PIVOTAL DECADE

HOW THE UNITED STATES TRADED FACTORIES FOR FINANCE IN THE SEVENTIES

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For George and Anne Stein

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PREFACE

Ask people old enough to recollect the 1970s and they will amuse you with tales of the flamboyant culture of garish clothes, big hair, and disco. Some will recall the therapeutic culture of TM and Esalen. A few may recount the experience of being "born again." Many will remember the political cynicism spawned by the Watergate scandal. And a number will evoke the social strife over race and gender. Writers have followed popular recollections. Some written accounts of the decade descend to kitsch, whereas others contain interesting insights on sex, music, films, and drugs.[1] But what do they add up to? Philip Jenkins portrayed a liberal culture that assimilated the social movements of the 1960s, while Bruce Schulman concluded that American culture became more southern, a synonym for conservative. Still, Schulman's depiction of ethnic, sexual, race, and New Age ideas and movements made American culture seem more sprawling than constricting. The film and music of the 1970s revealed profound critiques of authority—notably Martin Scorcese's *Taxi Driver* (1976) and the Talking Heads. Country music was more ambiguous than Schulman made it out to be. Was Loretta Lynn's "Coal Miner's Daughter" a conservative anthem, a reassertion of "southern chauvinism," as he claims?[2] Whatever we conclude, it is risky to deduce politics from popular culture.

Historians often psychologize the decade's conflicts. One book is called *Nervous Breakdown,* another, *Decade of Nightmares.* A collection of essays, *America in the 1970s,* declared, "It was during the 1970s in the backlash of political and economic crisis that Americans dealt with a productive uncertainty about the meanings of happiness, success, patriotism, and national identity."[3] A book on the Nixon years attributes the president's success to "Americans' yearning for *quiet,"* but also "anger and resentment."[4] Political and economic crises are

simply the background to the culture's quest for sanity, meaning, or sleep.

Other scholars trace rightward trends, culminating in the election of conservative Ronald Reagan as president in 1980. Since 1992, when Michael Kazin enjoined historians to write more about conservatism, the profession has answered the call.[5] Because most historians today are closer to the left than to the right, many treat their subjects the way anthropologists do theirs. A few argue that post-World War II political culture was never as liberal as assumed. They write about conservative communities or conservatives in general, a new Right, leading up to the 1964 presidential campaign of Barry Goldwater.[6] But the key fact about Goldwater was not that he presaged a future but that he lost massively in 1964. If Goldwaterites were the only people who voted for Ronald Reagan in 1980, he would have lost. There is a thread that links conservative ideas. But the significant question is why the ideology convinced majorities in some eras and not in others.

Writers who locate the growth of conservatism in the 1970s attribute it to backlash politics and conservatives' "concerted institutional and grassroots struggle to reshape the rhetoric and policies of America."[7] In the first, "working-class whites and corporate CEO's, once adversaries at the bargaining table, found common ideological ground in their shared hostility to expanding government intervention."[8] White workers abandoned liberalism because they identified it with African Americans. In the second, conservatives massively organized with political action committees, radio talk shows, think tanks, and clever communications networks to dislodge postwar liberalism.[9] Each makes Keynesian liberalism and the Democratic Party victims of right wing ideological and institutional assault. They assume that the ideology and the party were up to the task of confronting the nation's challenges and that the rise of conservatism had nothing to do with their failures. These Whiggish stories of rising conservatism do not intersect with any political or economic event.

I start with different assumptions. I began this book after I learned that the 1970s was the only decade other than the 1930s wherein Americans ended up poorer than they began.[10] As the *Economist* recently observed, “Other than sartorially, the ’70s weren’t funny.”[11] The decade featured the deepest recession since World War II, growing and permanent trade deficits, anemic productivity, rising oil prices, and high unemployment and inflation. The economy is the foreground. But every economy is shaped by politics. So the government response to these challenges was as important as the changes themselves. Could the practices and ideas of postwar liberalism meet the new circumstances?

Postwar U.S. liberalism, created by the New Deal, was rooted in the notion that high wages and regulated capital created and sustained U.S. prosperity. During the Age of Compression, 1947—73, income and wealth were mildly redistributed, even as economic growth soared. At the same time, the nation’s leaders cemented Cold War alliances with foreign access to the U.S. market. In 1945, U.S. economic superiority was so vast that onesided trade policies did not matter. Over time, they ultimately did. And when high oil prices and economic competition from Japan and Germany battered the economy in the 1970s, new policies—international and domestic—were needed. The fire bell in the night came in 1971 when the U.S. suffered its first trade deficit since 1893. The Age of Compression officially ended in 1973 when wages began to stagnate, largely because of a sharp drop in productivity.[12] Restoring growth was a project on the left and right throughout the 1970s. No one imagined that the productivity decline would continue until 1995 and that wage growth would continue to fall short of the achievements of the postwar period. Few predicted that U.S. trade deficits would remain and grow, producing the global imbalances between consuming nations (United States) and producing nations (China) that are at the root of the contemporary global economic crisis.

Yet telltale signs of this future were visible during the 1970s. First,

the Democratic Party, which enjoyed a two-to-one advantage over the GOP at the beginning of the decade, was less responsive to the economy and to workers. New Democrats, often from suburban, affluent districts, made it a badge of honor that they were not New Dealers. Coming of age during the affluent 1960s, they believed that posteconomic issues—foreign policy, race, gender, political process, and environment—were the important ones. They ignored or misread the new industrial competition with Europe and Japan and high energy prices that challenged the affluence that held the party together. They produced incoherent policies that neither protected labor nor promoted growth. The critical moments occurred in 1979 and 1980 when a Democratic president chose in vain to battle inflation, not unemployment, and promote a balanced budget, not growth. The defeat of President Jimmy Carter gave another man, Republican Ronald Reagan, an opportunity to restore growth and prosperity.

The new GOP was a conservative party, airming that capital freed from taxation, regulation, and trade barriers would produce national and labor prosperity. The effects of such policies in a global economy shifted resources away from manufacturing—the "tradables"—into finance and housing. The recipe, aided by high-tech innovations, worked for a while, even as it produced what I call an Age of Inequality.[13] Financing from abroad allowed Americans to maintain consumption despite stagnating wages and huge trade deficits. Recently, this model has failed to sustain its foremost selling point, prosperity. Signature industries, housing and financial services, placed the "world on the edge" in fall 2008.[14] The worst never happened, but, as this is written, the nation is experiencing the nastiest and most intractable economic recession since the Great Depression.

This book explains how the Age of Compression became the Age of Inequality. Why did the nation replace the assumptions that capital and labor should prosper together with an ethic claiming that the promotion of capital will eventually benefit labor—trading factories for finance—a very different way of running a nation that produced

very different results? The Age of Compression was a product of the Democratic Party, but Republican Richard Nixon governed according to its ethic. The Age of Inequality was created by the GOP, but Democrat Bill Clinton lived by its rules. Party and ideology are close but do not always coincide. Thus, unlike other historians who draw a sharp line in 1980, my key period is 1976—80, when the Democrats controlled both houses of Congress and the presidency. The challenges of the globalizing world were played out within the governing Democratic Party. When Democrats failed to restore prosperity, the electorate voted for Republicans, who then claimed that their victory was a rejection of the ideas and practices of the Age of Compression. Simply saying it did not make it true. But with the power of his office, President Reagan did create a new national blueprint. The new principles took hold. And, in many ways, they are still with us.

Today, a new Democratic administration promises to rectify matters. President Barack Obama speaks of redefining American capitalism. Obama has said that the nation must consume less and export more.[15] The language is opaque. The president is more comfortable talking about health care, education, and "green" jobs. Still, he implies that the U.S. market will no longer be the inexhaustible destination for the world's production. Success will require studying the history of the 1970s, when the United States first confronted the challenges of Japan and Germany, yesterday's China. Because the United States faltered then, the Age of Compression became the Age of Inequality. Sometimes nations get second chances.

My analysis is drawn from the primary sources of the period. The presidential records of Richard Nixon, Gerald Ford, and Jimmy Carter, including papers of key aides, were crucial. Examining presidential decision-making convinced me that the cultural conflicts that dominate some of the books on the decade were beside the point. The records do not demonstrate a rising conservatism, but a contentious polity. Understanding business thinking was crucial. The records of

the National Association of Manufacturers and the Chamber of Commerce are in the Hagley Library in Wilmington, Delaware. The Business Roundtable sent me public statements and congressional testimony on tax and labor legislation. The papers of the Trilateral Commission at the Rockefeller Archives in Sleepy Hollow, New York, offered an important source for international political and economic opinion during this period.

The records of the American Federation of Labor and Congress of Industrial Organization (AFL-CIO) at the George Meany Memorial Archives in Silver Spring, Maryland, are indispensable for documenting the changing politics of organized labor. Until 1981, the AFL-CIO was a major player in every important economic decision. I used, too, the National Urban League, National Association for the Advancement of Colored People (NAACP), Leadership Conference on Civil Rights, and Bayard Rustin papers, all at the Library of Congress, for the views of African Americans and other liberal groups. At the end of the 1970s and during the 1980s, monetary policy became important. Federal Reserve chief Paul Volcker has become the national hero as the slayer of inflation. Nevertheless, few scholars who applaud the bank's actions have read its deliberations. The Federal Open Market Committee minutes are online and reveal a much more uncertain and stumbling Volcker. Key senatorial papers were useful for understanding individual pieces of legislation. The Minnesota Historical Society in Saint Paul houses the Hubert H. Humphrey and Walter Mondale papers. The Frank Melville Jr. Memorial Library at the State University of New York in Stony Brook holds the papers of Senator Jacob Javits of New York. These sources were supplemented with newspapers, especially the *Wall Street Journal,* magazines, and the secondary literature on various topics.

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CHAPTER ONE
“The Great Compression”

AMERICANS IN 1945 were far richer than people of other nations. Still, only 54 percent of U.S. families possessed cars, and just 44 percent owned their own homes. More than 40 percent of the population lived below the poverty line. Over the next generation life improved for most Americans, and fears generated by the memory of the Great Depression faded away. By 1970, 63 percent of families owned their own homes, there were as many private cars as families, and only 10 percent were poor. After World War II, the economy grew 4 percent a year, and poor people gained more than the rich. The income of the lowest fifth increased 116 percent, while the top fifth grew 85 percent; the middle also gained more than the top.[1] Economists Claudia Goldin and Robert Margo called the result the “Great Compression.”[2]

In 1955 *Fortune* magazine, a precocious spotter of trends, declared that “man-made abundance is making the average man wealthy by the standards of fifty years ago, swiftly eliminating poverty and distress, stamping out disease, prolonging life, undermining useless or obsolete institutions, building up useful ones, helping other nations to struggle up the difficult and often disappointing road to efficiency, creating more and more leisure, and changing swiftly and radically the tastes and habits of the people world over. Nothing, perhaps, has altered the world more in all the history of Western civilization than rising American productivity has in the last half century.”[3] *Fortune* skipped over the Great Depression and failed to explain how that abundance came to be. A son of a steelworker recalled that his family “saw the union doing it.”[4] Goldin and Margo believed that a labor market favoring the unskilled, a strong union movement, and egalitarian ideology and practices, such as a rising

minimum wage and progressive taxation, contributed.

However we explain it, in the fifteen years following the war rising productivity advanced the GDP 37 percent and the wage component of national income rose. The country attained growth and mild redistribution. Between 1947 and 1973 disposable income increased 15 percent in real terms. For the first time in history, large numbers of workers had discretionary income, money that they could decide how to spend. Most unionized workers, over one-third of the working class, enjoyed paid vacations, holidays, pensions, and health insurance, which became norms of working-class life. The low unemployment seemed miraculous. Throughout the 1930s unemployment never fell below 14 percent, peaking at 25 percent in 1933. In the 1950s the average was 4.6 percent.

Many Americans now were homeowners and living outside of the cities. Fourteen of fifteen cities with more than one million inhabitants decreased in population during the 1950s. By 1960 the number of suburbanites equaled the number of city dwellers. In 1976, more people lived in suburbs than in either central cities or rural areas. Over 83 percent of the population of metropolitan Boston was suburban, 81 percent of Pittsburgh, 74 percent of Detroit, nearly 70 percent of Philadelphia, and 66 percent of Los Angeles.[5] The migrations were made possible by higher wages, thirty-year GI bill home loans, the application of mass-production techniques to home-building, federal highway construction, and corporate decisions to locate operations away from cities. Young, large families provided a ready market for all sorts of household goods that had been out of the reach of their parents. The washing machine, refrigerator, and vacuum cleaner had come to the working class, along with novelties that some made the signature of the era: color TV in 1953, all-transistor radios and polyurethane foams in 1955, synthetic diamonds in 1957, and stereophonic records in 1958.[6]

The automobile became the vehicle of choice. Americans owned 49 million cars in 1950, 62 million by 1960, and 119 million by 1972. They would eventually travel on 41,000 miles of fast roads—turnpikes,

freeways, thruways—planned by the Interstate Highway Act of 1956. Air travel was not far behind. In 1957, Boeing launched the 707, which halved flying time across the Atlantic and made air travel available to ordinary Americans. Between 1957 and 1973, a round-trip flight from New York to London fell to $487. Charter rates were still lower, below $200. Cheap airfares, guidance from Arthur Frommer's *Europe on $5 a Day,* and the strong dollar launched many first trips abroad.[7]

The fruits of abundance were everywhere, but they were cultivated. Governments of both parties concluded that democracies could not survive with high unemployment and that the catastrophe of the 1930s had been caused by the failure of free markets. The first edition of Paul A. Samuelson's classic *Economics* (1948) warned, "It is not too much to say that the widespread creation of dictatorships and the resulting World War II stemmed in no small measure from the world's failure to meet this basic economic problem adequately."

Before the Great Depression, economists believed that unemployment could never plague nations because fluid wages and prices would adjust and sop up the unemployed. But Britain between the wars and the U.S. during the 1930s did not reveal automatic rectification. The British economist John Maynard Keynes showed that economies lacked mechanisms to attain the full employment of their resources. Even if wages fell, the expectation of classical economists, profit prospects were not certain. If there was little prospect of demand, a businessman would not expand his factory, even if wages and interest rates were low. Keynes found answers by studying and compiling aggregate, nationwide statistics. He invented macroeconomics, the branch of economics that studied the performance of the economy as a whole.[8] He discovered that governments could either spend money or reduce taxes to increase the demand that would generate more private investment, leading to full employment. Keynes was no radical, but he believed that mass unemployment was unjust and a threat to free society and civilization.

The Keynesian idea that the state could promote employment fostered polices that produced the Great Compression. Persons with sterling

capitalist credentials like Averill Harriman observed: "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."[9] Keynesianism was in its heyday in the United States in the 1960s when Presidents John Kennedy and Lyndon Johnson cut taxes by $11.6 billion to increase aggregate demand and investment. (Spending on military items for the war in Vietnam helped, too.) The resulting investment rates of 16 and 17 percent, as a percentage of GDP, equaled those of the boom of the mid-1950s. Paul Samuelson proclaimed, with the hubris of the era, "By the proper choice of monetary and fiscal policy we as the artists, mixing the colors of our palette, can have the capital formation and rate of current consumption that we desire."[10] Governments could choose tax, spending, and monetary policies to produce full employment. In 1969, the unemployment rate fell to 3.9 percent.

