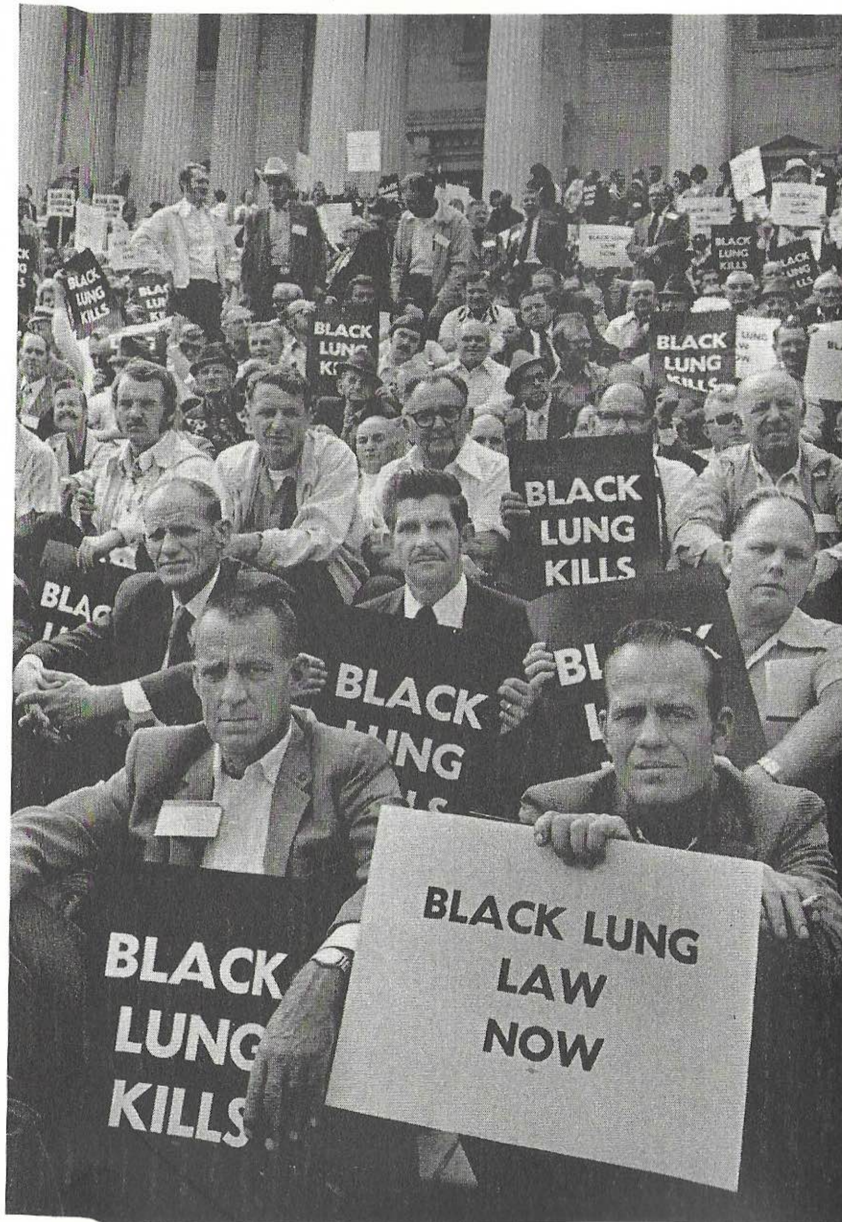

3

Conflict, Change, and Economic Policy in the Long 1970s

Judith Stein

Between 1973 and 1975, the long period of postwar economic growth ended. The Bretton Woods fixed currency regime collapsed, oil prices quadrupled, and the global economy entered the worst recession of the era. These system-shaking events brought in their wake an extended period of slower growth, higher unemployment, and reduced technological progress, putting an abrupt end to 1960s talk that the problems of regulating capitalism had been solved and that the business cycle was a thing of the past. The ensuing downturn could not and did not determine its own policy responses. But it unquestionably did demand new forms of economic regulation, different from those that had governed the economy in its golden age. The left, broadly speaking, and in particular the labor movement and its rank-and-file oppositions, was woefully unprepared for the policy challenges posed by the sudden economic shift. This was most generally because its approach to politics, and to economic policy in particular, had been premised upon the perpetuation of the long postwar boom. During the period of prosperity, there was little concern about what was needed to maintain the marriage between modernization and working-class progress that was the essence of New Deal liberalism. As a consequence, the left failed to develop forms of state intervention that addressed the changing needs of industries and the industrial labor force in a world of ongoing technical change and increasing economic integration and competition.

After World War II, U.S. state intervention was largely confined to the management of demand. Successive administrations—most notably the Democratic administrations of this era—relied on fiscal policy, and in particular tax rates, to manage growth and business cycles, and even the problems of particular industries. Presidents Kennedy, Johnson, and Carter—not to mention Nixon and Ford—thus stood consistently against

policies that addressed particular economic sectors or systematic efforts at educating and retraining the labor force. Meanwhile, internationally, they pursued free trade and free capital movements—opening the U.S. market, subsidizing direct investment overseas, and creating ever expanding realms of freedom for finance—while the United States' overseas rivals in Europe and Japan were doing pretty much the opposite: protecting the domestic market, imposing controls on capital, taming finance, and pursuing various industrial and active labor market policies. When boom gave way to crisis and the cushion hitherto provided by a fast growing economic pie disappeared, these differences became more salient. Yet Keynesian perspectives were not immediately traded in for free-market ideology, which did not actually triumph in the United States until the Reagan presidency of the 1980s. The long 1970s constituted an interregnum, a period of experiment between the eras of state intervention and of neo-liberalism, in which statist and social democratic alternatives remained on the agenda. But the fact remains that already during the golden age of capitalism, important U.S. industries and their labor forces were already finding themselves at a disadvantage vis-à-vis their European counterparts as a consequence of the nation's limited management of the domestic economy and the government's international policies of openness in the face of what turned out to be the first great wave of globalization. When the crisis struck during the mid- and late 1970s, neither liberals in government nor the U.S. left and labor more generally could mobilize sufficient strength to reverse what was a well-established policy stance.

Golden Age Economics

Keynesian objectives—industrialization, full employment, and social welfare—were the legacy of the Great Depression and World War II. They were, moreover, realized to a historically unprecedented degree in the United States and throughout the industrial world during the subsequent quarter-century. The average rate of unemployment in Europe during the 1960s was 1.5 percent. The United States reduced the figure to below 4 percent. Each nation had its own mix of policies, but all believed that government could promote growth and employment. Europeans managed their economies more than the Americans. As the *Wall Street Journal* quipped in 1972, "When things don't go well, the response in the US is to regulate, in Western Europe to nationalize."[1] American Keynesianism meant manipulating spending and taxes and allowing the market to determine the resulting levels of output and employment. Government macro-policy

1 *Wall Street Journal*, July 15, 1972.

aimed to reduce the risk and raise the rewards for business investment. As economist James Tobin said, "No one is to be ordered to grow."[2] Incentives, not compulsions, and grants, not specific plans, were the methods of the Americans. Microeconomic policies to encourage sector-specific investment, technical change, labor-force upgrading, rationalizing industries, reallocating production, and labor were outside the repertoire of the American government.

Other nations used Keynes, but he often took a backseat to Karl Marx or Frederick List. Whatever the inspiration, European and Japanese governments nurtured national industries, using import restraints, currency controls, income policies, and direct government assistance to enhance national wealth. France employed industrial planning and state ownership, and its budgets were always very balanced. Germany and Japan in different ways emphasized supply, not demand, and were also fiscally frugal. In Great Britain, Keynesian demand stimulation was more prevalent, but still took a backseat to nationalization. In all of these cases, governments concluded that the state must act deliberately and according to plan where markets feared to tread. The stunning results were mirrored, among other places, in Italian film. In 1949 Vittorio De Sica's hero in *The Bicycle Thief* was a man looking for a job in postwar Italy. Already by 1960, the hero of Federico Fellini's *La Dolce Vita* was one who had a very good job and life, but was dissatisfied with it, alienated from it.

