

US Decline, Once More?

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As everyone knows, the policy template that the Republican Party adopted for George W. Bush's presidency was lifted from the first Reagan administration. This mapping had many fateful consequences, but the one that may ultimately prove the most significant was the recrudescence of a syndrome of related economic imbalances. Under Reagan, the swing over to a combination of high military spending and regressive tax cuts brought on a 'triple debt' crisis – a long-lasting domestic budget deficit, an exaggerated trade deficit, and a global debt crisis centred on Latin America and the global lending practices of the largest US banks.¹ Critical analysis of the implications of this heady brew survived the ending of the Cold War and only began to partially recede in the mid-1990s, when increased tax receipts from the Clinton Boom combined with the shrinkage of welfare entitlements to put the US budget back on track for surplus. Having campaigned for it on his way to the White House, there was never any secret about George W. Bush's desire for top-end tax cuts. But when he implemented them as part of the policy response to 9/11 – thereby becoming the first president to march off to war armed with tax cuts – then signs of hubris were evident on the economic front well before they appeared on the strategic front. Today, the budget and trade deficits are every bit as bad as those of the Reagan years, while the sub-prime crisis that is now expanding out of housing finance has brought the debt question much closer to home.

With Iraq rather than the sub-prime crisis foremost in mind, Michael Cox has recently argued that it is time once again to dust off the familiar theme of American decline – and to begin by resurrecting the work of Paul Kennedy.² Kennedy's *The Rise and Fall of the Great Powers*, itself a product of the Reagan era, proved to be the right book at the right time in a publishing sense.³ Even though he did not seek an explicit prescription for the American condition, Kennedy placed US experience within range of a general historical law and clearly implied that it would eventually be covered by it. Each and every great power, he argued, invariably faced a three-cornered struggle over the division of social resources between consumption, investment and military spending. In particular, too much military spending abroad would invariably come at the expense of economic vitality at home, so generating the problem of 'overstretch' that could only be resolved by strategic retrenchment. Although he was careful not to directly say so, Kennedy clearly suggested that if the problem were left unattended, then Washington, too, would experience this natural cycle of rise and relative decline.

While argument was beginning to focus on this, Kennedy's mode of diagnosis appeared to be dramatically vindicated by the collapse of the Soviet empire. Here, everyone agreed, high levels of military spending had indeed come at the expense of mass consumption, stripping legitimacy from the Bolshevik empire by unleashing at home and

¹ For the idea and its elaboration, see Gerald Epstein, 'The Triple Debt Crisis', *World Policy Journal*, 2(4), 1985.

² Michael Cox, 'Is the United States in decline – again? An essay', *International Affairs*. 83(4), 2007.

³ Paul Kennedy, *The Rise and Fall of the Great Powers*, Random House, New York, 1987.

abroad the nationality claims that would pull it apart. Initially, therefore, the main role of the Kennedy thesis in US debates was to deny Washington short term celebratory rights over the ending of the Cold War, which many assumed had been won by Japan.⁴ Only when the Japanese real estate bubble collapsed and the 'Bull Clinton' boom gathered pace did a more pointedly triumphalist tone finally bury the Kennedy thesis.⁵ That burial then proved to be so complete that Dubya Bush's reverse engineering of the Reagan formula, and its likely implications for global economic imbalances, largely escaped notice. As the younger Bush headed off to Babylon, most critics of the war thought that the only question to discuss was the legitimacy of the operation. Much like its unquestioned military preponderance, there seemed to be no point in dwelling to long upon the issue of US economic dominance.⁶

Today, of course, that verdict from just a decade ago has been repealed. But the question that requires consideration is whether the Kennedy thesis provides the right place to start.

