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A Brief History of Economic Dominance

The United States has the sticks and carrots.

—John Foster Dulles in a memorandum to President Dwight Eisenhower in the aftermath of the Suez crisis[1]

The Suez Canal is as good a metaphor as any for economic dominance. It is well known that the Suez crisis of 1956 irretrievably buried any hopes (or illusions, some would say) that the United Kingdom might retain its status as a great power. But the history of the canal actually bookends both the apogee and collapse of the British empire. And at both points in time, the economically dominant creditor country gained at the expense of the enfeebled and indebted power.

Opposed originally to the canal's construction, which began in 1859, the United Kingdom subsequently rued its lack of a direct stake once the waterway's strategic possibilities as its "highway to India" and "backdoor to the East" became evident. The original Suez Canal company was majority-owned by the French, with the Egyptian ruler, Ismail Pasha—the *khedive* or viceroy nominally representing the Ottoman ruler in Istanbul—enjoying a 44 percent stake.

By 1875, however, Egypt teetered on the edge of insolvency, overstretched by military adventurism in the Sudan and Ethiopia, seduced into profligacy stemming from the *khedive's* grandiose ambition to make Cairo the Paris-on-the-Nile, and debilitated by dwindling export revenues once stability returned to international cotton markets after the US Civil War. A debt-to-GDP ratio of close to 200 percent, mostly owed to restive European bondholders, forced the *khedive* to sell his stake for a paltry sum of 4 million pounds, which amounted to 4 percent of his debt and 7 percent of Egypt's GDP at the time.

Spotting the opportunity, the British government, with the assistance of the Rothschilds, acquired the viceroy's stake—amounting to 0.3 percent of UK GDP compared with the 3 percent of GDP that the United States paid for

1. As reported by Kunz (1991).

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the Louisiana Purchase—with lightning speed. "You have it, Madam," Prime Minister Benjamin Disraeli wrote to Queen Victoria upon completion of the transaction. So rapid was the transaction that Disraeli's arch enemy, William Gladstone, fumed that parliamentary procedure was being circumvented (Ferguson 2000). The Suez Company became an Anglo-French concern, but the United Kingdom exerted effective control over the Suez zone and its sea traffic until the early 1950s.

But just as the United Kingdom acquired the canal by virtue of its economic dominance, and in particular as a net creditor to the rest of the world, it lost it when it faded as a power and became a net debtor. Following a long sequence of events, including the withdrawal of US and British support for the World Bank to finance construction of the Aswan dam, Egyptian President Gamal Abdel Nasser nationalized the Suez Canal in July 1956. The United Kingdom, France, and Israel mounted an attack in late October and November of that year and Egypt responded by sinking all the ships and vessels in the canal, thereby blockading the vital oil tanker traffic.

Investor anxiety about this campaign and its consequences for the United Kingdom led to sterling coming under attack, and the Bank of England was forced to draw down its reserves to defend sterling. By December, the threat of a devaluation was very real, especially since there was a fear that the United Kingdom's reserves might fall below the target level set by the UK authorities, which would signal the need for a devaluation of sterling.

Heading off a sterling devaluation was thought imperative for two reasons. Oil prices (denominated in dollars) spiked because of the Suez blockade, which reduced tanker traffic and global oil supplies, and a devaluation would make oil even more expensive in the United Kingdom, fueling inflation. Second, United Kingdom was still clinging to the vestiges of empire and the sterling area, which yoked together the United Kingdom and the Commonwealth countries through preferential trade and a loose monetary arrangement. A debased sterling would threaten these arrangements and hence the remnants of empire. The then-governor of the Bank of England, Cameron F. Cobbold, emphasized that a sterling devaluation "only" seven years after the previous one in 1949 "would probably lead to the break-up of the sterling or (possibly even the dissolution of the Commonwealth) . . . a reduction in the volume of trade and currency instability at home leading to severe inflation." Consequently, "we should regard a further devaluation of sterling as a disaster to be fought with every weapon at our disposal" (Boughton 2001a, 435, parentheses in original).

