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Chapter 6

THE CHANGING WORLD ORDER

Despite twenty-five years of remarkable economic growth, the United States after 1970 began to devolve as the world's premier economic and military power. While it would continue to produce the single largest part of the world's gross product and to consume a proportionately greater share of that product, the United States no longer retained its position of economic hegemony. A decade of crises forced a realignment of American relations with the global community and began the process of redirecting American business from its historic preoccupation with the American market to a larger global awareness. Hesitantly, but with growing assurance, American businesses turned from producing goods for the domestic market to producing and marketing goods and services for the global market.

The troubles encountered by the United States in the 1970s were many. In 1971 the American trade balance turned negative for the first time since 1893. Earlier, as a premonition of growing economic duress, the United States abandoned its historic support of gold at $35 per ounce and soon abandoned all efforts to maintain a fixed price for gold. Inflation was followed by experiments in wage and price controls. A sudden OPEC embargo on petroleum in 1973 created new financial crises in the United States and other Western nations. Concurrently, U.S. trading partners, including Europe and Japan, seemed to become more competitive and threatening to U.S. interests. Economic problems, coupled with military failures in Vietnam, cost the United States credibility at home and abroad. The

Soviet bloc, or as President Ronald Reagan would later identify it, "the Evil Empire," seemed ever more menacing.

The Demise of the Dollar

The first premonition that something was wrong occurred in 1968, when Western trading nations, led by the United States, agreed to distinguish between the "official" price of gold and the "private market" price. Central banks could buy and sell gold at the official price of $35 per ounce. But in the "private" or unofficial market the price of gold floated free; that is, gold could sell at any price agreed to by a buyer and a seller. Speculators and countries with large balances of American dollars, such as France, were beginning to buy gold at higher than the U.S. guaranteed price of $35 per ounce anticipating that the United States would not be able to continue to redeem gold at that price. In other words, the value of the dollar was in doubt.

This monetary crisis, as it came to be, had some deep and complex roots. In international trade, gold was the historic medium of exchange or payment, but the physical exchange of gold coins or bullion is difficult and unwieldy. Rather, those engaging in the exchange of goods between nations became accustomed to accepting a particularly stable and strong national paper currency as the base for exchange. Those historically strong currencies, such as the British pound, became key *reserve currencies* because nations held those currencies for exchange purposes. Sales were usually made by quoting the price in reserve currency terms. Until World War II the British pound was the major reserve currency. After the war the American dollar became the dominant reserve currency. Foreign nations obtained American dollars through the regular processes of trade, but between 1945 and 1970 most of those dollars flowed into foreign treasuries as a result of American Marshall Plan aid, loans, defense expenditures, and capital investment.

By the late 1960s European nations in particular held large quantities of U.S. dollars, which represented demands on American gold held in the U.S. Treasury. The United States was obligated to accept those dollars in exchange for gold at the rate of $35 for each ounce of gold. It was doubtful that the United States had enough gold to cover its obligations. The market thus began to devalue the dollar. As devaluation occurred, the demands for gold at $35 per ounce rose. The U.S. response in 1968 to separate "official" demands for gold from "private" demands for gold would in theory reduce the pressures on gold and the dollar. This began the process of demonetizing gold and devaluing the dollar.

Underlying the growing pressure on the dollar were, among other things, rising defense costs caused by the growing involvement of U.S. forces in Vietnam. A South and North Vietnam came into being when France was forced to withdraw troops from the region. North Vietnam was under communist influence, and the United States attempted to sustain a republican government headed by President Ngo Dinh Diem in the South by sending aid and military advisers.

By 1961, when John F. Kennedy became president, the number of American military advisers had grown to 3200. When the Vietcong (the South Vietnamese guerrillas supportive of the North) and North Vietnamese regulars stepped up attacks on South Vietnam, the United States countered to the point that by 1968, under the direction of President Lyndon B. Johnson, the United States had more than half a million men in combat in South Vietnam. But the war went badly. Thousands of Americans were killed, captured, or missing in action. Costs escalated. Opposition within the United States rose. Finally, after the elections of 1968, newly elected President Richard M. Nixon promised to "wind down" the war in Vietnam. He attempted to do so by turning the war over to South Vietnamese forces while gradually withdrawing American forces. During the withdrawal the United States intensified its bombing runs over enemy territory, and the extraction of American forces proved prolonged and costly. In the end, Vietnam fell to enemy forces. The United States lost the war at the cost of 46,000 killed, 300,000 wounded, and more than $100 billion expended. Internationally, the United States lost both credibility and money. During the war in Vietnam, outlays for defense rose from about $50 billion annually to $80 billion.