Economists became an honored breed. In 1965, *Time* magazine named Keynes its "Man of the Year." The Nobel committee first awarded prizes in economics in 1969 largely because Keynesianism transformed the gloomy science into a hard science that benefited mankind. Even today, when Keynesian analysis has been challenged, governments use fiscal and monetary policy to improve growth and employment, a project inconceivable before Keynes. As his biographer Robert Skidelsky concluded in 2002, "Whatever economists think of Keynes, there are no pre-Keynesian economists left."[11] (After the crash of 2008, Skidelsky's words on Keynes were more like, "I told you so.")[12]

Fiscal policy was not the only legacy of the 1930s. The New Deal message was that equality and growth were allies, not adversaries. Social reforms and industrial policies promoted equality even as they maintained the demand needed for economic growth.[13] The Social Security Act ensured income for the aged, and the National Labor Relations Act, promoting unionization, enhanced working-class income. Both bolstered the demand so necessary for capitalist enterprise. Building dams and infrastructure in areas like the Tennessee Valley created jobs

for poor people, who in turn became consumers of goods. The uncertainty of the future kept businessmen from investing. So the New Deal guaranteed farmers' incomes through price supports, enabling manufacturers of expensive machinery and fertilizers to expand production, knowing that they would have a market for their wares. Agricultural output per worker grew 85 percent in the 1950s and 77 percent in the 1960s.[14]

New Deal programs in communications, banking, housing, and airlines stabilized investment. To make the telephone accessible to all, the government set tariffs so that richer and urban consumers subsidized poorer and rural customers. New Dealers removed the risk in the mortgage market so that banks and other institutions could lend to many who otherwise never could have entered the housing market. They did not ignore renters, funding extensive public housing construction. The government promoted airlines by offering mail contracts to sustain the new business. The state funded research in defense and space and was itself the market for the products of that research. The New Deal kit contained many tools—government spending to reduce unemployment but also regulations to promote industries valuable to the nation.

THE UNITED STATES, EUROPE, AND JAPAN

Like Americans, Europeans and Japanese agreed that the lesson of the 1930s was that government should shape and stabilize markets.[15] Their economic progress was more dramatic and the state hand was heavier than in the United States. In 1950, Japan's GDP per person was the same as that of the United States in 1850. By 1973, it was equivalent to American levels of 1963 and as high as that of Western Europe.[16] Europe's growth was impressive, too. In 1950, Western Europe's GDP was 10 percent below Argentina's. By 1973, Western Europeans were 50 percent richer than Argentineans.[17] The average rate of unemployment in Europe of the 1960s was 1.5 percent. The number of automobiles in France and Germany increased twentyfold between 1950 and 1966. Income in Western Europe rose from about 40 percent of American levels in 1950 to over 70 percent by 1973.[18] The German variation was called the "economic miracle," the French called it "les trente glorieuses," and the English, the "golden years." Italian film epitomized the change. In 1949, Vittorio de Sica's hero in the *Bicycle Thief* was a man looking for a job in postwar Italy. In 1960, the hero of Federico Fellini's *La Dolce Vita* was one who had a very good job and life, but was alienated from both.

European and Japanese governments nurtured manufacturing, restrained imports, and controlled currency to enhance national wealth. European states planned, but also owned, the key industries. Except for Germany, every European nation owned steel mills. In Germany and Japan, where the industry was in private hands, the state channeled capital. Whatever the means, nations used carrots and sticks to ensure that wages were restrained and profits used for investment, not dividends.

Measuring each ingredient of the recipe of European and Japanese economic resurgence is a fool's errand. Still, the U.S. role was critical. Would the German economy have flourished had it depended simply on the Europeans, who feared its resurgence? And despite the virtues of Japanese culture, was it coincidental that its steel industry took of when the United States placed orders during the Korean war? The president of

Toyota called the war "Toyota's salvation" because the U.S. military's order of a thousand trucks a month made up for the steep decline of the company's sales.[19] The peak years of Japanese growth were 1966–70, when U.S. spending on the Vietnam war was the heaviest. But it was not simply war; Council of Economic Advisers chair Walter Heller told Japanese leaders in 1964 that the U.S. tax cut would produce "a strong and expanding [American] market for Japanese goods."[20] It did.

Europe and Japan prospered after World War II because American leaders decided that they would not retreat behind two oceans, as their predecessors had done after World War I. American leaders were moved by self-interest, not altruism. Chastened by the absence of international coordination during the Great Depression, Americans concluded that the United States could not thrive in a world of ailing economies. In 1944, two new institutions were created at Bretton Woods, New Hampshire, to promote global expansion and trade. The International Bank for Reconstruction and Development (World Bank) and the International Monetary Fund (IMF) would promote long-term international investment for roads and ports, unlikely to be funded by private investors, and exchange stability with flexibility, respectively.[21] U.S. leaders believed that high tariff walls had prolonged the Great Depression and in 1947 created the General Agreement on Tariffs and Trade (GATT) to reduce trade barriers through periodic bargaining.[22]

Conditions in Europe were too grave for loans, orthodox currency rules, and free trade. At war's end, industrial production was 40 percent of prewar levels in Belgium, France, and the Netherlands, and 20 percent in Germany and Italy.[23] As the Cold War developed in 1946 and 1947, American leaders feared that local communist parties or the Soviet Union itself would take advantage of the distress and reorient Western European resources eastward.[24] In response, the Marshall Plan provided $13 billion in U.S. government grants, not loans, over four years.[25] (This sum was about 5 percent of America's GDP in 1948.)[26] The money helped pay for needed imports of food and machinery. And, to make certain that Europe could export, the United States brokered a huge continent-wide

devaluation in 1949, between 20 and 50 percent. Cheaper currency reduced the price of European goods to facilitate sales abroad. The United States assisted the European Payments Union, which allowed Western Europeans to trade more with each other, even though this trade came at the expense of America's own commerce. U.S. companies received tax incentives to transfer American technology to foreign corporations, despite the dangers to the nation's economic dominance.

American free trade preferences were also scrapped because of the weakness of the European economies. In fact, free trade was the snake in the postwar Garden of Eden. On the one hand, the United States believed that the market needed the firm hand of government to produce full employment at home. But on the other, it asserted that goods should flow internationally according to market principles. Incompatibilities were masked for now by the overwhelming economic superiority of the United States and the rampant violation of free trade rules. Most countries rejected the free trade vision. They did not view the GATT as an instrument to create a liberal international order, but only as a body to provide a civilized common law to govern relationships among mercantilist states. The United States stepped back from requiring Cold War allies to implement free trade and even permitted discrimination against American goods because of Europe and Japan's fragile economic and political circumstances.

The American market was the Cold War's incubator for alliance prosperity. In April 1950 the Bureau of the Budget announced: "Foreign economic policies should not be formulated in terms primarily of economic objectives; they must be subordinated to our politico-security objectives and the priorities which the latter involve."[27] Three years later, the National Security Council urged the entry of Japanese goods to the United States to halt "economic deterioration and falling living standards" in Japan that "create fertile ground for communist subversion."[28] The State Department judged that "Japan's resistance to Soviet-Sino pressures will depend in large measure on whether the free world [is] willing [to] make reasonable place for Japan's trade."[29]

Many believed that American industry was so strong that it would not suffer from unilateral trade measures that drew in imports from Europe and Japan. After the war the United States contained 60 percent of all the capital stock of the advanced capitalist countries and produced 60 percent of all output. Even in 1970, these figures were still 50 percent. Trade policy could be hijacked by diplomatic elites because trade never figured prominently in U.S. economic planning. During the 1950s and 1960s, exports and imports together composed only 8 or 9 percent of GDP.[30] But even Americans who predicted economic harm supported unilateral reductions. An assistant secretary of state for economic affairs stated privately that "the great question is … whether the country to willing to decide, in the broader national self-interest to reduce tariffs and increase United States imports even though some domestic industry may suffer serious injury."[31] This mind-set drove the lesser mortals in the Congress and commercial world to distraction. State Department trade specialist Philip Trezise agreed: "We did make some big tariff cuts and didn't get any reciprocity. It was quite deliberate…. Businessmen and congressmen were right" to criticize State.[32] The United States looked the other way as Europe and Japan protected markets and discriminated against American producers. Conversely, the large American market became the safety valve for the export industries of U.S. allies, who quickly became economic competitors.[33]

George Ball, President Kennedy's undersecretary of state for economic affairs, welcomed European imports in the United States. Ball had been a lobbyist for the European Economic Community (EEC) in Washington. His definition of internationalism was meeting with U.S. textile makers "dressed in a British-made suit, a British made-shirt, shoes made for me in Hong Kong, and a French necktie." His delight at tweaking the industry left him no space to contemplate the situation of the thousands of southern agricultural workers who needed textile jobs. He operated on the premise that "we Americans could afford to pay some economic price for a strong Europe."[34] The question was which Americans would be paying that price.

CONFLICTS REALIZED: THE KENNEDY ROUND, 1964–67

The men conducting U.S. foreign policy ignored the domestic economy. Elected officials could not close their eyes. American growth rates in the 1950s were lower than those in Europe and Japan. The U.S. economy grew at a rate of 2.3 percent a year between 1955 and 1961. Germany grew at 8 percent and the rest of Europe at only a little less.[35] Eventually, the Keynesian tax cut planned by President Kennedy in 1963 and executed by President Johnson in 1964 turned the economy around. But in 1962, before Kennedy decided to cut taxes, he turned to trade to treat sluggish growth and 6.5 percent unemployment. Kennedy feared that mercantilist trends in Europe would depress U.S. growth rates and increase balance of payments deficits. The EEC, created in 1957, was really a customs union that violated the GATT. The community "averaged up" tariffs, increased farm imposts, and kept American coal out with tight quotas. U.S. exports to Europe fell while military expenditures in Europe continued. Thus, the U.S. balance of payments was in deficit. Kennedy warned that "if the U.S. should be denied the European market, we will either find a flight of capital from this country to construct factories within that wall, or we will find ourselves in serious economic trouble." American companies were already setting up shop in Europe, but Kennedy thought that the Trade Expansion Act of 1962 could replace those plants with exports from domestic factories.[36]

The law empowered the president to cut tariffs by 50 percent and provided a mechanism for across-the-board reductions, instead of item by item haggling. The trade act was "the administration's Holy Cause," and "decent people are prepared to lie for it," said Oscar Gass, an economist in FDR's Treasury Department.[37] Gass was referring to the congressional testimony of Kennedy's cabinet—Arthur Goldberg, Orville Freeman, Luther Hodges, George Ball—all of whom stated that the United States would be the net gainer from the trade negotiations and U.S. exports to

Europe would rise. Gass predicted mounting trade deficits, and then foreigners would exchange their accumulating dollars for gold. Because the U.S. dollar was in practice the reserve currency, the United States bolstered faith in the greenback by promising to exchange $35 for one ounce of gold. If too many nations got rid of their dollars, the only solution would be to raise U.S. interest rates, which would bring back the dollars but also significantly increase American unemployment.[38]

Seymour Harris, an economist in the Treasury Department, had other misgivings. Harris doubted that the president's men could reduce European tariffs. Europeans "generally made concessions where the result was not likely to be large increases at the expense of their domestic producers." Their rates on wristwatches, where Europeans were world leaders, were low, but the tariff on autos was 22 percent compared with the American duty of 6.5 percent. American leaders ignored the words of France's Minister of Industry Michel Bokanowski, who told the U.S. Chamber of Commerce in October, shortly after the bill was passed, that the EEC must preserve a high external tariff because "increased competitive pressure on Europe could compromise its growth and productivity."[39]

The skeptics were right. The Kennedy Round trade negotiations took place in Geneva from May 1964 to June 1967. The Europeans, who knew that the United States was more committed to fortifying the anti-Soviet bloc than to obtaining any item on its domestic agenda, refused to budge on agriculture, rebated value added taxes for exports, and sheltered domestic industries from manufacturing cuts. Chief negotiator Francis Bator told President Johnson that the United States came out on the short end of the economic stick. Nevertheless, Bator urged the president to accept the deal, finally completed in 1967, because rejection would produce "jungle warfare" in trade and make the EEC into an isolationist anti-U.S. bloc. This became the standard refrain. Any agreement was better than no agreement because the free world was in danger.[40]

The Japanese were pleased with the results of the Kennedy Round. Japan now enjoyed trade surpluses with the United States, and the new

reductions promised to increase them. A Japanese reporter explained that the cuts the United States made "include many heavy industrial and chemical products which Japan intends to emphasize in the future." Moreover Japanese negotiators had excluded almost all strategic industrial goods from its list of cuts.[41] Japan had quotas on more than 120 product categories, including computers, office machinery, and auto components as well as numerous nontariff obstacles to imports. Noting the disparity between its aggressive export policy and its restrictive import policy, American policy makers hoped that Japan would act like a mature economic power.[42]

Former ambassador to Japan and Harvard professor Edwin O. Reischauer rushed to the defense. He stated that Tokyo "was a good customer. Until the last year or two, we have always run a large trade surplus. Our hope for building a stable Southeast Asia depends on friendship with Japan."[43] The State Department agreed, noting Japan's willingness to hold reserves in dollars, accumulated from trade surpluses and American defense outlays, instead of withdrawing gold from the U.S. Treasury. This short-term "help" for the dollar actually aided Japan and also Germany, which was equally forbearing. Because both countries' currencies were undervalued, like China's today, their exports were advantaged. Japan allowed the Europeans and Americans to fight it out at the trade talks. Because of the most favored nation provision, the United States could not deny Japan the reductions in the American market, even while the Japanese home market was protected.

Big companies reinforced the trade deficits developing during the 1960s. They had much more latitude than American workers to navigate the new trading order. Before World War II, most multinational corporations were in the business of extracting minerals or oil in "undeveloped countries." The new ones were in manufacturing and populated the developed, not developing world. There were many reasons for this. According to Senator Jacob Javits of New York, "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."[44] Translated into neutral language, Javits's claim was that multinationals brought technology and up-to-date management. But what was in it for the corporation?

First, most countries, developed or not, had lower labor costs than the United States. However, because American productivity was generally superior, higher wages did not always translate into higher labor costs. Attaining cheap labor was not the only reason to go abroad. Producing abroad eliminated the transport costs. Locating in another country also clothed a foreign company in native garb. But probably the most important impetus, as Kennedy understood, was the creation of the EEC, which reduced restrictions within the union but erected barriers for outsiders who wanted to sell in Europe. Because exporting became more difficult, American companies set up new plants behind the EEC's protective walls. A manager from Caterpillar Tractor, a manufacturer of earth-moving machinery, explained that "originally we 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 U.S. plants."[45]

The new European mercantilism encouraged American corporations to transfer capital and jobs to Europe. (French nationalists thought this was an American invasion.) From 1958 to 1964, almost all of the expansion in the number of full-time jobs in the United States had been in the public, not private, sector.[46] It was not that the U.S. companies suddenly became producers of services, not goods. They just produced their wares abroad. U.S. companies increased their investment in foreign countries at a rate 50 percent faster than their investment in the United States. In 1965, new investment abroad accounted for 33.9 percent of overall net American investment in rubber manufacturing, 25.4 percent in manufacture of transportation equipment, 25 percent in chemicals, 22.1 percent in nonelectrical machinery, and 21.4 percent in electrical machinery.[47]

Caterpillar Tractor went further. By 1971, Caterpillar was buying foreign parts for its domestically assembled products. It planned to build

plants in other countries to produce parts to be assembled anywhere and everywhere. Without cheap transport and communication, it would have been infeasible to divide the production of a single article among say Texas, Taiwan, and Thailand. Global production also required state action. In 1964, the United States changed its tariff laws to allow products assembled abroad with U.S. components to enter the country, taxed only on the value added in assembly.[48] And, in 1967, Mexico, Taiwan, Singapore, Hong Kong, and Korea created export platforms, areas exempt from the usual levies, to lure firms that wanted to employ local labor to export elsewhere. In 1968, the *Wall Street Journal* sounded the alarm on increased imports of "unsophisticated electronics" for U.S. teenagers coming from American companies in Taiwan.[49] With anemic investment, American labor productivity, the mother's milk of growth, declined in the late 1960s. Real wages for manufacturing workers fell by 82 cents an hour from 1965 to 1969. These telltale economic signs were buried amid the noisy protests against the war in Vietnam, the decision of Johnson not to run for reelection, and the assassination of Martin Luther King Jr. in 1968.