The United Kingdom turned to the United States for financial help, relying on their "special relationship" for assistance either in the form of interest waivers on the United Kingdom's lend-lease credits (the system of financial assistance extended by the United States to its World War II allies) or new loans through the US Export-Import Bank. But President Dwight Eisenhower—furious about the attack because it occurred during the presidential campaign in which he was campaigning as a man of peace after having ended the fighting in Korea—refused to help. In addition, the United States made it clear that,

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unless the United Kingdom complied with a US-sponsored United Nations resolution involving quick and unconditional withdrawal of British forces from the canal area, it would not allow the British to access resources from the International Monetary Fund (IMF).[2] UK compliance would enable it to access Export-Import Bank loans as well as substantial IMF resources.

"This was blackmail. . . . But we were in no position to argue," recalled a senior adviser to Prime Minister Anthony Eden (who resigned in the wake of the Suez crisis) (Andrews 2006, 7). Once the United Kingdom agreed to a deadline for withdrawal, the United States in fact supported a massive financial package that included unprecedented borrowing from the IMF worth $1.3 billion and a $500 million loan from the Export-Import Bank. The United States also allowed the United Kingdom to postpone about $175 million of its payments under lend-lease.[3]

Four aspects of this episode are worth highlighting from the perspective of dominance and power. First, economic means were used by the dominant power to secure noneconomic objectives. Second, power was exercised by the rising superpower not against some small country but against the power that it was displacing, which was a political, economic, and military ally rather than an adversary. Third, the exercise of economic power was directed against a country to secure national objectives, not to change the rules of the system. National rather than systemic objectives were the motives for exercising dominance.

Finally, a key and less recognized aspect of the Suez episode was that the dominant power used not just sticks but carrots to change outcomes. The hardball played by the United States, and its ability and willingness to use tough financial sanctions before the crisis was resolved, were matched or even surpassed by its generosity after the United Kingdom agreed to the conditions imposed. Indeed, US willingness to go to bat for the United Kingdom was reflected not just in the unprecedented magnitude of the IMF loan[4] but also in the fact that the loan violated IMF rules at the time that prohibited lending to support large capital outflows, which the United Kingdom experienced during the Suez crisis.[5] Economic dominance is thus not just about penalties but also about incentives, and indeed one might argue that carrot-based dominance might have greater legitimacy than stick-based dominance.

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2. The IMF functions like a credit union, with contributions from each member country. These contributions have a hierarchy. The first 25 percent is called the gold tranche, which the country can withdraw at any time without permission from the IMF membership. Withdrawals beyond this gold tranche require approval of 50 percent of the IMF's membership. The United States made clear that it would block any UK request to access resources beyond the first 25 percent.

3. In fact, the lend-lease arrangement was renegotiated seven times to allow the United Kingdom the unconditional right to postpone payments of principal and interest (Kunz 1991, 181).

4. Indeed, the package was designed to be so big as to immediately deter speculation against sterling, which had the desirable effect that the United Kingdom ended up borrowing only $560 million of the total of $1.3 billion that was approved by the IMF.

5. IMF rules only allowed lending when a country's current account (consisting of trade in goods and services), not its capital account, was jeopardized.

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Whether irony or symmetry, the upshot of it all was that as an economically dominant net creditor, the United Kingdom, acquired the Suez Canal, and as an economically enfeebled net debtor, she lost it. The enfeeblement, of course, was a gradual process that had begun long before 1956. The Suez episode simply marked, dramatically and definitively, the relegation of the United Kingdom from the top league.

Systemic Manifestations of US Economic Dominance

The Suez episode illustrates one facet of economic dominance, namely dominance directed at one or a set of countries to attain direct national objectives. In this respect, the United States has used economic power in countless ways on innumerable occasions. For example, since World War II, the United States, acting alone or in concert with other countries, has accounted for nearly 70 percent of economic sanctions used or threatened to achieve foreign policy goals (Hufbauer et al. 2007).

As important as its exercise of economic power against individual countries has been the imprimatur of the United States in creating and shaping the overall economic, trade, and financial system. The measure of its economic preeminence has been the fact that in the postwar period the United States has been able to define the rules and exceptions of this system and change them when its perceived interests have so dictated. It is not that the United States has always achieved its economic objectives by successfully changing the actions of other countries or insulating its own actions from external influence. Nor is it the case that economic dominance has always been achieved by unilateral US actions, or that the changes sought by the United States have necessarily occurred speedily or by the use of threats alone. But the fact remains that, by and large, for much of the 20th century, the United States had the ability to influence outcomes. The sections that follow consider some major ways in which the United States has shaped the financial and trade system over time.