During those war years, however, federal expenditures rose rapidly in areas *other* than defense, compounding the drain on the U.S. Treasury. John F. Kennedy's New Frontier advocated broad social reform and federal programs including broader Social Security coverage, extended public-housing assistance, federal aid for education, medical care for the aged, higher farm price supports, and more foreign aid, particularly for Latin America. But for Social Security and housing reforms, Congress failed to approve most of the New Frontier programs. Following the assassination of President Kennedy in 1963, Lyndon B. Johnson succeeded in obtaining passage of the Kennedy-Johnson agenda for a "Great Society."

Declaring "war on poverty," Johnson won legislation for mass transit in urban areas and for conservation of wilderness areas. The Elementary and Secondary Education Act of 1965 channeled new federal funds into public schools on the basis of the number of children from poor families in each school district. Another bill provided government rent subsidies to low-income families. Social Security benefits were raised, and Medicare became law. Federal expenditures rose sharply in space research and technology, health, Social Security, housing, education, and interest on the public debt. Government expenditures on public health soared from $1.7 billion in 1965 to almost $13 billion annually by 1970. Social Security costs increased by 60 percent to $44 billion annually. Federal expenditures for education increased fourfold, and community development and housing costs that had been practically nonexistent in 1965 became a $3 billion (and rising) cost five years later. Interest on the public debt also doubled. Between 1961 and 1970 federal expenditures more than doubled, from $97 to $196 billion annually, with most of the increase occurring after 1965.

Despite the massive rises in expenditures, federal spending as a proportion of GNP rose only slightly—testifying to the underlying strength and resilience of the economy. Nevertheless, domestic financial pressures on the United States mounted rapidly in the latter part of the 1960s during the Vietnam War. Contributing to those pressures was increased competition from America's own trading partners. Japan, West Germany, Great Britain, and France, and Europe generally, were now fully recovered from the devastation of war. Their economies were now far stronger and more productive than at prewar levels. Indeed, West Germany and Japan in particular had replaced older, obsolete plants and equipment with technologically advanced systems. Labor costs were considerably lower than in the United States. The United States had seemingly lost its competitive edge.

For the first time since 1893, the United States in 1970 bought more goods than it sold abroad. Except for 1973 and 1975, the trade imbalance continued to grow. In 1980 the United States experienced a $40 billion trade imbalance, and five years later the imbalance was $140 billion. The growing imbalance of trade between the United States and its partners after 1971 did not reflect a decline in U.S. productivity so much as being evidence of the rising vigor of the

Japanese, European, and British economies. As those economies produced more goods and services, consumers within those regions depended less on the import of American products and services. And conversely, American consumers began to find that foreign-made products were often less expensive and of equal or superior quality to American-made products. American auto manufacturers in particular began to lose a portion of the domestic market to smaller, more fuel-efficient and often lower-priced imports. Volkswagens from West Germany were the favored import in the 1960s, Hondas and Nissan Sentras took the lead in the 1970s. American manufacturers began losing market share to foreign competitors at home and abroad.

The U.S. share of total world trade in manufactured goods declined from about 23 percent to 16 percent. In 1971, West Germany sold more manufactured goods in the world markets than did the United States. Japan's portion of the global market rose from 6 percent in 1960 to about 13 percent in 1971. A strong U.S. dollar contributed to the trade imbalance. Foreign manufactured goods were bargains given the value of the dollar compared to the currencies of other nations. The trade imbalance aggravated American financial pressures—and helped force devaluation of the dollar. The federal debt rose at the same time that the ability to service that debt (that is, as income into the economy from foreign sales) began to decline. Small wonder that the dollar came under increasing pressure as a reserve currency.

The International Monetary Fund (IMF) responded to the problem in 1970 by introducing a new reserve currency or asset called special drawing rights (SDRs), which were unconditional rights to draw on foreign currencies managed by the IMF. The IMF would thus function as a world trade bank, with the assets of the bank being "deposits" by member countries. Trading partners could in effect draw upon each other's currencies depending on the amount of trade conducted with those partners. The SDRs, however, continued to have an uncertain value and stability, while gold and the dollar received preference.

