THEODORE RUETER

THE UNITED STATES IN THE WORLD POLITICAL ECONOMY

Edited by THEODORE RUETER

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THE UNITED STATES IN THE WORLD POLITICAL ECONOMY

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Contributors

David Alan Aschauer is Elmer E. Campbell Professor of Economics at Bates College.

Robert E. Baldwin is professor of economics at the University of Wisconsin—Madison.

Daniel Bell is Professor Emeritus of Sociology at Harvard University.

C. Fred Bergsten is director of the Institute for International Economics.

Barry Bluestone is professor of political economy at the University of Massachusetts—Boston.

Clemens Boonekamp is a senior economist in the Geneva office of the International Monetary Fund.

Richard G. Darman was director of the U.S. Office of Management and Budget.

Rudiger W. Dornbusch is the Ford International Professor of Economics at the Massachusetts Institute of Technology.

Gerald Epstein is assistant professor of economics at the University of Massachusetts at Amherst, and staff economist for the Center for Popular Economics.

Aaron L. Friedberg is assistant professor of politics and international affairs at Princeton University.

Roger H. Gordon is professor of economics at the University of Michigan.

Stephan Haggard is associate professor of government at Harvard University.

Bennett Harrison is visiting professor of political economy at Carnegie—Mellon University.

Esmail Hosseinzadeh is assistant professor of economics at Drake University.

G. John Ikenberry is assistant professor of politics and international affairs at Princeton University.

Shintaro Ishihara is a member of the Standing Committee on Foreign Affairs of the Japanese Diet.

H. B. Junz is the director of the Geneva office of the International Monetary

Robert Kudrle is professor and director of the Freeman Center for International Economic Policy at the Hubert Humphrey Institute of Public Affairs at the University of Minnesota.

Wei Li is a graduate student in economics at the University of Michigan.

Robert J. Lieber is professor and chairman of the Department of Government at Georgetown University.

Helen Milner is assistant professor of political science at Columbia University.

Phedon Nicolaides is a research fellow at the Royal Institute of International Affairs in London.

Joseph S. Nye, Jr., is director of the Center for Science and International Affairs at the Kennedy School of Government at Harvard University.

James Poterba is associate professor of economics at the Massachusetts Institute of Technology.

Clyde Prestowitz is president of the Economic Policy Institute; he was formerly Counselor for Japan Affairs to the U.S. Secretary of Commerce.

Jeffrey J. Schott is a research fellow at the Institute for International Economics.

Susan Strange is a professor at the London School of Economics.

Lawrence H. Summers is Nathaniel Ropes Professor of Political Economy at Harvard University, as well as chief economist for the World Bank.

Howard M. Wachtel is professor of economics at the American University, as well as a fellow at the Transnational Institute.

Willi Wapenhans is vice president of the World Bank's Europe, Middle East, and North Africa Region.

Preface

The readings in *The United States in the World Political Economy* explore the major issues facing America as an international economic power. This book can be used in courses on international political economy, international relations, American foreign policy, international economics, macroeconomics, international relations theory, and American studies.

This volume features articles from some of the most prominent analysts of international political economy, including Daniel Bell, C. Fred Bergsten, Barry Bluestone, Richard Darman, Bennett Harrison, Shintaro Ishihara, Robert Lieber, Joseph Nye, Clyde Prestowitz, and Susan Strange. I have chosen selections from political scientists, economists, and policymakers. I have attempted to select readable, policy-oriented articles from a wide range of ideological perspectives.

The readings examine a variety of topics: American hegemonic decline, the American budget deficit, the structural basis of the American economy, U.S./Japanese economic relations, the distribution of international economic power, the American economy and international trade, the American economy and international investment, the political economy of international debt, and the future of the world political economy. They provide an overview of such issues as American infrastructure, industrial policy, Japanese economic policy, the Persian Gulf war, economic reform in Eastern Europe and Russia, Chinese economic behavior, the "Four Tigers" of Asia, the rise of regionalism in world trade, and the GATT talks.