International Financial System

Designing the rules for the IMF was a contest between Harry Dexter White, a senior US Treasury official, and Lord John Maynard Keynes, bravely seeking to hold the fort on behalf of a diminished and indebted the United Kingdom (Harrod 1951). Collectively, they designed a relatively open system and one that would keep in check the worst beggar-thy-neighbor instincts that prevailed during the interwar years. But it was a system that was partial to creditors over debtors, and in several important respects, White, representing the interests of the world's then-largest creditor, prevailed over Keynes. Of the technical discussions that eventually formed the core of the IMF, Robert Skidelsky (2003, 736) writes: "The seminars tended to follow a pattern: the

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British proposed, the Americans disposed. This was the inevitable consequence of the asymmetry of power."[6]

Keynes wanted more symmetric adjustment between surplus and deficit countries. He wanted to impose financial penalties on countries that ran excessively large current account surpluses, ease the burden of adjustment on deficit countries by providing more resources to the IMF, and have the IMF run more like an international central bank with less political control exerted by the United States.[7] White mostly rejected or significantly attenuated these ideas. It is either irony or historic justice that the refusal of the United States to institute more stringent rules on surplus countries to adjust has come back to haunt it today, when it has been asking China (and Germany) to do—reduce their surpluses—what it would not contemplate back in 1945.

Less well known is that Keynes wanted IMF quotas to be decided on the basis of the importance of a country in world trade, which would have reduced the disparity between the United Kingdom and the United States. White would have nothing of that. The United States decided on quota shares on explicitly political grounds and a (convoluted) technical formula was conjured up to give expression to, and provide cover for, clearly political decisions (Mikesell 1994, Boughton 2006). President Franklin Roosevelt wanted to give the largest quotas to his military allies in World War II—the United Kingdom, Russia (which did not become an original IMF member), and China. When the French protested at their demotion behind China, Treasury Secretary Henry Morgenthau explained that President Roosevelt had already promised the fourth largest quota to China, although cool relations between Roosevelt and Charles de Gaulle were thought to have played a role (Mikesell 1994).

What is as telling about US economic dominance, however, has been its ability to change the rules of the system. Between 1971 and 1973, the United States was essentially and unilaterally able to blow up the Bretton Woods

6. Louis Rasminsky, the Canadian representative who played an important role in drafting the Bretton Woods agreement and became Canada's first Executive Director to the IMF, put it much more starkly: "We have all been treated to a spectacle of American domination and domineeringness through their financial power which has to be seen to be believed. . . . US foreign economic policy seems to be in the hands of the Treasury who are insensitive to other people's actions and prepared to ram everything they want down everyone's throat" (as quoted in Pauly 2006, 191).

7. In his speech at the first meeting of the IMF Board of Governors in Savannah, Georgia, Keynes warned about US political control over the IMF and the World Bank with typical eloquence. Expressing the hope that the two Bretton Woods twins would not be cursed by the malicious fairy, Carabosse, he nevertheless feared that they would: "You two brats shall grow up politicians; your every thought and act shall have an arrière-penseé; everything you determine shall not be for its own sake or on its own merits but because of something else" (Skidelsky 2003, 829). Fred Vinson, the US Treasury Secretary, sensing that these words were targeted at him, responded, "I don't mind being called malicious but I do being mind called a fairy" (Skidelsky 2003, 829). To help minimize the political pressures from the United States, Keynes urged—unsuccessfully—that the IMF and World Bank be located in New York rather than Washington, DC.

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international monetary system of fixed exchange rates because fixed rates became an unacceptable straitjacket on US domestic policies.

In 1971, the United States, in violation of the spirit and also the letter of the IMF Articles of Agreement, suspended the convertibility of dollars into gold and refused to keep its currency within the bands required by IMF rules. Then, in violation of the letter and spirit of the rules of the General Agreement on Tariffs and Trade (GATT) in place at the time, the United States imposed an across-the-board import surcharge of 10 percent as a means of persuading partner countries to revalue their currencies (and hence indirectly devalue the dollar).[8] This action worked, reflected in the Smithsonian Agreement of December 1971, to change the values of the currency pegs. But when even this currency realignment proved insufficient to meet the needs of its domestic policies, the United States in March 1973 abandoned the fixed exchange rate system in favor of floating exchange rates, driving the final nail into the coffin of the original Bretton Woods agreement.