Rising inflation in the United States reflected the underlying trade, debt, and federal spending situation. Inflation became a vexing problem. Wholesale prices rose from an average base of 100 in 1967 to 119 in 1972, 135 in 1973, and 150 in 1974. Unemployment rolls jumped from less than 3 million in 1969 to almost 5 million in 1971. Meanwhile, the U.S. stock of gold held in reserve for international exchange declined to $11 billion, only a fraction of that needed to meet outstanding obligations to nations holding dollars. In August 1971 President Richard M. Nixon announced a ninety-day wage, price, and rent freeze in an unprecedented effort to halt inflation. He also announced that the United States would no longer buy and sell gold at $35 dollars an ounce. This freed the dollar from its gold valuation and halted the conversion of foreign-held dollars into gold. That action made the SDRs a more palatable, but still imperfect, reserve currency.

In Phase II of the domestic price freeze initiated by President Nixon, federal boards were appointed to monitor wage and price increases, and prices were to be gradually decontrolled. Inflation was in fact slowed, but unemployment remained high and American trade deficits continued to rise. Inflation was met in part by devaluing the dollar. The United States could pay its debts in cheaper dollars. In December, the president announced an 8.57 percent devaluation of the dollar, which raised the price of gold to $38 per ounce. Over time the dollar and SDRs were technically freed from any gold valuation and gold floated free as a market commodity. On January 1, 1975, American citizens were allowed to buy, sell, and own gold for the first time since 1934. But in the interim, the problem with the dollar and inflation refused to go away.

Devaluation of the dollar in theory made the American market more attractive to foreign consumers, thus promoting American exports. Despite the devaluation, the trade deficit did not improve but only seemed to worsen. President Nixon's administration initiated a new diplomacy that sought detente with the Soviet Union and other Cold War adversaries as a way both to contain the spread of war and insurrection in Vietnam, Pakistan, and the Middle East, thus reducing American defense costs, and as an initiative to open new global markets for American products. Nixon visited Peking in February 1972 and Moscow in May. A direct result of the new detente policies may have been the conclusion of large grain sales to the Soviet Union and Nixon's reelection to the presidency.

American trade balances began to show signs of improvement, and in January 1973 all mandatory wage and price controls were lifted. In February of that year, the United States announced a further 10 percent devaluation of the dollar and subsequently allowed the dollar to float free in international markets. The economy was stimulated by massive foreign grain sales that resulted in soaring domestic wheat, grain, and meat prices—and a new trigger to an inflationary

spiral. One result, critics pointed out, was that the Soviet Union executed a financial coup in purchasing American wheat for $3 a bushel and selling it back to us or others for $6. The administration imposed new ceilings on wholesale and retail meat prices. In June 1973, the administration clamped a freeze on retail prices excluding rent, interest, dividends, and raw agricultural products. Stability and recovery seemed to be returning. But in mid-1973, the United States and most global markets suffered a much more serious disruption.

The OPEC Embargo

An oil embargo imposed by OPEC nations created an energy crisis. That in turn had global financial repercussions. As almost every business index began to show improvement in mid-1973, a total ban on oil exports to the United States by the OPEC nations created severe energy and monetary crises in the United States and elsewhere. In 1960, when OPEC was formed following a collective decision by producers in the Mideast to reduce the price paid for oil, five major U.S. oil companies accounted for almost two-thirds of the world's petroleum production. U.S. companies produced most of the world's petroleum and the United States consumed most of the world's petroleum. Generally, between 1955 and 1970, crude petroleum sold at $2 to $3 per barrel. Cheap fuel coupled with rapid expansion in the petrochemical industry (plastics, paints, insecticides, synthetic fibers) combined to raise U.S. and global consumption of petroleum dramatically. Domestic production actually rose from 2.5 to 3.5 billion barrels (42-gal/bbl) between 1960 and 1970, but consumption rose more rapidly. Once a major exporter of petroleum, the United States now relied more heavily on imports to meet its own needs. During the decade, imports rose from 371 to 483 million barrels. Most of the imported oil came from OPEC production.

Politics, rather than economics, triggered the first embargo. The establishment of the state of Israel following the close of World War II had created continuing strife between Israel and its Arab neighbors. In 1967, during the Six Day War, Israel seized Egyptian and Syrian territories, including the controversial Sinai Peninsula, Arab East Jerusalem and the West Bank, and the Golan Heights, thereby enlarging its territory by four times the original 1949 boundaries. Syria, Egypt, and the Arab world chafed under the apparent Western concurrence with the seizures and maintained rising pressures on Israel. In October 1973, new fighting broke out between Israel and the Arab states. The United States, with the support of the Soviet Union, arranged a speedy truce. In an effort to win their objectives by means other than war, the Arab (OPEC) nations followed the truce with an embargo on the shipment of oil to the United States, Japan, and most of Western Europe. The idea was to force Western nations, particularly the United States, to force Israel to withdraw from Arab territories occupied during the Six Day War.

