Eight Takeaways from
PIVOTAL DECADE:
HOW THE UNITED STATES TRADED FACTORIES FOR FINANCE IN THE SEVENTIES

As the global trading system endures what seems to be either a correction or a collapse, it is worth taking a look at eight takeaways from Judith Stein's compelling book *Pivotal Decade*, which examines U.S. international economic policy in the 1970s, and beyond.

1. **Insanity is doing the same thing over and over again and expecting a different result.**

Let's start with a quiz. Name the decade in which the United States complained that Germany and Japan were too dependent on exports, that Germany needed to spend more domestically, and that Japan needed to increase imports.

a) 1970s
b) 2010s

Trick question! Both. (160-161)

Back in the 1970s, something called the "Commission on International Trade and Investment," chaired by the head of IBM, "urged Europe and Japan to assume some of the burdens of the international economic system that the United States shouldered alone." (37). John Connally, Richard Nixon's Treasury Secretary, concluded that

> no longer does the U.S. economy dominate the free world. No longer can considerations of friendship or need or capacity justify the U.S. carrying so heavy a share of the common burden. (41).

Sound familiar? The 70s is a tale of Germany and Japan either refusing to address trade imbalances, or promising – and ultimately failing - to do so. (32; 34; 40; 158; 160; 176; 214)

While one U.S. leader after another believed that achieving some kind of trade balance with Germany and Japan was around the corner, not everyone bought into the underlying premise. A prescient California producer, in response to a 1978 Japanese pledge to fix the trade imbalance, commented that

> [i]f we think we trying to balance our trade imbalance with the Japanese by selling them beef and grapefruit, we'll end up killing our industrial base. (167)

Later on, U.S. Trade Representative Sue Schwab validated the point, stating

> We were trying to get beef into the Japanese market, and I'm still trying to do that 30 years later. (168)

In the intervening period, we have constructed an entirely new global trading regime. We've created the WTO, and with it a suite of new agreements designed to address these fundamental issues. And yet more than two decades after the WTO was born, we still have the same problem with two of our biggest trading partners. We're still begging Germany to spend more domestically, and we're still begging Japan to import our stuff.

Not everyone in the 1970s thought multilateralism was going to solve the underlying problem. David Rockefeller, for example, contended that "[g]lobalism and bilateralism offer little hope for success but trilateralism does." (158). He urged an international commission of politicians, labor leaders, and businessmen from Japan, Europe, and the United States. There were, therefore, pro-traders who doubted the utility of multilateralism – even before we turned the GATT into the WTO.

But even trilateralism has its limits if two of the three parties don't want to change. And thus notwithstanding the sorry history of trying, and failing, to achieve these goals, we continue to believe that the answer lies in *more agreements* with *more rules:* TTIP, TPP – refashioned in this Administration as a deal with the Europeans that may or may not include agriculture, and some kind of bilateral deal with Japan.

We are besotted with the idea that we can somehow rulemake our way into inducing sovereign governments to change ingrained behaviors. If after 40 years, things haven't changed, then maybe it's time to ask ourselves if the prevailing approach itself is fundamentally flawed.

Indeed, Stein's book does a good job of showing how the Germans adapt to the rules and simply find other ways of supporting their industries. For example, the German penchant for subsidizing its industries apparently cropped up *after* the Kennedy Round of multilateral negotiations, which restricted the use of the other tools Germany had typically used to support its industries. (162). Robert Kuttner came to the conclusion that international markets were "not benign" and that neither the Europeans nor the Japanese "practiced global liberalism." (280).

And this Japanese promise from 1978 is equally sobering:

> [The Japanese Minister of State for Economic Affairs] promised [the U.S. trade representative] would ultimately make the Japanese market as open as the American . . . . (167)

He also said Japan would increase domestic spending and end its trade surplus in 1979. (167) The United States responded by believing this would result in a structural shift in the Japanese economy. Of course, it didn't, and cause and effect have switched places, and *trade,* not

Japan's own domestic policy, will somehow force these structural shifts that never seem to materialize. Or at least that's what [TPP advocates told us].

What kind of agreements will the Trump Administration negotiate with these countries that will produce results that haven't been achieved in any of the agreements negotiated over the past four decades?