POLITICS AND SOCIETY

The politics, as well as the economics, of the postwar world were constructed by the Democratic Party. Republicans agreed to live by the new rules of the New Deal. In 1952, after twenty years of Democratic power, the GOP won the presidency. President Dwight D. Eisenhower and his cabinet of gray businessmen did not repeal the New Deal. It is probably true that in the recessions of 1954, 1958, and 1960 the government was more passive than a Democratic administration would have been. GDP growth from 1955 through 1961 was a puny 2.3 percent. Still, Eisenhower tolerated budget deficits during the recessions, establishing Keynesianism as a bipartisan policy. He expanded Social Security and public housing programs, continued to subsidize farmers, and accepted labor unions. Ike's philosophy lacked a bible, but he called it "modern Republicanism." Right-wingers sneered at what they considered "me-too" Republicanism. Edgar C. Bundy, president of a conservative GOP club, complained, "The so-called Republican leadership is giving the country a bigger New Deal program and people cannot recognize it because it is being dished out under the guise of Republicanism!"[50] But as long as New Deal ideology was hegemonic, moderate Republicans controlled their party.

In the 1950s, conservatives headed European governments, too—Konrad Adenauer in Germany, Harold Macmillan in England, and General Charles de Gaulle in France. The economic boom in Europe, like the prosperity in the United States, made radical proposals seem unnecessary. In Japan, the conservative Liberal Democratic Party won election in 1955 and ruled for the rest of the era. But in the 1960s the moderate left regained power in the United States and Europe. Left governments made welfare expenditures—income maintenance, education, health care—the central part of public expenditures. In the United States, federal aid to education, Medicare, Medicaid, and various job programs put more flesh on the scrawny American welfare state. Although most African Americans had become Democrats during the

New Deal, the civil rights legislation in 1964 and 1965 both increased the number of black voters and wedded them more firmly to the party. By the end of the decade, Democrats outnumbered Republicans two to one.

Postwar prosperity altered the analysis of modern society. John Kenneth Galbraith's *Affluent Society* (1957) and *New Industrial State* (1968), Daniel Bell's *End of Ideology* (1959), Robert Theobald's *Challenge of Abundance* (1961), and Gunnar Myrdal's *Challenge to Affluence* (1963) all rested upon the assumption that the historic conflicts between capital and labor had been resolved. Affluence fostered new thinking about leisure, human relations, consumerism, and a host of extra-economic concerns. Keynes was a pioneer here too. In 1932, he thought that "the day is not far off when the economic problem will take the back seat where it belongs, and … the arena of the heart and head will be occupied where it belongs, or reoccupied by our real problems—the problems of life and of human relations, of creation and behavior and religion."[51] No longer did leaders accept the ancient nostrum that the poor will always be with us. Poverty was especially deviant in an affluent society. The Economic Opportunity Act of 1964, which launched Johnson's so-called War on Poverty, aimed to eliminate "the paradox of poverty in the midst of plenty."

Affluence was as much an ideology as a description of U.S. society. Politicians and academics forgot that the non-poor included many who were non-rich. Workers' incomes had dramatically increased after the war. The median family income for 1968 was $8,632, when it had been $3,031 in 1947. But $8,632 was about a thousand dollars less than what the Bureau of Labor Statistics defined as "modest but adequate" income for an urban family of four.[52] An accurate portrait of the working class fit uneasily into the prevailing dualisms of the decade: plenty v. poverty, rich v. poor, suburban v. urban, and white v. black. In 1970, the Bureau of Labor Standards formulated three standard budgets, lower, intermediate, and upper, corresponding to poverty, working class, and middle class. The budget for the lowest of these was $6,960 for a family of four; the intermediate budget was $10,664, and the middle-class budget was

$15,661. In 1970, government figures indicated that 30 percent of the nation's working-class families were living in what was actually poverty, with incomes of less than $7,000. Another 30 percent were above a poverty budget but below the intermediate level. Thus, 60 percent were either poor or hovering between poverty and the very modest level of the intermediate budget.

Let us examine the intermediate family budget that was the lifestyle of 60 percent of all American workers. A family would own

> a toaster that will last for thirty-three years, a refrigerator and a range that will each last for seventeen years, a vacuum cleaner that will last for fourteen years, and a television set that will last for ten years. The budget assumes that a family will buy a two year old car and keep it for four years, will pay for a tune up once a year, brake realignment every three years, and front end alignment every four years. The husband will buy one year round suit every four years, one top coat every eight and a half years.… The husband will take his wife to the movies once every three months and that one will go to the movies alone once a year. The average family's two children are each allowed one movie every four weeks. A total of two dollars and fifty four cents per person per year is allowed for admission to all other events, from football and baseball games to plays or concerts. The budget allows nothing whatever for savings.[53]

Unemployment rates underestimated the extent of joblessness. The numbers were determined by daily surveys which counted how many people were unemployed on any given day. They did not take into account the fact that the employed man might have been unemployed one month ago or could be one month from now. Using this broader measure, in 1969, a year of high employment, 20 percent of workers were unemployed for some period of time. In 1970 the figure rose to 23 percent. The median income for construction workers, often considered to be the aristocrats of the working class, was $9,494, below the intermediate budget. Despite high hourly rates, almost one-quarter were

unemployed at some time in 1969 and 30 percent in 1970. And, more than a third of the unemployed in 1970 were out of work for almost four months.

Still, liberal professionals judged workers harshly. The ex-Socialist Daniel Bell, writing for *Fortune,* now sympathized with the "unorganized middle-class" and "petits rentiers."[54] A. H. Raskin, the labor correspondent for the *New York Times,* declared, "The typical worker—from construction craftsman to shoe clerk—has become probably the most reactionary political force in the country." Harvard sociologist Seymour Martin Lipset agreed, finding workers to be intolerant and antidemocratic.[55] Liberal columnist Murray Kempton complained that "the AFL-CIO has lived happily in a society which, more lavishly than any in history, has managed the care and feeding of incompetent white people."[56]

Contrary to the claims of the professional classes, the labor movement was potent and liberal.[57] Union density peaked in the mid-1950s, when membership reached 35 percent of the working class, a number approaching that of northern Europe. Labor had built formidable political machines, which exercised clout in the West and the North, and of course in Washington, D.C. From 1948 to 1964, the Democratic presidential candidate launched his campaign with a Labor Day rally in Detroit's Cadillac Square. The various unions that composed the AFL-CIO were a diverse group. The building trades, which relied upon market power to win, were less socially conscious, or "progressive," than the auto, steel, and electrical workers in the CIO. The CIO industrial unions, joined by newly organized government workers, used their power to extend social welfare to workers without unions. But all unions accepted the Keynesian road to job expansion. On the bellwether issue of civil rights, polls demonstrated that there were no class differences among the population. On the other hand, unlike business associations, the unions were four-square behind civil rights legislation. Nevertheless, many in the civil rights movement, and historians following them, never forgave AFL-CIO head George Meany for not supporting the March on Washington in 1963,

even though he was the principal backer of the crucial Title VII of the Civil Rights Act of 1964, which banned employment discrimination. The AFL-CIO was the muscle behind many of the jewels of the 1960s and early 1970s—Medicare, Medicaid, and Occupational Safety and Health Act (OSHA). But Meany, a former plumber from the Bronx, New York, represented everything young activists derided—calculation, self-interest, compromise. The young valued morality, selflessness, confrontation. Meany ridiculed his critics, and they returned his contempt.

STUDENTS, WAR, AND THE REMAKING OF THE DEMOCRATIC PARTY

Many of Meany's young critics, who made up the civil rights, antiwar, and, eventually, women's movements, were college students or college-educated, a growing segment of the population. During the 1960s, the numbers of students enrolled in college more than doubled, from 3.6 to 7.4 million. The growth was a sign of the new affluence and new demand for educated workers. The big surge was in the public colleges and universities, whose student population rose from 2.3 million in 1960 to 5.7 in 1970.[58] To sociologist Daniel Bell, the growth of universities was the sign that society was now run with knowledge and not capital. The university was what the business corporation had been in an earlier era.[59] Whether Bell was right or wrong, the academy was no longer the ivory tower it had been before World War II. The federal government richly funded higher education because universities provided scientific, economic, and linguistic knowledge that was crucial for the nation's new international role. Businessmen endorsed the federal role because they assumed that economic growth depended upon the direct and indirect knowledge that universities produced. Liberals added their weight, believing that higher education was a democratic right, not a privilege for the rich.

Increased enrollment was another sign of the shift from manufacturing to service employment. From 1950 to 1971, the percentage of workers in goods related industries fell from 49.8 to 38 percent of the workforce; workers in service, including government, jobs increased from 50.2 percent to 62 percent.[60] Liberals believed that this meant new possibilities for "non-productive" or social tasks to help the needy and improve the quality of life. These ideas were deeply rooted in the university, which sanctioned reflection, criticism, and social responsibility.

Many of the students and knowledge workers lived in the growing

suburbs and college towns outside of cities. The modern student movement began in 1960 at one of those huge public institutions, the University of Michigan, in suburban Ann Arbor, thirty-five miles west of Detroit. A small group of students created the Students for a Democratic Society (SDS). Two years later, gathering at Port Huron, Michigan, SDS penned the program that became a manifesto for students of the 1960s. Its first words captured the social base and sensibility of their movement: "We are people of this generation bred in at least modest comfort, housed in the universities, looking uncomfortably to the world we inherit." SDS embraced traditional left goals—civil rights laws, reduced military spending—but its signature was the statement of values. Awed by the civil rights movement and embracing its moralistic language, the students cultivated the extra-economic goals of "self-direction, self-understanding, creativity, and human independence," lives that were "personally authentic," and a democracy that was "participatory," not simply formal. It was a New Left because it found the labor orientation of the Old Left limiting and in some cases irrelevant to their sense of America's ills. Its differences with liberals were more profound. Liberal elites believed that Western civilization embodied progress and enlightenment, but the students saw stultifying bureaucracies (universities, corporations, trade unions) that crushed the individual and transformed him—he was a him then—into the man in a gray flannel suit. SDS attempted community organization with mixed success. But the organization grew rapidly as the United States sent combat troops to prevent the union of South and North Vietnam under the Communist Party in 1965.[61]

Although most students were not antiwar activists, the largest sector of the antiwar movement was the student population. Antiwar politics rested on the premise that the university was the new strategic locus and that the students should remain on campus, not be sent to Vietnam. They did. The war was fought by the working-class portion of the baby boomer generation. Draft laws deferred undergraduate college students until they graduated, and graduate students until mid-1968. Most college-educated

professionals received deferments through numerous loopholes. Academics became antiwar organizers. The National Mobilization Committee to End the War in Vietnam (Mobe) was led by professors Douglas Dowd of Cornell and Sidney Peck of Western Reserve.

There were many intellectual strands woven into the opposition to the war, but the key one was simple: the massive death and destruction was morally repellant and should end as soon as possible. Unlike the students' dissent, liberal critiques were covert and measured in 1965. Senators Eugene McCarthy and Robert Kennedy made their first critical statements in early 1967. Victor Reuther, John K. Galbraith, Arthur Schlesinger Jr., and other prominent liberals formed a group in spring 1967 called Negotiations Now, an accurate thermometer of the heat of their appraisal. SDS was bolder and increasingly asserted that the war was not a mistake but the inevitable result of basic flaws of the United States—racism, inequality, militarism, and capitalism. Thus the war became the center of the American left in the late 1960s. The radicalization of the movement brought students into contact with individuals from the Old Left, religious left, and veterans of the peace and civil rights campaigns of the early 1960s.

The movement grew but appeared powerless, if measured by its goal of stopping the war—now. At the end of 1966, 385,000 U.S. soldiers were in Vietnam. One year later, the number reached 486,000, despite the demonstrations and antiwar activity. Racial conflict added oxygen to war protest. Eighty-three people died in two riots, or rebellions, as radicals called them, in Detroit and Newark at the end of July 1967. Unable to respond adequately to the war or the urban insurrections, the journalist Andrew Kopkind, writing in the *New York Review of Books,* declared, "To be white and radical in America this summer is to see horror and feel impotence."[62]

Such sentiments led many in the antiwar movement to believe politics was a dead end. But others attempted to find a political solution to the impasse. Allard Lowenstein, the liberal activist for all seasons, had embraced many of the causes of the 1960s—the Peace Corps, civil rights,

anti-Franco.[63] Lowenstein thought that the antiwar movement of 1967 was politically bankrupt. Rejecting the conventional wisdom, he believed that Johnson could be denied renomination. Lowenstein's zeal was both self-generated and transported from the passion of his radical competitors. But where they despaired, he organized to "dump Johnson," injecting the moralism of the antiwar movement into the politics of the Democratic Party. Lowenstein had wanted Robert Kennedy to challenge the president in the primaries; but instead of the passionate Catholic, he got the quixotic one, Senator Eugene McCarthy of Minnesota. The candidate of the "Dump Johnson" movement was an intellectual whose liberalism came from the church's condemnation of the individualism of capitalism. McCarthy's critique of modernism, materialism, and the "affluent society" was similar to that of SDS despite its different origins. McCarthy's doubts about the Vietnam war were amplified by his displeasure after Johnson chose the other Minnesotan senator, Hubert H. Humphrey, to be his running mate in 1964.[64] McCarthy was bored with life in the Senate. At the time he said yes to Lowenstein, he was planning to retire from political life. It showed. Even his aides found him vain, condescending, and erratic.[65]

Lowenstein's insurgency married two generations of dissent. It resuscitated the Democratic network that had rallied behind the losing presidential campaigns of Adlai Stevenson and added young, idealistic college students, who had been repelled by the growing anti-Americanism of SDS. "By upbringing, training and ambition, these children of affluence" were winners, observed former SDS head Todd Gitlin.[66] They wanted to do something and had the self-confidence to think they could. Money was no problem. Five contributors, antiwar angels, gave over $100,000 each.[67]Still, the McCarthy challenge did not take of.

But on January 31, 1968, the National Liberation Front (NLF), the Hanoi-affiliated opposition to the South Vietnamese government, launched a military campaign known as the Tet offensive to topple the South Vietnamese government. Although the NLF failed to capture South

Vietnamese cities, oust the government, or inspire a general uprising, the insurgent fighters demonstrated that they could launch attacks throughout South Vietnam. And it so registered with American public opinion.[68] On March 12, the New Hampshire returns, which included Republican crossovers, gave McCarthy 28,791 votes to Johnson's 29,021. The country ignored a poll showing that 60 percent of the McCarthy voters wanted more military action in Vietnam. And, confusing his McCarthys, one elderly voter told a journalist, "He chased all these communists out of the State Department, so I think we can give him a chance."[69] But the vote was a Johnson referendum, and the president lost. The results traced the geography of the new Democratic politics. McCarthy fared poorly in the labor-dominated cities and did well in middle-class suburbs and college towns.

In March, majorities in both parties wanted to phase out American operations in Vietnam, a position capable of uniting right and left, though for different reasons, of course. The rest was inevitable. Senator Robert Kennedy of New York threw his hat into the ring on March 15. Johnson announced on March 31 that he would not seek reelection and instead would work full time to end the war through treaty negotiations taking place in Paris. The shock of this message was overwhelmed by the assassination of Martin Luther King Jr. four days later. The resulting riots in 125 cities did not alter presidential politics but, like so much of the violence in 1968, injected it with desperate meaning.