The embargo had an impact far greater than any imagined. A worldwide energy crisis ensued. The crisis shocked the U.S. economy, which since 1958 had become energy dependent. By 1973, one-third of the petroleum consumed in the United States was imported, most of that from the Middle East. American transportation relied upon oil and gasoline. Electric generating plants used fuel oil and natural gas. Agriculture relied on petrochemicals for fertilizers and upon gasoline for cultivation. The embargo meant a traumatic rise in the costs of manufacturing, transportation, and food production. Household expenses soared. Gasoline, which averaged 30 cents per gallon or so in 1973, more than doubled in price in a few weeks and continued to climb. Household utility bills tripled; food prices soared. Secretary of State Henry Kissinger succeeded in negotiating a temporary settlement and a lifting of the embargo by convincing Israel to withdraw from part of the occupied territories. But the energy crisis had only begun. The OPEC nations, directed largely by Saudi Arabia's remarkable Abdullah Tariki, seized upon petroleum as the essential instrument of global diplomacy. For the following decade "oil power," rather than the more traditional seapower or airpower, dominated global policies.

Tariki, from Saudi Arabia, obtained a B.S. degree in geology from the University of Cairo in 1945 and an M.A. in petroleum geology from the University of Texas in 1947 before joining Texaco. After training with Texaco, he returned to Saudi Arabia to head the inspection office of the Bureau of Mines and became Director General of Petroleum and Mineral Resources in 1954. In 1960, he became Minister of Petroleum and Mineral Resources. He fought vigorously against what he termed "discriminatory pricing" by Western oil interests (ARAMCO). With the clear successes scored by the embargo in 1973 that was initiated as a political device, Tariki and OPEC seized upon petroleum as a tool for implementing economic changes. Although lifting the embargo, OPEC announced that OPEC crude—

Sheik Abdullah Tariki, trained in geology at the University of Texas, became Saudi Arabia's Minister of Petroleum and Mineral Resources in 1960, and architect of the Organization of Petroleum Exporting Countries (OPEC). OPEC has impacted heavily on world trade and commerce since a petroleum embargo in 1973.

(AP/Wide World Photos)

and hence world prices—would rise to $11.65 a barrel. They did. And more.

Over the next five or six years, crude oil prices rose almost 1700 percent. Petroleum that sold for $2 per barrel cost $32.50 in 1980. Despite long lines at filling stations, brownouts, and stiff price rises in almost all consumer goods, the U.S. dependence on imported oil grew rather than diminished.

American companies vigorously pursued sources for new domestic production. Improved drilling and extraction processes were developed. Alternative fuels, wind generators, solar cells, grain alcohol fuel supplements, lower-grade carbon fuels such as lignite, smaller automobiles and more efficient engines, and better generators and heating and cooling apparatuses were sought. The United States attempted to become energy efficient, while petroleum imports continued to climb. By 1977, when Alaska North Slope oil came on line, almost one-half of U.S. petroleum consumption came from imported oil. More than 70 percent of imported oil came from OPEC. (See Table 6-1)

Because of the escalation in crude petroleum prices, the United States and other Western nations including Japan, which depended almost entirely on petroleum imports, transferred billions of dollars of their wealth to the OPEC nations. Even within the United States, a

TABLE 6–1

Crude Oil and Petroleum Product Imports by Country of Origin, 1960–1985 (Thousand Barrels per Day)

	ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC)[1]														
Year	Algeria	Indonesia	Nigeria	Saudi Arabia	Venezuela	Other OPEC[2]	Total OPEC[3]	Arab Members of OPEC[4]	Canada	Mexico	United Kingdom	Virgin Is. and Puerto Rico	Other Non-OPEC	Total	OPEC Oil as Percent of Total Imports
1960	1	77	0	84	911	241	1,314	292	120	16	([5])	36	328	1,815	72
1961	0	62	0	73	879	272	1,286	284	190	40	1	44	357	1,917	67
1962	0	69	0	74	906	216	1,265	241	250	49	2	41	475	2,082	61
1963	1	63	0	108	900	211	1,283	258	265	48	3	44	480	2,123	60
1964	6	68	0	131	933	223	1,361	293	299	47	([5])	47	505	2,259	60
1965	9	63	15	158	994	237	1,476	324	323	48	([5])	47	574	2,468	60
1966	4	53	11	147	1,018	238	1,471	300	384	45	6	61	606	2,573	57
1967	5	66	5	92	938	153	1,259	177	450	49	11	96	673	2,537	50
1968	6	73	9	74	886	255	1,302	272	506	45	28	145	814	2,840	46
1969	2	88	49	65	875	256	1,336	276	608	43	20	189	971	3,166	42
1970	8	70	50	30	989	197	1,343	196	766	42	11	271	985	3,419	39
1971	15	111	102	128	1,020	296	1,673	327	857	27	10	368	991	3,926	43
1972	92	164	251	190	959	406	2,063	530	1,108	21	9	432	1,108	4,741	44
1973	136	213	459	486	1,135	564	2,993	915	1,325	16	15	429	1,479	6,256	48
1974	190	300	713	461	979	635	3,280	752	1,070	8	8	481	1,265	6,112	54
1975	282	390	762	715	702	750	3,601	1,383	846	71	14	496	1,026	6,056	59
1976	432	539	1,025	1,230	700	1,140	5,066	2,424	599	87	31	510	1,019	7,313	69
1977	559	541	1,143	1,380	690	1,880	6,193	3,185	517	179	126	571	1,221	8,807	70
1978	649	573	919	1,144	645	1,821	5,751	2,963	467	318	180	522	1,126	8,363	69
1979	636	420	1,080	1,356	690	1,456	5,637	3,056	538	439	202	523	1,116	8,456	67
1980	488	348	857	1,261	481	865	4,300	2,551	455	533	176	476	969	6,909	62
1981	311	366	620	1,129	406	491	3,323	1,848	447	522	375	389	939	5,996	55
1982	170	248	514	552	412	250	2,146	854	482	685	456	366	979	5,113	42
1983	240	338	302	337	422	223	1,862	632	547	826	382	322	1,111	5,051	37
1984	323	343	216	325	548	294	2,049	819	630	748	402	336	1,273	5,437	38
1985	187	314	293	168	605	264	1,830	472	770	816	310	275	1,066	5,067	36

[1]See Glossary for membership.
[2]Includes Ecuador, Gabon, Iran, Iraq, Kuwait, Libya, Qatar, and United Arab Emirates.
[3]Excludes petroleum imported into the United States indirectly from OPEC countries, primarily from Caribbean and West European refining areas, as petroleum products which were refined from crude oil produced in OPEC countries.
[4]Includes Algeria, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and United Arab Emirates.
[5]Less than 500 barrels per day.
Note: Data include imports for the Strategic Petroleum Reserve, which began in 1977.
Note: Sum of components may not equal total due to independent rounding.
SOURCES: •*1960 through 1975—Bureau of Mines,* Minerals Yearbook, *"Crude Petroleum and Petroleum Products" Chapter.* •*1976 through 1980—Energy Information Administration, Energy Data Reports,* P.A.D. Districts Supply/Demand, Annual. •*1981 through 1985—Energy Information Administration,* Petroleum Supply Annual. •*See Energy Information Administration,* Annual Energy Review, 1987, *Table 49, p. 113.*

transfer of money occurred from the energy-dependent states to the energy-producing states. Alaska, California, and Texas, for example, were beneficiaries of the embargo. The transfer of capital caused even greater financial problems among the Western economies, already in turmoil because of the weakening dollar and the demonetization of gold.

In 1973, the IMF had attempted to improve the credibility of the special drawing rights by adopting a fixed relation to the dollar, while maintaining a floating exchange rate for other currencies with the SDR. The continuing deterioration of the dollar led, in 1974, to the IMF adopting a basket valuation for the SDR—linking the U.S. dollar, German mark, Japanese yen, French franc, and British pound to the SDR. By linking the world's strongest currencies to a single reserve currency, the SDR, the IMF freed international exchange from its now precarious dependence on the dollar and devised a new, stable, and equitable base for international exchange. Gold, meanwhile, became (in theory) simply another commodity. In practice, of course, the "gold tradition" continued to lead investors and speculators to gold as a financial hedge. On January 1, 1975, Congress repealed the law prohibiting private ownership of gold in the United States and the U.S. Treasury began auctioning its surplus gold. On the same day, the IMF abolished gold as the base unit for international exchange and began auctioning one-sixth of its supplies at market prices with profits to go to less-developed nations. Thus, in 1975, at least in theory, world trade was detached from gold perhaps for the first time since the days of King Midas (whenever that was).