Had capitalism changed? Whatever you call it, the mixed economy flourished. Political leaders concluded that the catastrophe of the 1930s should not be allowed to return, and that the Great Depression had been caused by the failures of the unrestricted free market. Markets would have to be managed by the state so unemployment would not return. Persons with sterling capitalist credentials like W. Averell Harriman said that "People in this country are no longer scared of such words as 'planning' . . . people have accepted the fact that government has got to plan as well as individuals in this country."[3] But the fact remains that postwar U.S. governments not only proved reluctant to go beyond the Keynesian manipulation of aggregate demand to actually plan economic life, but applied different lessons internationally than they did domestically, with portentous implications for America's industrial trajectory and that of the entire capitalist world.

Since rising tariffs and competitive devaluations had closed off national

2 R. King, *Money, Time, and Politics: Investment Tax Subsidies and American Democracy* (New Haven: Yale University Press, 1993), p. 246.

3 C. S. Maier, *In Search of Stability: Explorations in Historical Political Economy* (New York: Cambridge University Press, 1987), p. 129.

markets and exacerbated the Great Depression, U.S. policymakers stressed the free flow of goods in order to buttress postwar economic dynamism. They were confident that, in view of the huge productivity advantage enjoyed by U.S. producers, that the nation would prosper in such a world. From the time of the Bretton Woods conference in 1944, the United States took the lead in the construction of three new international institutions—the World Bank, the IMF, and the GATT—to create an open global economic order. Nevertheless, the case for the free flow of commodities and investment internationally is ultimately the same as the case for laissez-faire domestically: The market knows best. The United States thus entered the postwar world with contrasting visions: On the one hand, the market needed the firm hand of government to produce full employment; on the other, laissez-faire should be the rule internationally, and goods and services should flow according to market principles.

The United States' commitment to free trade posed a direct challenge to its regulation of the economy through Keynesian demand management. The case for freer trade privileges consumption. It is claimed that the consumer will benefit from the cheapest widget, whether it is produced at home or abroad. By the same token, policies making for easier consumer credit highlighted the importance of consumption. But most consumers are producers, too. And no economy was separable from the society it served. The economic fluidity associated with the decline of supposedly "uncompetitive" products imperiled social stability. As a consequence, some states subsidized production in the interest of employment. Should imports of such goods be allowed to freely compete with unsubsidized domestic products? This question was not hypothetical because Keynesian deficits in a U.S. economy that was more open than that of its rivals tended to draw in imports, actually subsidizing the industries of its competitors at the expense of its own and putting downward pressure on the balance of trade. The U.S. combination of Keynesianism at home and laissez-faire abroad turned out to be an unstable recipe for progress. Its limitations were initially masked by the overwhelming superiority of American producers vis-à-vis their competitors, but once the Europeans and Japanese had rebuilt their economies and the U.S. trade surplus disappeared, its incongruity would be exposed.

In 1945, most nations other than the United States, whether they were rich or poor, eschewed free trade, and this was especially the case for America's leading rivals in Europe and Japan. According to the principle of comparative advantage, advanced by the British economist David Ricardo in the early nineteenth century, certain countries specialize in cloth and others wheat, and both benefit from producing one and buying the other. But the doctrine that seemed so obvious to economists

was shunned by political leaders and ordinary people. As Japanese trade delegate K. Otabe observed in 1955, "If the theory of international trade were pursued to its ultimate conclusion, the United States would specialize in the production of automobiles and Japan in the production of tuna."[4] Japan rejected such trade, on the principle that "each government encourages and protects those industries which it believes important for reasons of national policy." Like some of its European counterparts, Japan systematically integrated its trade policies within a state-led approach to industrial development that put the emphasis on supply, productivity, and international competitiveness, subordinating consumption to investment and exports. Unlike the United States, other nations did not view the GATT as an instrument to create a liberal international order, but only a body to provide a civilized common law to govern relationships among mercantilist states.

Although the United States aimed to impose the principles of free trade and free capital flows, it was forced to yield. Faced with the difficulties of restoring European economies and aware of the lure of Soviet models, the Americans stepped back from pushing the open economy on its allies, as well as offering the Marshall Plan. In the interest of solidifying opposition to the Soviet Union, the United States thus looked the other way as Europe and Japan protected domestic markets. The American tolerance for measures that discriminated against its own producers was sustained by overwhelming U.S. economic dominance. In 1945, the United States contained 60 percent of all the capital stock of the advanced capitalist countries and produced 60 percent of all output. American leaders expected that protectionism would be temporary, as the GATT provided a structure for reducing trade barriers by periodic bargaining.

But the evolution of international trade did not follow the pattern foreseen by Ricardo. Trade grew most rapidly among countries with similar economies. In 1953, the industrial countries sold about 38 percent of their manufactured exports to each other; in the early 1970s this figure rose to 75 percent. This meant that the industrial countries were producing very much the same kind of goods as their partners and rivals, making for a pattern of intensifying competition, not complementary production. In this context, it was understandable that America's rivals viewed free trade skeptically. When Japan joined the GATT in 1955, fourteen nations, including the UK, France, and Belgium, invoked Article 35, which permitted them to waive a most-favored nation relationship with Japan. They refused to allow the entrance of Japanese goods into their markets on the same basis as the goods

4 A. Eckes, Jr., *Opening American Markets: US Foreign Trade Policy Since 1776* (Chapel Hill: University of North Carolina Press, 1995), p. 301.

of other GATT members. Japan was a low-wage country, which could disrupt domestic markets through dumping cheap goods; also, Japan's own trade liberalization was puny. The United States did not invoke Article 35 and even gave special access to its market to countries that permitted the entrance of Japanese goods. Building up Japan in the wake of the Communist victory in China was a crucial battle in the Cold War. This early action partly explains why so many Japanese cars ended up in the United States and not Europe. The Americans looked the other way, too, when the Europeans created their common market, which lowered internal tariffs but raised those for non-members like the United States. That was one reason why President Kennedy initiated a new round of trade talks in 1962. But George W. Ball, the president's Assistant Secretary of State, admitted that negotiators operated on the premise that "we Americans could afford to pay some economic price for a strong Europe."[5] The results of the Kennedy Round showed that that price was being paid. Imports rose 311.8 percent from 1962 to 1974, compared with a 51.7 percent gain in the GNP. Exports did not match such figures, and trade deficits were the result.[6]

This toll on American production and employment was tolerable only with rapidly expanding global markets, all the more so because U.S. policy, intentionally and unintentionally, promoted globalization, particularly foreign direct investment by its multinationals. After World War II, the typical multinational was no longer involved with raw materials, such as oil, copper, or agricultural commodities in the Third World, as it had been during the first part of the twentieth century, but in manufacturing in Europe. There were many reasons for this: Senator Jacob Javits of New York claimed, "You have to have these enterprises to hurdle the stupidities and parochialism of the nationalities of the world or the world will go bust and become a large version of the Russian model, a dull gray prison."[7] Translated, Javits argued that multinationals brought with them technology and up-to-date management. But what was in it for the corporations themselves? In the 1950s and 1960s, most places, including Europe, had lower production costs. Producing in country X also eliminated the transport costs to sell in country X. Also, locating in another country clothed a foreign company in native garb. But perhaps the most important impetus for American firms was the formation of the European Economic Community (EEC) in 1957. The EEC reduced restrictions among its members but erected trade barriers

5 G. W. Ball, *The Past Has Another Pattern: Memoirs* (New York: W.W. Norton, 1983), pp. 191–2.

6 J. Goldstein, *Ideas, Interests, and American Trade Policy* (Ithaca: Cornell University Press, 1993), pp. 163, 168.

7 "Senate Foreign Relations Subcommittee on Multinational Corps," record of first hearings on OPIC, p. 318.

for outsiders who wanted to export into Europe. Because exporting became more difficult, American companies set up new plants in Europe, behind the high tariff walls. The new European mercantilism violated a postwar vision of free trade, and possibly the GATT itself. It also made for the transfer of much new US investment abroad. The American government only encouraged this development, offering preferential tax treatment on the multinationals' overseas profits.