2. **There are eerie similarities to the collapse of Bretton Woods and today's fight over the WTO.**

After the competitive currency devaluations that preceded World War II, exchange rates were fixed. The dollar became the *de facto* reserve currency, linked to gold. But by the 1970s, currency problems beset the United States. The dollar was overvalued. In 1971, the United States experienced its first trade deficit since 1893. Unemployment in the United States was 5.4%, but in Germany it was less than 1%; in Japan, 1.3%; in France, 2.1%; and in Italy, 3.3%. (45)

Beneficiaries of the system included Europeans and the Japanese, whose exports were comparatively cheap, whereas U.S. exports were comparatively expensive. Nixon grew frustrated with the situation and, in light of his increasing concern that foreign policy considerations had been economically costly, contended that

> [w]e cannot continue to sell out U.S. interests for State's foreign policy consideration . . . . It seems to me that we 'protest' and continue to get the short end of the stick in our dealings with [Europe]. (37).

Nixon was looking for progress on currency, trade, and military burden sharing. Sound familiar?

On currency, Treasury Secretary Connally had little confidence in a global solution and preferred unilateral action -a border tax. Nixon ultimately resorted to a package of tools, including a temporary border tax to try to force some kind of structural adjustment. (43) It seems that sticks work better than carrots, pleas for "cooperation" notwithstanding; in response to Nixon's move, the Japanese privately recognized that the bilateral trade deficit was no longer acceptable and even acknowledged that some of their policies were in breach of their GATT obligations. (43)

The foreign policy establishment was alarmed at the changes being undertaken. They warned of retaliation. (43). Kissinger argued that Europe would turn against the United States. Economists warned of a trade war. (44).

Negotiations for a longer-term solution to the currency misalignments were initiated. According to Stein, "the Americans believed that the major barrier to an agreement was the European 'unwillingness or inability to recognize the size of the needed adjustment, as we perceive it.'" (45). The United States felt an adjustment of around 15-20% was needed but proposed 11% and proposed progress on military and trade burden-sharing.

A deal was finally struck, with revaluations ranging from zero (France) to 9-11% (Japan). But the markets found the deal unsatisfactory, and the dollar sank.

The arrangement felt apart within a year. (46). The Europeans raised agricultural duties to offset currency alignment. (47). More broadly, "[t]he crisis revealed a new competition among makers of tradable goods, mainly manufactured items. The currency changes did not automatically increase U.S. exports because nations and companies possessed and array of tools to mitigate the effects." (49).

As with the U.S. efforts to rebalance the system today, the resistance is strong from those who benefit from structural imbalances, or simply buy into the status quo. They cite the possibility of retaliation, as if that is reason enough to do nothing; they claim the U.S. is starting a trade war, when there's a question as to whether the U.S. is merely responding to one. And so it is that the status quo is indeed the status quo, and we have a President whose argument that the United States was getting the short end of the global stick resonated with a lot of voters. In key states.

3. **Our leaders thought foreign jobs were more important than American jobs.**

Stein provides a comprehensive discussion of Presidents' express willingness to compromise domestic interests to support global ones. This aspect of her research – with ample citations – is particularly relevant in the Trump era, where, as noted above, he arguably won the presidency by alleged that his predecessors put America second.

In 1947, we designed the system to restore Europe and stabilize Japan. We made outsized trade concessions to do so. As one State Department official noted,

> We did make some big tariff cuts and didn't get any reciprocity. It was quite deliberate . . . Businessmen and congressmen were right [to criticize State]. (8)

Stein goes on to state that "the United States looked the other way as Europe and Japan protected markets and discriminated against American producers. Conversely, the large American market became the safety valve for the export industries of U.S. allies, who quickly became economic competitors." (8). This echoes the views of the U.S. Congress, which took negotiating authority away from the State Department for failing to recognize the competitive element in the relationship.

This lopsided situation persisted well after the European continent was rebuilt. According to Stein,

> The new European mercantilism encouraged American corporations to transfer capital jobs to Europe . . . . From 1958 to 1964, almost all of the expansion in the number of full-time jobs in the United States had been in the public, not private, sector. (11-12)

But as these countries grew stronger, we didn't change course, even in the 1970s, when economic chaos was hurting Americans as much as anyone else.

Nixon admonished his staffers that they were insufficiently focused on the interests of U.S. stakeholders – but he nevertheless was initially of the view that those interests might be overridden by "foreign policy considerations." (34). That was natural enough: advisors like Henry Kissinger were more concerned about textile jobs in Italy than in the United States, because communism. (34-35). It wasn't just Italy; Nixon couldn't get a textile agreement with Japan because the State Department thought things were fine. (35). (In the vein of "everything old is new again," a recurring question at the time was whether Japan was "a market economy or a state trading economy." (36).)