This process was neither smooth (domestically or with trading partners) nor speedy enough to allow any inference of unconstrained US economic power.[9] Nor, importantly, was it the case that other countries had not changed the value of their currencies prior to the US action—France, the United Kingdom, and Germany all did that. Nor indeed was it the case that the outcome—the move to flexible exchange rates—was undesirable from a global perspective. But at the end of the day, the US government "was exercising the unconstrained right to print money that others could not (save at unacceptable cost) refuse to accept" (Strange 1987). The hegemonic power was unwilling to accept the domestic costs of supplying the public good—which the fixed exchange rate system was considered to be then—and was able to change the terms of international cooperation. The abrasive US Treasury Secretary John Connally—author of the "dollar-is-our-currency-but-your-problem" quip—is reported to have told a group of experts at this time, "Gentlemen, the foreigners are trying to screw us, but I intend to screw them first."[10]

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8. That this action was extreme is suggested by the fact that to implement it, President Richard Nixon had to invoke very unusual domestic legal authority—emergency banking legislation from 1933, also known as the Trading with the Enemy Act of 1918—because normal authority to apply tariffs under the US Constitution rests with Congress.

9. The fact that the United States tolerated the yoke of fixed exchange rates throughout much of the 1960s, when it was running expansionary domestic policies, is invoked as evidence that even the economic superpower had to accept the rules of and constraints imposed by the system (that it had created). Put differently, even the power of the United States was not uncircumscribed (Gilpin 2001, 131–42).

10. Then-US Treasury Secretary John Connally also exercised American power in more personal ways. The IMF Managing Director at the time, Pierre-Paul Schweitzer, brother of Nobel Prize–winning doctor and philanthropist Albert Schweitzer, attempted to convince the United States that any change in the value of the pegs of the different currencies should involve both devaluation by the United States (to which Connally was adamantly opposed) and revaluation by the other currencies. An irate Connally subsequently ensured that Schweitzer would not secure reappointment as Managing Director.

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Now, fast forward 20 years. The counterpart of the current Chinese export juggernaut in the 1980s was Japan. Then, like today, Japan was the target of accusations of unfair trade (Lawrence 1987, Noland 1995, Bhagwati 1999). The recession of the early 1980s, and the sharp rise in the dollar, led to record US current account deficits (and counterpart surpluses in Japan). Protectionist rhetoric surged in the United States. But in this episode, with greater cooperation from European trading partners, the United States was able to get its way both on the currency and on actual protectionist action.

Under the Plaza Accord negotiated in September 1985, the United States, Japan, and European partners agreed to coordinated foreign exchange market intervention to appreciate the yen and Deutsche mark against the dollar. The United States also engaged in "talking down" the dollar. These official actions combined to reinforce market-determined appreciations of the yen and deutschemark, the consummation desired by the US authorities. In addition, the United States had been able to secure Japan's agreement earlier in the 1980s to "voluntarily" reduce its exports of cars, steel and machine tools, and other products. And the United States also was able to use antidumping actions and voluntary import expansions to secure changes in the semiconductor industry.

Multilateral Trading System

In the multilateral trade system as well, the United States was able to determine rules, exceptions, and outcomes. Just after World War II, the United States sought to eliminate the system of imperial preferences whereby the United Kingdom and its colonies discriminated in their trade relations against the rest of the world and strenuously worked to enshrine a system based on nondiscrimination,[11] usually referred to as the most favored nation (MFN) principle.[12] Having done this, the United States indulged Europe's efforts to integrate in a discriminatory fashion because of the broader political objec-

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11. The United States did not immediately achieve this objective. Imperial preferences declined gradually over time not because the preferences themselves were eliminated but because the tariffs applicable to other countries were reduced under successive rounds of tariff negotiations under the GATT. Schenk (2010a) notes that the average preference margin on trade between the United Kingdom and the Commonwealth remained at about 5 to 6 percent as late as 1953, which was about half the level in 1937.

12. There is some semantic irony in the term "most favored nation," which connotes discrimination rather than its opposite. But the point was to suggest that a member of the GATT should treat another GATT member no worse than any other country (including nonmembers of the GATT). The MFN principle made its first appearance in the 17th century (WTO 2007, 132) but was seriously tested during the opium wars between the United Kingdom and China. It was incorporated in the 1842 treaty between the United Kingdom and China signaling the end of the first opium war. In that context, China was required to extend to the United Kingdom any (not just trade) favor it extended to any other country. China's refusal to extend benefits it had granted the United States led to another war between the United Kingdom and China in 1854.