A manager from Caterpillar Tractor, which made earth-moving machinery, explained, "We originally went abroad with plants primarily to protect markets where competitive problems, monetary problems or political problems (such as import quotas or other restrictions) prevented us from selling direct from our US plants."[8] The effect of diverting investment that would otherwise have occurred in the United States for export to Europe and elsewhere was to reduce U.S. employment, output, and productivity. By 1965, new investment abroad accounted for 33.9 percent of overall net American investment in rubber manufacturing, 25.4 percent in the manufacture of transportation equipment, 25 percent in chemicals, 22.1 percent in non-electrical machinery, and 21.4 percent in electrical machinery. By 1970, new investment in manufacturing in oil, mining, and smelting abroad totaled almost 35 percent of domestic investments in the same sectors. A Commerce Department official feared that foreign subsidiaries operated as "a vacuum pump that sucks our new technology out as soon as it's created."[9] Still, it was a mark of the times and of the prevailing attitudes that American policymakers downplayed the negative economic effects of these developments on the U.S. domestic economy, not least their devastating impact on American workers, both directly in terms of jobs lost and indirectly in terms of their reduced leverage against the employers. They also convinced themselves that only the richer Less Developed Countries (LDCs)—Mexico, Brazil, and India—would benefit and only the domestic textile industry would be hurt by the emerging trend toward "runaway shops." But those closer to the problem reached a different conclusion. Already in 1968 the *Wall Street Journal* was sounding the alarm on increasing imports of "unsophisticated electronics" for teenagers coming from U.S. companies in Taiwan, and in less than a decade what was then still pretty much a trickle would become a torrent.[10]

8 *Wall Street Journal*, February 13, 1971.

9 *Wall Street Journal*, October 26, 1970.

10 *Wall Street Journal*, November 11, 1968.

The Kennedy and Johnson Years

The United States could confidently pursue the combination of Keynesianism and openness, because it operated on the premise that the boom would persist and that its industries would remain world beaters. Postwar affluence in the United States was real. Rising employment and productivity advanced GNP 37 percent in real terms, and the wage component of national income rose slightly. Whereas during the depression of the 1930s unemployment had ranged from 14 to 25 percent, it averaged just 4.6 percent during the 1950s. Nevertheless, from 1957 through 1963 the nation suffered from recession or low growth, accompanied by elevated levels of unemployment. Heavily focused on foreign policy, and particularly the threats from the Soviet Union, President John F. Kennedy refused initially to deal with joblessness. He told all who would listen that a 7 percent jobless rate meant that 93 percent were content.[11] Pushed by a Democratic majority in the Senate, Kennedy did sign a $900 million public works bill in 1962. But Kennedy would not speak to the longer-term problems of technological and structural unemployment that affected agriculture and manufacturing alike. Senate liberals wrote the Manpower Development and Training Act in 1962, but the compromises necessary to obtain the law left manpower programs fragmented and partial, and thus ineffectual. The president did see the dangers of the mercantilism of the EEC and sought to open up European markets to U.S. goods. But Cold War priorities meant that sustaining the alliance took precedence over creating opportunities for U.S. exporters. Because he insisted that freer trade would only increase economic activity at home, Kennedy would approve only the weakest possible version of a provision put forward by Senate liberals to compensate workers, communities, and firms hurt by tariff reduction and foreign competition. As it turned out, the U.S. Tariff Commission would find not a single worker to be eligible for assistance under this provision until 1969.[12]

Kennedy was ultimately moved to act on the sluggish economy not because of employment but because he understood the relationship between a strong economy and a strong foreign policy. In the end, tax cuts for business were the cure for everything. The investment tax credit and liberalization of depreciation schedules would make investment more

11 R. Reeves, *President Kennedy: Profile of Power* (New York: Simon and Schuster, 1993), p. 295.

12 J. Stein, *Running Steel, Running America: Race, Economic Policy, and the Decline of Liberalism* (Chapel Hill: University of North Carolina Press, 1998), p. 225.

profitable. These changes required business to invest, but they were untargeted and as available to firms that had sufficient capital as those that did not. They were as available to owners of racetracks as to owners of steel mills. In addition, fearing an actual recession in 1962, Kennedy agreed to a general tax reduction—lowering the rates of both individuals and corporations. Signed by President Lyndon B. Johnson in February 1964, the law reduced government revenue by $11.6 billion for 1965. It seemed to work, at least in the short run. By December 1965, the unemployment rate had fallen to 4.1 percent. Investment rates of 16 and 17 percent as a percentage of GDP equaled those of the boom of the mid-1950s. By adding Keynesian demand stimulus by way of tax cuts to the older commitments to spur competition and see to the dispersal of industry across regions, the nation seemed to have found the formula for industrial efficiency and working-class prosperity.

The long economic expansion of the 1960s, which appeared to be produced by Keynesian deficits, nurtured an economic complacency among American elites and intellectuals and activists on the left, who, believing the problem of economic growth to have been solved, contemplated the social, rather than the economic realm.[13] Telltale signs were ignored. Labor productivity, the mother's milk of growth, began falling in the late 1960s. Real wages for manufacturing workers fell by 82 cents an hour from 1965–9. Over-capacity in manufacturing began to grip the global system.[14] But if the conflict between liberal internationalism and managed national economies seems obvious in retrospect, living actors did not find it so. The combined commitment to free trade and Keynesian economics continued to constitute the unquestioned premise of economic policy. Nixon's election in 1968 did not change that.

The Nixon Years

Pundits commonly claim that conservatism triumphed with Nixon in 1968. One year later, Kevin Phillips published *The Emerging Republican Majority*, predicting a cycle of GOP power, ending the Democratic era begun by Franklin D. Roosevelt in 1932. Phillips alleged that the desertion from Democratic ranks by Southern whites, urban Catholics, and affluent migrants to the suburbs and the West in 1968 was permanent and marked a growing conservatism in American life. Similarly, Democrats Richard

13 H. Brick, "The Postcapitalist Vision as Theory and Ideology," unpublished paper at OAH convention, Boston, March 27, 2004.

14 R. Brenner, "The Economics of Global Turbulence," *New Left Review* 229 (May–June, 1998).

Scammon and Ben Wattenberg hectored their party to attend to a majority anxious about crime, militants, and the new permissive values.[15] Conservatives did note with pleasure the Democratic strife. But the king of right-wing Republicans, the *National Review*'s editor William Buckley, believed that it was not yet the time for conservatives. Richard Nixon himself thought the right-wing Young Americans for Freedom were "nuts and second-raters."[16] And Howard K. Smith, a principal commentator for the ABC news network, remarked in 1971, "No matter how often we reporters pronounce the old FDR Coalition dead—the blacks, the poor, labor, and so on—every election it seems to pull together enough to keep the Democrats the majority party."[17]

One way to clarify what was happening is to distinguish social from economic liberalism. Whatever the people concluded in 1968 about the values question, they did not reject Keynesian economics, which was not contested at all in the election. People often comment upon President Nixon's supposed Paul-like conversion in 1971 when he said, "I am now a Keynesian in economics."[18] Alan Matusow, the historian of Nixon's economic policies, claimed that Nixon, the ultimate political opportunist, adopted the idea only because of its political potency. But there is little evidence that he had rejected Keynesianism, any more than had Eisenhower before him. In any case, the prior question is: Why was it politically opportunistic to turn to Keynesian economics in 1971 when it would not be today? What is important is the content of the well from which leaders drink, and the political well in 1971 was Keynesian.

