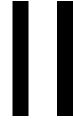


EROSION AND ADAPTATION: 1971–94

3

A Tougher World: Changes in the Context of Trade Policy

The 1970s and 1980s brought far-reaching changes to the world economy. US firms and workers became much more exposed to foreign competition in both home and overseas markets. The relative world position of the United States declined, as European rivals were joined by Asian ones—first Japan, then rapidly industrializing countries such as Korea. The rules of the international trading regime, the General Agreement on Tariffs and Trade (GATT), grew less effective. The advanced industrial economies, buffeted by two oil shocks, entered a period of stagflation, combining rapid price increases with sluggish growth. Fixed exchange rates among currencies could not hold, and the world moved to a floating rate regime, featuring massive financial flows and severe and protracted misalignments. Last but not least, the collapse of the Soviet Union in 1991 reinforced the long-standing trend toward tripolarity in the global economy. The United States had to share power with the European Union and Japan. And all three needed to cooperate without the glue that Cold War security alliances had theretofore provided.

15 August as Prologue

The new era was heralded by a US policy action both dramatic and unexpected. On 15 August 1971, at the urging of Treasury Secretary John B. Connally, President Richard M. Nixon took several related steps aimed at reducing the international value of the dollar. He suspended the US

commitment to support its currency by selling gold reserves on demand; he called upon other major nations to raise the value of their currencies against the dollar; and, to get everybody's attention, he imposed a temporary 10 percent "additional tax" on imports. The aim, Nixon declared, was to ensure "that American products will not be at a disadvantage because of unfair exchange rates. When the unfair treatment is ended, the import tax will end as well."[1]

The financial context of the 15 August actions was the increased vulnerability of the dollar in foreign exchange markets. Since the late 1950s, the United States had been running regular deficits in its international balance of payments, and these deficits had generated intermittent concern, in Washington as well as overseas, about the dollar's long-term strength. Under the Bretton Woods system, the dollar was the unit against which other nations defined their currency values, and concern about the dollar was therefore synonymous with concern about the viability of the broader international monetary system. Until 1971, the dollar's value had been sustained by a variety of cooperative efforts among the US, European, and Japanese central banks. The speculative pressure that summer, however, was of an entirely new order of magnitude.[2]

The trade context of 15 August was a shift in the overall US export-import balance. Merchandise trade surpluses had been a constant feature of the postwar American economic landscape, averaging more than $5 billion annually in the early 1960s. In 1968 and 1969, however, the US surplus dropped below $1 billion, and critics like Senate Finance Committee Chairman Russell B. Long (D-LA) argued that US commercial trade was actually in deficit, since export statistics included more than $2 billion financed by foreign aid.

---

1. This action was aimed importantly at getting the US economy moving, without worsening inflation, before the 1972 election. It also included, therefore, domestic economic stimulus measures and wage and price controls.

For an account of the Nixon decision in historical perspective, see Robert Solomon, *The International Monetary System 1945–1976: An Insider's View* (New York: Harper and Row, 1977), chapters 11 and 12. For comprehensive analyses of the forces behind this major policy change, see John S. Odell, *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change* (Princeton, NJ: Princeton University Press, 1982), chapter 4; and Joanne Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods* (Ithaca, NY: Cornell University Press, 1983). For a thorough analysis of American policy interests during this period, see C. Fred Bergsten, *The Dilemmas of the Dollar: The Economics and Politics of United States International Monetary Policy* (New York: New York University Press for the Council on Foreign Relations, 1975), especially part 2.

2. "In the first nine months of 1971 . . . US liabilities to foreign monetary authorities increased by more than $21 billion." Solomon, *International Monetary System*, 184. These authorities' increased dollar holdings reflected the movement of other holders out of dollars into other currencies. The average annual increase in such foreign official dollar holdings in the late 1960s, by contrast, was only $637 million. *Economic Report of the President*, 1974, table C-88.

An increasing number of economists saw the trade shift as evidence that the dollar had become overvalued. Its exchange rate with other currencies reflected a postwar preeminence that no longer existed. American industry and labor were experiencing greater foreign competition as a result, and official Washington was under new pressure for trade restrictions. Hardly was the ink dry on the Kennedy Round tariff-cutting agreement of 1967 when a range of industries began pushing for new protection. These included textile and apparel manufacturers, alarmed by the growing imports of man-made fiber products, and steel firms and workers concerned about competition from resurgent European and Japanese competitors. Organized labor, which had endorsed the Kennedy Round, was arguing by 1970 that a new competitive situation had "made old 'free trade' concepts and their 'protectionist' opposites increasingly obsolete." Labor now called for policies aimed at "*orderly* expansion of world trade."[3] As recounted in chapter 2, these pressures, combined with the Nixon administration's mismanagement of the textile issue, led the House of Representatives to pass a restrictive import quota bill in November 1970.

The overvalued dollar put the United States in an economic policy bind. Through the 1960s, devaluation was considered impractical—even unthinkable—because it would undercut the dollar-based exchange rate system established in 1944 at Bretton Woods. President John F. Kennedy told his advisers he did not want the subject mentioned outside his office; for Kennedy, devaluation "would call into doubt the good faith and stability of this nation and the competence of its President."[4] The traditional medicine for righting one's trade balance without devaluation was to depress overall demand. This would, however, drive up unemployment and generate increased pressures for trade restrictions. (And in fact, the Johnson administration did the opposite in the late 1960s. Its inflationary policies—increasing spending for the Vietnam War years before new taxes were enacted to finance it—made the trade balance worse.)

The United States could also support the dollar with measures that would limit capital outflows and discourage other activities requiring its conversion to foreign currencies. The Kennedy and Johnson administrations employed a variety of devices to this end: an interest equalization tax, limits on foreign direct investment, reduction of the value of duty-free goods that traveling Americans could purchase overseas, even a "balance of payments" program to cut official US overseas staffing. But these palliatives had no durable impact.

3. Statement of the AFL-CIO economic policy council, as reported in the *New York Times*, 22 February 1970. Emphasis added.

4. Theodore G. Sorensen, *Kennedy* (New York: Harper and Row, 1965), 408.

Nixon and Connally broke the United States free from this bind in a way that was deeply disruptive of the postwar economic system. Not only was the content of their actions unsettling; their rhetoric generated strong doubts in foreign capitals about whether the United States could still be counted on to support the international monetary and trade regimes its leaders had fostered. Connally actively provoked such anxieties, in part to increase US leverage: Europeans and Japanese might yield more if they saw their concessions as the only way to bring a suddenly rogue America back onto the international economic reservation.

