The End of American Hegemony

PS 142A.11
“I just don’t want to bullshit the American people.”

- In canceling a nationally televised address scheduled for July 4, 1979.

“The threat is nearly invisible in ordinary ways. It is a crisis of confidence. It is a crisis that strikes at the very heart and soul and spirit of our national will. We can see this crisis in the growing doubt about the meaning of our own lives and in the loss of unity of purpose for our nation.”
Decade of Despair

- Decline of U.S. power
- Vietnam
- Watergate
- End of Bretton Woods monetary regime
- Growing import competition
- Oil shocks and the New International Economic Order
- Stagflation
- Iranian hostage crisis
Decline of U.S. Power

- By 1970, Soviet Union had caught up with U.S. in military power
  - Now a “peer” competitor
  - Soviet economy still smaller
- U.S. lost its disproprotionate position relative to allies
  - America as an “ordinary country”
Share of World Power, 1750-present
Share of World Power

<table>
<thead>
<tr>
<th>Year</th>
<th>USA</th>
<th>UK</th>
<th>RUS</th>
<th>CHN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900</td>
<td>0.17</td>
<td>0.12</td>
<td>0.10</td>
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<tr>
<td>1930</td>
<td>0.24</td>
<td>0.14</td>
<td>0.18</td>
<td>0.08</td>
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<tr>
<td>1950</td>
<td>0.30</td>
<td>0.10</td>
<td>0.22</td>
<td>0.12</td>
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<tr>
<td>1975</td>
<td>0.17</td>
<td>0.08</td>
<td>0.25</td>
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<tr>
<td>2000</td>
<td>0.15</td>
<td>0.05</td>
<td>0.20</td>
<td>0.20</td>
</tr>
</tbody>
</table>

CINC score
U.S. Share of World GDP

Sources: Angus Maddison, IMF, CIM
U.S. Share of World GDP Compared

Source: Angus Maddison Project, International Monetary Fund (IMF), Bawerk.Net
U.S. Share of World Exports
End of Bretton Woods

- Under Bretton Woods, dollar fixed to gold, other currencies fixed to the dollar
  - Dollar convertible into gold at $35 per oz.
- Liquidity shortage after war prompted U.S. to run balance of payments deficits
  - “Exported” dollars to the rest of the world
  - Dollar becomes international reserve asset
  - Increasing quantity held by foreigners (including central banks)
- Dollar “Overhang”
  - By August 1971, official and private foreign holdings of $70bn, against $10bn of U.S. gold reserves
End of Bretton Woods

- Due to Great Society programs and military spending, U.S. unable/unwilling to solve balance of payments deficit

- Dollar effectively overvalued
  - Made U.S. exports too expensive
  - Made foreign exports (U.S. imports) less expensive
  - Encouraged U.S. FDI outflow

- In the “Nixon shock” of August 15, 1971, U.S. “closes the gold window”
  - Dollars no longer convertible into gold
End of Bretton Woods

- Instability ensues
  - Continuing speculative “runs” on the dollar
- By March 1973, all the major currencies are floating relative to one another
  - Dollar no longer “backed” by exogenous resource
  - Exchange rate set by market supply/demand
  - Now “managed” floats
- U.S. yields control over global economy!
- Ratified in the Jamaica Accords of 1976
  - Amendment to IMF Articles of Agreement
Import Competition

- Trade dramatically liberalized in the Kennedy (1967) and Tokyo (1979) Rounds of the GATT
  - Average tariffs fall to 3.5% by 1980
  - Imports as a share of U.S. GDP increased to 12% in 1980 from 4.6% in 1960
- Germany and Japan return as manufacturing “powerhouses”
  - Japanese trade “upgrades” from light manufactures (textiles) in 1960s to industrial goods, machinery and equipment, and consumer durables
- Shifts in U.S. comparative advantage
U.S. Trade Balance

U.S. Merchandise Trade Balance (1895-2015)

Sources: US Census Bureau, Department of Foreign Trade, MeasuringWorth
Import Competition

- Under GATT, raising tariffs is difficult and quotas are illegal.
- U.S. responded by demanding that Japan “voluntarily” restrict its exports to the U.S. in steel, TVs, automobiles, and other products
- Multi Fibre Arrangement introduced in 1974 to regulate flow of textiles from developing countries
Oil Shocks

- OPEC formed in 1960
- U.S. peak production of oil in 1970
- During 1973 Yom Kippur War, OAPEC imposes embargo on U.S. in retaliation for U.S. resupply of Israel (lifted March 1974)
  - Disrupts markets
  - Demonstrates power of cartels
- Iranian Revolution in 1979 further disrupts supply and panic sets in.
Oil Prices

**Imported Costs**

- **Real**: Green line
- **Nominal**: Red line

**Dollars per Barrel**

- 0
- 10
- 20
- 30
- 40
- 50
- 60
- 70

**Years**

- 1970
- 1975
- 1980
- 1985
- 1990
- 1995
- 2000
- 2005
Stagflation

- Official recession from November 1973 to March 1975; recovery slow (stagnation)
  - Unemployment at 9%
  - By comparison, 10% in 2009
- Inflation rose to 13.9% by 1980
  - Postwar period = 3.2% (on average)
  - 9.1% in 1975, 11.3% in 1979
  - Federal Reserve Bank tightens monetary policy
    - Fed funds rate: 11% in 1979, 20% in June 1981
    - Prime interest rate soars to 21.5% in June 1982
Interest Rates

High interest rates set off another recession in early 1980s
The Locomotive Strategy

- President Carter recognizes that U.S. can no longer lead international economy alone.
- G-7 Economic Summit in 1978 agrees to coordinate macroeconomic policy with Germany and Japan
  - Stimulate economy through fiscal policy
  - Restrain inflation through monetary policy
  - Avoid worsening U.S. balance of payments crisis
- Countries did not adjust as promised.
Iranian Hostage Crisis

- Nixon Doctrine promoted Iran as a regional stabilizer.
  - Shah Reza Pahlavi was our “SOB”
- Shah overthrown in Feb. 1979 in revolution led by Ayatollah Ruhollah Khomeini
- Carter allows Shah to enter U.S. for medical treatment (Oct. 22); Iranians respond by seizing the U.S. Embassy in Tehran (Nov. 4) and holdings its 52 Americans hostage
  - Ostensible purpose was to force extradition of Shah
  - Demands expanded over time
Iranian Hostage Crisis

- Rescue attempt on April 24, 1980 fails
  - Helicopters are disabled in desert
  - One helicopter crashes into C-130 tanker, killing 8
- Negotiations unfold through intermediaries
  - Algiers Accords signed Jan. 19, 1981
  - Release of hostages in return for unfreezing Iranian assets ($7.9bn) in the U.S.
  - Hostages finally released just minutes after President Reagan sworn into office (Jan. 20).
Human Rights: Putting the Liberal Back in the LIO

- Church Committee investigations (1975)
  - Examined CIA operations (publishing only Chile)
  - Revealed numerous assassination attempts — leading to law prohibiting assassinations of foreign leaders
  - Revealed FBI/NSA monitoring of U.S. citizens

- Carter administration attempted to address “blowback” against the U.S.
  - Returned the Panama Canal
  - Promoted human rights in Latin America, especially as abuses in Argentina (the “dirty war”) became known
Malaise v. Morning in America