Despite Nixon's small-town, Quaker upbringing, his service in the uptight, button-down Eisenhower administration, and his 1968 campaign against the hippies, he also embraced elements of the 1960s counterculture. In his first inaugural address, Nixon surveyed the nation's troubles and invoked Franklin Roosevelt's great speech of 1933. Roosevelt had concluded that the nation lacked, "thank God, only material things." The American spirit was intact and could be marshaled to produce the plenty, absent from the American larder. Nixon declared that "our crisis is in reverse. We find ourselves rich in goods, but ragged in spirit . . . We see around us empty lives, wanting fulfillment. We see tasks that need doing, waiting for hands to do them. To a crisis, we need an answer of the spirit." At the end of the year he told a group of businessmen that the key questions

15 R. M. Scammon and B. J. Wattenberg, *The Real Majority* (New York: Coward, McCann & Geoghegan, 1970).

16 D. J. Kotlowski, *Nixon's Civil Rights: Politics, Principle, and Policy* (Cambridge, MA: Harvard University Press), p. 23.

17 Presidential Papers of Richard Nixon, March 22, 1971, p. 460.

18 *New York Times*, January 7, 1971; *Business Week*, January 16, 1971.

were not material but rather "what has happened to the America idea?"[19] Nixon was practicing the politics of affluence, and this politics colored his views even of taxation and government, the key elements in all American political ideologies.

In the late 1960s and early 1970s, liberal tax reformers were seeking to shift more of the burden to the wealthy and business, not shrink the government and cut taxes altogether. Tax equity, not tax cuts, was the slogan. Nixon's tax proposals actually fit easily in this tradition. As the president put it in 1969, "We can never make taxation popular but we can make taxation fair." He accepted the Alternate Minimum Tax, embodying the idea that high-income persons should pay something. He also recommended removing the 7 percent investment tax credit for expanding plant and equipment, which had been part of John F. Kennedy's tax package in the early 1960s. Explaining why a Republican administration supported repeal of the credit that business wanted retained, Nixon's economic adviser and future chairman of the Council of Economic Advisers Herbert Stein said, "it seemed . . . that there were more important things at this juncture in history to do . . . than to make even more rapid a rate of growth that is already very rapid or making larger a gross national product in 1975 or 1980 which already in any case is going to be a staggering size."[20] John Kenneth Galbraith could not have said it better.

Nixon and most of the nation concluded that economic growth had become self-generating. The consumer demand created by the economy, supplemented when necessary by deficit spending, would be sufficient incentive for industrial modernization. In 1969, as in the Democratic 1960s, there appeared to be no conflict between consumption and investment, labor and capital, equity and growth. Business did not need subsidies to produce, and government needed revenue to regulate and compensate. Thus Nixon was for tax reform, not reduction. Still, Nixon was no Democrat. Nixon was critical of aspects of Lyndon Johnson's Great Society. But he proposed to mend them, not end them. "We are the richest country but need to modernize our institutions . . . We face an urban crisis, a social crisis—and at the same time, a crisis of confidence in the capacity of government to do its job." The answer was not to contract out government functions to private institutions, but "to make government effective." A young Donald Rumsfeld did just that with the poverty program. Rumsfeld called himself a "modern Republican," meaning one who accepted the mixed economy plus elements of the welfare state. It was not an accident that Nixon approved laws expanding Social Security and Medicare. He set up

19 Presidential Papers of Richard Nixon, 1969, pp. 2, 960.

20 *New York Times*, April 25, 1969.

the Environmental Protection Agency (EPA) and signed the Occupational Safety and Health Administration (OSHA), a Clean Air Act, and numerous other pieces of environmental legislation. All these reforms were evidence that liberal hegemony had not ended in 1968.

But it would be wrong to portray Nixon or the nation as obsessed with the economy or even domestic issues. That is the point. After the Kennedy-Johnson tax cut and the subsequent fine-tuning by the Federal Reserve, it appeared as if Keynes had repealed the business cycle. Nixon saw the most urgent problem facing the nation as foreign policy, and of course Vietnam monopolized his attention. Although attentive to his party's business constituencies, Nixon, unlike Robert Taft or even Gerald Ford, did not rise in politics on the basis of his service to industry. He built his career on anti-Communism, and although this ideology had domestic uses, it was the big stage of foreign policy that attracted him and provoked the opposition of the left.

Things Fall Apart: Money, Trade, and Oil

What ended the economic complacency and challenged Keynesian practices was the sudden emergence of economic conflict both among the advanced capitalist countries and between the Western world and what was then known as the Third World. Between 1971 and 1973, the international monetary system devised at Bretton Woods disintegrated. Then, in late 1973, oil prices quadrupled. The collapse of fixed currencies and the disappearance of cheap commodity prices placed severe pressure upon the international arrangements set up after World War II to facilitate economic expansion. U.S. policymakers had little choice but to re-examine their assumptions about the workings of the open international economic order.

A dreary statistic, the merchandise trade deficit in 1971, the first one since 1893, catalyzed the process of crisis and conflict. The deficit sent off alarm bells among government officials, if not the populace. For it revealed three tectonic effects of globalization that blunted Keynesian forms of managing the economy and U.S. adherence to laissez-faire internationally. First, U.S. imports had been growing much faster than exports. A dollar of Keynesian stimulus was thus yielding fewer jobs because some of the demand it created was being satisfied by imports. Second, the trade deficit, along with military spending abroad and the buildup of foreign investment by multinationals, was producing piles of dollars in what was called the Eurodollar market, a sphere of unfettered money and credit. The rise of the Eurodollar market undermined Fed's ability to control business expansions by setting interest rates, as it enabled corporations to borrow dollars abroad. It also meant that financial operators could freely convert the dollar into, say, German marks,

if there was belief that the dollar would fall, or buy German bonds if interest rates in Germany were higher than elsewhere. A new element of instability and speculation thus entered each ordinary economic transaction. Third, the emerging trade deficit put the spotlight on the export of jobs out of the U.S. economy as a consequence of fast rising foreign investment. The adjective "multinational" entered Webster's dictionary only in 1971, when the placement of plant and equipment overseas by American firms began to affect the U.S. economy. As Paul Volcker, Undersecretary of the Treasury for Monetary Affairs, noted, business's "approach to foreign markets has been to put plants abroad instead of direct selling of US products," and this was one obvious source of the trade deficit.[21] Unlike today's elites, Volcker did not assume that such behavior was economically efficient, necessary, or inevitable

Volcker did not connect the multinational with U.S. trade policy. But throughout the postwar epoch, as we have seen, trade negotiators opened the U.S. market, but failed to open foreign ones. In this way, they not only encouraged foreign competition in the domestic market and weakened exports in overseas markets, but encouraged the building of U.S. factories abroad. Like his predecessors in the Kennedy and Johnson administrations, Henry Kissinger made certain that Nixon was aware that to protect American shoemakers would jeopardize military bases in Spain and play into Communist hands in Italy.[22] Shoes were left dangling in the wind. Like most Cold War strategists, Kissinger was uninterested in economics. His aide Fred Bergsten quipped, "Working as an economist for Kissinger was comparable to being in charge of the military for the Pope."[23]

Sacrificing domestic industries in order to realize foreign policy goals had been tolerable in the days when the U.S. competitiveness was unmatched and global markets expanding. In the shrinking and turbulent economy of

21 P. Volcker, "Memorandum of Conversation," May 3–5, 1970, Foreign Relations of the United States, 1969, III, Foreign Economic Policy, 1969–72; International Monetary Policy, 1969–72 (Washington, DC: GPO, 2001).