Then, on April 27, Vice President Hubert H. Humphrey joined the race. Liberals saw Humphrey as a stand-in for Johnson, so the antiwar vote divided between Kennedy and McCarthy. But nothing was certain in 1968. On June 4, the evening after Kennedy's victory over McCarthy in the California primary, Kennedy was shot and killed by Sirhan Sirhan, a Palestinian loner. Most of the Kennedy support went to Humphrey, not McCarthy, who already had shown the less-attractive features of the New Politics. In his contest with Robert Kennedy, McCarthy had remarked that his opponent was "running best among the less intelligent and less educated people in America."[70] McCarthy believed, author and journalist

Garry Wills wrote, that "he *should* be President because he would not *try* very hard to be."[71] The candidate's style, the notion of being above and beyond politics, already damned him among those who wanted to win elections. Those same qualities made him attractive to some of the antiwar intellectuals. McCarthy pitched his appeal to his "constituency of conscience," flattering his suburban followers. "The middle class has always been the greatest force for change. You're the best and you're the ones that are most needed," he said. In the California primary McCarthy carried suburban Orange County and others like it.[72]

Although Humphrey entered too late to contest many of the primaries and lost others, he was in the lead because at that time only 49 percent of the delegates to the convention were chosen through primaries, and only 36 percent of those delegates ran committed to individual candidates.[73] The other delegates, selected by the state parties and conventions, overwhelmingly preferred Humphrey. Polls confirmed the decisions of the party leadership; Democratic voters preferred Humphrey to Kennedy or McCarthy. The last poll before Kennedy's death put Humphrey at 40 percent, Kennedy at 31, and McCarthy at 19.[74] This arithmetic does not support the belief of Kennedy supporters that he would have won the nomination had he lived. Nor does it affirm McCarthy's claim that the nomination had been stolen from him because he topped the list with 38.7 percent of the votes cast in the primaries. Both beliefs fueled antiparty emotion, which exploded at the convention over the war plank of the platform. But the passion should not obscure the fact that the preference of party officials had been closer to the wishes of Democratic voters than the primary voters had been.

In 1968 the single issue for many liberals at the convention was Vietnam, and they defined the critical question to be whether Humphrey was his own man or a Johnson proxy. The vice president tried. He proposed an immediate halt in the bombing of North Vietnam, a position supported by many and capable of uniting his and McCarthy's supporters. Another plank, supported by Johnson, promised a conditional end to the bombing. Johnson now followed the scenario that Woodrow Wilson had

scripted after World War I. He refused to issue the passport that Humphrey needed to enter the land of the antiwar forces and unite the Democratic Party. Whether Johnson regretted his decision to step down or genuinely believed that a burst of new bombing in Vietnam could turn the tide, his obduracy and the compliance of the members of the National Committee injured Humphrey's candidacy. The two planks were put to a vote and the president's position won, 1,567¾ to 1,041. The vice president yielded to the president, too. The platform fight was overshadowed or perhaps underscored by events outside the convention hall. On the streets close to the convention hall the battle between taunting antiwar demonstrators and police bullies upstaged everything that went on inside. Humphrey won the nomination, but Democrats left Chicago embittered, divided, and certain that they had lost the election.

Labor leaders, even those who opposed the war, campaigned vigorously for Humphrey. Unlike middle-class liberals, they could not make the war their only cause. They also had to shore up their ranks against the appeal of George Wallace, running as a third-party candidate. The Alabama governor traded a racist message for a populist championing of ordinary people against an indifferent government and condescending intellectual class. Labor worked overtime for Humphrey, registering 4.6 million voters and recruiting 94,000 Election Day volunteers to make certain they cast ballots. Johnson's distance from the Democratic campaign was mysterious. Some thought he preferred Nixon.[75] Whatever the truth, he did not lift a finger to help his vice president. Stung by criticism that he was gutless, Humphrey separated himself from the president at the end of September and came out for a halt to the bombing, and some of the antiwar forces returned to the Democratic Party. But not enough; on November 5 Nixon won 43.4 percent of the vote, Humphrey 42.7 percent, and Wallace 13.5 percent. Despite the narrow popular vote margin, Nixon overwhelmed Humphrey in the Electoral College, 301–191. Wallace accumulated 46 Electoral College votes from five Deep South states.

The presidential election in 1968 etched demographic and regional

fissures in the Democratic Party between professionals and working class, suburbs and cities, white southerners and white northerners. These conflicts enabled Richard Nixon to win but did not end the golden age boom, nor the ethic that made prosperity egalitarian. Nixon did not challenge the New Deal. George Wallace's success demonstrated that the South was no longer reliably Democratic, but the governor ran against King, not Keynes. The Democratic leaders who toppled Johnson and embraced Kennedy or McCarthy did not repudiate the New Deal but assumed that the age-old conflicts between capital and labor had been tamed, which was one reason why they were inattentive to the telltale signs of trade deficits and investment abroad. They believed the key issues were now minority and gender rights, quality of life, and, of course, the war. The question after 1968 was whether the Democrats' fractious components, which had honed their weapons on issues of war, race, and culture, could retool when the economic tremors of 1968 became a tsunami in the 1970s. But first the GOP, considered dead in 1964, had its chance. Like the Democrats, the GOP thought the economy was on autopilot. It hoped to create a Republican majority on the posteconomic issues of law and order, patriotism, and family.

CHAPTER TWO
1971
AFFLUENCE CHALLENGED AND RESTORED

IT IS COMMONPLACE for pundits to trace the current age of conservatism to the 1968 election of Richard M. Nixon. As early as 1969, Kevin Phillips, in *Emerging Republican Majority,* predicted a new cycle of Republican power, ending the Democratic era begun by Franklin D. Roosevelt in 1932. Phillips claimed that the migration of southern whites, urban Catholics, and suburbanites from Democratic ranks in 1968 was permanent, marking a rising conservatism in American politics. Some Democrats viewed the same landscape but sketched a resurrection. Richard Scammon and Ben Wattenberg hectored their party to attend to a new conservative majority anxious about crime, militant activism, and permissive values.[1] But the king of right wing Republicans, *National Review* editor William Buckley, believed that it was not the moment for conservatives. Nixon himself thought that members of the right wing Young Americans for Freedom were "nuts and second-raters."[2] The president did not want the "hard right-wing, Bircher, or anti-Communist" in the new majority he was trying to build.[3] Howard K. Smith, a principal commentator for ABC news, 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."[4]

One way to cut through this dispute is to separate notions of social and economic liberalism. Whatever the people concluded in 1968 about

values or culture, they did not reject Keynesian economics, which was not debated at all in the election. Some claim that Nixon underwent a Paul-like conversion in 1971 when he said, “I am now a Keynesian in economics.”[5] According to historian Alan Matusow, Nixon, the ultimate political opportunist, was uninterested in ideas and embraced Keynes to win reelection.[6] That may be so. But the relevant question is why it was politically useful to espouse Keynesian economics in 1971 but not after 1980. Politicians are known for being opportunistic and embracing prevailing ideas. What is important is the content of the well from which leaders drink. The content in 1971 was Keynesian. But it was also Keynesian in 1969.

In Nixon’s first inaugural address he said, “We have learned at last to manage a modern economy to assure its continued growth.” He did not label his course of action Keynesian, but the words required no label. Even the values issue was not so simple. Despite Nixon’s small-town, Quaker upbringing, his service in the uptight, button-down Eisenhower administration, and his 1968 campaign against hippies, he embraced elements of the 1960s counterculture. Surveying the nation’s troubles, he invoked Roosevelt’s 1933 inaugural address. The Democratic president had judged the nation’s deficiencies to be “material.” “Thank God,” FDR said, “the American spirit was intact” and could be marshaled to produce the plenty so absent from the American larder in 1933. Nixon said 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.”[7] At the end of the year he told a group of businessmen that the key questions facing the nation are not material but, rather, the question is, “What has happened to the America idea?”[8]

POLITICS OF AFFLUENCE

From the beginning, President Nixon practiced the politics of affluence, rooted in the assumption that material questions had been resolved because governments had learned to manage the economy. Let us look at his views on taxation and government. Economic conservatives argue that low taxes were intrinsically good because taxes removed incentives to work and siphoned away money from investment. But in 1969, tax equity, not tax cuts, was the national goal. Often this meant shifting the burden to the wealthy and to business, not shrinking the government and cutting taxes, the mantra after 1980. Although Nixon was not a tax reform activist, his proposals fit easily in this tradition.

The president said, "We can never make taxation popular but we can make taxation fair."[9] In 1969, he effected the repeal of the 7 percent investment tax credit, part of John F. Kennedy's tax package of the early 1960s, which offered credits to corporations expanding plant and equipment.[10] Explaining why a Republican administration repealed the credit that businessmen loved, Nixon's economic adviser 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."[11] John Kenneth Galbraith could not have said it better.

The underlying assumption behind repeal was Keynesian: Treasury Secretary David Kennedy told the House Ways and Means Committee that the economy was sluggish when the credit was first offered in 1961. But now "the consumer demand to be generated by our economy in the foreseeable future will provide sufficient impetus for industrial modernization without the investment tax credit."[12] There seemed to be no conflict between consumption and accumulation, labor and capital, equity and growth—the essential harmonies of affluence. Nixon retained the income tax surcharge, President Johnson's belated effort in 1968 to reduce the excess demand generated by the Vietnam war. But it was cut

from 10 to 5 percent. Nixon agreed to remove nine million poor Americans from the tax rolls and got behind the Alternative Minimum Tax (AMT), which ensured that high income individuals and corporations, both eligible for so many tax benefits that they paid little or no taxes, would pay something. Both measures revealed a national consensus on tax equity.

Nixon was for tax reform, not reduction, because like most Republicans, as well as Democrats, he believed that the government had important functions. Still, Nixon was no Democrat. Democrats generally were more interventionist in the microeconomy. Both Kennedy and Johnson used jawboning and wage and price guidelines to shepherd economic growth, attempting to keep wages from exceeding productivity and to allow sufficient price increases to allow profits, the source of investment, but not so great that the increases would cause inflation. At a news conference on January 27, one week after his inauguration, Nixon told the nation that he would fine-tune the economy, a phrase popularized by Democratic economists, but not with the wage and price guidelines that Kennedy and Johnson had employed.[13] Similarly, Nixon was critical of aspects of Johnson's Great Society. But he proposed to mend it, not end it. "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."[14] The answer was not to get rid of government and liberate market forces, but to "make government effective."[15]

Nevertheless, it would be wrong to portray Nixon or the nation as obsessed with the economy in 1969. The president believed that his main job was to conduct the nation's foreign affairs, and Vietnam monopolized Nixon's attention. Nixon, unlike Robert Taft or even his successor, Gerald Ford, did not build his political career on economic issues. Shortly before the 1968 election, the National Association of Manufacturers (NAM) judged Nixon barely preferable than his opponent, Hubert H. Humphrey, in this area: "If unemployment reached 4 percent, Humphrey would be willing to attempt almost anything to check the climb … Nixon

would attain the same frame of mind at about 4frac12; percent." The NAM correctly predicted that the business agenda will be "undelivered" during a Nixon presidency.[16] Nixon said that "the best way we can be pro business is to make business toe the line. We must not overreact or make them pull all the cars of the market, or hit them over the head, but business must take the justifiable reaction of the public into consideration."[17] This might sound reasonable, but not to businessmen who believed that they were the scapegoats for a laundry list of social ills —pollution, job discrimination, materialism, and war, to name a few. David Rockefeller, chair of Chase Manhattan Bank, complained that "people are blaming business and the enterprise system for all the problems of our society."[18] Nixon was well aware of the growth of antibusiness sentiment and was prepared to take advantage of it. In the fall of 1972, he okayed the Justice Department's antitrust suit against IBM and added that a public relations effort should give the administration "credit for attacking business."[19]

But it was anti-Communism, not the economy, that was the platform that had propelled Nixon to national prominence, and although the Red issue had its domestic uses, it was the big stage of foreign policy that compelled him. President Nixon spent his first term working to diffuse the Vietnam issue. Hoping to snatch victory out of the jaws of defeat, Nixon saw his program of withdrawing American troops, maintaining a tough bargaining position, bombing occasionally, and training the South Vietnamese to defend their country succeed at home, if not in Vietnam. As American deaths declined, Vietnam was no longer on the front burner of American politics. Still, when students continued to protest American policy, Nixon deepened division, referring to dissenters as "bums" who were "blowing up the campuses."[20]

After the American incursion into Cambodia to destroy enemy staging areas, announced on April 30, 1970, the campuses erupted. On May 4 national guardsmen and police killed four students during a protest at Kent State University in Ohio, and two at Jackson State in Mississippi. After hearing of the Kent State tragedy, Nixon said, "This should remind

us all once again that when dissent turns to violence it invites tragedy."[21]Students were easy targets. He told his speechwriters to hit collegiate dissenters, not protest "among Negroes."[22] At the same time, he sent condolences to the families of the victims of Kent State and appointed a commission, headed by former Pennsylvania governor Richard Scranton, to investigate the causes of student protest. But after the Kent State crisis subsided, and in the months leading up to the midterm elections, Nixon once again caricatured student protest. And he took special pleasure when a Kent State grand jury indicted twenty-five students and no National Guardsmen in October, a legal action that he believed totally refuted Scranton's conclusion that students were alienated.[23]

The president went after more powerful targets. After a few rock-throwing protesters harassed him at San Jose State University in California, Nixon blamed not just the hurlers but "anyone who talked recklessly of revolution, anyone who has chided with mild disparagement the violence of extremism, while hinting that the cause was right all the time."[24]Nixon struck at the people he believed were "enablers"—college administrators, faculties, liberals. He assigned Vice President Spiro Agnew the task of reinforcing this message. Agnew, who specialized in alliterative invective, told a crowd that the disruptive radicals were the "pampered prodigies of the radical liberals in the United States Senate."[25] Two days before the 1970 elections, Nixon asked "the great silent majority to stand up and be counted" and vote for congressional candidates who supported the president.[26]

However potent the "silent majority" might be, its weight was not felt in the fall elections. Republicans gained two seats in the Senate (Nixon had been hoping for seven), but lost nine in the House and many governorships. Nixon blamed the results on the economy, specifically unemployment. When Nixon came into office, he vowed to reduce the 5.4 percent inflation without causing a recession. President Johnson, belatedly, had tried to control inflation, caused by the extra stimulus the Vietnam war injected into the buoyant economy, by capping federal

spending and placing a 10 percent surtax on income taxes. Nixon continued these efforts. His budgetary stringency and the Fed's relatively tight money of 1969 were supposed to reduce inflation gradually without causing a recession. But they did not. GDP declined by 2.2 percent during the fourth quarter of 1969 and another 1.4 percent in first quarter 1970. After virtually no growth in the second quarter, the economy picked up in the third quarter, but then fell dramatically in the fourth. Like night following day, unemployment, which was 3.4 percent when Nixon took office, rose to 6.1 percent in December 1970, and was even higher among blue-collar workers.[27] Nixon had hoped that his attacks on radicals and call for law and order would trump the bad economic news. They did not. *New York Times* columnist R. W. Apple called 1970 "the year of the non-emerging Republican majority."[28] San Jose, California, where the stone-throwing incident occurred, went Democratic. It was not because the people were with the dissenters; rather, the layoffs at the local Lockheed plant counted more than law and order did.[29] Nixon would not make the same mistake again. He acted to make certain that the economy was his number one priority as he prepared for the 1972 elections.