Kennedy: over-stretch and under-reach

In the late 1980s, consistent with the unilateralist sentiments unleashed in the Reagan era, the primary attacks on the Kennedy thesis tended to emphasize the exceptional nature of American experience. This line of attack commenced in the pages of the influential journal *Foreign Affairs* with an unusually long (6 page) review article from Walt Rostow. His main point was that the US was not just another great power, and that the implicit covering law on which Kennedy's argument rested therefore constituted a false analogy.⁷ This was quickly followed up with a more sustained contribution from Samuel Huntington, who emphasized the process of renewal that Reagan had kicked off while the decline debate pointed in the wrong direction. Compared to Rostow's singular target, Huntington sought to dispense with a broader array of 'declinists', but he nonetheless drew most of his statistics from and counter-arguments against Kennedy.⁸ Then, in the following

⁴ For one of many examples, see Walter Russell Mead, 'On the Road to Ruin', *Harper's Magazine*, 280(1678), 1990. Perhaps more memorably, Gwyn Prins brought the ethology of the deer herd to the study of the Cold War, suggesting that Japan would emerge as 'the sneaky fucker' while the American and Russian stags locked horns: see his 'The Role of Superpower Summitry: Recessional', *Political Studies Quarterly*, 61(3), 1990, p. 266.

⁵ For the last gasp of arguments about decline at this time, see Jeffrey Hart, 'A comparative analysis of the sources of American's relative economic decline', in M.A. Bernstein & D.E. Adler (eds.), *Understanding American Economic Decline*, Cambridge University Press, Cambridge, 1994.

⁶ For one example of quick movement over the issue, see Christian Reus-Smit, *American Power and World Order*, Polity, Cambridge, 2004, p. 1.

⁷ Walt W. Rostow, 'Book Review Essay: Beware of Historians Bearing False Analogies', *Foreign Affairs*, 66(4), 1988. It is worth observing that Rostow's most famous work, *The Stages of Economic Growth*, also rested upon much the same kind of British-centred historical analogy and covering law. Unlike Kennedy, however, Rostow largely avoided discussion of the US in that work.

⁸ Samuel Huntington, 'The U.S. – Decline or Renewal?', *Foreign Affairs*, 67(2), 1988/1989.

year, Henry Nau weighed in with a book that combined the non-determinist theme of policy choice with its uniquely broad field of play in Washington, effectively amalgamating the thrusts of both Huntington and Rostow.⁹

Although exceptionalist arguments about the US have come in many shapes and sizes over the years, they are most commonly forged out of constitutional and cultural considerations. There was, however, no good reason why they should have remained restricted to these domains - especially so after the path of American economic evolution took such a decidedly unique path during the Great War. With increasingly significant fractions of the infrastructure of the British Empire hocked to American investors, this was the moment in time where the US suddenly emerged as an 'immature creditor' to the world – immature in the sense that the new capital account surpluses now stood in the company of more long-standing trade surpluses. This conjunction was never true in the history of UK development, where capital account surpluses emerged as a counterweight rather than the complement to trade deficits. Building on this foundation, a good case could have been made across the whole of the twentieth century for American economic exceptionalism.

Had that case been mounted, then it would have immediately picked up on one of the greatest novelties of the Reagan era – the relatively sudden American reversion to a deficit on the capital account that complemented trade deficits of somewhat longer standing. Like most things, this retreat can be seen more clearly in retrospect; early in the current century, Niall Ferguson repeatedly drew visual attention to the significance of the Reagan-era transition from capital exporter to capital importer, treating it as one of the most important issues determining the future field of American strategic possibilities.¹⁰ Despite the fact that he was working much closer to the point of the inversion, Kennedy failed to pick this up – and for the simple but compelling reason that his analytic framework did not really have a place for it.

Exceptionalism is, of course, nothing other than a nativist American rendering of the more general theme of nationalism, but Kennedy's framework was nationalist in a more methodological sense. His whole argument rested on a 'closed economy assumption' that was becoming markedly less relevant precisely as he wrote. At the centre of things was a zero-sum competitive relationship between consumption, investment and military spending within a national economy, where any one of these variables could only increase at the expense of the others.¹¹ This may have been a

⁹ Henry R. Nau, *The Myth of America's Decline: Leading the World Economy into the 1990s*, Oxford University Press, 1990. A decade later, at the end of the Clinton boom, Nau returned in a more focussed way to Kennedy's failure to treat these two themes in his 'Why "The Rise and Fall of the Great Powers" was wrong', *Review of International Studies*, 27(4), 2001.