That helped, but it did not solve the energy crisis nor resolve the U.S. dwindling balance of trade. In 1971, even before the OPEC embargo, the United States experienced its first trade deficit; that is, it bought more than it sold for the first time since 1893. In 1975, perhaps in part due to the demonetization of gold, the end of the Vietnam War, and to inflation that increased the cost of foreign goods in the United States, the United States experienced an improvement in its balance of trade, enjoying a $9 billion surplus compared to the $2 billion surplus in 1970. (Because of inflation, however, the $9 billion would have been about $5 billion in 1970 dollars.) The improvement proved to be only fleeting. By 1980, the United States was running a $25 billion deficit.

The demonetization of gold and the inflation of the dollar had been expected to improve the balance of payments. It had not. Inflation should have raised the cost of foreign-made products to the

American consumer and thus slowed imports, while effectively lowering the cost of U.S. products abroad and encouraging exports. Inflation possibly had that result. But it did more. Inflation resulted in higher interest rates for investment capital. Capital became more scarce. The lack of investment capital and the higher costs of the capital reduced productivity. Declining productivity promoted higher inflation. The weaker dollar raised prices paid for foreign products, including petroleum. The balance of trade worsened, and inflation rose in response. The economy seemed to be stuck in a new inflationary spiral. But there was more, inflation aside.

U.S. sales abroad (that is, the American share of the global market) was declining. Exports of manufactured goods had been in a steep decline since about 1967, and the U.S. share of high-technology exports, particularly electronics, had drifted lower since 1967. This occurred while American imports of not only petroleum, but also automobiles, electronics, and clothing climbed. By 1980, among the ten best-selling automobiles in America were the Honda, the Hyundai, and the Nissan Sentra. The problems with the American economy did not wholly relate to the OPEC embargo, war and defense spending, increased spending by the federal government for social programs, the recovery of European and the Japanese economies, or the demise of the dollar as the world's reserve currency. There was something more.

The New Reality: Global Competition

A sense of unease about the economy grew throughout the decade of the 1970s, yet there was no clear definition about the problem. The economy continued to grow, as did inflation and unemployment in many industries. By 1980, the number of workers employed by the American steel industry had declined by more than one-half from the 1970 level. But in other industries such as computers and electronics, opportunities and expansion appeared to be strong. Agricultural exports and farm prices continued to grow throughout the 1970s, in a few years exceeding the export of manufactured goods. But overall, imports were rising sharply, while exports declined. The export of farm products reached a plateau in the early 1980s. The export of manufactured goods continued to decline. American public and private spending soared, particularly between 1975 and 1980.

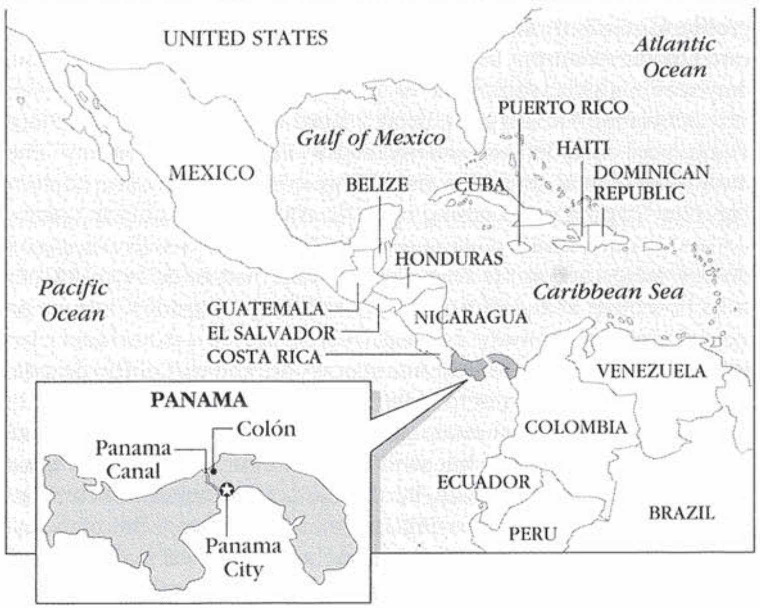
The trade imbalance grew, as did the federal deficit. Managed inflation and budget and tax revisions failed to stimulate or correct the problems. Growth in GNP, and in personal income, although indicated by the numbers, seemed to be eaten up by inflation. The economy was in a state, some said, of "stagflation."