THE RETURN OF THE ECONOMY

Nixon set a goal in 1971 to reduce the 5.9 percent unemployment rate to 4 percent by the 1972 presidential election, a goal that led him to announce publicly that he was a Keynesian. Nevertheless, most economists concluded that Nixon's frugal budget would hardly budge either the GDP or the unemployment figures. The president's advisers were divided. George Shultz, now the head of Office of Management and Budget (OMB), wanted to continue the tight budgets and modest monetary expansion. After all, inflation had risen to over 5 percent in 1970, but now it was down to a little more than 3 percent. Additional stimulus would simply reignite inflation. Shultz's mentor, the monetarist Milton Friedman, also told the president to stay the course.[30] Fed chief Arthur Burns, the man with his hand on the monetary spigot, also preferred restraint.[31] The opposition was in the Council of Economic Advisers (CEA). Chair Paul McCracken believed that the economy needed more fiscal and monetary stimulus. CEA member Herbert Stein was even more insistent, predicting mediocre economic performance. Nixon was, for the moment, indecisive. His political understanding of the unemployment rate made him eager to reduce it. Yet George Shultz, whom Nixon had come to admire, told him to continue the inflation fight.[32]

If this had been simply a debate about the domestic economy, it is likely that the president would have kept to gradualism. But Nixon did not consider just the situation at home. Nixon's second Secretary of the Treasury, John Connally, appointed in February 1971, warned, "We are in trouble overseas…. Anybody can topple us—anytime they want—we have left ourselves completely exposed."[33] Connally referred to the nation's depleted gold supply. Nixon, like most presidents, had been only too happy to delegate such problems to subordinates. "I do not want to be bothered with international monetary matters … and I will not need to see the reports on international monetary matters," he told Henry Kissinger in 1970. Kissinger, too, preferred to let someone else read the reports. His aide Fred Bergsten recalled that "working as an economist

for Kissinger, was comparable to being in charge of the military for the Pope."[34] So Nixon designated Arthur Burns, his economic counselor, until the president made him Fed chair in February 1970, to monitor those monetary reports. Nixon placed trade policy in the same category. As he put it, "it won't make a lot of difference whether we move one way or another on the glass tariff."[35]

But by the middle of 1971, Nixon himself began reading reports on international monetary and trade matters because he became convinced that both questions went to the heart of the economy that seemed resistant to the employment growth he required for 1972.

CURRENCY RULES

Currency rates linked the universe of traders. Money markets, where people buy and sell national currencies, exist because international traders need them. If an American wanted to buy a French machine, she would need to buy francs to pay for it. She would sell dollars for francs in the foreign exchange market. After World War II, exchange rates were fixed, by agreement at the Bretton Woods conference, to avoid the competitive devaluations of the 1930s. As Europe and Japan regained their industrial prowess, the U.S. dollar became overvalued because currencies were fixed. The expensive dollar meant that U.S. exports became more costly and U.S. tourists stayed in grand European hotels at bargain rates. Declining exports were more important than upbeat tourists. Beginning in the 1950s and escalating during the 1960s, the U.S. trade surplus disappeared. That surplus "paid" for military expenditures abroad and net foreign investment. When the surplus went, the U.S. balance of payments turned negative. The deficits were financed by the creation of liabilities: dollars.

The dollars became, willy-nilly, the major reserve currency, lubricating growth everywhere. In the Euro-dollar market big sums moved from one country to another in search of profit after 1958, when European currencies became convertible, meaning that they could be bought and sold freely.[36] Speculators, short-term investors, moved money quickly in response to differences in national interest rates. This global activity was unregulated. Deposits in London branches of U.S. banks were not subject to reserve requirements applicable to those at home; ceilings on interest rates did not apply to overseas deposits. This was not simply an American problem. The British, French, and Italians experienced currency crises throughout the 1960s.[37] Any hint that a currency was overvalued or undervalued triggered huge trades out of or into that currency. These speculative flows made it difficult for central banks to maintain exchange rates. Fixed rates married to the free movement of capital spelled trouble and made it difficult for countries to

maintain independent monetary policies. Any attempt to set interest rates, say, below world levels because of a domestic slowdown would result in the movement of capital out of that country.

Like all countries, the United States had used capital controls to stem the outflows of capital in the 1960s. President Kennedy instituted the Interest Equalization Tax, a 1 percent levy on foreign security issues in the United States, to level the cost of borrowing in the United States and Europe without raising long-term interest rates for domestic borrowers. President Johnson expanded the kinds of loans covered and started a voluntary program to restrain foreign loans and foreign direct investment. The first imposed ceilings on loans to foreigners by U.S. financial institution while the second restricted the availability of funds from U.S. companies to their overseas affiliates. The government tightened limits on the value of duty-free goods that American tourists could bring back to the United States. These measures plugged some of the holes in the dike.[38] Still, banks found ways to evade controls.

In 1970, to counter the recession, the Fed reduced interest rates. The high U.S. interest rates of the late 1960s, set to restrain inflation, kept money at home. Now the low rates in the United States reversed the money stream, and capital flowed from the United States to Europe. (Nixon opposed capital controls.) Making matters worse, in 1971 the United States suffered its first merchandise trade deficit since 1893. U.S. dollars swelled world reserves in 1970 and 1971, and American gold reserves dwindled. The dollar was the sun around which the other currencies revolved, and now it was in trouble. Countries could demand gold for dollars under the rules of Bretton Woods. Anticipating that the dollar would be devalued, meaning its gold value would be reduced, nations might trade their dollars for gold. If they did, the United States would have to restore its gold reserves. To do this the government would have to raise interest rates, cut spending, and drive the economy into recession or impose barriers on imports until a trade balance was restored. The situation was like that faced by gold standard nations in the 1870s and 1880s. But the experience of the Great Depression ruled out

deflation. This was obviously true for the United States, but it was also true for Germany and Japan, which depended upon the U.S. market for its exports-led growth.[39]

The world was awash with solutions for fixing the system, among them returning to the gold standard, creating a new reserve currency, and finding better means of addressing deficits and surpluses. But nothing was done because Europe and the United States each nursed its own grievance and failed to see the other's complaint. The Europeans, led by the French, believed that the reserve currency role of the dollar encouraged American businessmen to buy up European industries and allowed the U.S. government to spend beyond its means. Yet they benefited from the overvalued dollar. The French finance minister admitted that if the choice was between inflation (the result of U.S. deficits) and a parity adjustment (a cheaper dollar), he would prefer inflation. A cheaper dollar would reduce the competitiveness of French export industries. The governor of the Bank of Italy acknowledged that "the basic cause of current monetary and other economic problems is the mercantilist approach adopted by most countries over the past decade or more. Other countries have allowed exports to lead their economic growth and enjoyed the U.S. deficit while complaining about it."[40]

To return to a pegged exchange rate system, which they claimed to prefer, Europeans would have to agree to symmetrical adjustment, imposing obligations on surplus and deficit countries alike. But the Bretton Woods system had come to depend on adjustment by deficit countries alone, and that is why it broke down. Like the Chinese position today, the Europeans and Japanese rejected the notion that surplus countries should bear their share of adjustment. They feared that revaluations of their currencies would depress exports, output, and employment. The United States looked at the situation differently. During the Kennedy-Johnson years, the government supported the value of the dollar, fixed by the Bretton Woods agreement. Now government officials questioned that policy because they came to believe that the dollar was overvalued, leading to declining exports and jobs. James Schlesinger,

head of the Office of Management and Budget (OMB), thought that the overvalued U.S. dollar, by encouraging imports and discouraging exports, explained why the American economy had become dominated by producers of services, not goods.[41]

TRADE TALK

The U.S. consensus on the overvalued dollar was not matched by a consensus on trade. Most nations viewed trade policies to be fundamental because they affected the nation's top policy priority—strong domestic economic performance. Each had a trade ministry to promote exports. The United States did not. Many parties—Treasury, State, Commerce, Labor, Agriculture, the White House, etc.—had a say in any trade decision. Initially, trade was handled by the State Department. But because Congress objected to State's foreign policy priorities, it created the Office of the Special Trade Representative (STR) in the White House in 1962. But the STR was at best a broker, and the White House and State were usually behind strategic priorities—the revival of the European and Japanese economy to prevent Communist inroads—not economic goals. The American market was the huge carrot that solidified Cold War alliances, and the State Department sliced it up. The trade deficit was an inevitable result of the policy even though the United States had traditionally used its trade surplus to pay for foreign aid and military expenditures. President Kennedy had been alert to the problem, but the critics of the Kennedy Round were right; it did not reverse trade trends. From 1962 to 1972 the payments deficit grew from $3.6 to $11.2 billion.[42]

Nixon, like most politicians schooled during the Cold War, was a free trader. In 1968, however, trade became a political issue for him. In return for the support of Senator Strom Thurmond of South Carolina for his presidential nomination, Nixon promised to do something for the textile industry, which was threatened by escalating imports. He acted in response to a political promise, not to a vision of domestic economic development. Meeting with key textile CEOs in August 1968, Nixon agreed to better enforce the long-term cotton textile agreement negotiated by President Kennedy and to extend the same concept of voluntary quotas with foreign countries to man-made and woolen textile imports. Textile industry leaders, in turn, raised huge sums for a special campaign in key

southern states.[43]

Textiles were the exception. The president reiterated his commitment to free trade and in 1969 proposed new trade legislation to give him the authority to further reduce tariffs. But in a sign of the times he also asked for liberalization of the escape clause of the trade law, which protected domestic producers from injury. Free traders had tightened the clause in the Trade Expansion Act of 1962 so that few applicants ever got relief. Nixon also wanted more trade adjustment relief for workers and businesses injured by trade. Although the act had authorized assistance to workers who lost jobs as a result of trade concessions, Kennedy had accepted the provision simply to ensure labor support for the legislation. He believed that the new jobs coming from trade would absorb any dislocation. The U.S. Tariff Commission seemed to agree with the president. It was not until late 1969 that the commission found any worker who was eligible for assistance.[44]

Because a chorus of complaints was overwhelming the free trade message, Nixon reminded his NSC advisers that they "should take greater cognizance of the problems of U.S. businessmen and their concerns abroad, even when ultimately they may have to be over-ridden by foreign policy considerations."[45] But it was not so easy to substitute palliatives for substance now. First, getting the Japanese to agree to a new textile agreement was difficult.[46] Although the Europeans had quotas on Japanese textile imports, they were unsympathetic to the U.S. cause.[47] The president needed their help to implement any agreement with the Japanese. Europeans would have to refrain from raising their own barriers against Japanese textiles for the U.S. to gain from Japanese restraint. But first he had to convince the Japanese. Nixon thought he had an agreement with Japan's prime minister, Eisaku Sato, who had met with the president in California at the end of 1969. The United States would return the island of Okinawa to Japanese control in exchange for a voluntary agreement to limit textile exports to the United States. But at Sato's request, the trade accord was not publicized, and when the prime minister returned to Japan he reneged after heavy pressure from Japanese textile

CEOs.[48]Nixon was furious but unable to do anything. The U.S. industry turned to Congress for help.[49]

Wilbur Mills, chair of the House Ways and Means Committee, began hearings on a trade bill, which, among other things, contained quotas on imports of woolen and synthetic textiles. The quota would equal the average of 1967–68 imports but would be superseded by any voluntary agreement which might be negotiated. On May 11, 1970, the president came out against the law, although he said he would consider quotas if negotiations failed.[50] After meeting with Roger Milliken and other textile leaders, the president reversed course. He now said that he would accept the bill, provided that the quota legislation included textiles only.

But other industries, such as footwear, were pressed by imports. Footwear imports had risen to 35 percent of the market. But the shoe question threatened primary Cold War interests, or so his foreign policy advisers told the president: shoe quotas would produce "a major confrontation with the European Community, which would probably retaliate." Also, Spain would not renew U.S. military base leases because shoes were Spain's leading export to the United States. Kissinger predicted "new gains for the Communists in Italy since shoe (and textile) production is centered in the 'red belt.'" And the cutback in European exports would create new unemployment, which would be blamed on the United States. Finally, quotas would encourage protectionism far and wide and ravage foreign policy everywhere.[51]

These gloom and doom scenarios cut no ice in the Congress. The president lost control, as the legislators larded the bill with quotas, and it passed the House. Congress adjourned before the Senate could act. Nixon was lucky this time, but he had misread the situation. The quotas reflected the widespread belief in Congress that the United States had gotten the short end of the economic stick and that the high U.S. unemployment was a function of the asymmetrical trade treaties negotiated by Cold War presidents. Although they inveighed against what they called protectionism, American foreign policy elites admitted privately that strategic interests had trumped economic ones in postwar

trade policy. Free trading Fred Bergsten told Kissinger "that foreign economic policy had been the handmaiden of overall U.S. foreign policy, throughout the post-war period and foreign policy considerations have dictated the U.S. position on virtually all issues of foreign economic policy." This situation "must be changed to some extent—to increase the 'economic' content of foreign economic policy." However, before anything could be done, Bergsten warned "that foreign policy should not become the handmaiden of foreign economic policy."[52] Bergsten, Kissinger, and State Department officials might agree that change was necessary, but as each item came up they always found a vital foreign policy reason that superseded economic interest.

The paralysis of the government's trade policies was structural. Nixon could not get a textile agreement with Japan partly because of the division between the State Department, which thought that "our economic relations with Japan are basically good," and most of the other branches of government, which believed they were poor.[53] All agreed that Japan was the major source of the U.S. balance of payments problems. Imports from Japan grew by 96 percent between 1967 and 1970. The growth was particularly sharp in autos, motorcycles, and office machines. In 1970 the deficit with Japan was $3 billion, and it would shoot up to $8.5 billion in 1971. But there was no unanimity on solutions.[54] The Emergency Committee for American Trade (ECAT), the lobbying arm of international business, opposed placing so much effort on textile imports when opening Japanese markets was more important. Others thought the government should offer across-the-board export incentives and impose border taxes on imports, which would not be directed specifically against Japan. Even if the Japan-only approach was chosen, the departments had different wish lists. Commerce wanted Japan to allow more American private investment, but Treasury believed, correctly, such a policy would have a negative short-run effect on the U.S. balance of payments. Most wanted Japan to raise the value of the yen, but Treasury, State, and Defense had different numerical targets. State always resisted pressuring the Japanese and believed that an agreement was around the corner. And

underlying these differences and the strategies for success was disagreement on the nature of the Japanese economy. Officials asked, “Is it a market economy or a state trading economy?”[55]

The Europeans, concerned with the expansion of the EEC, were unwilling to help unless they obtained something in return.[56] They promised not to raise their own barriers on Japanese goods in the wake of a voluntary U.S.-Japanese textile agreement, but only if the United States maintained the current escape clause, which made it difficult for U.S. producers to obtain protection. From the American point of view, such a situation did not alter the structure of disadvantage, and further, the United States had many other problems with the EEC, whose agricultural policy not only supported commodities, but imposed variable import levies, set so that no foreign commodity could undersell the EEC product. This one regulation reduced agricultural exports to EEC countries 47 percent since 1967.[57] Grain exports fell from twelve to four million tons. The community stated bluntly that the elaborate protections for its agriculture were not negotiable.