¹⁰ Niall Ferguson, *Empire*, Allen Lane, London, 2003, p. 369, and also *The Cash Nexus*, Allen Lane, London, 2001, p. 313.

¹¹ This, it should be noted, was not an entirely new invention. At the beginning of the decade, the American realist Robert Gilpin had used the same three-cornered contest as the motor force of change

reasonable framework for analysing the considerably more insular US economy from earlier stages of the twentieth century. But the US economy was, like other national economies, increasingly moving to the beat of what everyone would soon be calling globalisation. And in this more open environment, it was possible for the US to avoid much of the short-term pain that arose from Kennedy's three-cornered competition. The trick required sufficient volumes of money to be sucked in to the US economy – which in principle made it possible for the US to have higher levels of consumption, investment and military spending at the same time. Countries with large current account surpluses – some OPEC countries, when the price of oil was right; but increasingly the Japanese – had been or were big investors across the range of US assets, thereby helping to bring about and sustain lower levels of interest rates within the American economy. Kennedy's closed economy assumption, however, denied him a point of entry for thinking about the significance of the capital account reversion. Indeed, he continued to ignore the issue in the forward-looking sequel to his historical bestseller, where his attention moved on to emerging problems with global dimensions.¹²

The US: three post-war revolutions

The question which requires asking is whether there can be a theory of the American exceptions – and in particular the whether such a theory can be constructed in a way that throws light upon the current problem of economic imbalances. The balance of this paper is given over to this task. The argument unfolds by drawing attention to three 'revolutions' that marked the entry of the US into the post-war era, and then exploring some of their individual and combined consequences for the transit of the US through that period of time.

As a backdrop, one is painfully aware of the relative ease with which an economically-oriented account of American exceptionalism can be provided for the so-called 'isolationist' pre-war period. From the War of Independence through to WW2, the US was re-made over and again by a sequence of socio-economic processes which each pushed quite insistently in one policy direction. These processes commenced, in a chronological sense, with geography: the phased acquisition of new territory, which through the first century of the US converted the original thirteen colonies clustered on the Atlantic seaboard into a nation of truly continental proportions with many distinctive and differently endowed regions. This geographic expansion was then complemented by the process of social in-fill behind the west-moving frontier, with successive generations of European immigrants, nearly forty million 'huddled masses', entering through the open door on the Atlantic in the second half of the nineteenth century. Later still, and growing out of Union victory in the Civil War, the shift from extensive to intensive capitalist development

in great power policies; see his *War and Change in World Politics*, Cambridge University Press, New York, 1981.

¹² Paul Kennedy, *Preparing for the twenty-first century*, Random House, New York, 1993.

washed over earlier processes, being confirmed in the popular mind by the exhaustion of the frontier and culminating with the depression-era industrialisation of California.

As geography, immigration and industrialisation were folded and re-folded into one another, they progressively shaped the US into an extremely large, self-contained and robustly endowed economy with an isolationist foreign policy. Geography alone meant that any potential enemy confronted the immense logistical problem of oceanic traverse before taking conflict up to US territory. For the two hundred years between the War of 1812 and September 11, geography alone provided Homeland Security for continental America, thereby allowing the US to conduct low-level asymmetric warfare against potential enemies. Behind these oceanic ramparts, the increasing socio-ethnic diversity of the American population and the fear of giving offence to one or another ex-European constituency made it difficult for governing political elites to take clear positions on European affairs: better, therefore, to have none at all, and ultimately to give that rejection legal expression through neutrality acts.¹³ Meanwhile the increasingly self-sufficient continental-scope industrial economy that emerged after the Civil War made international trade more of an option than a necessity, turning the US economy back upon itself well before the logic of the Great Depression drove this to the extreme.