Within four months and three days, however, agreement was reached on a new set of exchange rates that effectively devalued the dollar by about 10 percent against other major currencies. Within two years, the dollar went down substantially further, and the major trading nations were forced to abandon the system of fixed exchange rates altogether. By the mid-1970s, in fact, it seemed that the net effect of the "Nixon shocks" had been not to bury international economic cooperation but to give it new life. Realignment of exchange rates restored the US capacity to pursue open trade policies and to press others to do likewise. The US trade balance began to improve in early 1973, just as legislation to authorize the new Tokyo Round made its way through the House of Representatives. With their competitiveness thus buttressed, firms and workers were less disposed to press for protection against foreign products and more conscious of the opportunities a new trade round might bring. When the oil crisis hit later that year, the floating rate regime made it easier for the world to make the wrenching adjustments forced by the fourfold increase in the price of that critical commodity.

Nonetheless, the world Americans faced after 15 August 1971 was clearly one of greater economic insecurity and turmoil. Seven intertwined features of this world stand out:

- increased exposure of the US economy to trade;
- the relative decline of the United States, real and perceived;
- the rise of new (particularly East Asian) competitors;
- the erosion of the GATT international trade regime;
- the worsening of "stagflation," with the United States and its European trading partners facing a combination of slow economic growth, high unemployment, and rapid price increases;
- the move to floating, and oft-misaligned, exchange rates; and
- beginning in 1989, the end of the Cold War and the emergence of a tripolar economic world.

All of these developments put new strains on an American trade policymaking system shaped in more insular economic times.

The Trade Explosion

In 1960, exports of US merchandise to the rest of the world totaled $19.7 billion; in 1990, they totaled $387.4 billion (table 3.1).[5] During this same period, US global merchandise imports shot up from $14.8 billion to $498.4 billion. The numbers are in current prices and ballooned by inflation, but on a price-deflated, constant-dollar basis exports rose more than sixfold, and imports nearly eightfold.[6] Perhaps the most important indicator, however, was the growth of trade in proportion to the US economy. In 1950, the United States exported just 6.3 percent of its total production of goods. This percentage rose modestly for two decades—to 7.7 percent in 1960 and 9.2 percent in 1970. Then it shot up to rates more than double that: 19.1 percent in 1980 and 18.2 percent in 1990. The corresponding figures for imports were 5.6, 5.8, and 8.7 percent for the earlier years, and 21.3 percent and 23.2 percent for 1980 and 1990.[7]

The expansion of trade with the United States' primary overseas trading partner was even more dramatic. In 1960, the United States sold $1.4 billion in goods to Japan and bought $1.1 billion. By 1990, it was exporting $48.6 billion and importing $89.7 billion.[8] When adjusted for price increases, this amounted to an elevenfold increase in US exports to Japan over this period and a nineteenfold increase in imports.

The causes of the trade explosion were many: reduced international transportation and communication costs; reductions in tariff barriers; the broader internationalization of the US economy; and the ballooning cost of oil imports, which required an expansion of foreign sales to pay for them. A thorough examination of these causes goes beyond the scope of this book. But the effects of the trade explosion are an important part of our story, and they were substantial.

First and perhaps most significant, the expanded inflow of foreign products brought an inevitable political response. Measured by any standard, US firms were facing significantly more import competition in the

5. Though this portion of the book covers developments only through 1994, table 3.1 offers—for reader convenience—trade balance data through 2004. Figure 3.1 later in this chapter does the same for exchange rates. The resurgence of the dollar and the trade imbalance in 1998 is addressed in chapter 9.

6. US Commerce Department data, as reported in *Economic Report of the President*, 1991, table B-102, and US Congress, Joint Economic Committee, *Economic Indicators,* June 1991, 36. The growth of real exports and imports is calculated from the constant (1982) dollar figures in table B-21 of the *Economic Report of the President*, 1991.

7. Percentages obtained by dividing total merchandise exports (or imports) by total production of goods, as reported in *Economic Report of the President*, 1991, tables B-102 and B-6, and US Congress, Joint Economic Committee, *Economic Indicators*, June 1991, 36.

8. US Department of Commerce data.

Table 3.1 US merchandise exports, imports, and trade balance, 1960–2004
(billions of current dollars)

Year	Exports	Imports	Balance
1960	19.7	14.8	4.9
1961	20.1	14.5	5.6
1962	20.8	16.3	4.5
1963	22.3	17.0	5.2
1964	25.5	18.7	6.8
1965	26.5	21.5	5.0
1966	29.3	25.5	3.8
1967	30.7	26.9	3.8
1968	33.6	33.0	0.6
1969	36.4	35.8	0.6
1970	42.5	39.9	2.6
1971	43.3	45.6	–2.3
1972	49.4	55.8	–6.4
1973	71.4	70.5	0.9
1974	98.3	103.8	–5.5
1975	107.1	98.2	8.9
1976	114.7	124.2	–9.5
1977	120.8	151.9	–31.1
1978	142.1	176.0	–33.9
1979	184.4	212.0	–27.6
1980	224.3	249.8	–25.5
1981	237.0	265.1	–28.1
1982	211.2	247.6	–36.4
1983	201.8	268.9	–67.1
1984	219.9	332.4	–112.5
1985	215.9	338.1	–122.2
1986	223.3	368.4	–145.1
1987	250.2	409.8	–159.6
1988	320.2	447.2	–127.0
1989	359.9	477.7	–117.8
1990	387.4	498.4	–111.0
1991	414.1	491.0	–76.9
1992	439.6	536.5	–96.9
1993	456.9	589.4	–132.5
1994	502.9	668.7	–165.8
1995	575.2	749.4	–174.2
1996	612.1	803.1	–191.0
1997	678.4	876.5	–198.1
1998	670.4	917.1	–246.7
1999	684.0	1,030.0	–346.0
2000	772.0	1,224.4	–452.4
2001	718.7	1,145.9	–427.2
2002	681.8	1,164.7	–482.9
2003	713.1	1,260.7	–547.6
2004	807.6	1,473.1	–665.5

Note: Data reported on balance of payments basis.

Sources: Economic Report of the President, 2005; *US International Trade in Goods and Services*, March 2005.

1970s and 1980s than at any previous point in the 20th century. Of course, exports also rose during this period. But the firms that benefited from exports were by no means comparably aggressive in the political arena, though exporters (and import users) did act to limit protectionism when their own specific interests were at stake.