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tives related to European reconstruction in the aftermath of World War II.[13] This discrimination could be intellectually rationalized as an overall gain for the world on the grounds that the trade-creating effects of preferential tariff cuts would outweigh the negative trade-diverting effects. But discrimination it was, and it was institutionalized for political reasons.

Then, when the United States started to feel the discriminatory effects of European integration, it pushed strongly for reductions in MFN tariffs under various "rounds" of multilateral trade negotiations, especially the Dillon (1960–62) and Kennedy (1962–67) Rounds. President John F. Kennedy, in his special message to Congress seeking support for the eponymous round, cited European integration at the top of the list of reasons for undertaking multilateral trade negotiations. Between 1956 and 1967, tariffs on nonagricultural goods in the United States and Europe were reduced from 20 percent to below 9 percent (WTO 2007).

The major motivation of the US administration to start the Tokyo Round of trade negotiations in 1973 was to respond to its difficult economic times, including high and rising unemployment, chronic trade deficits, and rising inflation (WTO 2007, 185).[14] The Bretton Woods system of fixed exchange rates had collapsed, the first oil price shock reverberated through the world, and, above all, a rising Japan embodied the larger competitive threat facing the United States. As a result, the Tokyo Round focused more on making trade fair rather than free, stemming from the widespread perception in Washington that other countries were taking advantage of the United States and reflected in the emphasis on disciplining subsidies and permitting contingent protection actions (safeguard, antidumping, and countervailing duties) against surges in imports. Congress made clear to the US administration that disciplining subsidies should be a priority in the Tokyo Round. As Mac Destler (1992, 148) writes: "The codes on subsidies and countervailing measures and on antidumping, however, were the MTN's (Tokyo Round of multilateral trade negotiations) centerpieces." In other words, the Tokyo Round was as much about disciplining and sanctioning the departures from free trade—to reflect the US economic situation—as it was about promoting free trade.

Furthermore, for most of the postwar period, the United States ensured that agriculture and textiles would remain beyond the scope of serious liberalization because of the political strength of its domestic farm and textile interests. The textile sector was regulated by a series of periodically deter-

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13. Jean Monnet, one of the moving spirits behind early European integration, had close connections with prominent US officials and financiers, including John Foster Dulles. The United States financed the first integration initiative—the Economic Coal and Steel Community—to the extent of $100 million. And even before that, the United States financed the creation of the European Payments Union—the precursor of European monetary and currency integration—to the tune of $50 million.

14. Another motivation was the fear that enlargement of the European Economic Community (EEC) would have a negative impact on US trade and investment, and in particular that UK membership in the EEC would adversely affect US exports of agricultural goods to Europe.

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mined bilateral quotas agreed to among the major importing and exporting countries. This arrangement began in 1961 under the so-called Short Term Agreement on Cotton Textiles (STA), which gave way to the Long Term Agreement Regarding International Trade in Cotton Textiles (LTA), which became the Multi-Fiber Arrangement (MFA) in 1974. In other sectors, especially steel and autos, whenever the domestic industry came under pressure from foreign competition, the United States was able to minimize this competition, notably by securing "voluntary export restraints" from its trading partners or by seeking recourse to antidumping and countervailing import restrictions.

In the 1980s, when its near-abroad foreign policy considerations became important, the United States itself departed from the cherished MFN principle for which it had long crusaded by negotiating a free trade agreement with Israel in 1985 and Canada in 1987. The latter was later extended to Mexico as part of the North American Free Trade Agreement (NAFTA). These agreements presaged and indeed galvanized the negotiation of other free trade agreements around the world. In some ways, the embrace of discriminatory free trade agreements by the United States—rather than its enthusiastic support of European integration—might have been the great betrayal of the nondiscriminatory trading system that it had worked hard to create after the Great Depression.