The elegant complementarity of the forces standing behind this isolationist tradition served to highlight the significance of ‘the American diplomatic revolution’ that commenced eighteen months after the end of WW2 with the Truman Doctrine.¹⁴ Up to that point in time, the US had the characteristics of what we might today call ‘a civilian power’; that is to say, low levels of defence preparedness in times of peace, with a mightily impressive ‘surge capacity’ into war-related production when serious conflict nonetheless happened along. But Truman, by pledging to aid ‘free peoples everywhere’ against internal subversion or external aggression, now foretold a global foreign project with, in potential, no end-point. In short order, therefore, that foundational diplomatic commitment was first leveraged into the realm of civil assistance (with the Marshall Plan and the Point Four programme), and later, after the onset of the Korean War, into a substantially higher level of permanent defence preparedness. Without ever involving the US in ‘hot war’, peacetime defence preparedness would now cost an average of six per cent of GDP through the next forty years – a dramatic jump from the one per cent or so associated with the isolationist period.

¹³ It is worth noting in this context that the US drift to expansionism and even imperialism in Asia and the Caribbean took place in regions from which the process of in-migration was dramatically lower. The ‘open door’ in the Pacific was a trade policy rather than an immigration policy. For one compelling account of the implications of that difference, see Avner Offer, ‘Asian Labour and White Nationalism, 1907-1914’, chapter 14 in his *The First World War: An Agrarian Interpretation*, Clarendon Press, Oxford, 1989.

¹⁴ I borrow this phrase from Joseph Siracusa (ed.), *The American diplomatic revolution: a documentary history of the cold war, 1941-1947*, Kennikat Press, Port Washington, N.Y., 1977.

Although the diplomatic revolution unquestionably had massive and far-reaching implications at home and abroad, it was not the whole picture. For as that revolution unfolded, two other quite independent revolutions were also in progress. One was sweeping across the field of US trade policy, where the open door policy of the previous century swung in reverse over the large American domestic market. The other revolution was centred on the world of oil, the energy of choice for the age of mass consumption, where a new Age of Discovery of reserves was under way. In an adequate account of American exceptionalism, these two revolutions demand attention.

A vital part of the isolationist tradition had been the US policy of high tariffs. As dictated by the US constitution, this policy was made and reinforced in Congress, where the Republican Party, the party of big business, was its prime broker. But in 1934, at the depths of the Great Depression, these traditional dispositions began to change. The new Democratic president Franklin Roosevelt and his Secretary of State Cordell Hull wrote new legislation that gave them the ability to negotiate lower tariffs with US trading partners.¹⁵ Armed with this new power, they began to bilaterally bargain down the level of US tariffs, hoping thereby to stimulate the US economy out of the Depression. Although this policy was not particularly successful in this respect, it nonetheless went on to much greater things at the end of WW2. For the process of bargaining down tariff reductions that they bedded down provided the procedural basis of the General Agreement on Tariffs and Trade (the GATT) and the international quest for free trade. With the biggest of businesses increasingly regarding lower tariffs as a small price to pay for easier access to foreign markets, the Republican Party haltingly abandoned its long historical association with protectionism. And so, by the mid-1950s, a new bipartisan consensus was emerging that re-positioned the US as the champion of free trade rather than the showcase of protectionism. In the next decade, with the completion of the Kennedy Round, the world's largest market had been decisively opened on a multilateral scale, becoming an important engine for economic growth for other places.

Like the Reverse Open Door, what proved to be a protracted Age of Discovery in oil also saw the US leading the way. In 1930 the largest known oil province in the world was discovered in East Texas, already the home of a buoyant American export industry. When proved up at more than five billion barrels, the East Texas field appeared to guarantee the centrality of US reserves to the world's oil market through the indefinite future. But henceforth the Age of Discovery moved off-shore to the Arabian Peninsula, where US oil companies were concessionaires of choice for independent Arab authorities. Armed with new ideas about likely geological locations, a long string of 'super-giant' oil reservoirs with low extraction costs was unearthed up and down the Persian Gulf, but most notably along its southern littoral. And the biggest of these new Arabian finds increasingly made East

¹⁵ The legislation in question was the Reciprocal Trade Agreements Act. For its origins and workings, see K.E. Schnietz, 'The Institutional Foundation of U.S. Trade Policy: Revisiting Explanations for the 1934 Reciprocal Trade Agreements Act', *Journal of Policy History*, 12(4), 2000.