Furthermore, there was great disparity in the impact of the trade explosion on various industries and regions. During the 1970s—the period of greatest relative increase in US trade—producers of farm and high-technology products reaped great benefits. Overall, "in high-technology industries in which U.S. comparative advantage continue[d] to increase," the US trade surplus "grew from $15 billion in 1973 to $52 billion in 1980."[9]

But those who made standard producer and consumer goods suffered, whether their business was steel or autos or television sets. And the suffering was regional as well as sectoral. In the United States as a whole, employment in manufacturing stayed roughly the same between 1973 and 1980. But in the rust belt states from New York to Michigan, it declined by 10 to 15 percent. Within the highly unionized basic industries concentrated in this region, laid-off workers faced, on the average, substantial drops in their income levels even after they found new jobs outside those industries. As William H. Branson has noted, this meant that the greatest adjustment was being forced upon those very "workers and companies . . . in the best position to bring pressure on trade policy."[10] With their plight as concrete evidence, they could claim that a major American achievement of the earlier 20th century, the bringing of industrial workers into the middle class, was now being threatened by foreign competition.[11]

---

9. Robert Z. Lawrence, *Can America Compete?* (Washington, DC: Brookings Institution, 1984), 95. Between 1980 and 1985, as spelled out later in this chapter, virtually all US product sectors, including agriculture and high-technology industries, were hurt by the rise in the dollar, and many were helped, in turn, by its subsequent decline.

10. William H. Branson, "The Changing Structure of U.S. Trade: Implications for Research and Policy," paper prepared for the Washington Conference of the National Bureau of Economic Research, 9 March 1984, photocopy.

11. Defining a middle-class income as within 30 percent of the median for the economy, Lawrence finds that, according to census data, the proportion of manufacturing workers earning such incomes declined from 44.6 percent in 1969 to 39.3 percent in 1979. Lawrence, *Can America Compete?*, 80.

More generally, "the earnings of less skilled American men began dropping in real terms after 1973 and fell precipitously during the 1980s." This was "a striking break with [the] historical pattern," for "[f]rom 1900 through the 1960s the real earnings of less skilled American workers grew substantially." See McKinley L. Blackburn, David E. Bloom, and Richard B. Freeman, "The Declining Economic Position of Less Skilled American Men," in Gary Burtless, ed., *A Future of Lousy Jobs? The Changing Structure of U.S. Wages* (Washington, DC: Brookings Institution, 1990), 31.

The "Decline" of the United States

The nation that was suddenly more exposed to world trade was also comparatively less well off. As late as 1960, the incomes per capita of the United States' major "trilateral" competitors—France, Germany, Japan, and the United Kingdom—ranged from 30 to 68 percent of its own. By 1979, their per capita incomes had risen to between 64 and 86 percent of that of the United States.[12] The US share of world trade had also declined, albeit much less dramatically, and in the context of rapidly growing absolute trade flows. In 1950, US international commerce accounted for fully one-third of the trilateral total. This portion dropped to 27 percent in 1960, 23.5 percent in 1970, and 22.1 percent in 1980.[13]

As these last statistics suggest, most of the decline in the US share of world production and trade took place before the 1970s. Moreover, a major goal of postwar US foreign policy had been to restore its European and Japanese allies to economic health. After 1970, broad indicators suggest that the United States held its own economically vis-à-vis western Europe; for example, between that year and 1989, the US index of industrial production rose 76 percent, compared with just 48 percent for the European Community. And while Japanese industrial production grew by 110 percent over the same period, the difference between the real annual economic growth rates of the United States and Japan was only 1.7 percent a year over 1976–90—compared with an average annual difference of 7.9 percent in the 1960s.[14]

By these broad indicators, the US "decline" came mainly in the 1950s and 1960s, and could be seen as an inevitable correction of the abnormal and unsustainable preeminence created by World War II. But the full impact was felt in the 1970s and 1980s. Industrial sectors that were once world leaders came under intense trade-competitive assault: first steel and consumer electronics, then automobiles, then microelectronics. By the late 1980s, concern about the apparent erosion of America's economic and geostrategic position had made Paul Kennedy's heavy work of world history into a surprise best-seller.[15] And such concerns were reinforced by a

---

12. Irving B. Kravis, Alan Heston, and Robert Summers, *World Product and Income: International Comparisons of Real Gross Product* (Baltimore: Johns Hopkins University Press [for the World Bank and the United Nations Statistical Office], 1982), 15. Figures are for "gross domestic product per capita," in terms of actual purchasing power.

13. Calculated by Robert O. Keohane from the *UN Yearbook of International Trade Statistics*, 1981. See his *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, NJ: Princeton University Press, 1984), 199.

14. *Economic Report of the President*, 1991, tables B-107 and B-110.

15. Paul Kennedy, *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Random House, 1987). Kennedy's argument triggered nu-

separate phenomenon that was frequently, albeit oversimply, interpreted as reflecting an *accelerating* decline. This was the onset of regular merchandise trade deficits.

Every year from 1894 through 1970, the value of the goods the United States sold on world markets exceeded the value of those that Americans bought. The inflow of funds from these merchandise trade surpluses was offset, in important part, by an outflow of funds for investment overseas. But beginning in 1971, the year of Nixon's policy bombshell, the pattern changed: the United States ran a merchandise trade deficit that year, and in all but two of the 20 years thereafter. And the numbers looked increasingly alarming. The negative balance of $2.3 billion in 1971 was succeeded by records of $6.4 billion in 1972, $33.9 billion in 1978, and $159.6 billion in 1987.[16] Bilateral deficits with the United States' most-watched trading partner, Japan, grew apace, with records of $4 billion in 1972, $11.6 billion in 1978, and $56.3 billion in 1987.[17]

The deficits of the 1970s were not unreasonable for a mature industrial economy. What the United States was doing, essentially, was using the income from its foreign investments to finance a higher level of consumption than its current production would have allowed. Once it ceased being a consistent net capital exporter, simple mathematics dictated that modest "structural" trade deficits (amounting to less than 10 percent of total US trade) would be its normal condition, to offset net returns on overseas investment.[18] And the United States could do this while still running, on the average, an approximate balance in its current account, which includes not only merchandise trade but also services and investment income. In other words, US trade deficits were no larger than what its overseas earnings could finance; the United States was not going into debt to pay for imports.[19]

However, this was hardly the way the deficit was characterized in US politics. Rather, it was treated as offering clear evidence that the United

---

merous rebuttals, including those by Joseph S. Nye, Jr., *Bound to Lead: The Changing Nature of American Power* (New York: Basic Books, 1990), and Henry R. Nau, *The Myth of America's Decline: Leading the World Economy into the 1990s* (New York: Oxford University Press, 1990).

16. *Economic Report of the President*, 1991, table B-102.

17. Japan Economic Institute of America, *Yearbook of U.S.-Japan Economic Relations in 1982* (Washington, DC: JEI, 1983), 129.