Americans had other complaints. The six EEC nations levied duties against U.S. goods while collecting none from each other. Its enlargement and special arrangements with Spain, Israel, and other Mediterranean countries, all nonmembers, had the effect of shutting the United States out of those markets.[58] France, especially, used these arrangements to extend its political, commercial, and cultural influence. Nevertheless, they violated the EEC’s most favored nation commitment, endangered U.S. agricultural exports, and threatened to worsen the U.S. balance of payments deficits. But the EEC, dominated by internal problems and concluding that trade benefits were the best cement for European unity, would not budge. Finally, the GATT permitted indirect or sales-type taxes to be rebated to exporters and levied against imports but did not allow this to be done with such direct taxes as corporate income tax, the levy used in the United States.[59]

So Bergsten reminded Kissinger that “U.S. trade partners also needed to take free trade initiatives to help hold protectionism at bay.” The EEC

was "blatantly violating the international rules of the game in (a) agricultural policy, (b) the proliferating preferential arrangements with non-member states, and the nascent 'Community industrial policy.'"[60] But Kissinger told Nixon that the EEC could not address the agricultural issue while the negotiations for the entrance of Great Britain in the community were ensuing. The State Department desperately wanted Britain to join to counter French influence. While Nixon agreed, he added, weakly, "But the emphasis must be on U.S. interests. We cannot continue to sell out U.S. interests for State's foreign policy consideration."[61] The president warned Kissinger, "It seems to me that we 'protest' and continue to get the short end of the stick in our dealings with the community. Agriculture is a prime example—the Congress is simply not going to tolerate this too passive attitude on the part of our representations in such negotiations."[62]

Nixon wet his feet on textiles, but numerous complaints from labor, business, and Congress convinced him that trade posed deeper questions. On January 18, 1971, Nixon asked the new director of the Council on International Economic Policy (CIEP), Bell and Howell chairman Peter Peterson, a prominent free trader, to examine American foreign economic policies.[63] Nixon ordered a thorough review of trade policy and even wondered whether foreign investment is "good or bad for the United States."[64] In April Peterson gave the president grim news: the nation's economic superiority was gone and other industrial nations pursued their economic interests more vigorously than the United States did. He recommended reversing priorities: economic interests should take precedence over diplomacy. Then, the blue-ribbon Commission on International Trade and Investment Policy that Nixon created earlier in 1969 confirmed the gloomy conclusions, but offered a different solution. Chaired by Albert Williams of IBM, the commission urged Europe and Japan to assume some of the burdens of the international economic system that the United States shouldered alone. It called for exchange rate changes to end the trade deficit. But the commission's main suggestion was to propel the free trade, free capital project and

"eliminate all barriers to international trade and capital movements within twenty-five years."[65]

The commission's two labor members, I. W. Abel of the United Steelworkers of America and Floyd Smith of the International Association of Machinists, dissented, finding that capital movement was the problem. Abel, citing a government report, said that American capital abroad increased 31.5 percent compared to 7.4 percent in the United States between 1969 and 1971. This outflow was a major reason why labor productivity and growth rates had fallen absolutely and in comparison to EEC countries.[66] Unlike the official reviews, the labor movement indicted multinational firms for going abroad to produce for the American market. It pointed to Bendix stranding 600 employees in York, Pennsylvania, to open a plant in Mexico in 1970. In the same year, Warwick Electronics moved 1,600 jobs from Zion, Illinois, to Mexico and Japan. General Instrument shut down two plants in New England while retaining 12,000 workers in Taiwan. RCA transferred an operation from Cincinnati, which employed 2000, to Belgium and Taiwan.[67] And so it went. In 1969, the AFL-CIO had broken with its past and concluded that the "old concepts and labels of free trade and protectionism have become outdated in this world of managed national economies, international technology, skyrocketing rise of U.S. foreign investment and growth of multinational companies." In September 1971 the AFL-CIO would sponsor legislation, introduced by Senators Vance Hartke and James Burke, that used tax measures to discourage production abroad and gave the president authority to regulate the outflow of U.S. capital.

The labor movement did not simply indict the American multinational. U.S. companies went abroad because they could not export goods into protected markets. Thus, labor demanded more vigorous government efforts to eliminate import barriers in foreign nations. And it wanted systematic enforcement of U.S. trade laws to protect against dumped and subsidized goods.[68] Enforcing the antidumping act of 1921, which penalized imports sold at less than the selling price in the home market, was a low priority of the Treasury Department. Similarly, imports that

received a government subsidy were supposed to receive a duty equivalent to the subsidy under the countervailing duty law, first passed in 1897. The law was a dead letter. Treasury dropped cases involving politically important nations, accepted promises to raise prices, and avoided collecting duties, or simply dragged out investigations for years.[69]

In the case of milk products, the U.S. dairy industry filed a complaint against European subsidies in 1968 and requested the assessment of countervailing duties. But the case was not considered by the Treasury until 1974 and then only after a court ordered the department to hear the case. Treasury then deferred the investigation when the EEC ended some subsidies and resumed it when the subsidies were reinstated and then waived the duties when the Europeans promised to drop the subsidies.[70]Hendrick Houthakker, a member of the CEA, admitted that "there seems to be widespread agreement that complaints about long delays in handling cases are valid."[71]

Linking the expensive dollar and trade deficit with anemic growth, unemployment, and declining international power breathed life into the economic issue, anaesthetized by affluence. Peter Peterson made those connections for Nixon, and his recommendations went beyond new trade and foreign investment policies. Peterson thought the country would have to plan more because the world was more competitive. Governments abroad regularly intervened and propped up key industries. The U.S. government had aided the aircraft, nuclear power, and satellite communications industries. But these efforts were piecemeal. Many industries lacked sufficient capital because of the length of the payout to profitability. Companies ignored opportunities that would benefit the nation in the long term. In other words, the market often was not a reliable barometer for long-term growth, a problem Keynes did not address. Peterson thought that a tripartite committee—composed of business, labor, and government —should determine how to insert a planning mechanism into government. The American problem, he said, was that there was no central forum for reviewing such proposals.[72] But

the planning idea was overtaken by the developing currency crisis of the summer of 1971. And the president found a new counselor who offered a cocktail that promised quicker solutions to all of the American problems.

THE END OF BRETTON WOODS

Nixon's guru was the former governor of Texas, Democrat John Connally, a protégé of Lyndon Johnson. The son of a sharecropper, the young Connally had honed his political skills at the University of Texas, where he was elected president of the student body. He had been a navy commander during World War II. President Kennedy appointed him Secretary of the Navy in 1961, but Connally returned home to run, successfully, for governor of Texas the next year. He was in the limousine with Kennedy in Dallas and was struck by one of the bullets fired at the president. Connally was practicing law in Houston when Nixon selected him for an elite committee on executive reorganization. Nixon was attracted to Connally's ability to forge bold solutions to bureaucratic quagmires. But there was more. "The President's in love again," observed Nixon's speechwriter William Safire.[73] It was not Connally's economic views that had smitten Nixon. It was the Texan's self-confidence and charisma, qualities Nixon lacked. And, Connally could play a big role in Nixon's plans to reshape American politics. Connally had no future in the liberal Democratic Party, but a bright one in Nixon's projected conservative party. So Nixon wooed him, making him Secretary of Treasury in February 1971 but dreaming that he would be his running mate in 1972.

The financial troubles of 1971 guaranteed that the Treasury and Connally would be front and center of U.S. policy making. It is often said that it was the Texan's nationalism that appealed to the president. Connally allegedly told an assistant, "My philosophy is that all foreigners are out to screw us, and it's our job to screw them first."[74] But his critique of European and Japanese mercantilism, expressed more politely, was widely shared by Peterson's and Williams's appraisals. In March 1969, before Connally's appointment, even Treasury concluded that "Japan, along with Germany and other major surplus countries, must bear a very substantial part of the required payments adjustment."[75] There was a consensus. Everyone agreed that the overvalued dollar and the trade

deficit eroded U.S. economic and thus its international power. No one argued that the current account should be balanced by deflating the economy, producing a recession to reduce imports. No one wanted to diminish the scope of foreign policy to rein in the outflow of dollars. No one advocated intensifying or expanding capital controls. No one supported outright devaluation because other countries would simply devalue their currencies.[76] Connally did not create the idea that American foreign policy privileged strategic over economic interests and was not the first to discover the link between the domestic and international economy.

But unlike the diplomats at State and Treasury, Connally did not sugarcoat his criticism. He was not reluctant to point out the contradictions in European grievances, informing the German finance minister that the French government "had told a major U.S. manufacturer that he could not sell in France unless he built a plant there. At the same time France constantly complains about U.S. foreign investments."[77] Connally stated the Americans' core beliefs directly and undiplomatically. He told the world's leaders of high finance at the annual meeting of the International Monetary Conference in Munich on May 28, "Something had to be done." Net U.S. military expenditures abroad exceeded the U.S. balance of payments deficit. "No longer does the U.S. economy dominate the free world. No longer can considerations of friendship or need or capacity justify the U.S. carrying so heavy a share of the common burdens. We are not going to devalue. We are not going to change the price of gold."[78] The pitch was fevered by the May figures for trade, which had deteriorated sharply. The year 1971 would see the first merchandise trade deficit since 1893, elegant proof of the warnings of the Petersons, Connallys, and the AFL-CIO.

The urgency was not simply Connally's. The trade and currency turmoil in May scared everyone. CEA chair Paul McCracken fingered the problem: "A system that combines rigidly fixed exchange rates with free trade and capital movements appears to be unworkable."[79] That was Keynes's point. Controls prevented capital from moving around, seeking

out the highest interest rate, and allowed countries to keep their rates low to achieve full employment. But McCracken's solution was not to reinstate capital controls—Keynes's preference—but to promote exchange flexibility. As a result, a preference for low interest rates would translate into a lower exchange rate. McCracken and the foreign policy people wanted to negotiate a solution at the next IMF meetings, but Connally dismissed the possibility because there was no international consensus.

In June Nixon made clear that Connally would lead and "move on the problem," not "just wait for it to hit us against—e.g. in the fall of '72."[80]Waiting could endanger Nixon's reelection. Connally overcame his adversaries' qualms and arguments and convinced the president to act, in some cases against Nixon's long-held beliefs. Treasury had been assembling a basket of currency solutions, including suspending the dollar's convertibility to gold. The recent trade numbers added a new item, an import surcharge or border tax. Although this device had occasionally been used by countries defending their currency parities, Treasury undersecretary Paul Volcker was uncomfortable about using it. Connally was insistent.[81]The Texan also believed that unilateral action was the only way to effect the changes. Connally and Nixon planned to implement these changes at the next monetary crisis. The package got an unexpected green light from Democrat Henry Reuss, chair of the Joint Economic Committee (JEC). The JEC concluded that the dollar was overvalued and that unless exchange rates were realigned the United States would have to suspend the dollar's convertibility to gold and establish new parities.[82] The administration now knew that leading Democrats would support the changes. As the JEC report circulated, the Treasury quickly asserted that it had no plans to realign exchange rates. If the action was to evade the radar of the currency speculators, it would have to be a surprise.

On August 2 the president met with Connally, who added the domestic reforms—a wage/price freeze, reinstitution of the investment tax credit, and tax advantages for exports through domestic sales corporations—to

the Treasury's currency and trade reforms. The domestic additions flowed from the international decisions. As late as June the president had opposed wage and price controls, even though the Democrats and public opinion supported them.[83] But because the import tax and closing of the gold window would be inflationary, some stronger anti-inflationary measures were necessary. The return of the investment tax credit made sense given the determination to make industry more productive and competitive. Nixon also decided to repeal the 7 percent excise tax on the sale of new cars, another measure that he hoped would encourage the demand and hence supply of autos. Each of his economic advisers needed convincing on something. Burns wanted to maintain gold; Shultz was not happy with wage and price controls, and so it went. But the whole was greater than the sum of its parts. Connally told the president that for him to be effective the American people had to believe that he had thought through the whole problem. If one piece was done, there would be speculation about what was next. Both men wanted to communicate that they were on top of the issues, which could be done only with a comprehensive program.

The resumed pressure on the dollar in early August triggered implementation. Connally and the president had all of the pieces in place, but they were presented to Nixon's economic advisers over a tense and somewhat giddy weekend at Camp David on August 13 and 14. Kissinger, up to his neck in Vietnam negotiations and uninterested in economic matters, and Secretary of State William Rogers were not there. Had they been present, both men would have spoken up for traditional foreign policy and warned about the adverse reaction of U.S. allies.[84] Nixon's speech to the nation on Sunday night, August 15, adopted the activist tone he and Connally sought. Instead of apologizing for devaluation, the package was presented as a bold new initiative, named the New Economic Policy. The results were positive. Both John Kenneth Galbraith and the NAM applauded the wage and price controls.[85]

Abroad, it was a different story. Most of the foreign media was critical. Paul Volcker was sent to London to brief the financial ministers and chief

bankers of the big countries. He reported "that they [the Europeans] did not feel anger as much as anguish that the United States had not arrived with a prepared solution to save the system [Bretton Woods]."[86] The administration was divided on the fate of the fixed exchange system. Shultz, like his monetarist mentor Milton Friedman, wanted flexible rates. Volcker and Burns sought to salvage as many of the trees of Bretton Woods as they could. Connally and Nixon, who had neither institutional nor ideological loyalties, were agnostic. Both just wanted to get the job done— reverse the balance of payments, produce prosperity, and reduce unemployment. The bold action, especially the temporary border tax, was the stick to get the Europeans to accept a big shift in exchange rates, trade liberalization, and more help on defense costs. Although publicly the Japanese condemned Nixon's "shock," privately government officials acknowledged that America's trade deficit with Japan was unacceptable and that the president had "in effect 'lanced the boil' without singling out Japan as culprit."[87] In December, Japan did revalue the yen by nearly 17 percent, more than any other nation, although movement on trade was snail-paced. Japanese officials said that they would consider removing the quotas on computers, integrated circuits, and agricultural products, which even they acknowledged were illegal under the GATT.[88]

But the old divisions returned. Robert Hormats, Kissinger's new economic aide, got cold feet. He warned that if the United States retained the surcharge, trading partners would institute export subsidies, capital controls on the inflow of dollars, or restrictions on the imports of U.S. products. Hormats's solution was to set out clearly what the United States wanted.[89] But it was not so simple. Peterson believed that U.S. and Japanese goals were "seriously incompatible." The United States could not both eliminate the trade deficit and "allow Japan to achieve *her* stated objectives of large trade surpluses."[90] Even if Peterson was correct, there was no obvious alternative to negotiating with Japan. After enjoying the ride with Connally, Nixon edged toward Shultz, who seemed to combine a more sober combination of nationalism and internationalism. Connally

had been happy to allow the power of the surcharge and the market work. He believed it would be a "mistake of major political importance" to obtain a currency realignment only.[91] Without trade changes, American prosperity would be mortgaged to a balance of payments deficit. Returning from a trip to Japan in November, Connally remarked that monetary uncertainty could continue for "an almost indefinite period" and that the United States would not suffer if it did.[92] These words produced hysteria among the foreign policy elites. Hormats warned Kissinger that Europe would become hostile and the United States would become a "scapegoat" for Europe's economic woes.[93] Leading economists across the spectrum, from Milton Friedman to Paul Samuelson, predicted a trade war if things were not settled soon.[94] Amplified by daily warnings from foreign embassies that the sky was falling, Shultz concluded at the end of October that now that "we have their attention" it was time to move on negotiations.[95] Connally and Shultz got down to work.