Texas look modest: Kuwait's Burgan field of 1938 was, for instance, fifteen times larger, and the Saudi super-giant at Ghawar ultimately revealed another ten billion barrels on top of that. Consequently, by the end of this Age, East Texas ranked below twenty in terms of absolute size,¹⁶ and the centre of gravity of known world reserves had shifted decisively away from Texas to the Middle East.¹⁷

counter-revolutions within revolutions

Revolutions are short and sharp breaks with past traditions, but they inevitably provoke conservative resistance. Whether, in the longer run, the revolution prevails over the restoration is therefore an open question. Zhou En Lai's quip about the effects of the French revolution – it is too soon to tell – is therefore pertinent to each of these three post-war American revolutions.

In the case of the diplomatic revolution, the old order was never quite put to rest, although the rub was most evident in the economic rather than the strategic realm. Americans took to the new gospel of standing defence preparedness with considerable enthusiasm, always voting in favour of presidential candidates with new and expensive proposals for enacting the strategy of containment. But the very same ballot boxes also evidenced the continuing attractions of the small-r republican tradition, where the defence of individual liberties and the commitment to a small state were pre-eminent. In policy terms, this translated into a strong preference for tax cuts, which in turn meant that the US would not go on to become a 'welfare state' in the European sense of that term. Most importantly, the hard carapace of the diplomatic revolution rubbed against the soft social underbelly to yield a tendency towards internal budget deficits.

This contradictory combination of social preferences for high military spending and lower taxes might have been manageable had the US economy grown very rapidly, but in fact its Cold War performance was hardly exemplary. As a result, after Eisenhower's balanced budget fanaticism had departed the scene, this tendency became more and more evident, and especially so during the Cold War's hot wars. Consequently, the internal budget deficit first became openly apparent during the late Vietnam era, going on to assume menacing proportions amidst Reagan's defence build-up, and returning with considerable vengeance in first year of the George W. Bush presidency.

¹⁶ For a rank-order listing by size of known oil fields immediately after the first OPEC price hike, see Richard Nehring, *Giant Oil Fields and World Oil Resources*, report prepared for the Central Intelligence Agency, R-2284-CIA, Rand Corporation, Santa Monica, California, June 1978, p. 14. For contemporary purposes, it is worth noting that none of the discoveries listed here post-dates that 1973 drama.

¹⁷ For a chart showing the rise of the Middle Eastern reserves, see A.A. Kubursi and S. Mansur, 'The Political Economy of Middle Eastern Oil', in Richard Stubbs & Geoffrey Underhill (eds.), *Political Economy and the Changing Global Order*, Macmillan, London, 1994, p. 314.

In the commercial realm, the revolution rather quickly ran out of steam. The GATT was just an agreement rather than an institution whose main virtue was its made-in-America label that meant it was acceptable to Congress. For the Democrats who carried forward the legacy of Roosevelt and Hull, it was a practical first step that would expeditiously clear the ground of tariffs, thereby preparing the site for the workings of a more powerful free trade institution, the International Trade Organization (ITO). Under American leadership, a charter for this institution was duly negotiated at Havana in the immediate post-war years, and amongst other things it foreshadowed interventionist capabilities that the GATT agreement never possessed. The ITO was, for example, endowed with the power to pass judgement on the compatibility between hitherto domestic policy prerogatives such as competition policy and its free trade mandate, and wind back incompatible policies where necessary.

But the ITO was a bridge too far for Congress. It was thwarted by an alliance between 'protectionists' and 'perfectionists'¹⁸ – Democrats worried about the survival of sunset industries such as textiles in the face of virile Asian competition, but small government Republicans who feared that the ITO was not strong enough to bring foreign governments into line on domestic policy. Being able to count, the end result saw the Truman administration sit on the ITO charter rather than put it before Congress where it was certain to be voted down. Except for the GATT – which now came to have Shakespearean greatness thrust upon it – the course of larger hopes for free trade proved eerily reminiscent of Woodrow Wilson's legendary failure with the League of Nations charter at the end of the Great War.