Nixon decided that U.S. trade policy required a comprehensive review. Pete Peterson at the time chaired the Council on International Economic Policy and presented the results of the review: U.S. economic superiority no longer existed, and U.S. trade partners pursued economic self-interest more aggressively than did the United States. (36)

This led Nixon to question the subjugation of trade policy to foreign policy more generally, articulating what is another talking point all too familiar today: Nixon concluded that U.S. economic interests should take precedence over diplomacy. And the business community felt that Europe and Japan should step up. (37)

The Ford Administration rejected its predecessor's concern with eroding U.S. manufacturing supremacy and perpetuated the theory that it was the responsibility of the United States to prop up manufacturing elsewhere at its own expense.

> Ford's Treasury Department applauded a U.S. trade deficit of more than $14 billion in 1976. It tracked rising Japanese exports to the United States . . . and noted that developing countries in East Asia . . . were following the Japanese model. The Treasury Department stated, 'The U.S. and other relatively strong economies must thus accept trade and current account deficits as their contribution to maintenance of a reasonably stable and orderly international economic regime. Otherwise, the open, liberal trade and payments system will not survive.' The American economy was playing its historic role as the market of last resort for the rest of the world. (156)

The Carter Administration followed in Ford's, not Nixon's footsteps, disagreeing with the assessment that U.S. economic superiority had eroded:

> [The] U.S. competitive position remains strong, and . . . the U.S. should not take measures which would attempt to improve our trade balance at the expense of our trading partners. (158)

Thus, when confronted with choosing between American workers and foreign workers, Carter chose the latter. His advisers encouraged it:

> "others will look to you to speak to the common interest, to the need for according it priority over more parochial concerns, and to the US willingness to play its full part in mutually reinforcing actions to this end." (172).

Indeed, one of Carter's aides stated that "Congress and Labor were our natural enemies." (181) That U.S. economic interests were on the losing end of this deal was appreciated by, for example, British scholars:

> "postwar trade liberalization has been a beneficial exercise for America's trade partners, and . . . if any country could be said to have 'lost' within our given time horizon, it was the United States itself." (172).

As evidence of the U.S. penchant for sacrificing its domestic interests to satisfy global ones, during the Tokyo Round of trade negotiations, the United States agreed to adopt an injury standard in subsidy cases. That made it more difficult to protect U.S. industries and workers from foreign subsidies; but Carter contended – naively – that "obstacles to American goods going overseas will be removed or drastically reduced." (174). It is a recurring theme of American trade policy to underestimate the degree to which other governments have multiple, nontransparent tools with which to thwart American import penetration, and to overestimate the degree to which agreements alone will open up export markets.

But even taking into account the fact that the United States might end up on the losing end of the bargain, the Carter Administration "believed that the country must sacrifice domestic interests for global prosperity. 'Free access to U.S. markets is a matter of ranking importance for our allies and almost all the developing countries of the world.'" (245).

Carter went further, reducing U.S. tariffs on cars without demanding reciprocal treatment from trading partners. (253). This opened the door for Japan to target the U.S. market, because its barriers were lower than others' (e.g. Europe). (254-55) Carter declined to take a stand against the Europeans for fear of a U.S.-European trade war. (256). This asymmetry has ongoing relevance today, in the form of the Trump Administration's investigation of autos and his impending decision as to whether to use Section 232 to impose tariffs on imports.

And there is still further relevance to today: when the U.S. negotiated an autos deal with Canada, the Canadians demanded a local content threshold (254) – the same concept that the United States advanced in the NAFTA renegotiation, which the Canadians rejected.

The pattern continued – indeed accelerated – under the Reagan Administration (of which the current U.S. trade presentative is an alumnus). Reagan reinforced the paradigm of the United States as the market of last resort, invigorating the offshoring of U.S. jobs in the process. James Baker was a disciple, indeed a proselytizer, of "export-led growth." (290) "Export-led growth" is a euphemism for encouraging foreign countries to manufacture not based on domestic demand, but global demand. And global demand really means American demand, because the United States generally has the most open markets.

Why export-led growth? Because Baker prioritized the philosophy of small governments overseas, and that meant jobs had to be created elsewhere. (290) These countries had comparatively small domestic markets, and limiting their production to serve their own consumers would not have sufficed. Hence, export-led growth. Korea and other "Asian Tigers" were the principal focal points of Baker's strategy.

(And in yet another foray into everything old is new again: The Trump Administration has criticized Korea and others for relying on export-led growth as a path to prosperity. The Administration is less quick to acknowledge that the strategy was the product of a Republican predecessor.)