Also in the 1980s, the United States began to perceive that its comparative advantage lay in the intellectual property and service sectors, so it pushed for new international rules to open international markets for intellectual-property-intensive products (e.g., pharmaceuticals, software, and movies) and especially financial and telecommunications services. This push led to the Uruguay Round of multilateral trade negotiations completed in 1994. The move to incorporate intellectual property in the multilateral system was especially controversial both in terms of the means deployed and the objectives targeted by the United States. Several analysts wrote that intellectual property was unlike trade liberalization in that the global benefits were questionable because up to the first order, the economic impact was a rent transfer from poor to rich countries. Achieving these objectives was sought by threatening countries with trade retaliation unless they agreed to increase the standards of intellectual property protection in their markets. Special domestic legislation—the infamous Section 301 of US law—was enacted in the United States to authorize such retaliation.

Finally, the United States was able to secure significant opening of China's goods and services markets as part of China's accession to the World Trade Organization (WTO) in 2001. Again, it is true that the United States was pushing on a door already slightly opened because the Chinese leadership under Zhu Rhongji was attempting to use external pressure to further reform domestically. But it is a measure of how radical the opening was that a senior Chinese negotiator—10 years later—cast the Doha impasse as payback by China for the concessions it had to make under its WTO accession.

After WTO Director General Pascal Lamy proposed his compromise in the Doha Round, and after it was tentatively accepted by most of the G-7 (not including India), some US negotiators went to the Chinese embassy in

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Geneva to try to pry loose some additional concessions. Paul Blustein (2009, 271) writes that "the U.S. negotiators knew they would have a tough sell, because the Chinese have nursed grudges ever since the 1999 talks concerning their entry into the WTO; [they] feel that the United States bullied them into accepting excessively stringent terms. . . ."

Perhaps an even more telling illustration of the radical nature of China's opening is the fact that China embarked on a mercantilist exchange rate strategy (to push exports and reduce imports) in part to offset the trade opening brought about by its WTO accession.[15]

In many of these proliberalization and occasionally antiliberalization efforts of the United States, it is not that the United States did not have the complicity of trading partners in achieving some outcomes. Most notably, many developing countries were quite happy to have textiles and clothing beyond the scope of international rules as a quid pro quo for not having to undertake liberalization obligations in the manufacturing sector (Wolf 1987), since they were ideologically committed to import-substitution and protectionist polices at home. And many if not most of the inefficient textile exporters were glad to have guaranteed quotas rather than face open competition from other, more competitive exporters. This was the dirty secret of the MFA and the main reason why it persisted for so long.

Nor was it true that the United States always got its way; for example, in the Tokyo Round, the United States was unable to significantly discipline agricultural practices of the then European Economic Community (EEC). Neither did the United States get its way expeditiously: It took same 12 years of protracted and tortuous negotiations from the initial effort to secure global intellectual property and services liberalization in 1982 until the final agreement in the Uruguay Round of trade negotiations in 1994. And the United States indeed had to "pay" to achieve its objectives: For example, in return for opening up intellectual property and service sectors globally, the United States had to offer to open up its own apparel sector.

But broadly speaking, the trading system and the rest of the world proved malleable to the efforts of the United States: The system may not have been putty in the hands of the United States to shape entirely to its liking, but it did shape it, and much moreso than any other country.

Contrast this history of US dominance with that today, in particular vis-à-vis China. For the last five years, the United States has been attempting to change China's exchange rate policies. China has maintained a consistently undervalued exchange rate (Cline and Williamson 2010) and as a result has run consistently large current account surpluses (Goldstein and Lardy 2008), leading to a historically unprecedented level of foreign exchange reserves totaling $3 trillion. Since the global economic crisis of 2008, China's exchange rate policies have acquired greater political salience in the United States, where high levels of unemployment and underutilization of economic resources

15. See chapter 6 for further discussion of this point.

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make China's undervalued exchange rate seem more demonstrably a beggar-thy-neighbor policy. And yet, the United States has been largely ineffective acting unilaterally in its efforts to change China's policies.

The United States has threatened unilateral trade actions but has been unable to translate these threats into any meaningful legislative action. The initiative by Senators Charles Schumer (D-NY) and Bob Graham (D-FL) in 2005 to impose across-the-board tariffs on imports from China never saw the light of day. And the bill passed by the House of Representatives in October 2010 looks decidedly weak in that it would affect a small fraction of China's imports in contrast to the Nixon surcharge of 1971.[16]

This inability to act reflects in part growing Chinese dominance. Action against China does not command broad support in the United States: Labor may be in favor of tough actions against China's undervalued exchange rate, but capital—that is, US firms—are at best ambiguous. US firms located in China and exporting abroad might actually benefit from the undervalued exchange rate, and other US firms that are invested in or do business with China are vulnerable to Chinese retaliatory action, such as by being denied access to Chinese government procurement contracts. Thus, the United States barks but cannot bite. The balance of power in the US-China relationship is especially striking given that it was only about a decade ago that the United States was able to muscle China into radically opening its agriculture, goods, and services market as part of China's accession to the WTO (Bhattasali, Shantong, and Martin 2004).