The domestic forces of counter-revolution were even stronger in relation to the spread of the Age of Discovery. Even though large US oil firms dominated off-shore discoveries in the Middle East, and in spite of the quasi-diplomatic functions they took on there for Washington, they provoked a dramatic political backlash at home. The great fear which animated the backlash was that cheap imports of Middle Eastern oil through the internal conduits of the oil majors would undercut the commercial position of smaller domestic producers and refiners. After a decade of congressional lobbying which saw this import fear adorned in the sacrosanct garb of national security, a mandatory quota restricting imports of sea-borne oil to just eleven per cent of anticipated future consumption was imposed in 1959.¹⁹ Despite the patriotic dress, this was, in reality, nothing more or less than a classic example of a protectionist lobby at work.

No sooner was this target proclaimed than it fell under attack for not being realised. While that is true enough at the level of national imports as a whole, it was not true at all in

¹⁸ These insightful labels come from William Diebold's masterly analysis of the ITO's political orphaning: see 'The End of the ITO', *Princeton Essays in International Finance*, 16, 1952.

¹⁹ For one detailed account of the backlash, see Steve Isser, *The Economics and Politics of the United States Oil Industry, 1920-1990*, Garland Publishing, New York, 1996, esp. 97-120 dealing with 'The Battle Over the Oil Import Quota'.

relation to Middle East oil imports, which nearly petered out in the quota's fifteen year lifetime. And this in turn had significant long-run implications. No substantial market-based connection was created between the new centre of gravity of world reserves in the Middle East and the centre of gravity of oil consumption in the US. The disconnect put in motion a dynamic which cast – and still casts – a dark shadow over the issue of oil security, the objective ostensibly served by the quota. Denied access to the large US market, the Middle East's share of world production pulled up well short of its share in reserves, rarely exceeding fifty per cent.²⁰ By itself this had obvious and ominous forebodings for the future sourcing of oil supplies. But making matters worse, the quota simultaneously accelerated the decline of US domestic oil reserves; it was, as its unsuccessful critics said it would be, a policy to 'drain America first'. This made a mockery of the national security rationale of the quota in that import dependence now was being exchanged for exaggerated import dependence in the future. Given that this exchange took place at a time when oil prices were low and trending downwards, it also implied significant future pressure upon the balance of trade and inflation rates when scarcity duly increased and prices went up.

the search for a silver bullet

The central problem, therefore, is that of the tensions between revolution and counter-revolution within each of these domains was not capable of independent resolution. A period of sustained high growth, the most significant for the US in its twentieth century peacetime history, did eventually reappear under Clinton, ultimately restoring the domestic budget to surplus. But this achievement only served to activate two new plans about how to spend it that dominated the 2000 presidential election, with Bush the younger going on to realise his previously mentioned tax cuts. In the commercial realm, and with the notable exception of defence procurement, the American tradition of regulatory policy prevailed, blocking possibilities for following East Asian 'developmental' practices. The result of this foreclosure was that the adverse trade outcomes resulting from the early Cold War policies of positive commercial discrimination towards important strategic allies could only be countered with the development of 'bully boy' tactics (exemplified by super-301 actions) against trade surplus nations. Meanwhile, when internationally traded oil prices rose dramatically off their Long Boom floor, the first reaction in Washington was a bipartisan freeze on petrol prices. Given its mass popularity, the message was clear: the chances for politically brokering a federal tax on petrol prices were non-existent. This kept US oil consumption, and therefore imports, on an upward trajectory, while simultaneously denying Washington the significant contributions to revenue and balanced budgets being reaped through energy taxes in other countries.²¹ Within each of these three revolutionary

²⁰ According to the 2007 edition of BP's influential *Statistical Review of World Energy*, the Middle East's share of proved reserves now stands at 61.5 per cent and its share of production at 31.2 per cent. These proportions have been remarkably constant over a very long period of time.