18. No one, of course, "decided" that the United States should do this, and it could have made its future returns even greater by continuing the substantial net capital exports of the 1950s and 1960s.

19. The same could not be said of the genuinely alarming trade deficits of 1984 and thereafter, addressed later in this chapter.

States was losing out in the world marketplace.[20] This had several related and constraining effects on executive branch policymakers and on the broader political environment.

First of all, it undercut the argument—already very weak in American politics by 1970—that the United States should absorb costs to its specific trade interests in order to help maintain the broader international trading system (and US alliances that were intertwined with that system). The belief that "we could no longer afford" such generosity was hardly limited to Richard Nixon's demanding Secretary of the Treasury, John Connally; in the 1970s and 1980s, it became nearly universal.

Second, merchandise trade deficits increased political receptivity for claims that American firms and workers were facing unfair foreign competition, broadly defined. In many instances, foreign governments subsidized products destined for export and restricted imports more than the United States did for comparable products. One plausible—albeit analytically incorrect—explanation for trade deficits was that foreign markets were less open than the US markets.[21] Once we equated negative trade balance figures with a decline of the United States, it was more comfortable to blame this on foreign nefariousness than on domestic inadequacies.

Third, deficits placed American trade negotiators on the defensive because they suggested a negative market judgment on prior US trade bargaining: the United States had not been tough enough with foreign governments, and its producers were being battered as a result.

All of these constraints forced US negotiators to assume a more demanding international trade posture, by pushing for more concessions overseas and offering fewer in return, at a time when US power in the world was diminished. This seemed, at a minimum, a recipe for increased

---

20. Russell Long (D-LA), chairman of the Senate Finance Committee throughout the 1970s, argued persistently that the Commerce Department's preferred method of valuing imports—"customs value," or f.a.s. (free alongside ship)—led to understatement of the real US trade deficit, because it excluded the cost of shipping those imports. To get people to use what he considered the "right" numbers, Long attached to the major trade legislation of 1979 a provision requiring that import statistics be reported on the c.i.f. (cost, insurance, and freight) basis "no later than 48 hours before the release of any other government statistics" on imports or the balance of trade (Trade Agreements Act of 1979, section 1108 [a]). He expected the numbers released first to the press to become the ones most used—and his expectation was borne out. Thus, during the height of the trade imbalance, the annual deficit number commonly cited was inflated by roughly $18 billion, and the monthly number by about $1.5 billion.

This requirement was repealed by the Omnibus Trade and Competitiveness Act of 1988, section 1931 (a), enacted after Long's retirement. This returned Commerce Department reporting to the practice, preferred by most economists, of treating shipping as a service.

21. For discussion of why, in a floating exchange rate regime, the US trade balance is not fundamentally a function of market openness here or overseas, see Catherine L. Mann, *Is the US Trade Deficit Sustainable?* (Washington, DC: Institute for International Economics, 1999), especially chapter 6.

trade conflict, as US leaders were driven to ever more demanding exercises in "export politics."

The Rise of New Competitors

The relative decline of the United States meant, by definition, the rise of other nations. Foremost among them was Japan. That story is well known, and it is underscored by the dramatic rise in US-Japan trade that was noted earlier in this chapter. But a few other numbers are worth recalling as well.

In 1960, after recovery from World War II, per capita income in Japan stood at just 30 percent of the US level in terms of purchasing power—about equal to that of Mexico, a bit below that of Spain. Nineteen years later, it had grown to 71 percent of that of the United States, placing Japan squarely in the middle of the more prosperous Western European nations—ahead of Italy and Britain, if still behind France and Germany.[22] And Japan advanced further in the 1980s—by the comparative measure of the Organization for Economic Cooperation and Development (OECD), Japanese GNP per capita had reached 76 percent of the US level by 1989.[23] Between 1960 and 1980, Japan's share of total world GNP increased from 3 to 10 percent.[24] By 1989, at current exchange rates, Japan's GNP had reached 54 percent of the US level.[25]

Japan achieved this rise through phenomenal annual increases in national production and trade. Between 1960 and 1970, its real GNP rose an average of more than 11 percent a year.[26] Its merchandise exports grew even faster: by 17.2 percent annually in the 1960s and by 8.5 percent (from a much larger base) between 1970 and 1982.[27] Japan's share of world

22. Kravis et al., *World Product and Income*, 15.

23. Calculated from Organization for Economic Cooperation and Development, *Main Economic Indicators* (Washington, DC: OECD, July 1991), 175. The OECD figure for 1980 was 67 percent.

24. Keizai Koho Center, *Japan 1984: An International Comparison* (Tokyo: Japan Institute for Social and Economic Affairs, 1 September 1984), 9.

25. By 1989, income per capita in Japan already exceeded that in the United States if converted at current exchange rates. But analysts generally found Japan's cost of living (at these rates) to be 40 to 75 percent higher than that in the United States. Hence purchasing power parity (PPP) comparisons, like those developed by Kravis et al. and those employed by the OECD, are preferable. For a comprehensive analysis, see Robert Summers and Alan Heston, "The Penn World Table (Mark 5): An Expanded Set of International Comparisons, 1950–1988," *The Quarterly Journal of Economics* 106, no. 2 (May 1991): 327–68.

26. *Economic Report of the President*, 1991, table B-110.

27. World Bank, *World Development Report* (Washington, DC: World Bank, 1984), 235.

exports rose from 3.5 percent in 1960 to an estimated 8.3 percent in 1985.[28] No other major nation had had growth rates anything like these.

Any large country rising so rapidly was bound to cause problems for the world trading system. In fact, Japan had been perceived as a special trade problem, and its products subjected to a range of discriminatory barriers, well before its era of double-digit growth began.[29] But there were other problems in absorbing Japan as one of the preeminent players in the world trading system. As the first non-Western nation to achieve industrial success, Japan was culturally different. This traditionally closed and close-knit society had maintained substantial formal barriers to imports throughout the 1960s. The pace at which these barriers were dismantled always lagged behind that which Japanese export success would have allowed; the de facto opening of Japan's markets seemed to lag even further, though the strong yen of the late 1980s brought an enormous surge in imports. Moreover, in contrast to the aggressive business behavior of Japanese firms, the standard style of the Tokyo government in trade diplomacy was not to take the initiative but to await foreign pressure for trade liberalization and to open up markets, bit by bit, in response to this pressure.[30]

Hence, there developed a widespread perception of Japan as a "free rider" on the international trading system, exploiting market opportunities abroad while only grudgingly making changes at home. It also seemed clear that Japanese producers benefited from some special form of government-business cooperation, although experts differed sharply over its precise nature and impact. By the 1970s and 1980s, when American firms complained about what they perceived to be unfair trade practices—whether producers dumping television sets or governments promoting development of future export industries—Japan was most often their target. They could compete against companies, US business executives argued, but not against the government of a major economic power. Making matters more sensitive was the fact that Japan was the first

28. Percentages computed from International Monetary Fund, *International Financial Statistics: Supplement on Trade Statistics,* no. 15, 1988; and International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1990.