China has, of course, facilitated this strengthening of its own economic power by encouraging US foreign direct investment (FDI) and influencing American politics and political economy by building a stake for these firms in China. In the 1980s, Japan was the target of US trade action, but Japan was less successful in fending off trade measures taken against it. Japan did not have the economic heft that China currently enjoys, and by limiting US FDI in Japan, it had forgone the opportunity to create a constituency in the United States to speak up for Japanese interests.[17]

If China has been able to resist the exercise of US power through its size and strategic use of FDI, it has also been able to do so indirectly. For example, China has used its surpluses to provide aid to and finance investments in Africa, extracting in return the closure of Taiwanese embassies. It has used its size to strengthen trade and financial relationships in Asia and Latin America. (China's offer to build an alternative to the Panama Canal to boost Colombia's prospects is one dramatic illustration of this phenomenon.) More recently, it has offered to buy Greek, Irish, Portuguese, and Spanish debt as a way of forestalling or mitigating financial-market chaos in Europe. ("China is

16. At the time of this writing it is unclear if this measure will also be passed in the Senate.

17. Interestingly, Japan's response was to build factories, especially in the contentious automotive sector, in the United States. By doing so, it has now built a stake for US labor and suppliers, and hence made US politics a little more sympathetic to Japan and Japanese investments.

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Spain's best friend," effused Spanish Prime Minister José Luis Rodríguez Zapatero in April 2011 on the occasion of the Chinese president's visit.)

Chinese exchange rate policy has adversely affected emerging-market and developing countries as much as the United States. But Europe and emerging-market countries have stood on the sidelines while the United States has had to carry the burden of the crusade and, for that reason, not very successfully. China has had more allies and fewer critics in part because of the support it has been able to buy and the potential opposition it has been able to ward off through financial generosity and trade links. Many countries—including Brazil and India—chafe at their competitiveness being undermined by the undervalued renminbi, yet they maintain a studious public silence, refraining from criticizing Chinese policy. If dominance is as much about being able to not do what others want you to do, China's dollar stockpile and large market have already conferred dominance.

Another illustration of declining US influence relates to trade. Today, the politics of the Doha Round is very complicated because of US ambivalence under the Barack Obama administration about completing it. But it must be remembered that a Republican president and Republican Congress between 2000 and 2006—generally considered to be a combination that is more conducive to trade opening—were unable to wear down opposition from major emerging-market countries, including China and India, and successfully complete the Doha Round of trade negotiations.

Caveats to US Dominance and Decline

The foregoing should not be interpreted as portraying some golden hegemonic era of US dominance during which the country got all that it wanted, as soon as it wanted it, and from whomsoever it wanted it. Nor does the recent change in fortunes by any means suggest that the United States has suddenly gone from omnipotent to impotent. First of all, in several respects the United States did *not* get its way.[18] It did not eliminate imperial preferences, even though it wanted to; it failed to persuade the United Kingdom to become a charter member of the EEC; it did not stop the creation of the European free trade area; and it was unable to change European agricultural policies. Moreover, the United States often had to pay or incur some domestic political costs to secure outcomes of interest, often securing them only after considerable delay, and possibly more easily when there was a weaker or more compliant trading partner (than Europe, for example). In the trade arena, it also helped that the European Union partnered with the United States in pushing the broad agenda of market opening.

And of course, the lack of complete hegemony in the noneconomic sphere was also clear, as described by Joseph Nye (2010, 4): "After World War II, the

18. For example, the Hufbauer et al. (2007) database suggests that in the postwar period, economic sanctions by the United States were partially or fully successful in about 45 percent of the cases studied.

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United States had nuclear weapons and an overwhelming preponderance of economic power, but nonetheless was unable to prevent the 'loss' of China, to roll back communism in Eastern Europe, to overcome stalemate in the Korean War, to stop the 'loss' of North Vietnam, or to dislodge the Castro regime in Cuba."