Organization

The readings are organized into nine chapters. Following the introductory essay, the first chapter examines the role of the United States as the leader of the world economy, including recent changes. The next two chapters examine factors internal to the American economy, such as public infrastructure and the federal budget deficit. Chapters 4 and 5 consider American relations with Japan, OPEC, the Group of Seven, the former Soviet Union, Eastern Europe, the Newly Industrializing Countries of East Asia, and China. The next three chapters investigate the relationship between the American economy and three sectors of the world economy: trade, investment, and

debt. Finally, the last chapter concerns the future of the world political economy.

Themes

This volume has two themes. One is that the United States is the most important actor in the world political economy. The United States has the world's largest economy, it is the key player in global economic institutions, it holds the world's dominant reserve currency, and it is the world's largest debtor nation (after having been the world's largest creditor nation). Therefore, it is appropriate to view international political economy from an American-centered perspective.

The second theme is the close relationship between domestic politics and international economics. There are domestic sources of international economic policy as well as international sources of domestic economic policy. Political factors affect economic policy, and vice versa.

These interactions were evident in the 1992 American election. Bill Clinton made the economy his central campaign issue. Indeed, a sign in the "War Room" at his campaign headquarters reminded his staffers, "It's the economy, stupid."

Clinton's election may portend changes in American international economic policy. He promised to press for a "stronger, sharper" trade bill, to "work more aggressively to open foreign markets to American goods and services," to renegotiate the North American Free Trade Accord, and to abolish tax breaks for American corporations "that shut down their plants in America and ship American jobs overseas."

Clinton's campaign rhetoric was consistent with economic nationalism, an ideology supported by Rust Belt congressmen, smokestack industries dependent upon government help, and industrial unions. Economic nationalism calls for regulation of foreign investment, direct assistance to American firms, and a militant trade strategy to open up Asian markets.

Several prominent members of the Clinton administration are advocates of industrial policy and economic nationalism. Laura D'Andrea Tyson, an economist at the University of California, Berkeley, is the head of Clinton's Council of Economic Advisers. She has edited books on trade and employment, American international competitiveness, and Japan's economic performance. Her latest book is Who's Bashing Whom? Trade Conflicts in High-Technology Industries (1993).

Ira Magaziner, another advocate of industrial policy, is on Clinton's White House staff. Magaziner is author or co-author of Japanese Industrial Policy (1981), Minding America's Business: The Decline and Rise of the American Economy (1983, with Robert Reich), and The Silent War: Inside the Global Business Battles Shaping America's Future (1989).

Robert Reich, Clinton's Secretary of Labor, is an advocate of improved

worker training, greater American investment, and closer relations between labor and management. He has written *The Next American Frontier* (1983), *Tales of a New America* (1987), *The Resurgent Liberal* (1989), and *The Work of Nations: Preparing Ourselves for the 21st Century* (1991).

In February 1992, President Clinton presented his program to rejuvenate the nation's economy. He proposed extending federal unemployment benefits, creating an investment tax credit, and spending \$16 billion on new

public works projects.

Clinton also called for austerity measures. He proposed establishing a broad-based energy tax, increasing the tax rate on Social Security benefits, increasing the top rate for individual and corporate income taxes, reducing domestic and military spending, and decreasing federal employment and administrative costs.

Economic policy will continue to be a major issue in American politics. One objective of this volume is to improve the quality of the public debate.

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Theodore Rueter

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Introduction: The Nature of International Political Economy

My purpose in this essay is to provide an introduction to the field of international political economy (IPE). I will review the significance of international economic issues in American politics, historical change in the IPE, leading theories of IPE, and competing levels of analysis in IPE.

International political economy may be defined as the relationship between international politics and international economics. The academic discipline of IPE is becoming increasingly prominent, creating greater unity between the fields of political science and economics.

INTERNATIONAL ECONOMIC ISSUES AND AMERICAN POLITICS

The growing popularity of IPE parallels the increasing significance of international economic issues in American politics. The agenda of international relations is no longer limited to the "high politics" issues of national security, alliances, and armaments. Increasingly, the agenda of international relations consists of "low politics" issues, such as foreign direct investment, oil imports, and the balance of payments.