To be fair, Carter was part of this problem, too. During his Administration, Ex-Im Bank approved a nearly $18 million loan to Korea – for a *steel mill*. (207) The United States *lent money* to a foreign steel company, even as domestic producers had been killed by European subsidies and Japanese dumping. (246). U.S. steel mills had been operating at 78% capacity. (246). Yet the Europeans and the Japanese were able to increase their capacity. (246). (To anyone following the concerns over Chinese excess capacity, these refrains will sound familiar.)

Is there an example of a foreign government – not private industry, the government -- making a loan to a U.S. company to produce goods that compete with the foreign government's own producers?

4. So did our bankers.

The United States has provided one-way trade preferences for developing countries since 1975. These preference programs are widely seen as important development vehicles and are today supported both on a bipartisan basis, and by labor unions.

Stein, however, presents an interesting link between U.S. banks, U.S. investment abroad, and U.S. preference programs for developing countries. She notes that historically the United States had declined to grant unilateral preferences to least developed countries, requiring some form of reciprocity. (95) But the U.S. position changed. In the 1970s, Western banks financed steel mills in Brazil, shipyards in South Korea, and petrochemical plants in Mexico. They wanted to be certain of repayment; and thus they lobbied for developing country access to the United States to facilitate it. (95)

The United States passed the Generalized System of Preferences – the granddaddy of preference programs -- in 1975.

Developing country trade programs are typically seen as part of a "trade not aid" strategy. But Stein's link to the banking industry suggests a Machiavellian dimension: finance securing its own interests at the expense of domestic production.

As the discussion in the next section confirms, this isn't the only example of manufacturing sacrificed on the altar of finance.

5. **Our leaders thought hot money was a feature, not a bug…**

One of the reasons James Baker championed export-led growth in foreign countries was to open up those economies to foreign capital. (290). A push for financial liberalization in developing countries ensued, with support from other major trading partners such as the Europeans.

In anticipation of the entry into force of NAFTA, money poured into Mexico, including from U.S. investment banks such as Goldman Sachs. (291) But then peso crisis hit in 1994. Investors sought to withdraw their money, but Mexico could not redeem the bonds. The United States then floated Mexico a loan so that repayment was ensured.

Stein then notes the subsequent flight of capital into the Asian Tigers. A similar story resulted: the countries had trouble meeting their obligations, and the United States stepped in to ensure that investors were repaid. The IMF insisted on cuts in government spending as part of its bailout package, and the economic circumstances in those countries worsened as a result. (291)

While the spin on the crises was to blame corruption, concentration, and excess regulation, Stein points out that China and India – with their own corruption, concentration and excess regulation – were largely insulted from the crisis. How were China and India different? They had not engaged in comparable financial liberalization. (292)

Stein's link between financial liberalization and crises recalls This Time is Different, the famous work examining the history of financial crises. The book shows over and over again that hot money causes bubbles, bubbles burst, and burst bubbles lead to financial crises.

Stein adds a critical element to the discussion. She points out that both the Mexica and Asian financial crises were resolved with American intervention that ultimately promoted exports, including manufacturing exports, from the failing countries back to the United States. (292)

Heads, bankers win; tails, manufacturers and workers lose.

6. … having gutted domestic investment incentives.

The Revenue Act of 1978 saw the demise of the investment tax credit. The credit was "offered to those who added to the stock of physical assets" and was the "customary method of business aid." (194). But the government "gave money to savers, not investors." The capital gains tax was also reduced, under the theory that it would increase venture capital. Yet research indicates that it did no such thing. (201). Indeed, capital gains cuts were paid for by the middle class, where tax relief was reduced. (202)

On the positive side of the ledger, Carter wanted to get rid of the option of deferring taxes on overseas profits. Labor agreed with Carter because the deferral promoted investment abroad instead of at home. With echoes of prioritizing overseas jobs and domestic finance, Carter's Secretary of Commerce wanted to retain because it promoted development in least-developed countries. (195)

Stein challenges the argument that there is an inexorable relationship between foreign investment and significant reexports to the home market. She notes the significant difference between the relationship between European foreign investment and imports, and American foreign investment and imports. With markets of the same size, European multinationals re-exported $260 million to Europe, whereas American multinationals re-exported $4.1 billion. (200) Under Carter, American banks and corporations nearly tripled foreign investment, to $530 billion. (204)

There were further tax cuts under Ronald Reagan, which did not increase productivity. The increase came in 1995 – after taxes went back up. (289)

Stein in essence argues that the combination of financial liberalization in developing countries, developing country access to the U.S. market, and the elimination of domestic incentives to invest in the United States were responsible for the deterioration of the U.S. manufacturing base.