29. Gardner Patterson devoted an entire chapter to the various ways that other major trading nations developed special barriers against Japan in *Discrimination in International Trade: The Policy Issues* (Princeton, NJ: Princeton University Press, 1965).

30. American trade negotiators, by contrast, were prone to take the initiative, in part to channel trade pressures in the export-expanding rather than import-restricting direction. Hence, "officials in both governments" have recurrently employed "intense, highly visible United States pressure as a catalyst for Japanese policy change." Report of the Japan-United States Economic Relations Group, prepared for the President of the United States and the Prime Minister of Japan (Tokyo and Washington, January 1981), 101. See also I. M. Destler and Hideo Sato, eds., *Coping with U.S.-Japanese Economic Conflicts* (Lexington, MA: Lexington Books, 1982), especially 279–81.

nation since the rise of mass-production manufacturing processes to challenge the United States for industrial preeminence across a wide range of industries. Books that highlighted this phenomenon, like Clyde Prestowitz's *Trading Places*,[31] won wide circulation and broad credence.

Trade concerns triggered by Japan were magnified by the rise of "new Japans": nations that were following Japan's rapid-growth, export-expanding path. The most impressive single example, perhaps, was the Republic of Korea, whose exports increased annually by 35 percent in the 1960s and by 20 percent in the 1970s, and whose growth in income paralleled Japan's, albeit at lower levels.[32] Taken together, the share of world trade of the "four tigers" of East Asia—Hong Kong, Korea, Singapore, and Taiwan—rose from 1.9 percent in 1963 to 7.7 percent in 1988.[33] Thus, from the 1970s onward, American firms faced a trading world very different from the bipolar (US-EC) one of the Kennedy Round.

The Erosion of the GATT

Even as these new competitors were emerging, the system of rules for regulating international trade was weakening. In the first two postwar decades, the GATT had provided a surprisingly effective framework for negotiating trade liberalization and disciplining import restrictions. But thereafter it came under siege.[34]

One reason for its erosion was the identity of the new competitors. The GATT had originated as a North American–European enterprise, shaped by leaders who drew common lessons from the prewar (and wartime) experience. Nations from these two continents continued to provide the GATT's primary political leadership through the 1970s, but the rise of other nations meant that the lead trading states now formed a less homogeneous community, making it harder to maintain agreement on trade policy norms. And since the new competitors were slow to assert leadership

31. Clyde V. Prestowitz, Jr., *Trading Places: How We Allowed Japan to Take the Lead* (New York: Basic Books, 1988). A superb retrospective look at this period of US trade policy and politics is provided by an Australian analyst, John Kunkel, in *America's Trade Policy Towards Japan* (London: Routledge, 2003).

32. By the estimates of Kravis et al., gross domestic income per capita for Korea rose from 8.15 percent of the US level in 1960 to 24.8 percent in 1979. *World Product and Income*, 15. Korean export statistics are drawn from World Bank, *World Development Report*, 1984, 235.

33. Marcus Noland, *Pacific Basin Developing Countries: Prospects for the Future* (Washington, DC: Institute for International Economics, 1990), 5.

34. For a good summary of the original GATT system and its evolution, see Miriam Camps and William Diebold, Jr., "The Old Multilateralism and What Became of It," *The New Multilateralism: Can the World Trading System Be Saved?* (New York: Council on Foreign Relations Press, 1983), chapter 1.

in multilateral trade negotiations, there was a growing divergence between the locus of trade-political activism and the locus of trade-economic power.

A second reason for the GATT's weakening was, ironically, its enormous success at what it did best: multilateral tariff-cutting negotiations. As noted in chapter 2, the remarkable postwar reductions in customs duties forced international trade relations onto the harder ground of nontariff trade barriers: harder to measure and negotiate, more intertwined with issues of domestic policy and national sovereignty, and not well defined by the original GATT rules. The Tokyo Round, or MTN, of the 1970s resulted in agreement on a number of "codes" addressing such subjects as subsidies, dumping, product standards, and government procurement. But not all GATT members accepted the obligations of these codes, and enforcement procedures proved slow and cumbersome. The Uruguay Round initiated in 1986 sought to establish GATT-type rules for international investment and services transactions—another task much more complex than the tariff cutting of earlier periods.

A more general problem for the GATT was the erosion of its bedrock principle of nondiscrimination, the core notion that each national government would grant equal treatment to the products of all others adhering to the GATT system. The European Community was one enormous exception; by definition, its members agreed to grant one another more favorable (i.e., duty-free) market access than they granted to outsiders. Tariff preferences for less developed countries were another exception. The Canada–United States Free Trade Agreement of 1988 was yet another, as was the North American Free Trade Agreement (NAFTA) that followed five years later.

Governments discriminated in restricting imports as well as in admitting them. Under the GATT escape clause, Article XIX, members were allowed to impose temporary import barriers for the products of trade-injured industries. But they were supposed to do this on a nondiscriminatory basis. In practice, Article XIX was increasingly circumvented by "voluntary" export restraints (VERs) or orderly marketing agreements (OMAs), in which specific exporting nations agreed to limit their sales. Such arrangements became the norm for trade in textiles and apparel; they spread to steel and automobiles; and, in particular, they were employed to limit the sales of such rapidly rising competitors as Japan and the East Asian newly industrialized countries (NICs).

For American trade policymakers, the erosion of the GATT weakened one important postwar source of leverage in domestic trade bargaining: the argument that a particular restrictive action would undercut the international trading system from which the United States derived great benefits. For the more the international trade regime was viewed as ineffective and riddled with exceptions, the less credible were claims that US interests were served by following its rules.

Stagflation

The GATT also faced growing strain because, from the 1970s to the mid-1980s, the United States and its advanced industrial trading partners were beset with what became known as "stagflation": slow growth and high unemployment coexisting with high inflation. The United States sowed the seeds of the stagflation era when, for several years, Lyndon B. Johnson refused to seek a tax hike to finance the Vietnam War. Richard M. Nixon made matters worse with his overstimulation of the American economy in the election year of 1972. In both cases, the United States pursued fiscal and monetary policies that increased overall demand at a time when production was at or near capacity. The immediate result was price rises, which proved contagious. By early 1973, inflation in the United States was running at double-digit levels.