22 "Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon," January 2, 1971, NSC Files, Agency Files, Box 196, Agriculture vol. 2, 1971—president's handwritten comments; "Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon," July 8, 1970, NSC Files, Subject Files, Box 401, Trade General vol. 2 4/70–12/70. Confidential, Nixon Presidential Materials, National Archives. Ford, too, rejected help for the industry on the same strategic grounds. R. B. Porter, *Presidential Decision Making: The Economic Policy Board* (Cambridge: Cambridge University Press, 1980), pp. 159–69; Alan Greenspan, "Memorandum for the President," April 7, 1976, Box 2, Folder April 1976, Council of Economic Advisers Papers, Ford Library.

23 *New York Times*, September 30, 1982.

the 1970s, the economic and political costs of such policies became much more difficult to absorb. Nixon told Kissinger, "we cannot continue to sell out US interests for State's foreign policy considerations."[24] In 1971, this was a bipartisan conclusion. In the words of the Democratic-controlled Senate Finance Committee, "throughout most of the postwar era, US trade policy has been the orphan of US foreign policy. Too often the Executive has granted trade concessions to accomplish political objectives." Peter Peterson, chair of Bell and Howell, told Nixon that "other industrialized nations have been more vigorous in pursuit of their economic interests," and he should give precedence to the nation's economic over its diplomatic interest. Instead, the president created a blue ribbon commission headed by the CEO of IBM. As it was composed of the heads of major international companies like IBM, its recommendation—that the United States simply continue to "eliminate barriers to international trade and capital movements"—could have surprised no one. The commission's two labor members, I. W. Abel of the steelworkers union and Floyd Smith of the machinists, dissented, calling attention to the sharply rising foreign investment and its costs.[25]

The thinking of Abel and Smith was embodied in the Foreign Trade and Investment Act, the Burke-Hartke bill, proposed by the AFL-CIO at the start of the 1970s. This law would have imposed across-the-board import quotas and changes to international tax laws so sweeping that most foreign direct investment would have become unprofitable for U.S. companies. The bill also proposed to create a tripartite commission with strong powers to regulate imports and capital flows. The law constituted what was in effect the first critique of and alternative to the international economic arrangements of the affluent society. Senator Vance Hartke from Indiana had earlier been critical of the Kennedy Round trade treaties. Even though the unemployment rate was falling in the late 1960s, he argued that the influx of foreign steel was depriving U.S. workers of the good jobs that the War on Poverty was promising. Congressman James Burke from Massachusetts was aiming, among other things, to respond to the problem of his state's textile workers. George Baldanzi, head of the textile workers union and a strong supporter of the bill, was worried about the fate of American textile workers, and especially African Americans now seeking to enter the industry in the wake of the passage of Title VII of the Civil Rights Act. On the one hand, the U.S. government was encouraging black

24 Nixon's comments on "Information Memorandum from Kissinger to Nixon," November 13, 1970, box 322, WXM vol. 1 1969–70, Nixon Presidential files, National Archives.

25 Stein, *Running Steel, Running America*, pp. 202–3.

employment, but on the other it was promoting the export of jobs that blacks could fill.[26]

Nixon was able to ward off the Burke-Hartke challenge because of the overwhelming opposition by American business, led by the multinationals assembled in the Emergency Committee for American Trade (ECAT). ECAT was created in 1967 by David Rockefeller to make sure that the Kennedy Round of tariff cuts were ratified and remained the leading proponent of global free trade. But the business mobilization might not have been successful had not labor-liberal forces been so distracted and divided. The internal division within the Democratic Party between the McGovern liberals, uninterested in the issue, and the AFL-CIO was worsened by another, between the AFL-CIO and UAW, which had left the federation in 1968. The UAW did not support Burke-Hartke because it hoped to create a global auto union and because auto jobs were not yet threatened in the way they would be from the mid- to late 1970s. UAW support for trade adjustment assistance instead of managed trade allowed liberals to do the same without feeling they had abandoned the working class. Moreover, few liberals opposed multilateral corporations on anything but anti-imperialist grounds, for the most part neglecting their impact on the domestic working class.

Nonetheless, the threat of Burke-Hartke forced the Nixon administration to do something about the problem of international competition. As it turned out, the related currency crisis offered a more palatable way to address the issue. So long as U.S. productivity was far ahead of the others, the Bretton Woods system had worked fine. But after the recovery of Europe and Japan, the value of their currencies should have risen or the value of the U.S. dollar should have fallen. Neither happened. The over-valued dollar made U.S. exports more costly, putting downward pressure on the United States' trade balance.[27] Germany and Japan were in no hurry to revalue their currencies because their undervalued mark and yen cheapened exports. Moreover, threatening the hegemonic currency could backfire. The dollar was not just the nation's currency but the world's, so an unstable dollar would rattle not just the American but the global system of finance. The Federal Reserve long sustained the currency's value by buying up the dollars accumulating in Europe. But to do so, it had to draw down the U.S. reserves of gold and foreign currency. This could not go on forever. As countries like Germany and Japan increased their surpluses, they demanded gold from the United States in exchange for their

26 Ibid., pp. 219–21.

27 J. S. Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods* (Ithaca: Cornell University Press, 1983), p. 110.

dollars, and in the end the Nixon administration had little choice but to close the Treasury gold window in August 1971, abandon the special gold-exchange obligation assumed at Bretton Woods, and reduce the dollar's exchange value. The president also placed a temporary 10 percent surtax on imports, as a bargaining tool to get other countries to raise the value of their currency, and instituted a temporary wage and price freeze to dampen inflation.[28] By 1973, the United States formally renounced its obligation to sustain the fixed exchange rate, and the dollar floated, its value determined on the free market. Nixon sold the package as a way to increase U.S. exports and decrease its imports. Devaluation could provide a quick fix and hold off more radical changes in international economic policy. In 1971, to demonstrate its concern to make the U.S. economy more productive in the longer term, the administration brought back the investment tax credit, which it had disposed of in 1969.

In his elation, the president told Secretary of Treasury John Connally that the economic program would be like the China thing, totally unexpected. It surely was. To this day, the Japanese refer to it as the Nixon shock. The president was not very interested in economics, but he liked big, bold moves. However, these big, bold moves—the economic package, the opening to China, and détente with the Soviet Union—were grounded in more than personality. They reflected the diminished economic and strategic power of the United States in the 1970s.

Oil

Shortly after the currency deliberations ended in early 1973, the onset of the oil crisis sent the system spinning again. This conflict between the developed countries and the underdeveloped world, represented now by the Organization of Petroleum Exporting Countries (OPEC), shifted resources from industrial to oil powers, produced a wave of global inflation, created new distributional and regional struggles, and fragmented relations among developed states as each tried to cut the best deal with the oil producers. To moderate these inter-capitalist rivalries, the first economic summit of what would be known as the G-7 nations met in 1975. Secretary of State Henry Kissinger acknowledged that "the bipolar world was dead, replaced by a new world of multiple centers of power. Consciousness of global interdependence was the basis of the ultimate fulfillment of national objectives." In plain English, United States prosperity was dependent upon global relationships, which it could not always command. The best example was oil. In 1970, 90 percent of the nation's energy needs were supplied

28 Ibid., pp.135–75.

domestically. By 1980, only 50 percent would be. Europe and Japan were even more dependent on foreign sources of energy.