²¹ In Australia, for example, where the tax on liquid fuels has only been moderate by European standards, it nonetheless contributed between 8 and 9 per cent of government revenue at its high point. At that time, this was more than half the take from the newly introduced Goods and Services Tax. For an

issue areas, therefore, direct approaches to domain-specific policies for managing the tensions were politically unavailable.

Given this, there commenced the search for a silver bullet capable of jointly managing all three problems simultaneously. The technical requirements were extremely demanding: bullets travel in straight lines, and the three issue areas rarely line up. Fast growth, for example, will invariably expand imports, compounding the trade and oil imbalances – as the Clinton boom showed all too well. Nonetheless, the bullet that appeared to have the most promise for satisfying this alignment problem was dollar devaluation. A lower dollar should, in theory, promote US exports and shrink the trade gap, with export-led growth in turn increasing tax revenue and helping to close up the internal deficit. It can also lower the costs of servicing dollar denominated debts in foreign economies, helping alleviate debt crises in these places and staunch the financial position of US banks involved creating them. To many administrations over the last forty years, dollar devaluation has therefore appeared to provide a likely starting point.

In practice, things are almost always more complex than this. The first and most immediate effect of devaluation, which cuts in well before any expansion of exports, is to make imports more expensive, thereby compounding the trade imbalance through ‘J-curve’ effects. The theory also assumes the ability of the US economy to substitute domestic production for these more expensive imports without questioning whether that assumption is warranted. For a mature industrial economy, even one that has lost competitiveness in many world markets, there often is a retained capacity to engage in this kind of import substitution across a wide range of manufacturing sectors. But where this assumption becomes most questionable is in resource sectors where endowments ultimately reflect the bounty of nature. If the natural resource base is in decline, then no amount of devaluation can reverse the trend; it will, instead, simply increase the cost of structurally mandated imports. And oil, of course, fits right into this box.

Despite all these caveats, there is one notable occasion when they were largely held in suspension – namely, during the great dollar devaluation of the mid-80s orchestrated through the Plaza process. Working with active financial support from the German and especially the Japanese governments, who also placed their interest rate policies behind the devaluation, the Yen-Dollar exchange rate was brought down in a semi-controlled way over eighteen months from 260 to 120.²² This devaluation was fortuitously supported from the sidelines by significant developments in the oil market. When Reagan repealed the oil price freeze of the Ford and Carter administrations, domestic exploration and production expanded in the US on a small scale, reversing for a while what had been

overview, see Richard Webb, ‘Petrol and Diesel Excises’, *Research Paper* No. 6 2000-01, Department of the Parliamentary Library, Canberra, 2000.

²² ‘Semi-controlled’ is used quite advisedly since, in spite of the best efforts of the G3, the dollar still fell much further than anyone had originally hoped for. Nonetheless, it did not fall as far as it might have done had devaluation been guided just by the ‘herd instinct’ of financial markets.

a rising tide of oil imports. More important still, international oil prices were already falling after 1983 in prelude to the dramatic price collapse of 1986. Lower oil prices and lower oil imports combined with the demand reductions effected by the second OPEC-induced recession to provide a massive once-off shot in the arm for growth rates across the non-communist world.²³ Meanwhile, the lower dollar made a significant contribution to containing the Latin debt crisis by returning debt service ratios to the bounds of respectability.

There is, however, an earlier period where dollar devaluation did not play out anywhere near so favourably. Prior to the descent into the era of neo-liberalism, when all OECD economies were struggling to define a growth path out of the first oil shock, the late Ford and early Carter administrations pursued 'the old-time religion' of Keynesian stimulation, US-style – which primarily meant tax cuts.²⁴ This placed the US at considerable cross-purposes with the drift of national policy in Japan and Germany, where higher oil import dependency induced unrelenting attention to the containment of inflation. The result was strong US growth, albeit at the short-term expense of the trade balance – and, of course, higher US rates of price inflation. Naturally, the dollar fell quite rapidly in value, with Carter in particular regarding this fall as a leading indicator of the coming expansion of exports. However, US domestic production of oil had also just peaked, and high growth with frozen domestic oil prices sucked in ever-greater volumes of oil imports. Indeed, by the late 1970s, US oil import dependency had escalated from thirty per cent at the time of the oil shock to fifty per cent – and its allies believed that this was helping to sustain market control by OPEC producers. One consequence was that Carter's greatest of all hopes – to 'trilateralize' the control of the world economy – floundered completely, most notably at the Bonn Summit of 1978.²⁵