Then came the October War in the Middle East. Seizing the opportunity presented by tight supply conditions, members of the Organization of Petroleum Exporting Countries (OPEC) quadrupled the price at which they offered their crude oil on world markets. This generated enormous new inflationary pressure, driving up costs for productive enterprises and gasoline-dependent consumers. At the same time, the oil shock depressed demand in all the advanced industrial countries, since paying for needed oil imports at the new prices forced a massive shift of funds from consumer to producer countries. The world plunged from a 1973 boom to a 1974 recession—the deepest of the postwar era. In 1979, revolution in Iran led to the second oil shock, a near tripling of the OPEC export price. Again, inflation rates rose and the world economy plunged into recession.

Once under way, stagflation proved endemic. The higher the US rate of inflation became, the greater the level of unemployment that was needed to wring expectations of future inflation out of the economy. Hence, in 1979, the Federal Reserve Board under Chairman Paul A. Volcker began to pursue consistently tight money policies, even as growth flagged and the number of jobless increased. What economists and journalists came to label the "misery index"—the sum of the unemployment and inflation rates—rose to new heights.

Statistics once viewed with alarm came to be seen as normal, even encouraging. In the United States in 1957, a 3.6 percent rise in the consumer price index (CPI) had alarmed the Eisenhower administration; for more than a decade thereafter, the country did not again see a year-to-year increase above 3 percent. But the 1970s and early 1980s brought four years of double-digit price inflation, and President Ronald Reagan could claim victory when the 1983 CPI was "only" 3.2 percent above that of 1982.[35] Prior to 1975, the highest annual postwar rates of civilian unemployment

35. *Economic Report of the President*, 1985, tables B-54 and B-55.

were 6.8 percent in 1958 and 6.7 percent in 1961. By 1982, unemployment reached 9.7 percent. Expectations in the United States were so reduced that, in a year when unemployment averaged 7.5 percent, Reagan could be credited with an impressive economic recovery and ride to a landslide reelection victory.[36]

The trade problems of key industries were exacerbated by their failure to adjust to this less congenial environment. Management and labor continued to negotiate hefty wage increases, notwithstanding slower domestic growth and stiffer international competition: "In 1970 hourly compensation for auto and steel workers was about 30 percent higher than the average compensation in manufacturing. By 1981 the difference had grown to 70 percent for steel workers and 50 percent for auto workers."[37] Only after both industries faced massive layoffs were significant wage and benefit concessions forthcoming.

Coming together with stagflation, as both cause and effect, was a decline in the rate of economic growth. Not only did the United States experience five negative growth years between 1970 and 1982 (there were none from 1959 to 1969), but its average GNP growth also fell by a percentage point despite an exceptional increase in the labor force.[38] This reflected a sharp decline in productivity growth. As a result, the average real wages of the American worker stopped growing around 1973, in dramatic contrast to their near doubling over the 25 previous years.[39] Moreover, income inequality rose over the 1970s and 1980s.[40] Nor were such changes affecting the United States alone. All advanced industrial nations found the going harder after the early 1970s. Average Japanese growth of 4.4 percent in 1971–83 might look good to Americans and Europeans, but it was a big drop from the 11.7 percent of the decade preceding.[41] The worsening in US unemployment looked mild when set against the much steeper proportionate rises in Germany, France, Canada, and above all

36. Ibid., table B-29. By the end of 1985, Reagan (and the US economy) were beginning also to benefit from an oil glut, precipitating a sharp decline in oil prices and undermining the always tenuous OPEC effort to buttress prices through national production quotas. In the ensuing years, driven by sharp US growth in 1984 and moderate growth thereafter, the average civilian unemployment rate declined to 5.3 percent in 1989 before rising with the 1990–91 recession.

37. *Economic Report of the President*, 1984, 92.

38. Average US GNP growth was 3.8 percent from 1961–70, and 2.7 percent from 1971–84. Yet the labor force grew by 29 percent over 1971–80, much more than in either previous postwar decade. See *Economic Report of the President*, 1991, tables B-109 and B-32.

39. The best work on this subject is Frank Levy, *Dollars and Dreams: The Changing American Income Distribution* (New York: Russell Sage Foundation and W. W. Norton, 1988).

40. Bartless, *A Future of Lousy Jobs?*, 1.

41. *Economic Report of the President*, 1991, table B-110.

Britain, whose jobless rate leaped from 3 percent in 1970 to 12 percent in 1984![42]

The mid- and late 1980s did bring some good economic news for Americans. Inflation fell substantially: from 1982 through 1989, it never exceeded 4.6 percent, whereas it was above that level every year from 1974 through 1981. US economic growth averaged 3.5 percent over 1984–90, compared with 2.5 percent over 1976–83. There was a rebound in the productivity growth of manufacturing (though not services) industries. And toward the decade's end, Europe also experienced a surge in growth, as did Japan.

But by 1990–92, the United States was back in recession, a problem that in short order also beset Europe and Japan. Thus, other nations would not be very receptive to American demands that they give the United States more in international trade talks than they were likely to get in return.

Floating Exchange Rates and Dollar "Misalignment"

The monetary regime within which the United States faced these new difficulties was no longer the Bretton Woods system of fixed exchange rates pegged to the dollar, but one in which the dollar's relative price—the single most important determinant of US producers' trade competitiveness—was being set and reset, day by day, in foreign-exchange markets.[43]

As noted at the outset of this chapter, the end of Bretton Woods initially made life easier for US trade policymakers. The "Nixon shock" of 15 August 1971 had begun the process, and devaluations of roughly 10 percent followed in December 1971 and February 1973. Renewed currency speculation forced the major trading nations to move to a floating-rate regime a month later, in March 1973. After that, the markets generally kept the real (inflation-adjusted) value of the dollar at or below the March 1973 level through the Nixon, Ford, and Carter administrations.[44] American exports benefited; import competition eased somewhat; and the management of trade-restrictive pressures was somewhat less of a burden. And it was at a time of dollar weakness, with US exports expanding rapidly, that the world completed (and Congress approved) the Tokyo Round agreements aimed at reducing nontariff barriers to trade.

42. Ibid., table B-108.

43. For a general analysis of the challenges this posed for US policymakers, see I. M. Destler and C. Randall Henning, *Dollar Politics: Exchange Rate Policymaking in the United States* (Washington, DC: Institute for International Economics, 1989), especially chapters 1–4.

44. In fact, the markets brought the dollar sharply down in the early Carter administration, necessitating a "dollar defense" initiative on 1 November 1978 to reverse this fall.