In the early 1970s, "third-world" nations were only in the process of becoming important manufacturing competitors of domestic producers, but they were already suppliers of strategic commodities, which now took on a new role when prices rose in response to the extended boom of the 1960s and early 1970s. The success of the oil producers in 1973, after the Arab-Israeli war, and then in 1979, in the wake of the revolution in Iran, shaped global politics in two ways. First, the siphoning off of funds from oil importers to oil exporters, mainly Middle East nations, produced new centers of wealth and power. Second, by demonstrating the vulnerability of industrial nations, the oil cartel emboldened "third-world" producers of other vital commodities—bauxite, tin, copper. Although no other commodity was able to command as oil did, that conclusion is more obvious today than in 1975. It is not unreasonable to assume that a more confident and prosperous United States would have taken a harder line on the OPEC action in 1973 and against Iran in 1979. The United States had effected regime change in Iran in 1954 after the government threatened to nationalize the oil industry. But in 1973, most of the oil was in the hands of states, not Western oil companies, a mark of the new third-world power. After Vietnam, military action was out of the question.

The global economy of the 1970s was thus inflected by inter-capitalist rivalries and North-South conflicts, which complicated and at times overshadowed Cold War politics. The North Vietnamese united the nation in 1975, and Communist victories in Laos and Cambodia followed the Vietnamese win. The United States could not be everywhere, so Nixon and Kissinger had designated regional surrogates, like the Shah of Iran, to manage a turbulent world, and struck deals with the Soviet Union and China to limit its overseas commitments. By the end of the decade, both political parties were practicing a more sober foreign policy, under the pressure of the defeat in Vietnam and economic decline. If Lyndon Johnson thought he could have guns and butter, Richard Nixon, Gerald Ford, and Jimmy Carter knew they could not. The new international tensions inevitably affected the way the United States resolved its domestic troubles.

The trade, currency, and oil crises of the early 1970s did not replace the Keynesian ideas of the mixed economy with pro-market ideologies. Given the dangers, it seemed that states had to do more. The international banker David Rockefeller concluded that "nothing less than serious economic planning on an international scale" was required.[29] Most Americans were

29 Trilateral Commission meetings, October 15–16, 1973, January 1974, Trilateral

slow to recognize the new challenges because of the Watergate crisis. Nixon and the rest of the country were preoccupied with the scandal from the middle of 1973 through August 1974 when the president resigned. His successor, Gerald Ford, and his chief economic adviser Alan Greenspan were obsessed with inflation but were blind to the encroaching recession. Neither man knew that from October 1974 through March 1975 the nation would experience its deepest economic downturn since the 1930s. Their initial prescription of tax increases was thus good old-fashioned Republican medicine for inflation—but badly out of touch with reality.

The president switched gears in late December. With criticism coming from all quarters, he reduced taxes, tilting toward the lower and middling population, those who would spend. He had already agreed to the Earned Income Tax credit, which removed millions of the poorest working Americans from the rolls and supplemented their income. Nevertheless, in May 1975 unemployment peaked at 9 percent. Dollars that would have bought appliances went to oil companies and other countries to pay for costly gasoline and heating oil. Factories in the north faced with higher energy costs escaped to the Sunbelt and increasingly abroad, where lower wages might keep them in the black. Urban crises like the near bankruptcy of New York City littered the land.

Fierce disagreements arose between the Republican president and Democratic Congress over consumption and investment, labor and capital, equity and growth. But although the consensus of the affluent society had ended, it was still a Keynesian world, with political liberalism very much alive, if not entirely well. President Ford was interested in corporate tax cuts to revitalize industry. But he ended up accepting the interclass equity of the Keynesian era, refusing to support the plan of his Secretary of Treasury William Simon to end the double taxation of dividends, which would become the centerpiece of President G. W. Bush's tax cut legislation of 2003.[30] For Ford, the simplification of the tax system could not justify the handout to the rich.[31]

In 1976, with unemployment still at 7.7 percent, it still seemed possible that the most effective challenge to the Keynesian world might come from the left, rather than the right. Believing that deficit spending had proven itself inadequate and that the government had to do more, Democratic Senator Hubert Humphrey and Republican Senator Jacob Javits introduced legislation that would require planning for full employment and growth.[32] Alan Greenspan feared that what the two senators were really after was "mandatory planning," which he vehemently opposed.[33] The masses were not rallying in the streets for Humphrey-Javits in 1975, but they had not rallied for the National Recovery Act in 1933. The difference was that in 1933 key White House officials—Adolph Berle and Rexford Tugwell, to name two—and then-President Roosevelt himself supported NRA. Humphrey-Javits had no such luck in 1975, but prospects seemed to brighten the next year when the country elected a Democratic president.

Commission papers, Rockefeller Archives; Mike Duval to Jim Cannon, August 28, 1975, Cannon Box 13, file Energy-Independent Authority, June–September 1975, Cannon Papers, Gerald Ford Presidential Library, Ann Arbor, Michigan.

30 W. E. Simon, "Memorandum for the President" nd, f. Capital Formation, July 1975, Box 45, William Seidman Papers; Leach, "Tax Reform: Outlook and Options," May 19, 1975, f. "Tax Reform Act, December 1975," Box 18, Leach Papers, Ford Library.

31 R. L. Dunham for the president, March 27–28, 1975, f. Economy-Meeting, March 28, 1975, Box 12, Cannon Papers, Ford Library.

Carter and the Democrats Tackle the New World Order

By giving the Democrats a narrow victory in the race for the presidency and overwhelming control of Congress, the elections of 1976 offered them an opportunity. The *Wall Street Journal* asked whether the GOP would survive and urged the Republican big four—Gerald Ford, Nelson Rockefeller, Ronald Reagan, and John Connally—to step back and let younger people come to the fore.[34] If conservatism was the wave of the future, the *Journal* did not see it in 1977. As longtime Republican economic adviser Herbert Stein concluded, "we are left now with accumulating criticism of the kind of fiscal policy we have been practicing for the last twenty years but with no substantial support for any alternative to it. The result is that we shall go on playing the old game of fine-tuning functional finance, not because it is a good game but because it is the only wheel in town."[35]

On the other hand, Alan Greenspan's fears of a new era of industrial planning were much exaggerated. The Democratic Party's resurgence sprang from the electorate's revulsion with Watergate, not their embrace of a Democratic alternative. The scandal both distracted Democrats and made

32 The Ford administration took Humphrey-Javits seriously. See R. Hormats for Economic Policy Board, March 19, 1975, f. EPB March 1975 (2), Box 58; D. Metz for B. Weidman and B. Gorog, March 23, 1975, f. Humphrey-Javits bill, Box 46, Council of Economic Advisers Papers, Ford Library. The Chamber of Commerce and National Association of Manufacturers also took it seriously. See Report of Task Force on National Economic Planning, October 13, 1976, Board of Directors of Chamber of Commerce, "Meeting," November 11–12, 1976, Box 1D, Chamber of Commerce Papers; File Richard C. Kautz memo, March 24, 1976, Box 24, National Association of Manufacturers Papers, Hagley Library, Wilmington, Delaware.

33 A. Greenspan, "Memorandum for L. William Seidman," June 26, 1975, f. Humphrey-Javits Bill, Box 46, Council of Economic Advisers Papers, Ford Library.

34 *Wall Street Journal*, January 14, 1977.