American public concern about the economy grew substantially in the 1970s—a decade which witnessed the Arab oil embargo, a global recession, the final years of the Vietnam war, the end of the Bretton Woods system of international finance, and the Islamic revolution in Iran.

Public concern about the economy may be grouped into three areas. The first is deficits. For the last twenty years, the United States has regularly run a federal budget deficit, a trade deficit, and a balance-of-payments deficit. Many analysts argue that each deficit is the result of the nature of the American political economy. The federal budget deficit may be seen as the result of the structural inability of the American political system to impose costs and resist interest group pressures. The trade deficit may be seen as the consequence of the failure of the American economic system to modernize plants and equipment and to improve the quality of the labor force. Finally, the balance-of-payments deficit may be seen as the result of the foreign direct

investments of American-based multinational corporations, as well as the international role of the dollar.

The second general area of concern is American competitiveness. In the 1990s and beyond, the United States faces stiff competition from Japan, Germany, the European Economic Community (EEC), and the Newly Industrializing Countries (NICs), such as the "Asian tigers" of Hong Kong, Taiwan, and Singapore. The American economy has lost world market shares as well as manufacturing facilities. American growth rates and productivity rates have declined. Barry Bluestone and Bennett Harrison call the loss of American industrial capacity and high-wage jobs "the deindustrialization of America." In an interdependent world economy, the availability of low-wage labor depresses the market power of high-wage labor. While the American economy has created millions of jobs in the last twenty years, many of these jobs are part-time, seasonal, or low-paying (and they are often without health insurance or other benefits).

Concern about American competitiveness may also be viewed from a sectoral perspective. Much of the debate over seeming American economic decline concerns the ability of specific American industries—such as steel, automobiles, semiconductors, and agriculture—to compete in the global marketplace.

A third area of public concern about the American economy involves national autonomy. Critics of excessive foreign direct investment in America fear loss of control of strategic industries. Economic nationalists also fear American dependency on foreign sources of natural resources, especially petroleum. Finally, it may be argued that the United States has lost control of its national borders, as evidenced by the wave of drugs and illegal immigrants entering the nation.

American economic problems have inspired numerous proposals for change. Several ideas have been offered to deal with the federal budget deficit, including a balanced budget Constitutional amendment, a line-item presidential veto, and congressional term limitations. The theory behind each proposal is that Congress is institutionally incapable of passing a balanced budget, due to the constant pressure to spend federal dollars in order to satisfy constituents, interest groups, and political action committees. However, defenders of Congress note that neither President Ronald Reagan (1981–1989) nor President George Bush (1989–1993) ever submitted a balanced budget to Congress. Other proposals for resolving the federal budget deficit are more dramatic, such as cutting deeply into military spending or middle-class entitlement programs (including Social Security).

Of course, these deficit-reduction measures would do nothing about the federal debt—the aggregate of past deficits. The United States national debt is now about \$4 trillion. Interest on the national debt takes about 15 percent of the federal budget.

Several proposals have also been made to deal with the American trade deficit. One approach looks to address external sources of the American trade

deficit. These include agricultural subsidies within the EEC and nontariff barriers to trade by Japan (such as health specifications, inspection requirements, and safety regulations). Many "Japan bashers" support the imposition of retaliatory tariffs (or even quotas) against Japanese exports to the United States.

Another externally directed approach to the trade deficit is "managed trade." Under "voluntary export restraints" or "orderly marketing agreements," a nation "voluntarily" limits its exports of a particular product to another country. These devices are becoming increasingly prevalent.

The internal approach to the American trade deficit (and other economic problems) looks to methods of improving American education and job training, as well as America's infrastructure (such as roads and bridges). The biggest problem with the internal approach is that it would not yield significant results in the short run.

The fear that America is experiencing economic decline has affected the rhetoric of American politics. One response of the Democratic party is to employ the politics of class. In a period of economic expansion, the middle class may be expected to identify more with the upper class than with the lower class. During a time of retrenchment, however, many members of the middle class begin to worry that their economic status will plunge. Many Democratic office seekers stress the need to institute national health insurance and expand job-creation efforts.

