining American power and international economic performance is mixed. The level of openness in the international economy has not decreased in any unambiguous way, despite a decline in American power and change in American policy. The ultimate economic performance of the world economy, the rate of real growth, has deteriorated since 1970. A full analysis of this

50. Ibid., passim.

degeneration is beyond the scope of this paper and relates to factors as diverse as the end of the recovery period following the second world war and the exhaustion of pools of rural labor in more advanced industrialized countries.

One cause of relatively poor economic performance since the early 1970s is, however, a result of the decline of American power -- the unpredictable nature of the international oil markets. The United States lost control of the international energy market after 1970, primarily because it became a net oil importer and secondarily because oil exporting states were able to nationalize their oil fields ending the full vertical integration that had previously been enjoyed by the major international oil companies, most of which were American. As a result oil prices rose precipitously in 1973-74, 1979-80 and 1990. Fuels accounted for 10 percent of world exports in 1963, 11 percent in 1973, 20 percent in 1979, and 21 percent in 1983. By 1987, however, fuels had fallen back to 11 percent of world exports, but the price increases of 1990 will undoubtedly increase this figure.[51] International financial imbalances, particularly the accumulation of third world debt in the 1970s and its disastrous consequences for real growth in the 1980s, and the decline in the rate of productivity growth are associated with the unstable nature of international energy markets.

---

51. Figures from GATT, International Trade 87-88, Vol. II, Tables AB 1, 2, and 3.

CONCLUSIONS AND SPECULATIONS

Has the power of the United States declined? Yes.

Has the United States taken a more self interested stance towards international economic matters since 1970? Yes.

Is the United States, therefore, a less effective international leader? Yes, because American central decision makers are more concerned with specific American interests than with general milieu goals.

Is the international economic system crumbling? No.

Has overall macro-economic performance fallen since 1970? Yes.

While these answers are, I believe, reasonably clear, what they imply about the major theoretical perspectives that have informed the study of international political economy, and correlatively, what they intimate for the future is not self evident.

There are a number of variants of a realist argument. The most well known is the hegemonic stability thesis. The dependent variable in this argument has generally been taken to be the international economic regime and associated patterns of transactions. Hegemonic stability is generally understood to mean that a single hegemon is needed to provide a stable international regime. The evidence for hegemonic stability understood in this way is problematic. Despite the decline of the United States, international regimes have not collapsed, and international economic transaction have not declined.

The simplest realist defense is that the United States is still a hegemon, and the stability of the international economic regime can be accounted for by the continued pre-eminence of the United States.[52] It is true that the United States is, today, far more powerful than Britain, the most important economic actor in the 19th century, ever was. Indeed, the virtually two to one ratio in aggregate economic output that the United States has maintained over its nearest rival is almost certainly greater than that which any other state has ever enjoyed. Nevertheless, there have been significant declines in American capabilities in some issue areas, especially oil and more recently finance. Resources are not necessarily fungible across issue area.[53] It would have been far more attractive for the United States to counter the Iraqi invasion of Kuwait with increased domestic oil production than troops; but the United States no longer has any surplus productive capacity. A defense of the hegemonic stability thesis based on the assertion that the United States is still a hegemon is too easy because of the loss of American power

---

52. For one elaboration of the argument for continued American power see Bruce Russett, "The Strange Case of Vanishing Hegemony."

53. The argument is developed in Robert Keohane and Joseph Nye, Power and Interdependence (Boston: Little-Brown, 1977), in their concept of issue area structuralism.

in some significant issue areas. Hence, if hegemonic stability is taken to mean that the stability of the international economic regime -- especially openness -- is a function of the position of the hegemon, then the theory is not well supported by developments over the last two decades. The power of the United States declined through 1970, but the international economic regime has not fallen apart, or even, in any general sense, significantly deteriorated.

Hegemonic stability could, however, be assessed in terms of another dependent variable -- economic performance as indicated especially by aggregate growth rates. Here the evidence for hegemonic stability is stronger. Economic growth rates declined after 1970. Inflation increased. Productivity slowed. There are many explanations for these changes, including the end of the post war recovery and the exhaustion of rural labor pools in Europe. The increase in world energy prices, however, are a proximate cause. The first oil price increase in 1973-74 resulted in a decline in the rate of productivity growth which has not been reversed. Higher oil prices created severe financial crises and later stagnant or even declining growth rates for a number of major Third World countries. The erratic character of the world energy market since the 1970s is associated with changes in the relative power capabilities of the United States -- more specifically the transformation of the U.S. from a net exporter to a net importer and the loss of control suffered by the major international oil companies, five out of seven of which were American.

A version of hegemonic stability that treats economic performance and not international economic regimes as the dependent variable does have significant empirical support. It also does not augur well for the future stability of the international economic system. It suggests that the decline in American power will be consequential not just for American policy which has already shifted from milieu goals to more narrow American interests, but also for economic performance.

The collapse of the Soviet Empire may even exacerbate the consequences of American decline. The economic hegemony of the United States was always limited to the Western bloc. One of the reasons that the United States was so open handed toward its allies was the desire of its leaders to balance against the Soviet threat -- both military and ideological. A strong Europe and Japan were seen as a critical part of the American alliance. American central decision makers were not concerned with relative gains from international economic cooperation with their alliance partners. A traditional obstacle to international cooperation and commerce was eliminated by the conviction that gains for alliance members enhanced rather than undermined American national security. The Soviet Union, not Japan or Germany, were the focus of any relative power calculations made by American leaders.

The collapse of the Soviet Empire, and even the possible disintegration of the Soviet Union itself, would remove the communist threat. The already weak incentives of American leaders to maintain the western alliance in the face of an alien, threatening, and powerful opponent would evaporate altogether. The United States would become more concerned with its relative position vis a vis Europe and Japan. If such a stance revived American relative capability, hegemonic stability arguments would suggest that this would be beneficial for the system as a whole. But if American decline continued then the maintenance of a stable order would become more problematic.

From a realist perspective, however, hegemony is not the only international distribution of power that is consistent with international stability whether it is understood in terms of international regimes, international transactions, or economic performance. Keohane has argued that it is possible, after hegemony, to achieve stability through the creation of international institutions. David Lake has suggested that two leading states can, through strategic interaction, arrive at mutually open policies. I have argued that a world of small highly developed states would probably be economically open.[54]

These realist formulations, which associate stability with

---

54. Keohane After Hegemony. David Lake, "Beneath the Commerce of Nations: A Theory of International Economic Structures," International Studies Quarterly 28 (1984). Stephen Krasner, "National Power and the Structure of International Trade," World Politics (1976).

one kind of multipolarity or another, as well as the liberal perspective sketched out at the beginning of this paper, all hold the promise that the liberal, open, non-discriminatory regime so clearly articulated after the second world war, will continue. Declining growth rates and higher inflation can be understood as only a temporary setback. The ability of actors to cooperate, suggests a robust rather than a fragile international environment. If, however, a hegemon is truly needed, then a single major shock could severely disrupt the system, because the only nominee for that role, the United States, has seen its power erode in important areas and, paradoxically, seen the major incentive for open handedness and generosity to its allies, the threat of the Soviet Union, diluted.