35 *Wall Street Journal*, May 31, 1977.

them complacent, as they harvested the votes of suburban Republicans outraged at the president's behavior. The Democrats had forgotten how to think about the economy. That too had a history. If conservatives viewed the era of affluence as a triumph of free enterprise, liberals saw it as the down payment on a socialized future to be built upon a welfare state that they expected to continue to expand into the indefinite future. The environmental and consumer movements had also emerged from the booming economy of the 1960s and early 1970s, and they too operated on the assumption that the economy's health was now assured. Based in a new middle class employed in education, government, and social services, they had only loose ties to American industries or the labor movement, and they often made their arguments about the costs of growth, over-consumption, and the manipulation of the consumer without acknowledging the economy's growing difficulties and the way these were affecting the citizenry. As a result, after 1974, their issues competed for the Democrats' attention with declining incomes and vanishing jobs. Environmental regulation does not have to conflict with economic growth. But the early environmental legislation was written with the assumptions of the affluent society—all things were possible. The Clean Air Act of 1970 mandated strict standards independent of cost, and such a law guaranteed trouble. Moreover, the early activists were often contemptuous of industry. One member of Carter's Environmental Protection Agency concluded that "the steel industry should die."[36] Such adversarial and self-righteous behavior made it difficult for the Democratic Party to harmonize with the interests of its constituents. Even when there was no direct conflict, priorities differed. In 1978, a member of the Congressional Black Caucus, concerned about rising black unemployment, complained, "black causes rank 50th, behind the snail darter," a fish on the endangered species list.[37]

To rekindle the economy, the Democratic Party had to shift gears and figure out how, in a period of deepening economic problems, to promote the production and consumption that many of its intellectuals and activists had derided. Yet the Humphrey-Hawkins law, guaranteeing full employment and proposed by the Democrats, was, again, premised on perpetual prosperity. Strong on symbols but weak on blueprints, it offered at best an ancillary source of jobs for a healthy economy. But the economy was not healthy, and the left did not engage the issue.

Translating the idea of full employment into policy would have been

36 Lloyd Cutler, "Memorandum for the President," August 26, 1980 [1], C-201, Staff Secretary Papers, Jimmy Carter Library, Atlanta, Georgia.

37 J. Malkin to J. Douglas, October 12, 1978, f. 6, Box 3, Records of the Washington Bureau of the National Urban League, II, Library of Congress, Washington, DC.

difficult for a Democratic president possessing the political skills and intellectual ability of a FDR. As it turned out, the man given the job had none of them. President Jimmy Carter initially continued the Keynesian tradition—raising spending and reducing taxes. But many believed that Keynes did not address the kind of inflation the nation was experiencing. It was not a case of too much demand for too few goods, but inadequate or too costly supplies. Most of the inflation of the 1970s was caused by the rising prices of commodities—oil, grains, and beef. (Everyone remembers the Clinton scandal over Whitewater, but few recall the scandal over Hillary Clinton's participation in the beef price boom.) Because these were onetime developments, not patterns reflecting excessive wage increases, solutions required supply-side measures addressing each sector, larded by consensual measures between labor and capital. This was the recipe employed successfully in Germany and Japan.

But Carter was elected as an anti-Washington, anti-Watergate candidate. As governor of a small Southern state, he never had to deal with a powerful labor movement; he had wooed business, not bargained with it. His great successes were bringing Georgia's benighted state government into the twentieth century and accepting the changes produced by the civil rights movement. Taking Washington for Atlanta, he stressed the need to rationalize government. When his reform efforts failed, he fell back on the anti-Washington themes of his campaign and blamed the nation's problems on a bloated federal bureaucracy and recalcitrant Congress. During his 1976 campaign, he promised a government as good as the people; now the people were the problem, and he prescribed fewer demands on government and less selfishness. He pointed to the deficit as the source of inflation and spending fueled by selfish interest groups as the cause of the deficit, an analysis that only amplified his anti-government themes. But the leader of the Democratic Party, a diverse coalition that since the 1940s had argued for the goal of full employment and the expansion a mélange of federal programs, could not succeed politically on such principles.

The international situation didn't help. Carter's foreign policy was informed by the new internationalism of the Trilateral Commission, founded by David Rockefeller in 1973, both as a response to the unilateralism of Nixon and Kissinger and as an alternative to the universalism of the United Nations. Carter had been a trilateralist, and sixteen Trilateral Commissioners populated his administration. Their core belief was that the United States, Japan, and Europe had to cooperate in order to manage the new global situation of the 1970s. Carter thus stimulated the U.S. economy for both domestic and international reasons, hoping to make the United States "the locomotive" for a teetering global economy. But Europe and Japan, more

fearful of inflation, attempted to export themselves out of trouble, rather than turn to public deficits to increase domestic demand, with the result that a torrent of manufacturing imports entered the United States from Germany and Japan. Between 1975 and 1978, U.S. imports more than doubled while exports increased less than one third.[38]

Declining productivity growth, especially in relative terms, also contributed to the rising U.S. trade deficits. After 1973, productivity increase fell in all of the developed countries. Having averaged 5.3 percent for the industrialized world as a whole between 1969 and 1973, it averaged just 2.8 percent between 1973 and 1979, but with the U.S. rate the lowest of all at less than 1 percent.[39] Yet the U.S. government lacked many of the best tools to enhance productivity. American Keynesianism commanded by manipulating budgets and taxes. It allowed the market to sort out the fate of different sectors. The United States did subsidize the home building industry, but homes are not tradable goods and did little for the balance of payments. The United States also planned and subsidized agriculture to good effect, the agricultural export surplus helping the nation's trade balance significantly during the 1970s. Unfortunately, agriculture supplied fewer and fewer jobs. Meanwhile, the Europeans and Japanese were closing off many of the best markets for American commodities.

So what could Carter do? He did not pick up the Humphrey-Javits initiative or any other kind of industrial planning when he first took office. His attacks on government and special interests made it difficult for him to bargain with business and labor on prices and wages. The growth of imports, the exodus of jobs and capital, and the fluidity of money blunted the old Keynesian tools, and the United States had no others in the kit. The president's insistence that deficits caused inflation limited whatever room to maneuver even the Keynesians still had. Carter did not fully understand the implications of his own appointment of the austerity-minded Paul Volcker in 1979 to head the Federal Reserve Board. He chose Volcker "to reassure the markets" about the dollar, in the words of *New York Times*

38 I. M. Destler and N. Mitsuyu, "Locomotives on Different Tracks: Macroeconomic Diplomacy, 1977–79," in I. M. Destler and Hideo Sato, eds, *Coping with US-Japanese Economic Conflicts* (Lexington, MA: D.C. Heath, 1982); Z. Brzezinski, *Power and Principle: Memoirs of the National Security Adviser, 1977 1981* (New York: Farrar, Straus & Giroux, 1981), pp. 314–5; S. Eizenstat and B. Ginsburg, "Memorandum for the President," August 12, 1977, 5 (Treasury opinion); R. Cooper to Z. Brzezinski, n.d.(Oct. 1–Dec. 31, 1977), WHCF, TA, C-TA-1; A. W. Wolff, "US International Trade Policy," March 21, 1977, International Trade, CF O/A 243, C-227, Eizenstat Papers, Carter Library.

39 A. Lindbeck, "The Recent Slowdown of Productivity Growth," *The Economic Journal* vol. 93 (March 1983), p. 14.

columnist Leonard Silk.[40] Inflation had shot up from 7.6 percent in 1978 to 13.5 percent in 1980, mainly because of the second oil crisis in the wake of the Iranian Revolution and rising food prices. But Carter's pollster Pat Cadell warned the president that it was the elites, especially the financial community, that were most concerned about inflation, not the people.[41] In fact, elite industrialists knew that there was no necessary relationship between inflation and growth,[42] and the Business Roundtable argued that the only solution to inflation was to "improve productivity."[43] It wanted tax changes, not austerity.