conclusion: beating about Bush

The second Bush administration, after four years of following the Reagan policy template, reproduced the predictable results of a yawning internal deficit and a massive trade gap. These results, in turn, elicited the reasoned advice that their management should be multilateralised through a new round of Plaza-like agreements.²⁶ The essential problem with this advice was political, and along a number of fronts. On the domestic front,

²³ Conversely, one might add, these developments constituted a huge setback to the USSR, which had become more reliant than ever on oil exports during the lead-up to *perestroika*. In the continuing histories of the end of the Cold War, this exaggeration of Soviet vulnerability along the oil front never receives the attention it deserves.

²⁴ The phrase is lifted from Miles Kahler: see his 'America's Foreign Economic Policy: Is the Old-Time religion good enough?', *International Affairs*, 56(3), 1980.

²⁵ For that failure, see Robert D. Putnam and Randall Henning, 'The Bonn Summit of 1978: A Case Study in Coordination', in Richard N. Cooper *et al.*, *Can Nations Agree? Issues in International Economic Cooperation*, Brookings, Washington, 1989.

²⁶ Most notably, see William R. Cline, 'The Case for a New Plaza Agreement', *Policy Briefs*, PB05-4, Institute for International Economics, December 2005.

it ignored the extent to which the Reagan template relied entirely from the experiences of his first administration; Plaza, along with the spirit of Reykjavik, the INF treaty, and debt forgiveness, were not parts of the Reagan experience that the present day Republican Party hierarchy cared to remember. The continuing preference for Reagan-I unilateralism eventually, therefore, yielded the conceit whereby all major macro-economic problems were essentially of someone else's making – witness the Bernanke Doctrine, where US current account deficits are said to play the helping hand to Asian surpluses. Blame-shifting rather than problem-solving became institutionalised.

On the international front, possibilities for a return to Plaza also ignored some very substantial differences between Japan and China, the country that now holds the whip hand over the use of dollars in the context of international economic imbalances. Especially under Nakasone, Japan was a close American ally, willing to pay almost any economic price to ease the US out of a tight corner. It takes a very peculiar kind of ally to keep investing in assets that are denominated in a falling currency, and Chinese authorities have made it clear that they do not intend to play this role. They would understand that the 'Ron-Yasu' relationship did not generate any sense of public gratitude in the US for Japan's funding of the Plaza devaluation – and, down the road apiece, nothing but derision for the 'chequebook diplomacy' that was the centrepiece of this underwriting.²⁷ They would, in addition, be extremely mindful of the causal relationship between Plaza and the Japanese recession that commenced in 1990; when smaller countries commit as a point of principle to helping bigger ones adjust, they should expect a large backwash.²⁸

Bush's America is now beginning to experience something that the architects of Plaza sought to avoid – namely, an uncoordinated devaluation of the US dollar. And this at a time when low official interest rates, the opaque qualities of the market in mortgage backed securities, and the rising price of oil will discourage the inflows of capital that have been the backbone of American growth for the last quarter century. Throw into the mix some potential wild-cards – the Russian intention to begin shifting oil sales from dollars to roubles²⁹ – and it is clear that questions of economic decline will be around for some considerable time yet.

²⁷ This point was emphasised by Tetsuya Kataoka, 'The Truth About the Japanese "Threat": Misperceptions of the Samuel Huntington Thesis', *Hoover Essays*, no. 9, Hoover Institution on War, Revolution and Peace, Stanford University, Stanford, 1995.

²⁸ The main connection between them was established by super-low Japanese interest rates, which were intended to compensate domestic industry for the new and unfavourable post-Plaza exchange rate. This ended up creating the largest property bubble in the history of the contemporary world economy.

²⁹ In 2006, Russian production accounted for nearly twelve per cent of global production, only slightly smaller than the Saudi effort.