However, in the first half of the 1980s, this exchange rate situation reversed itself with a vengeance. From its level in 1980 to its peak in late February 1985, the trade-weighted value of the dollar rose an incredible 67 percent by the MERM index of the International Monetary Fund (see figure 3.1), and 88.2 percent by the index of the Federal Reserve.[45] At this point, the dollar was roughly 40 percent above the level that would have brought balance to the US current account. In terms of trade competitiveness, this was a severe and protracted currency misalignment that had been unseen—and unforeseen—by postwar economists, businessmen, and politicians.[46]

Beginning in March 1985, the dollar turned around again. Given a major push by a joint declaration by the finance ministers of the Group of Five nations (France, Germany, Japan, the United Kingdom, and the United States) in the Plaza Agreement in September 1985, the dollar had plummeted by the end of 1987 to roughly its 1980 level, and it moved within a far narrower range in the years thereafter—as figure 3.1 shows. With both the decline and the subsequent stabilization came renewed cooperation in exchange rate management among the finance ministers and central banks of the advanced industrial nations.[47]

How could the exchange rate shift so much? How was the dollar able to reach a level that rendered many American products uncompetitive, as it had by early 1982, and continue to rise for three more years despite burgeoning US trade deficits, only to plummet over the next three years? A critical underlying source of such currency fluctuations and misalignment was a revolution in world capital markets.

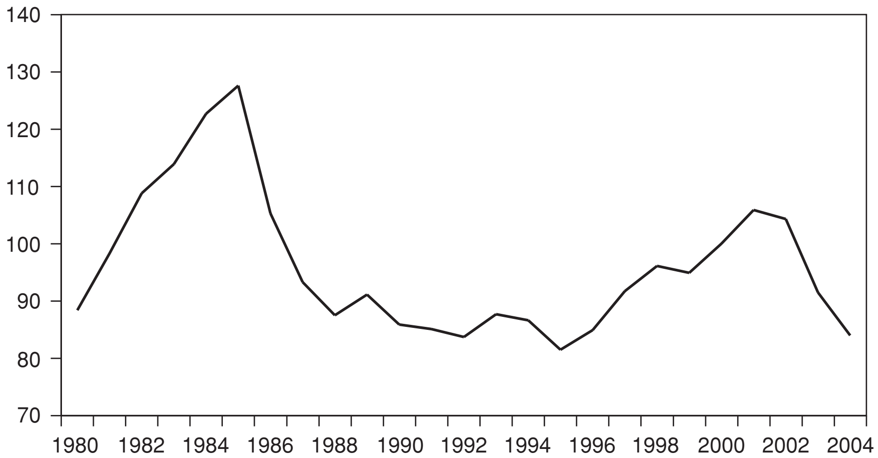
Many international economists had favored a floating exchange rate system well before the world was forced to accept one. Generally, they expected that trade transactions would dominate foreign-currency markets. Since the trade competitiveness of major countries was generally slow to change, this meant that relationships among the strong currencies would

45. Destler and Henning, *Dollar Politics*, 22–25. MERM stands for the Multilateral Exchange Rate Model.

46. For a definition of currency misalignments, see John Williamson, *The Exchange Rate System*, Policy Analyses in International Economics 5 (Washington, DC: Institute for International Economics, September 1983, rev. June 1985), 12. For a proposal to reduce them, see Williamson and Marcus H. Miller, *Targets and Indicators: A Blueprint for the International Coordination of Economic Policy*, Policy Analyses in International Economics 22 (Washington, DC: Institute for International Economics, December 1987). For a comprehensive contemporary analysis of the dollar misalignment's macroeconomic causes and trade consequences in the 1980s, see Stephen Marris, *Deficits and the Dollar: The World Economy at Risk*, Policy Analyses in International Economics 14 (Washington, DC: Institute for International Economics, December 1985, rev. August 1987).

47. See Destler and Henning, *Dollar Politics*, chapter 4, and Yoichi Funabashi, *Managing the Dollar: From the Plaza to the Louvre* (Washington, DC: Institute for International Economics, 1988, rev. 1989).

Figure 3.1 US nominal effective exchange rates, 1980–2004



Source: International Monetary Fund, *International Financial Statistics*.

be rather stable.[48] Shifts in exchange rates would be gradual, and a function primarily of shifts in trade flows.

What no one anticipated was the impact of the dramatic increase in the magnitude and international mobility of investment capital, particularly "short-term" funds seeking the most rewarding current situation. As one informed observer characterized matters in early 1985: "The flow of money was now dwarfing the growth of world trade. In 1984, for example, world trade in goods and services was on the order of $2 trillion, while global capital transfers reached $20–30 trillion."[49] This meant that exchange rates were increasingly driven not by trade transactions, but by whatever might cause those who controlled capital to shift funds from one currency to another. Portfolio managers, responsible for large pools of investment money, became critical participants in the world economy. And while no school of economics could model their behavior with much confidence, they seemed to be motivated primarily by two factors: differences in real interest rate returns between countries, and anticipation as to how, in the near term, a currency's value was likely to move.

---

48. This would not, of course, apply to the currencies of countries experiencing very high inflation.

49. Jeffrey E. Garten, "Gunboat Economics," *Foreign Affairs* 63, no. 3 (America and the World, 1984): 453. As Garten's broad range suggests, estimates of the magnitude of capital flows were necessarily imprecise.

When a major country like the United States pursued policies the markets perceived as inflationary—likely to reduce the currency's value and hence the "real" returns on dollar assets—that currency's value plummeted. The swing was exacerbated by the herd instinct of money managers, whose rewards come from calling the day's market correctly. Thus the dollar sank in 1977 and 1978.

When, conversely, the United States began its "riverboat gamble"[50] with Reaganomics in 1981, the situation turned around. The United States now needed foreign funds to finance its suddenly mammoth budget deficits. And real US interest rates were strong, spurred by this expanded government borrowing and by the tight-money policies of Federal Reserve Chairman Paul A. Volcker, who had come into office in 1979 determined to squeeze inflation out of the US economy. Foreign money therefore flowed in and drove the dollar skyward. By the end of 1984, a dollar would buy more than twice as many French francs, British pounds, and German marks as it had in October 1978. The dollar could even buy about 40 percent more Japanese yen.