"Churning" might have been a word to apply to the economy. There was considerable activity in the financial community. The outflow of capital caused by the energy crisis seemed to be correcting. New capital was coming into the country, particularly "petrodollars" from Saudi Arabia and other OPEC nations. Those petrodollars were the profits from selling what had once been $2 per barrel crude at $12, $16, and finally $32.50 per barrel. It was, to an extent, American money coming back home. But it no longer belonged to Americans. Almost unnoticed until the end of the decade, Japanese investors began to make substantial capital investments in American banking, real estate, and financial instruments. British investors, even less visibly but with no less vigor, poured new capital into the American economy. By the close of the decade America's financial centers were enjoying an aura of well-being. But manufacturers, farmers, workers, and consumers felt uneasy and experienced discomfort but lacked a sense of focus or direction. America's awakening to a new economic reality was slow.

Journalists and economists began to register an unease that went beyond the usual liberal versus conservative rhetoric. A lead article in the September 1980 *Atlantic Monthly,* for example, looked at "American Industry: What Ails It, How to Save It." The story began with an account of a vacation trip by recently elected U.S. Senator John Danforth (R-MO) and his wife Sally to Europe in 1977. "Everywhere they went they encountered prosperous travelers from Japan." They were at the Louvre, at the Gucci shops, everywhere, doing the same thing—buying! "Something's going on!" Danforth told his wife. *Atlantic Monthly*'s author voiced the radical and perverse thought that "the American era of economic domination may be nearing its eclipse."

Evidence of the end of that economic domination, even within the Western hemisphere, seemed to many Americans to be born out by the decision to transfer the Panama Canal from American control to that of the government of Panama. A right-of-way through the Isthmus of Panama had been obtained by the United States in a treaty with the newly created Republic of Panama in 1903. It was considered the hallmark of Theodore Roosevelt's presidency and

The Panama Canal



The Panama Canal, completed by the United States in 1914, is one of the great international waterways of the world with a history that dates back to the sixteenth century. In 1977, reflecting in part the decline of American economic hegemony, a growing sense of hemispheric cooperation, and the fact that the canal could no longer accommodate many of the larger warships and freighters, the United States agreed to a treaty with the Republic of Panama granting sovereignty over the canal to Panama with control to follow in the year 2000.

evidence of the new global stature being attained by the United States. The construction of the Canal by the Corps of Engineers under the direction of Colonel George W. Goethals was considered one of the great engineering achievements of all time. The Canal opened in 1914 and became one of the world's most important commercial waterways, proving critical in American naval defense in both world wars.

In the 1970s Panamanians began agitating for the return of the Canal to Panamanian sovereignty and control. Other Latin American nations regarded American control of the Canal as imperialistic and evidence of America's disregard for the national rights of the American republics. The United States, sensitive to the charges of imperialism and fresh from defeat in Vietnam, was sensitive to the charges. In addition, the Canal now had logistic limitations. It could not handle the large supercarriers and supertankers being used by the United States and other maritime nations. The Canal was expensive to operate and became a political liability. In 1977 the United States and Panama ratified two treaties, one of which immediately conveyed sovereignty over the Panama Canal to the Republic of Panama while the other provided that possession and control over the Canal would pass to Panama by the year 2000. Although transfer of the Canal may have been correct and expedient, Americans sensed, given the time and seeming decline of American competitiveness, that the United States was losing global stature.

Politicians talked of a new partnership with business to "reindustrialize" America, editorialists lamented the loss of America's will and ability to produce, economists offered "theoretical explications" of a greater truth, manufacturers blamed labor, labor blamed business, academics blamed everybody, everybody faulted government, and government accused its trading partners of unfair competition. Fall 1980, perhaps like fall 1932, marked a "winter of American discontent."

The general disaffection and concern, still largely unfocused, led to the election of Republican President Ronald Reagan, and a turn not so much to the "right" as in a new direction. The federal government instituted what were nominally "austerity" measures, including tax and spending reductions and deregulation of industries (primarily communications, transportation, and utilities) designed to stimulate more production and lower costs. Trade policies were eased and tight monetary policies imposed.

The results seemed to be, in the short term, rising unemployment, larger trade deficits, larger federal budget deficits, and declining economic growth. A recession in 1981 to 1983 created hard times. But imports declined, the dollar strengthened, and inflation fell sharply from its high of near 13 percent annually to a more manageable 3-4 percent level. Petroleum prices also fell rapidly, settling to about $18 a barrel, then declining to $12.50 by 1986. Beginning in 1978, American consumers began using the 650 million barrels pumped annually from the Alaska North Slope oil fields. America's energy crisis seemed to be over. Paradoxically, the rapid fall of petroleum prices created a new round of financial destabilization in the American petroleum industry, in banking, and in the oil-producing regions of the United States—including Alaska. The energy crisis may have been solved, but a deeper and more pervasive economic ailment had not.