On the other hand, it is certainly not accurate to say that the United States has suffered such a loss of dominance as to render it unimportant today. During the recent global financial crisis, the United States—or rather the US Federal Reserve—performed a key role traditionally associated with a hegemony: supplying countercyclical liquidity during a financial crisis. The Federal Reserve was the central banker to the world, providing $600 billion in credit via foreign exchange swaps (not including the foreign institutions that participated in the various US programs). Countries such as Brazil, Singapore, Mexico, and Korea not only participated in these swaps but they actually sought help from the United States rather than turn to the IMF for similar financial assistance.

The fact that, on the one hand, the United States could not secure all the outcomes in the past, or, on the other, that it continues to have influence in the present is undeniable. But these facts cannot be invoked to obscure the possible and possibly clear differences in the breadth and magnitude of influence then and now; simply put, the probabilities associated with the United States being able to successfully shape outcomes were greater in the past than today. The question today is whether US economic dominance in this more nuanced sense of some clear loss of ability to influence outcomes is declining, and if so what are the economic causes.

There is now a cottage industry of writings arguing that the world is on the cusp of a change in economic dominance, with power and influence moving away from the United States toward Asia. Niall Ferguson's dramatic description states that "on closer inspection, we are indeed living through a global shift in the balance of power very similar to that which occurred in the 1870s. This is the story of how an over-extended empire sought to cope with an external debt crisis by selling off revenue streams to foreign investors. The empire that suffered these setbacks in the 1870s was the Ottoman empire. Today it is the US. . . ."[19] The question is whether there might be some economic antecedents to such alarmist prophesying.

Defining Dominance and Power

Power or dominance is not easy to define. Hans Morgenthau (1949, 13) wrote: "The concept of political power poses one of the most difficult and controversial problems of political science." But one can talk more easily about or around power. Power can have intrinsic and instrumental value. Countries might seek power for its own sake or in order to influence the actions of others

19. Niall Ferguson, "An Ottoman Warning for Indebted America," *Financial Times,* January 1, 2008.

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and insulate their own actions from external influence (Kagan 2008). Robert Dahl's celebrated and widely accepted definition of power was "the ability to induce another party to do something it would not otherwise do" (cited in Scott Cooper 2006, 80).

Another aspect of power, of course, is that it has a zero-sum quality to it. Paul Kennedy cites two early thinkers who saw power up to the first order in these terms. "Whether a nation be today mighty and rich or not depends not on the abundance or security of its power and riches, but principally on whether its neighbors possess more or less of it" (Philipp von Hornigk, the mercantilist German writer, cited in Kennedy 1989, xxii); "Moreover national power has to be considered not only in itself, in its absolute extent, but . . . it has to be considered relative to the power of other states" (Correlli Barnet cited in Kennedy 1989, 202).

Power can broadly derive from military strength. Mao Zedong famously noted that power flows from the barrel of a gun; "How many battalions does the Pope have?" Josef Stalin is supposed to have asked his aides on being informed that the Allied cause had the support of the Vatican. Military might has clearly been seen as a source of power and influence throughout history, and, conversely, overreaching by the military has often been the cause of the decline of great powers.

If hard power occupies one end of the spectrum, Nye's soft power occupies the other. According to Nye (2004, 31), "the primary currencies of soft power are a country's values, culture, policies and institutions"—and the extent to which these "primary currencies," as Nye calls them, are able to attract or repel others to "want what you want."

Between hard and soft power, or perhaps even underpinning both, is economics. Seldom in history have economically small or weak nations dominated others. Kennedy (1989, xv) argues that, "the triumph of any one Great Power . . . has also been the consequences of the more or less efficient utilization of the state's productive economic resources in wartime, *and, further in the background, of the way in which that state's economy had been rising or falling, relative to the other leading nations, in the decades preceding the actual conflict.* For that reason, how a Great Power's position steadily alters in peacetime is as important to this study as how it fights in wartime."

This suggests not only that economics is a key factor in shaping great power status but also that what matters are economic factors not in some absolute sense but in a relative sense. It is this economic dimension and these economic determinants of power that will be the focus of much of this book. But even as I assert the importance of economics, it immediately gives rise to questions about the specific economic attributes that confer economic power and whether economic dominance can be quantified. These issues are taken up in the next chapter.

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