Nixon’s economic package attempted to alter exchange rates and open up European and Japanese markets in order to restore U.S. affluence in 1971. The surprise decisions were front-page news in Japan. (AP Images/Naokazu Oinuma)

But first the basic issues had to be decided. Did the United States want a return to the system of fixed parities after the rates were readjusted? On this, everyone said no, especially over the next two years. Only Shultz was proposing floating rates for the long term. To drive the point home, Shultz told Nixon that a return to fixed parities would mean that the only way to address a balance of payments deficit would be to deflate the domestic economy to lower prices, creating “unemployment to satisfy international pressure.” He was right. This was the solution that European bankers, especially the French, wanted.[96] Unlike the original system

proposed by Keynes and rejected by the United States then, Bretton Woods placed all obligations on debtor countries, leaving those in surplus under no obligations. Without the ability to adjust rates, fixing balance of payments deficits required deflation or import controls. Nixon instituted the second with his border tax. Deflation was out of the question. After all, the mean U.S. unemployment rate between 1970 and 1973 was 5.4 percent, while in Germany it was 0.9; Italy, 3.3; France, 2.1; and Japan, 1.3.[97]

Volcker calculated that the United States required a package capable of producing a $13-billion swing in the balance of payments. To achieve that sum, there would have to be a depreciation of 17 percent against Japan, 13 percent against Germany, and 8 percent against France, the United Kingdom, and Italy. The Americans believed that the major barrier to an agreement was the European "unwillingness or inability to recognize the size of the needed adjustment, as we perceive it."[98] The French were particularly recalcitrant because they "had a phobia on gold," Connally concluded.[99] They wanted the United States to raise the price of gold, because it would underscore that the problem was an American one, and also because many of the French saved by accumulating gold. A higher price for gold would be a windfall for them. The French responded that they had devalued the franc in 1969 and that to revalue now would be "politically impossible." But the French resistance led to other problems because the more compliant Germans could not revalue the mark if mark-franc alignments made German goods uncompetitive in France. Britain, on the verge of entering the EEC, would do nothing to anger the French.[100]

On November 23, Nixon and Connally agreed that they could yield on gold but that they should save this bargaining chip for a meeting with the French president.[101] When Connally met with the other finance ministers in Rome on November 30, he suggested the average exchange rate adjustment of 11 percent, plus progress on trade and military burden sharing. This figure was considerably less than the 15–20 percent change that would produce the $13-billion swing the United States thought

necessary. But combined with progress on trade and burden sharing, and the unstated rise in the price of gold, the United States could accept the 11 percent.[102] But no one signed on the dotted line. There was a rough sense of progress, and the Europeans promised to negotiate on trade, but the two sides were far apart on the exchange rate changes.[103]

A deal was struck at the Nixon-Pompidou summit in the Azores in early December. The French resisted at first. President Georges Pompidou told Nixon that "France is allergic to unemployment." Nixon, reminding him that the French rate was 2.5 percent while the American was 6 percent, parried, "We too were allergic to unemployment."[104] In the end, the United States agreed to raise the price of gold to $38 an ounce, an 8.6 percent change, while the German mark would be revalued by 5–6 percent and the Japanese yen 9–11 percent. The franc, sterling, and lire would remain the same. The deal was signed when the G-10 ministers met at the Smithsonian Institution in Washington on December 17–18, and Nixon called it "the most significant monetary agreement in the history of the world."[105]

If so, the markets did not concur. Almost immediately, the dollar declined in value, and the whole arrangement collapsed in a little more than a year. To the consternation of the French, the United States did not intervene to support the dollar. Pompidou had assumed that the United States would secure the parities agreed upon at the Smithsonian. But the dollar declined as a result of the lack of confidence in financial markets that the U.S. balance of payments would improve because the United States had not concluded trade agreements with Japan, Canada, and the EEC. At the time, U.S. interest rates were low because the Fed was increasing the money supply to boost the domestic economy.[106] This produced a money exodus from the United States to Europe. Pompidou was not shy about complaining and told Nixon that the U.S. budgetary deficit and low interest rates were at fault. Nixon defended his course of action, which he claimed would produce a prosperous United States and then strengthen the dollar. He expressed his own disappointment that the EEC had taken the decision to raise agricultural levies, in essence

denying the normal competitive benefits of a devaluation that would have accrued to U.S. agricultural exports.[107] Indeed, the trade negotiations were going nowhere. Connally told the president that the Canadians were giving nothing, the Europeans little, and the Japanese small items that added up to very little.[108]

Shultz, who succeeded Connally as Treasury secretary in May 1972, put his finger on the problem. Despite the celebration at the Smithsonian last December, "We cannot assume present exchange rates are satisfactory." The U.S. trade and balance of payments positions were still weak, which meant that supporting the dollar was out of the question.[109] Although the Europeans blamed Connally for U.S. policy, the sober Shultz, who believed in floating values, was not so far away from the flamboyant Texan. The monetary waters were calmed when Fed chief Arthur Burns intervened in July to defend the dollar, buying them with foreign currencies.[110] Still, the shape of the monetary system was in flux. The longer the issue was postponed the more likely it would be resolved by accepting fluctuations and nonconvertibility of gold.

In the end, the trade issues were also deferred and the Europeans and Japanese agreed only to a new round of trade negotiations, which began in 1974. After the Smithsonian agreement, Nixon returned to his first love, strategic policy. The China and Soviet summits dispatched the trade issues to their traditional, subordinate place in U.S. foreign policy. Even at the Nixon-Pompidou meeting, the first morning had been spent discussing the Soviet Union, China, détente, and Germany. In September 1972, when told by his advisers that EEC trade preferences were even more questionable legally and damaging to U.S. interests, Nixon said, "Nevertheless, the political aspects of our relations should be overriding…. Trade is part of a bigger package…. [W]e have to treat Japan with 'tender loving care' since what Europe could become to the Soviets, Japan to China would be even more. That means we may have to give more than our trade interest, strictly construed, would require."[111] In any event, Nixon concluded, referring to the high Japanese tariffs on computers, "Computers were not politically important."[112] So ended the

experiment in foreign economic policy. None of this was announced in 1972 because of the elections. Nixon told his aides that it should be crystal clear that the administration was protectionist. If any person claims that the United States was yielding on its economic interests, "we will repudiate it."[113]

Did the border tax and depreciation further the nation's economic interests? Labor and business delivered mixed verdicts. The AFL-CIO thought that exports were more affected by economic growth abroad than by the price of U.S. goods. "Business practice and trade flows do not depend on prices alone because prices are not the only reason for importing and cost differences here and abroad or mark-up on imports may be very great." Then, many items were exempt from the duty. Only 23 percent of U.S. imports from Canada were taxed and the Canadian government quickly adopted a subsidy for affected firms. Although some U.S. exporters benefited from the cheaper dollar, Chrysler, which manufactured its Colt car in Japan, benefited from the stronger yen. It got more dollars from each sale of the Japanese-made car in the United States.[114]

The reaction of members of the elite Business Council was mixed. Almost a year later, in September 1972, many concluded that the favorable effects of the cheaper dollar were trumped by other factors. IBM thought that the Smithsonian agreement reintroduced stability, allowing it to better plan its international business operations. But the subsequent downward float of the pound and increasing controls on foreign exchange and capital flows instituted by some European countries undid some of those benefits. Foreign competitors of its dictating equipment cut prices to of set the effects of the currency realignment. The effects for General Electric were also mixed. Lower prices were important for some products, but not for the sale of nuclear power plants because the technology was not available elsewhere. Different equipment standards, tariffs, government procurement policy, or other nontariff barriers, not price, often prevented GE from selling abroad. "We are still a long way in many countries from being able to compete on a free and

fair basis."

Deere & Company, which manufactured agricultural equipment, was unsure whether the increase in its export volume was due to improved overseas economic conditions or the realignment in exchange rates. Its executives, like those from GE, thought that "import restrictions designed to protect or encourage domestic manufacturers or to conserve scarce foreign exchange, particularly in the developing countries," limited exports more than exchange relationships. On the other hand, Deere found that the costs of components exported from the United States had been reduced, making it more profitable to produce abroad. This result was not what Nixon and Connally had in mind.[115]

The crisis revealed a new competition among makers of tradable goods, mainly manufactured items. The currency changes did not automatically increase U.S. exports because nations and companies possessed an array of tools to mitigate the effects of currency changes. Peter Peterson believed that "had we [the United States] not taken that very vigorous action on the dollar, it was the sure road to protectionism."[116] Whether or not devaluation prevented a more thoroughgoing revision of U.S. trade policy, it and the worldwide boom in 1972 and 1973 eased the crisis. The U.S. trade deficit grew in 1972 and fell in 1973, largely because of booming markets elsewhere. The trade deficit with Japan followed that pattern. The Japanese government had removed many quotas and announced plans to liberalize tariffs on computers and peripherals in 1975. Still, cyclical more than structural changes accounted for the growth of U.S. exports to Japan.[117]

The brief Nixon-Connally effort to change the rules of trade was a bump in the road. The Trade Act of 1974 furthered the liberalization project and also muted criticism of the global agenda by increasing trade adjustment assistance, liberalizing the escape clause, and facilitating countervailing duties. It redirected victims from the friendly, quota-prone Congress to politically insulated bureaucratic agencies like the Tariff Commission. The legislation introduced "fast track" procedures, requiring Congress to vote up or down but not amend the agreement, and

gave the U.S. government the power to reduce nontariff barriers to trade, now seen by the Americans as a key barrier to U.S. exports.

It was consequently no surprise that, with the exception of the recession year 1975, the trade balance was in deficit for every subsequent year in the twentieth century and thus far in the twenty-first.[118] The deficit was structural, continuing in good and bad times, in years of balanced budgets, and in years of budget deficits. Experienced hands believe that the global crisis in 2008 and 2009 was caused by the deficits of the United States and the surpluses of China, which took the place of the Japan of the 1970s.[119] But that future was invisible. In 1972, GDP rose 5.4 percent and unemployment was 5.6 percent, down from the 5.9 of 1971. Thanks to the wage and price controls inflation fell to 3.2 percent. The president’s actions in August 1971, boosted by the global boom, rejuvenated the politics of the affluent society for at least another election, that of 1972.

CHAPTER THREE
1972
THE LAST ELECTION OF THE 1960s

DEMOCRATS AND REPUBLICANS ignored the economic turmoil of 1971 during the presidential election of 1972. The scripts were written from memories of 1964 and 1968 and from consciousness of the overwhelming ascendancy of the Democratic Party. In 1972 Democrats outnumbered Republicans by nearly 2 to 1.[1] Democrats felt free to fight for control of what they believed was the nation's governing party, cast out temporarily in 1968 by the public's disgust over Lyndon Johnson's war in Vietnam. Aided by rules that opened the race to outsiders by reducing the role of party officials, the reform Democrats nominated Senator George McGovern, who had polled only 3 percent in the beginning of 1972. Republicans sat tight. The memory of the Goldwater loss in 1964 kept them disciplined behind President Nixon. The president ignored his party, hoping to peel off portions of the Democratic electorate to produce a majority that GOP numbers alone could not generate. McGovern made that task easier than anyone had expected.

POST-1968 DEMOCRATIC PARTY REFORM

The fight over Vietnam at the 1968 convention transformed Democratic presidential politics for 1972. First, the battles lived on in platform committees, on the campaign trails, and in the press, reinforcing the party's social, class, and policy conflicts. Second, the antiwar activists launched a "New Politics" movement, which eventually changed the party rules, making it easier for the young, racial minorities, women, and middle-class pressure groups to influence the presidential nomination. Third, the reforms produced new party leaders who thought that the liberal middle class could win elections without the party's historic constituencies. New Politics activists omitted labor from their coalitions, believing that unions had done their work in raising the standard of living but now were a conservative force in U.S. politics. The reformers ignored the white working class and embraced the poor and minorities; it wrote off the South and went after northern and western suburban voters, the heart of their movement. They were a middle class rooted in postindustrial sections of U.S. society.

In 1968, the reformers had created the New Democratic Coalition to unite Kennedy and McCarthy followers to change the way presidential candidates were nominated. As New Politics advocates, the reformers believed that party regulars, not the people, had anointed Humphrey. Most of the convention delegates were chosen by party leaders through committees or conventions. In the words of Connecticut's John Bailey, Democratic National Committee (DNC) chair from 1961 to 1968, "I go with the bird that can fly, not with the pigeon that can't get off the ground."[2] George McGovern put it differently. "The Democratic presidential nominating process was dominated by party wheel horses, entrenched office holders, and local bosses."[3] Believing that leaders like Bailey had marginalized antiwar activists, the reformers aimed to institute a participatory or primary system that cast out the regular state party organizations and their leaders. New Politics reformers aimed to purify politics. They echoed middle-class progressives in the first

decades of the twentieth century who felt shut out of politics dominated by party bosses. The progressives' solution had been more primaries, popular election of senators, and other direct expressions of public sentiment through referenda, recalls, and the like. With such changes, the citizens, people like themselves, enhanced their own power in politics.

Current reformers also believed that party bosses had marginalized them and offered similar solutions, more participation, and more primaries. Of course, much had changed since the early twentieth century. The Democratic Party after FDR was not the boss-dominated entity of the muckraking era. But the New Deal had also weakened the party. Non-discretionary income supports such as social security, unemployment insurance, and public employment replaced the proverbial Christmas turkey and jobs with which the ward boss rewarded the party faithful. Still, the party possessed plenty of offices and contracts to reward loyalty. And, its association with labor unions and desire for victory kept it as close to the popular pulse as the machines of old.

The reformers followed a different muse. They pursued the public good, not a plurality of interest groups. Independence from what they considered the downward pull of mass constituencies was an asset, not a liability. The New Deal, once a badge of honor, was now a hurdle to be transcended. The party reformers understood that changing the rules of politics changed incentives for politicians, behavior, and, thus, political results. They hoped to use the party to take their issues beyond the college campuses and liberal magazines, all the way to the White House.

The reform process began at the 1968 convention when a group of Kennedy and McCarthy supporters convinced party officials to create a new commission to investigate the way the party selected delegates. The new DNC chairman, Senator Fred Harris of Oklahoma, did not appoint any party regulars to the commission, which was formed in February 1969. Harris explained in 2003, "I made up the membership of the commission in such a way as to ensure that they would come up with what they did come up with."[4] Headed by Senator George McGovern of South Dakota, the body reported in April 1970. It decided to

revolutionize, not reform, the process. The bitterness of the Vietnam issue, the violence of Mayor Daley's police at the Chicago convention, and the assumption that the young and women were antiwar triggered the changes. The reformers aimed, not simply to increase participation—which was their charge—but to strike at the regular party. Harris and many members, like chair McGovern, came from states that lacked strong Democratic parties; indeed, many lacked Democratic voters. These state parties were so weak that there was little resistance to the takeover by independent activists. James Lengle and Byron Shafer observed that the western states, which spawned many of the reformers, fostered pure political styles.[5] They were more liberal than social democratic.

In the older states, the reformers were suburban. None of the report's authors was a product of regular party politics or of traditional constituencies. Sometimes the political purpose of the project slipped through the high-minded rhetoric. Political scientist Sam Beer, a staff member, noticed that in the regional meetings in Philadelphia, Chicago, Atlanta, and Saint Louis, there were few blacks or people from cities. "This was really a suburban white middle class movement," he said.[6] That was the logic—to expand the base of the New Politics from the universities to the suburbs. In Pennsylvania, the heart of Democratic reform was the suburban areas around Philadelphia and Pittsburgh, plus College Park, the home of Penn State, areas normally Republican in state and national elections.

A decent respect for Democratic opinion required Harris to appoint some labor representatives to the commission. He chose Walter Reuther of the United Auto Workers and I. W. Abel of the United Steelworkers of America. The autoworkers had left the AFL-CIO in 1967, so it seemed balanced. But labor leaders usually did not have the time to attend such meetings. The commission permitted Walter Reuther's director of political action to sit and vote in his place. It did not extend that courtesy to Abel, who, unlike Reuther, was not behind the reform effort. Abel ended up leaving the commission. Both McGovern and Fred Harris knew that this was a mistake, but, seeking to gain and retain the support of the

activists for presidential runs, they were silent. And so it went.[7]

At meetings on November 19 and 20, 1969, the commission made three major changes. First, state parties would have to comply with its rulings. Second, women, youth, and blacks would have to be represented in numbers in "reasonable relationship" to their demographic presence. (The reformers ignored characteristics that traditionally distinguished Democrats from Republicans: class, income, and occupation.) Finally, state central committees could appoint only 10 percent of the delegates. Thus, state parties would no longer control from two-thirds to four-fifths of the delegates.[8] To comply with these rules a number of state legislatures instituted new primary elections or open party caucuses. The presidential primary became the key route to nomination. In 1968, sixteen states held primaries; by 1972, twenty-eight did, and the number was thirty in 1976.