American economic decline has also spurred a neo-isolationist impulse within the Democratic party. Many Democrats have criticized President Bush for his seeming preoccupation with foreign affairs. Also, some congressional Democrats have proposed the financing of expanded national health care through cutbacks in foreign aid.

While Democrats have been focusing on class divisions within the American polity, Republicans have been focusing on the politics of race. Many Republican officeholders have argued strongly against affirmative action, crime, and welfare dependency; each of these terms may be viewed as a racial code.

HISTORICAL CHANGE IN IPE

Many analysts regard the year 1648 as the beginning of the modern world political system. After the Thirty Years War, the Treaty of Westphalia established the contemporary system of nation-states and sovereignty. Immanuel Wallerstein argues that the seventeenth century was the beginning of the modern world capitalist system as well.

The international capitalist system involves production for sale in a market, in order to maximize profits for the producer. It also entails an internal division of labor and an international division of labor. According to standard analyses, capitalists seek to accumulate surplus value on a world

scale, and the international capitalist economy forces all states to act similarly. Capital accumulation is the goal of nation-states as well as capitalists.

Of course, not all states are equally adept at this task. Since the outset of the world capitalist system, dominant states, or hegemons, have appeared, such as Spain, the Netherlands, Great Britain, and the United States.

In the nineteenth century, Great Britain was the world's dominant economic power. Many historians have contended that "the sun never set on the British empire." The British used a system of military power, formal colonialization, and international trade and investment to sustain their dominance. The British pressed their "comparative advantage" in numerous sectors—what critics called "the imperialism of free trade."

The period of American economic hegemony had its genesis during the interwar period. After World War I, the United States gradually began to equal and then surpass European states as the world's largest economy. However, the United States did not *act* like a hegemon during this period. A protectionist Congress rejected the 1934 Reciprocal Trade Act, reflecting the same biases that led it to pass the protectionist Smoot-Hawley Act (which helped cause the Great Depression).

By the end of World War II, however, the United States was clearly the world's strongest economic (and military) power. The United States created a series of institutions to support the American postwar vision. The Bretton Woods conference of 1944 created the International Monetary Fund (IMF) and the World Bank, in order to provide liquidity and foster development within the world economy. Bretton Woods also established the dollar as the world's reserve currency, and linked the dollar to gold. In 1947, the United States helped establish the General Agreement on Tariffs and Trade (GATT), in order to create rules to govern international trade and foster economic liberalism. Also, the Marshall Plan provided significant aid to Western European countries, in order to reconstruct their devastated economies (and thus lessen their possible leftist temptations).

The United States also played a strong role in creating two political institutions—the North Atlantic Treaty Organization (NATO) and the United Nations (UN). NATO, established in 1949, institutionalized a system of collective defense for the nations of Western Europe. Under the treaty, America pledged to come to the defense of Western Europe, even to the point of employing nuclear weapons (called the doctrine of "first use"). Also, the establishment of the UN reinforced the power of the victors in World War II (the United States, Great Britain, France, the Soviet Union, and China) by granting them a permanent right of veto within the Security Council.

While the genesis of American hegemony is clear, pinpointing the date of its decline (or termination) is much more difficult. One candidate is the Vietnam war. By the time of the Tet offensive in January 1968, the American public had turned against the war. By the Paris Peace Agreement of January 1973, America had lost 58,000 soldiers in combat and had spent hundreds of billions of dollars. Vietnam was the first military defeat experienced by the United States; the fall of Saigon in 1975 was particularly humiliating.

Also, Vietnam played a strong role in creating massive federal budget deficits. President Johnson financed the Vietnam war by taking advantage of America's role as world monetary hegemon—by printing dollars. The Federal Reserve Board's expansionary monetary policy led to the massive spread of dollars throughout the world, known as "Eurodollars."

The excessive international spread of the dollar led to the "Nixon shocks," another possible demarcation of the end of American hegemony. On August 15, 1971, President Richard Nixon (1969–1974) removed the link between the dollar and gold, instituted a 90-day wage and price freeze, and imposed a 10 percent import surcharge. Nixon took these actions because of inflation, the depreciating value of the dollar, and the threat that foreign central banks might turn in their dollars for gold in massive amounts. By 1971, there were more Eurodollars around the globe than there was gold in Fort Knox to support them. By closing the gold window, Nixon unilaterally abrogated the most important element of the Bretton Woods agreement. After several rounds of international negotiations, the international capitalist community established a system of flexible exchange rates to replace the previous system of fixed exchange rates.