This isn't to say that developing country access to the U.S. market was a mistake. Rather, the implication of Stein's arguments is that financial liberalization in developing countries, coupled with the erosion of domestic manufacturing investment incentives, led to the offshoring of jobs that otherwise would have remained in the United States.

7. **Nixon's advisors thought industrial policy was the answer. Carter's didn't**.

If we're going to promote offshoring of U.S. manufacturing jobs, either in the name of sustaining the global system, or in the name of indulging bankers, what do we do to promote the creation of new U.S. jobs?

Pete Peterson, of the eponymous Peterson Institute – a pro-trade think tank – concluded that

> the country would have to plan more because the world was more competitive. Governments abroad regularly intervened and propped up key industries. The U.S. government had aided the aircraft, nuclear power, and satellite communications industries. But these efforts were piecemeal. Many industries lacked sufficient capital because of the length of the payout to profitability . . . . The market was not a reliable barometer for long-term growth. (39)

Peterson's solution? Start with a tripartite commission with business, labor , and, and government to "insert a planning mechanism into government." (39). David Rockefeller agreed, arguing that "nothing less than industrial planning on an international scale" would address U.S. economic woes. (75)

They weren't alone. Herbert Stein, Nixon's chief economist, said that the United States might need "an economic planning agency like the Japanese or French. (103)

Even Alan Greenspan, who replaced Stein under Ford, thought we might need a new Reconstruction Finance Corporation. (103) The AFL-CIO agreed and elaborated its vision of what such a bank would look like. (250)

A Wall Street banker joined the chorus. "Corporations plan and the government should too." (119). An industry head agreed: "with the high level of technical competency in this country . . . we should be able to do a better job of sorting out goals and priorities rather than just muddling through." (121)

The National Association of Manufacturers was not to be left behind. A NAM Vice President contended that "Industrial policy is only a problem for the United States because only the United States doesn't have an industrial policy." (245)

Lloyd Bentsen and others supported the creation of a bank that would help incubate and launch "sunrise" companies. (249).

But Carter rejected industrial policy. His team denied that the U.S. industrial base was disappearing. (249) Until 1980, when just before the vote Carter "cobbled together an industrial policy." (259)

If Republicans in the 1970s thought industrial policy was the answer, how did have we gotten to a point where even floating the idea in 2018 is a non-starter?

8. **War-hero/President Dwight D. Eisenhower was left of today's Republican party. Way left.**

Dwight Eisenhower "expanded social security and public housing programs, continued to subsidize farmers, and accepted labor unions." (13). His remarks on social security are particularly interesting in today's climate:

> Should any political party attempt to abolish social security, unemployment insurance and eliminate labor laws and farm programs, you would not hear of that party again in our political history. There is a tiny splinter group, of course, that believes that you can do these things. Among them are a few Texas oil millionaires, and an occasional politician or businessman from other areas. Their number is negligible and they are stupid . . . .

In 2018, he'd be a Democrat, and a left-leaning one at that.

Just for good measure: Richard Nixon supported *expanding* Trade Adjustment Assistance for workers and businesses. (33). That's the same program Congressional Republicans claimed in 2015 should be sunsetted; they settled instead for a massive slashing of the training budget, as the price of getting Trade Promotion Authority in 2015.

Conclusion

There is a prevailing assumption that because the United States designed the global trading system, the global trading system must be good for the United States. Challenges to the system tend to be met with jibes.

What can be extracted from Stein's compendium of sourced quotes about U.S. policy during these formative years is that U.S. leaders had outsized faith in the resiliency of the U.S. manufacturing base – and U.S. economic superiority – and as a consequence were blinded to the adverse consequences of the U.S. decision, among successive administrations, to sacrifice domestic jobs for the global good. Even as they opened the U.S. market asymmetrically to foreign goods, they gutted incentives to invest in production here in the United States so that capital could flow freely into overseas production.

Her work also catalogues the degree to which foreign economies have benefited from this arrangement. The Trump Administration's frustration with what it considers foreign government free-riding is not novel; there are significant similarities to the Nixon and Trump Administrations when it comes to international economic policy.

Economic policy has moved so far to the right in recent decades that Dwight Eisenhower would no longer qualify as a Republican. In this context, floating the idea of having an industrial policy to promote U.S. economic strength in the face of modern global competition is considered heretical, though it was mainstream among Republicans in the 1970s.

Stein quotes a French economist, Thierry de Montbrial, who in the 70s commented:

> free trade is, of course, a myth (an Anglo Saxon myth in particular!) . . . . [w]e stick to the idea that free trade is an ideal to be achieved and think that we owe our prosperity . . . to this ideal." (157)

What would the world look like today if we had learned our lesson from the 1970s?