The Fed began its radical tightening on October 6, 1979, just after Volcker returned from an IMF meeting in Europe, where European bankers, who held many dollars that were losing value, gave Volcker an earful about U.S. inflation. It was a sign of the growing power of financial interests within the American polity that, unlike the price rises that accompanied the first oil crisis, those that accompanied the second one of 1979 would be met with deep austerity measures.[44] But the Fed went overboard, producing a short but sharp recession and instability everywhere. Carter's chair of the Council of Economic Advisers, Charles Schultze, told him in September 1980, "the Fed has made us all prisoners of its own rhetoric; monetary policy is driven much more by mechanics (short-term fluctuations in the money growth) than by consideration of what is going on in the economy itself."[45] Nothing worked for Carter. The Fed's sky-high interest rates, combined with elevated oil prices, pushed the economy into a sharp recession in 1980 without reducing inflation, preparing the ground for the advancing of new, radical economic solutions by the Right, even though the economy was in better shape than it had been in 1975, or would be

40 L. Silk, *New York Times*, July 27, 1979, D-2.

41 P. H. Caddell, "Memorandum for the President," March 1, 1980, CF O/A, Box 1, file Caddell, Pat 7/773/-80, Eizenstat Papers, Carter Library.

42 For inflation rates below 20 percent a year, relations between growth and inflation are not statistically significant. See R. Barrow, "Inflation and Economic Growth," Bank of England Quarterly Bulletin vol. 35:2 (May 1995), p. 12. J. E. Stiglitz makes the same point in his *Roaring Nineties: A New History of the World's Most Prosperous Decade* (New York: W. W. Norton, 2003).

43 "Statement of L. Stanton Williams on behalf of the Business Roundtable," submitted to the Joint Economic Committee, Congress of the United States, June 18, 1980, copy in possession of the author.

44 C. Schultze, "Memorandum for the President," September 25, 1979 [2], C-148, Staff Secretary Papers, Carter Library; H. Stein, *Presidential Economics: The Making of Economy Policy from Roosevelt to Reagan and Beyond*, 2nd rev. ed., (Washington, DC: American Enterprise Institute, 1988), pp. 229–31.

45 Schultze, "Memorandum for the President," September 18, 1980, p.2, f. 9/1980 [4], Box 206, Staff Secretary Papers, Carter Library.

during the recession of 1982. But everything appeared out of sorts and out of control in 1980. Old answers looked feeble, and supply-siders offered a seductive alternative, one which proposed to cure the country's problems without economic pain.

As the election approached, some of Carter's political advisers finally concluded that his program of budget cuts and high interest rates offered no prospect of economic revival, and was politically suicidal at a time when Ronald Reagan was offering broad tax cuts for individuals and businesses. So, in August 1980, the president proposed a semi-public corporation to mobilize private, pension, and public funds to finance critical industries. The bank would have tripartite management. Initially proposed by Lane Kirkland, the new leader of the AFL-CIO, the initiative assumed that industry needed new funds but that the tax cuts proposed by Reagan would not, any more than earlier ones, necessarily result in investment where it was needed or even at home. Even though Carter's embrace of this proposal for industrial policy was weak, the proposition created a firestorm within the Democratic Party. Charles Schultze declared there was "no evidence that we needed a new and vastly enlarged federal role in channeling investment among industries or locations."[46] Liberal Keynesians were not the only opposition. The proposal produced a mini-war between two tendencies in post-New Deal liberalism. The first was the anti-government strain that originated within the New Left. Ralph Nader's anti-corporatism led him to oppose all forms of tripartite governance. His politics substituted consumers, represented by activist lawyers like himself, for the traditional working class. Empowering unions was not part of his program. The second was the social democratic strain that had constituted a minor trend within the labor movement during the era of affluence, but now assumed an important role at a time when unions were concluding that the U.S. economy faced structural, not simply cyclical problems, and the more worldly Lane Kirkland replaced George Meany as head of the AFL-CIO.

The past weighed heavily on the present. There was no tradition of industrial planning. Acting reluctantly in response to short-term problems and political pressures rather than in accord with a long-term vision of domestic economic development, governments of both parties offered import relief sporadically, and usually only after the industry was hit by severe or unfair import competition.[47] Meanwhile, foreign investment

46 Schultze, "Memorandum for the President," August 24, 1980, f. 8/28/80 [4], Box 202, Staff Secretary Files, Carter Library.

47 In the 1980s, government spent five times more on R&D for commercial fisheries than for steel, and provided $455 million in tax breaks for the timber industry but none

abroad filled the gap opened up by the absence of an industrial policy. Multinational companies like Caterpillar Tractor solved their immediate problems by buying foreign parts abroad that went into domestically assembled products, while it made plans to build plants in countries where costs were lowest. The outcome was the rise of transnational production, based in international supply chains. Electronics producers were already globalizing during the mid-1960s, even though this form of production would fully mature in the late 1970s and 1980s, when corporations felt intensifying pressure on costs, due especially to rising oil prices and emerging competition from state-led, newly industrializing economies, especially in East Asia.

Even had Carter been more committed to industrial policy, he had run out of time. Neither traditional Keynesianism nor the Fed's new monetarism improved the economy, and their failures empowered groups who proposed alternatives. Ronald Reagan was aided by a newly mobilized business community. Through associations like the Business Roundtable (1973) and richly funded think tanks, such as the American Enterprise Institute (1970) and the Heritage Foundation (1973), American business, which had traditionally lobbied to advance the interests of individual businesses or a single business sector, now ended its parochialism and used its combined power to influence broad areas of public policy—labor, taxation, energy, and regulation. Business now openly repudiated the mixed economy of enterprises regulated by the state and labor. Government and unions, and in some instances democracy itself, were seen as fetters on investment and production. Reagan gathered the support of the new industries of the South and West, especially energy, defense, and financial services, which had never been enthusiastic about the mixed economy, along with traditional manufacturing, which now disengaged from it. Even so, most who voted for Ronald Reagan were unfamiliar with the new coalitions and the new economic theories. They had simply lost faith in Jimmy Carter. Only 11 percent of those who voted for Reagan did so because they believed he was a conservative; 38 percent because they thought it was time for a change.[48] The electorate repudiated Carter, but it was a decision based upon his performance, not any particular ideology.

Power allows those with ideas to implement them. After Ronald Reagan won, he acted to weaken unions and government regulation and promote business and market solutions. But this recipe for economic governance did not triumph in the 1970s, or even 1980, but only in 1983, when the president convinced the nation that his policies of tax reduction and

for semiconductors. R. B. Reich, *Tales of a New America* (New York: Times Books, 1987).

48 *New York Times*, November 9, 1980.

deregulation had produced the upturn, reducing the unemployment rate from 10.8 percent in January 1983 to 7.5 percent by January 1984. In the meantime, the 1982 recession had reduced inflation to 3.2 percent, and at the beginning of 1984 it was still only 4.3 percent. So the president went into the 1984 election year with employment rising and inflation falling. Ironically, the president had to destroy the economy in order to save it, his government s policies producing the worst economic slump since the 1930s in 1982, when GNP fell 2.1 percent. But Reagan blamed the recession on Carter and then took credit for the upward turn in 1983, claiming that his supply-side policies and the free market had done it. The Reagan way was not the only way to resolve the conflicts of the 1970s. But the Democrats put forward no alternative to the classical Keynesianism of the postwar years, and the Fed's austerity, helped by falling oil prices and the recession, ended the inflation, while Reagan's tax cuts and defense spending boosted consumption. Reagan's promises of increased productivity and investment were unkept, the trade deficit grew, now accompanied by a huge budget deficit. Nevertheless, because it was a recovery, its methods—tax cuts, deregulation, and privatization—were enshrined as the new bipartisan consensus, replacing the Keynesianism of the postwar era.