The Arab oil embargo is another possible demarcation of the end of American economic hegemony. In 1973, OPEC suspended oil exports to the United States, in retaliation for American support of Israel. As a consequence of this action, world oil prices quadrupled and American unemployment skyrocketed. Millions of American motorists spent time in long lines at gas stations. Many states imposed limited forms of gasoline rationing.

Several events during the administration of President Jimmy Carter (1977–1981) were consistent with the pattern of American decline. First and foremost was the national indignity experienced as a result of the Iranian hostage crisis. Fifty-two American citizens were held hostage for 444 days in the American Embassy, in blatant violation of international law. In April 1980, President Carter ordered a rescue mission, "Desert One," which failed dramatically. After the fall of the Shah, Iran greatly reduced its oil production, resulting in "oil price shock II." Increased global oil prices contributed to 20 percent interest rates in 1980.

A number of events during the Reagan administration may also be regarded as indicators of American economic decline. Most prominently, the Reagan administration oversaw the transformation of the American economy from the world's largest creditor to the world's largest debtor. This was largely due to "Reaganomics," which cut federal income tax rates sharply, especially for the wealthy. Meanwhile, President Reagan instituted large increases in military spending.

The theoretical foundation of Reaganomics was "supply-side economics." According to this view, a reduction in marginal tax rates would actually *increase* tax revenues, by increasing incentives to work and produce. Similarly, the Reagan ideological revolution entailed extensive deregulation of the economy. Also, the Reagan administration attempted to spread its economic and social gospel to the third world.

6 Introduction

Another significant event during the Reagan administration was the beginning of the international debt crisis. On August 30, 1982, Mexico stunned the world by announcing that it could not meet the interest payments on its foreign loans, owed to 1,400 banks. Mexico's declaration prompted similar proclamations by other nations. The United States and the IMF undertook a series of debt payment rescheduling plans; this process is very much in effect today.

Finally, the Reagan administration was witness to the stock market crash of October 1987, known as "Black Monday," set off by American criticism of Western European interest rate policy. The events of Black Monday gave at least temporary credence to the predictions of two best-sellers: Ravi Batra's The Great Depression of 1990, and Paul Erdman's novel, The Panic of '89.

The United States faces severe economic challenges in the 1990s. America continues to run a massive trade deficit with Japan, and Japanese direct investment in the United States is increasing rapidly. Germany is now reunified and has become Europe's preeminent economic powerhouse. The agreement unifying the twelve economies of the EEC took effect on December 31, 1992. While this agreement greatly simplifies trade regulations (and could thus assist American exporters), it also threatens to exclude outsiders from European trade.

Other developments are equally foreboding. The collapse of the Soviet Union and the demise of the Warsaw Pact create great opportunities for deep reductions in American defense spending. However, these developments could also threaten American security and economic interests. The potential spread of nuclear weapons to former Soviet republics could create prospects for their use. Indeed, there were reports that the eight leaders of the August 1991 coup against Mikhail Gorbachev had control of the Soviet nuclear code. Further, the apparent end of the international system of nuclear bipolarity has lessened inhibitions against hypernationalism in Europe. Finally, the collapse of the Russian economy is necessitating a large-scale bailout by the West.

THEORIES OF INTERNATIONAL POLITICAL ECONOMY

There are three dominant theoretical traditions in IPE: liberalism, Marxism, and mercantilism. Each theory makes differing assumptions about the role of the state and the nature of capitalism.

Economic liberalism holds that free markets and free trade will maximize global prosperity, thereby reducing economic and political conflict. Liberals contend that the state should play a very limited role in the operation of the economy.

The intellectual forefathers of liberalism are Adam Smith and David Ricardo. Smith, an eighteenth-century Scottish economist, is often regarded as the founder of modern economic theory. He wrote *The Wealth of Nations*