US producers of traded goods found their competitive position demolished, as the currency misalignment made foreign goods far cheaper for Americans to buy and American products very dear for purchasers overseas. Exports stagnated, with the total for 1986 actually below that of 1980. Imports surged. The overall US trade deficit ballooned to $67 billion in 1983 and $159.5 billion in 1987. As former Federal Reserve Chairman Arthur F. Burns noted at mid-decade, such 12-digit deficits were "awesomely different from anything experienced in the past," by any country.[51]

The strong dollar was not the sole cause of the enormous shift.[52] But Secretary of State George P. Shultz stated the consensus view when he blamed it for "over half . . . of the deterioration in the US trade account."[53] From the perspective of producers of traded goods, the strong dollar of the mid-1980s was a devastating source of competitive disadvantage. It was something about which they, as individual economic agents, could do absolutely nothing. And it was something against which traditional intergovernmental trade bargaining was impotent as well.

But the trade balance *was* responsive to exchange rate change. And just as the rise of the dollar brought unprecedented trade pain, its rapid fall

---

50. The phrase is that of Howard Baker, then majority leader of the US Senate, who guided the Reagan program to enactment.

51. "The American Trade Deficit," *Foreign Affairs* 62, no. 5 (Summer 1984): 1068.

52. The other major sources were the developing-country debt crisis, which sharply curtailed exports to Latin America, and the fact that the US economy grew more rapidly, in 1983 and 1984, than those of its major trading partners.

53. "National Policies and Global Prosperity," address at the Woodrow Wilson School, Princeton University, Princeton, NJ, 11 April 1985, photocopy.

brought substantial relief. By the end of 1987, the dollar could buy only half as many yen—or marks—as it could in early 1985. With this new price advantage, US exports, stagnant for six years, doubled between 1986 and 1992. Imports maintained their rapid growth for a while, and the annual trade deficit did not begin to decline until 1988. By 1991, however, it had finally dropped well below the $100 billion annual rate; import growth had slackened (with recession an important cause), while the export boom continued.[54]

But if the monthly trade deficits were now lower, deficits they remained. And the United States was still borrowing overseas to finance them.

Economic Tripolarity and the End of the Cold War

Finally, Americans had to digest the fruits of a great victory: the end of the Cold War and the demise of their longtime Soviet adversary. For over 40 years, that global political-military confrontation had dominated American foreign policy. It had also muted economic conflicts, since leading US trade competitors were also its most critical Cold War allies.

Now, suddenly, the Cold War was won, with the collapse of the Warsaw Pact in 1989–90 and the disintegration of the Soviet Union in 1991. The United States emerged as the sole military superpower, flexing its military muscle by leading a United Nations coalition in reversing Iraq's conquest of Kuwait, and extracting major financial contributions in support of this campaign from Tokyo and Bonn. Yet simultaneously it found the going harder on economic issues, as illustrated by the December 1990 breakdown in the Uruguay Round multilateral trade talks, and the rise in trade and economic frictions with Japan.

54. The dollar began falling in early 1985, but as Paul R. Krugman noted, "through much of 1987 [trade] imbalances continued to grow, leading to widespread assertions that the traditional international adjustment process no longer worked." In fact, Krugman concludes, the US "export boom . . . happened just about when and in the magnitude that the traditional [economic] models would have predicted." *Has the Adjustment Process Worked?* Policy Analyses in International Economics 34 (Washington, DC: Institute for International Economics, October 1991), 1–3, 46. Stephen Marris, on the other hand, writes that "the actual improvement in the US trade balance was about 30 percent less than it should have been according to the D&D model, reflecting an overestimation of the benefits from devaluation (common to most models of the US trade balance extant at the time)." See his essay, "Why No Hard Landing?" in C. Fred Bergsten, ed., *International Adjustment and Financing: The Lessons of 1985–1991* (Washington, DC: Institute for International Economics, 1992), 250. The "D&D model" is that in Marris' *Deficits and the Dollar.* Robert Z. Lawrence concludes that the experience of the 1980s offers "little support for the pessimists who have claimed that U.S. trade flows would not respond to exchange rate changes." See his "U.S. Current Account Adjustment: An Appraisal," *Brookings Papers on Economic Activity* 2 (1990): 382.

As recounted earlier in this chapter, the relative US economic position had been receding for decades. But mutual security dependence had kept Europe and Japan responsive to US trade leadership, and made leaders in all three inclined to compromise on trade issues in order to preserve the free world coalition. As Robert Gilpin noted, "Difficult economic issues dividing the three centers of world capitalism could frequently be resolved through appeals to the need for unity against the common Soviet enemy."[55] Now trilateral economic relations had lost their "security umbrella."[56] Leaders would need to pursue trade and trilateral cooperation for its own sake, or not pursue it at all.

A Tougher World

As these seven changes were intertwined, so too were their political effects. Explosion in the volume of trade meant greater import competition for American producers, and greater pressure for trade restrictions, even in the 1970s when the dollar was comparatively weak. The dollar misalignment of the early and mid-1980s compounded the political problem: It increased the volume of imports and consequent protectionist reaction, while demoralizing export interests because it curtailed their gains from open trade. The dollar decline of 1985–87 brought needed relief, economically and politically. But frustration continued.

The diminished relative position of the United States joined with stagflation and recession to cast a shadow on future American economic prospects. Such unhappy economic outcomes discredited, to a degree, arguments for a continuing commitment to open trade. And the end of the Cold War eliminated the necessity to compromise with allies on economic issues in order to maintain the grand anti-Soviet alliance. More generally, as successive presidents found themselves embattled with economic woes, they had less leeway to press market-opening measures at home, and felt more pressure to restrict imports or to demand that US trading partners buy US exports.

Stagflation and American "decline" were accompanied by the growing visibility of unfair foreign trade practices, as well as unequal market access in specific product areas. There was an understandable tendency to blame at least some of the "decline" on these foreign trade practices. The weakening of the GATT made it harder to achieve effective remedies for unfair practices within the multilateral system, and pressure for unilateral

55. "The Transformation of the International Political Economy," Jean Monnet Chair Papers (San Domenico, Italy: The European University Institute, 1991), 12.

56. C. Fred Bergsten, "The World Economy After the Cold War," *Foreign Affairs* 69, no. 3 (Summer 1990): 96–112. See also the articles by Theodore C. Sorensen and Peter Tarnoff in the same issue.

responses therefore increased. Reinforcing such pressure was the threatening nature of the United States' new competitors—Japan and the NICs—whose trade was growing at historically unprecedented rates, who clearly benefited from some form of government-business cooperation, and whose aggressiveness in exports preceded and exceeded their willingness to open their markets to imports.

Changes of this magnitude would have posed severe problems for the 1934 system even if it had retained its basic postwar character and strength. But it too was changing. This was due in part to the new international economic realities, but also in part to developments that were specific to US politics.

We turn now to these domestic system changes—the primary focus of part II of this book. And we begin with the United States Congress, that central constitutional authority whose interest in protecting itself from trade pressures was the key element in the effectiveness of the old trade order.