Something was going on outside of the United States. By 1973, the United Kingdom, Ireland, and Denmark had joined Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany in the European Community (EC). Greece joined in 1981, and Spain and Portugal followed during the decade. By 1968, under a timetable set in 1957, the European Community had established itself as a free trade zone, eliminating all restrictions on trade in manufactured goods (but not agricultural products) among member nations. By 1970, the European Community had raised its value of industrial product by five times the 1957 level and offered a common external tariff system. Beginning in 1980, the EC began integrating its internal markets more fully; that is, eliminating customs regulations, red tape, contradictions in laws, and financial impediments to trade. By 1980, the United States no longer competed internationally with the independent nations of Europe, but with a new integrated European Economic Community. The implications of that were not fully apparent in the United States. The rhetoric of national leaders in Europe was still traditional nationalistic rhetoric, but the reality was quite different.

Nor had the United States fully come to grasp that the "Japanese miracle" had imperceptibly changed American business relations with Japan. While the United States remained the dominant economic partner, it was by no means as powerful or as dominant as in the past. Only slowly did American business realize that the "economic miracle" had also begun to permeate Southeast Asia. South Korea had become a major producer and exporter of automobiles, air conditioners, and electronics. Hong Kong, long a thriving commercial center under British authority, had become an international trading center. Canton, China; Bangkok, Thailand; and Singapore, Malaysia, began to creep into the American geographical comprehension. When one visited those areas of the world, once so remote to the United States and its interests, the sense of global business, commerce, and industry became immediately evident. Without Americans having fully realized it, over the past two decades "the global economy has been transformed around us." And the United States had not fully participated in that transformation despite its seeming intensive involvement in global affairs through its defense and foreign aid programs.

In June 1983, President Ronald Reagan appointed a special presidential Commission on Industrial Competitiveness, to study "the new reality of global competition faced by American industry, both at home and abroad." The problems recognized by the commission were that American business's ability to compete in world markets was eroding. Growth in U.S. productivity lagged far behind that of foreign competitors. Real wages in the United States were not improving. Returns on assets invested in manufacturing were so poor as to discourage investment and expansion in manufacturing.

Perhaps the best understanding as to what global competitiveness meant, the commission reasoned, was to understand what competitiveness was *not*. Being competitive did not mean maintaining a favorable balance of trade. Even the poorest nations could sell more than they bought, but remain poor. It did not even mean increasing employment in the manufacturing sector. Japan, for example, while increasing its competitiveness in the world had seen manufacturing decline by 25 to 35 percent of its GNP. Global competitiveness did not mean maintaining the viability of all manufacturing industries. "While competitiveness does not require the success of any particular industry, it is in the U.S. national interest to maintain a broad and diverse industrial base in which many industries achieve high levels of productivity," the report concluded.

One key to gauging global competitiveness was the gross domestic product per employed person. How did that productivity compare to the productivity of other nations? Between 1973 and 1983 the real gross domestic product per employed person in the United States was only one-seventh that of its major trading partners. Real wages paid American workers rose steadily at an annual rate of 2.6 percent between 1963 and 1973, but became essentially stagnant for the next decade. The industrial economy had in recent years failed to support an increase in the standard of living of American workers. Returns on investments in manufacturing had fallen behind returns on investments in passive financial assets such as stocks and bonds. The U.S. merchandise trade balance had been in decline (except for 1973 and 1975) since 1967. U.S. firms were no longer producing products that met the test of international markets.

Concurrently, the American position in the world economy had fundamentally changed. The world had become wealthier and more interdependent. Trade occupied a larger portion of each nation's GNP. Foreign trade accounted for an increasingly larger part of American income. Trade as a percentage of GNP in the United States doubled from 7 percent in 1960 to 14 percent in 1983. American products sold abroad and the American purchase of products manufactured overseas had become increasingly sensitive to changes in the international marketplace. The American domestic economy no longer drove the engine of world commerce as it once did. American consumers no longer consumed most of the world's product, and thus set the market for global trade. Once positioned above competition, American technology now confronted heavy competition, in part because the pace of technological change increased rapidly in Europe and in Asia, while the United States rested upon its seemingly commanding lead. American industry focused on the still seemingly insatiable and still profitable domestic market, a market which, coincidentally, was much more accessible and much more comprehensible and manageable than foreign markets or the global market.

While the United States had been singularly successful in Americanizing the world economy between 1945 and 1970, restructuring the American economy for that new global environment after 1970 proved to be a difficult and often painful process.