How was it possible for the amateurs to defeat the pros? First, the initial charge to open up the party to more participation seemed benign. The mandate was transformed by the staff, which ran rings around the commissioners. Eli Segal, a young lawyer from Brooklyn, and Ken Bode, a young political scientist from South Dakota, were both ardent McCarthyites. Chair McGovern, eyeing the nomination in 1972, did not want to alienate the reformers, whom he saw as the base for his campaign. And the party, now led by Larry O'Brien, decided to bargain with the reformers.

O'Brien's history explains his course. He had been an assistant to John Kennedy, Postmaster General for Johnson, Robert Kennedy's campaign manager once Johnson decided not to run, and head of candidate Humphrey's DNC. This resume, the ability to work for every major Democratic politician during the 1960s, testified to his professionalism and party loyalty. After Humphrey's defeat, O'Brien stayed on at the DNC until 1969, when reformer Fred Harris was elected chair. It was Harris who received the reform commission report, but he left the DNC at the end of 1970, when he decided to run for president himself. The faithful O'Brien returned to head the DNC and implemented the report.

Determined to keep the party together, neither he nor the state party leaders mobilized against the changes. O'Brien explained, "We [the Democrats] had lost in 1952 and 1956 and remained reasonably united. But in 1970 the bitter divisions of 1968 still existed—hawk versus dove, liberal versus conservative, reformer versus regular and no reconciliation in sight."[9] The desirability of maintaining short-run party unity overcame any doubts he might have had.

Finally, the reformers were nurtured by the citizens' culture of the late 1960s and early 1970s. New organizations focused on opening up the political process through institutional reform, not mass mobilization. The most important was Common Cause, created in August 1970 by John Gardner, a Republican who had been Secretary of Health, Education, and Welfare under President Johnson. Gardner explained that he organized Common Cause because Washington, D.C., was "teeming with special interest groups." He added, without irony, "Everybody's organized but the people." Within six months, the group had more than 100,000 members, many of them reform Democrats and opponents of the Vietnam war. Common Cause aimed to reform the Congress, voting laws (initially by lowering the voting age to eighteen), and the parties.[10] The new head of Americans for Democratic Action, Allard Lowenstein, made registering the young its principal project in 1971. Lowenstein hoped for a bonanza after the Twenty-fifth Amendment reduced the voting age to eighteen. Another effort was the Center for Political Reform, led by Ken Bode, who helped write the party rules and now was determined to implement them. The center was funded by millionaire Stewart Mott, heir to a General Motors fortune and perennial banker of liberal causes.

The new organizations were officially nonpartisan and assumed that they each represented a public interest. One study of eighty-three public interest groups found that 30 percent had no members at all, only lobbyists. Of the rest, 57 percent had no structure that elicited public opinion.[11] The best example was the Ralph Nader organization Public Citizen, founded in 1971 to represent the consumer, uncontaminated by special interests. Public interest advocates claimed that public policies

affected many who were unrepresented—the people, the consumers, the citizens.[12] They fostered the belief that government cannot protect the people but only active citizens, generally wielding a lawsuit and not a ballot. This anti-institutional ethic was embraced by the Democratic political reformers. Both were miles away from New Deal practice, dependent upon a strong party and government institutions.

The demographic obligation of party reform was reinforced from the outside. Appropriate racial and gender representation were becoming mandatory in many areas of national life. Because it was difficult to prove employment discrimination, courts were accepting deficient statistical representation as a surrogate. New organizations representing demographic or identity groups multiplied rapidly. They were not the fruit of grassroots activity. The ubiquitous Stewart Mott created People Politics with $100,000 to fund new organizations—the National Women's Political Caucus, National Black Political Caucus, and National Youth Political Caucus, as well as Bode's Center for Political Reform.[13] These groups promoted identity politics in both parties. However, only the Democrats endorsed such representation, so these committees in essence were caucuses of the Democratic Party. The Congressional Black Caucus, founded earlier, in 1969, was another group, but it reflected the more complicated currents within black political life. African Americans, unlike women, had done well without the benefit of the new rules and had more concrete policy goals than party reform. The black population was mostly blue collar, and its power depended more on social solidarity than on the bureaucratic rules of party reform. Many of its elected leaders were closer to the regular party forces, although the younger, highly educated leaders without constituencies, and protest leaders like Jesse Jackson, were with the reformers. It is not surprising that the quotas for blacks were dropped, because they were redundant, and those for women remained and became part of most party instruments.

Encouraging participation and mandating demographic outcomes conflicted. But the reformers were not philosophers but politicians determined to empower a coalition—the young, women, minorities, and

the professional middle class. Still, the presidential primaries ignited an unanticipated dynamic—promoting candidates, not the party or ideas.[14] The task in the primary was to motivate one's personal following. To succeed often meant magnifying small differences among candidates. Fashioning winning coalitions after such contests often proved difficult. Because candidate selection was a public process, the media played a much more important role than it had under the old system. Primary elections required an army of technocrats—pollsters, lawyers, etc.—that professionalized politics, raised the costs of elections, and isolated candidates.

THE RACE FOR THE NOMINATION

Still, it was not simply the rules that won the nomination for McGovern. At the beginning of 1972, the conventional wisdom was that Senator Edmund Muskie of Maine would win the nomination.[15] He had campaigned well as Humphrey's vice presidential candidate in 1968. The senator was decent and dignified, and many thought he possessed a Lincolnesque demeanor. That he was of Polish descent added to his appeal. Humphrey, the favorite of many labor and party leaders, had many, perhaps too many, scars from past battles. McGovern, representing the New Politics constituency, was the first to declare, in January 1971, and had been patiently and quietly gathering supporters. Given McCarthy's diffidence and indolence, McGovern easily replaced the Minnesotan with this constituency, but in January 1972 he was polling only 3 percent of the Democratic vote. Congresswoman Shirley Chisholm of Brooklyn, Mayor John Lindsay of New York (who had left the GOP for the Democratic Party), and Senator Vance Hartke of Indiana added to the menu of liberal choices.

Labor was divided. The steelworkers were for Humphrey, the auto-workers for Muskie, and the more conservative unions in the AFL-CIO were for Henry "Scoop" Jackson of Washington State. Jackson represented the pro-war, New Deal part of the party. But in the 1972 Democratic primary, however, Jackson would be placed on the right. Although he was known as a hawk, he had moved toward the antiwar position. Jackson had voted in December 1970 for the Cooper-Church Amendment, which would have prohibited President Nixon from sending troops or advisers to Cambodia without the consent of Congress.[16] Then there was George Wallace, who surprised everyone by running as a Democrat. (Wallace had run as an independent in 1968.)

Even though polls showed that Vietnam was taking a backseat to economic issues, this was not so in the Democratic primary. The generals were fighting the last war. Most of the pressure was on Muskie, who, like Humphrey, had supported the majority plank at the 1968 convention. But

in 1970, Muskie backed legislation, introduced by McGovern and Republican Senator Mark Hatfield of Oregon in August 1970, which set a deadline of December 31, 1971, for complete withdrawal of American troops from South Vietnam. The amendment lost, 39–55. Going further, Muskie told a New Hampshire audience in January 1972 that the investment of 55,000 American lives and $130 billion in Vietnam had been "wasted." It was time, he concluded, to end the war "not by dropping more bombs, but by withdrawing every soldier, sailor, and airman from Vietnam."[17] There was no difference between the Muskie and McGovern, except for their pasts. McGovern's slogan "right from the start" appealed to some, but not all, in the antiwar movement.

Muskie was the only candidate that Nixon feared. During the first half of 1971, polls showed him beating Nixon, 47–39 percent. As late as February 1972 Muskie led McGovern among college students.[18] Ahead of the others, Muskie became his opponents' target. Liberal labor lawyer Joseph Rauh criticized Muskie's centrism, urging liberals to support the most liberal Democrat, either McGovern or Lindsay. At the other end of the political spectrum, Nixon's dirty tricks did their work. Someone claiming to be from the Harlem for Muskie Committee, telephoned New Hampshire households in the middle of the night, urging them to vote for the Maine senator because "he's for us blacks."[19] William Loeb, the right wing publisher of the *Manchester Leader,* engaged a running battle against a man he called "Moscow Muskie." These broad assaults plus several Muskie missteps enabled McGovern to win 37 percent of New Hampshire's vote to Muskie's 47 percent.

Muskie was on the defensive after the primary, especially as the McGovern campaign, still under the radar, cherry-picked the states it would contest. The McGovern campaign itself was not especially potent; Muskie's inadequate showing is what hurt him. When McGovern exceeded his very low expectations, the press magnified his achievement. Muskie was the more thoughtful politician. Where McGovern embraced abolishing the draft, Muskie worried out loud about the political morality of a volunteer army that depended on the poor and minorities and, in

effect, gave the rich and privileged a pass. But Muskie lacked a strong public identity; he was not associated with an issue that people cared about. His trust theme would work against Richard Nixon, but not among Democrats. Like many front-runners, he did not plant a firm grassroots effort. Even if he had, there were so many candidates in the early primaries that FDR would have had difficulty accumulating 50 percent of the vote.

The South Dakotan's genial demeanor masked great ambition. Allard Lowenstein had asked McGovern to challenge Johnson in 1968 before he invited McCarthy. McGovern declined, explaining that he was up for reelection in South Dakota in 1968 and could not do both. But after Kennedy's assassination he had thrown his hat in the ring, ten days before the convention, encouraged by Kennedy supporters who wanted an acceptable nominee to park their delegates for the moment. McGovern was not a reluctant stand-in. He even thought that he could win the nomination. After Humphrey was named, he endorsed him, despite the wishes of antiwar supporters. At home in South Dakota, he was overwhelmingly reelected with 57 percent of the vote. McGovern's soft-spoken tongue took the sting out of many of his positions. And, as one former state legislator from South Dakota said, "Taking money away from the Pentagon and staying home minding our own business is pretty conservative stuff here."[20] But McGovern had been bitten by the presidential bug. Shortly after his reelection he began thinking about running and, in January 1971, was the first person to declare his candidacy. His preparations had begun much earlier.

The son of a Wesleyan Methodist minister, McGovern nearly followed his father's calling. His college years at Dakota Wesleyan University were interrupted by World War II. He earned a distinguished record as an air bomber. McGovern got his B.A. degree in 1946 and, after a brief flirtation with the ministry, earned a PhD degree in history and political science at Northwestern University, outside of Chicago. Along the way he traded his father's fundamentalist Christianity for the social gospel. Even when he switched to history, his thinking continued to be inflected with

the moral tenets of social Christianity. His dissertation on the Ludlow massacre, the killing of twenty coal miners and their families by company police in 1914, revealed his preference for issues with an unambiguous right and wrong side. As a senator, he chose issues that could be packaged into a simple morality—the war, hunger, poverty. In 1950, he returned to teach at Dakota Wesleyan. Like many liberals from the western states, he revitalized a moribund state Democratic Party, ran for Congress in 1956, and again in 1958. He lost the Senate race in 1960 but won in 1962 after his Republican opponent died of a heart attack. The ensuing division in the Republican Party over a substitute candidate made it possible for McGovern to win—barely, by one hundred votes.[21]

McGovern took care of the agricultural interests of his state. On other issues he had a liberal record and spoke out against the war earlier than most senators. After 1968, McGovern became the most outspoken senator against Nixon's policies regarding training Vietnamese and the bombing of North Vietnam. He spoke at a major antiwar rally in Washington on November 15, 1969. But further he did not go. His argument always was that peace is the highest form of patriotism, not that America is an immoral, imperialistic country. He attempted to marshal support in the Congress to stop funding the war and to withdraw all of the troops immediately. McGovern understood that Nixon's strategy of bombing and withdrawing American troops had defused the war issue. In August 1971, in the midst of the currency crisis, he said that he would have little more to say on the war. "I am a political realist and I believe the state of the economy is more decisive politically."[22] It was not so easy to switch gears.

McGovern accumulated astute advisers—Gary Hart, a young lawyer from Colorado; Morris Dees, the direct-mail millionaire who set up the campaign's fund-raising network; young Harvard graduate and pollster Patrick Caddell; and Frank Mankiewicz, Robert Kennedy's press secretary. They planned to survive the early primaries, win big in Wisconsin and Massachusetts, pick up McGovern's South Dakota and Nebraska in the middle, and conquer California through a win in Oregon.

If McGovern won California, New York would fall into his lap. Their strategy was generally successful, but it was not a romp. McGovern won Wisconsin with 30 percent of the vote, drawing heavily from Republicans, who were eligible to vote in this cross-over primary. Humphrey received 21 percent, Wallace, 22, Muskie, 10, Jackson, 8, and Lindsay, 7.[23] McGovern had least appeal in the big labor oriented states: Pennsylvania, Illinois, Michigan, Indiana, and Ohio. In all of them, Muskie, Humphrey, and Wallace essentially divided the Democratic vote. Wallace had the South to himself, except for parts of Florida.

The great surprise was the Wallace vote. McGovern won 4.05 million votes, Humphrey 4.12 million, and Wallace 3.76 million in the 1972 primaries. After his 1968 run, the Alabama governor had been losing steam. He was born again in the Florida primary on March 14, when he triumphed over eleven other candidates with 42 percent of the vote. Humphrey won 18 percent, Jackson, 13, Muskie, 9, Lindsay, 7, and McGovern, 6. Everyone agreed that Wallace's embrace of the busing issue did it. That the press and the candidates were so surprised that busing would be a big issue revealed how distant they were from the concerns of ordinary people. By now, Wallace had moved beyond his racialism to attacks on government for favoring the rich.

The new Wallace was created partly by the Voting Rights Act of 1965, which added many blacks to southern voting rolls, thereby diminishing the utility of racism as a mobilizing strategy. But Wallace was also reverting to the older populism of his early political career. In the current context, however, he was the demagogue, better at rubbing salt in wounds than at healing. He attacked busing mainly to get votes. Still, the Wallace campaign raised two questions that the party would not debate—the South and race—so consumed was it about the proper position candidates took on Vietnam.

Although the South became a Republican bastion in the 1980S, that future was not inevitable. The 1970 elections in the South featured the rise of moderate or populist Democrats like Dale Bumpers of Arkansas, Reuben Askew and Lawton Chiles of Florida, and Jimmy Carter of

Georgia. The Wallace vote went to these Democrats, not to their Republican opponents.[24] The results suggested that the South would remain Democratic and that the Wallace-type candidate was a thing of the past. The primary system, however, was a life support system for the old Wallace. In a multi-candidate primary election, the best way to win was to mobilize one's best constituency, not create coalitions. Whatever his changing political rhetoric, Wallace had his primary constituency among white southerners. Except for the "Northern" parts of Florida—the elderly and Jewish—the white South went to Wallace uncontested. The black vote divided among the various candidates. In this way, the primary system impeded the work of creating a biracial, Democratic majority in the South.

But Wallace would not have been so poisonous without the issue of school busing, which resonated among northern as well as southern voters. Although the issue first appeared in the Florida primary on March 15, it was also the main reason why Wallace won Michigan on May 16, with 51 percent of the vote to McGovern's 27 and Humphrey's 16. Just as in Florida, a federal court in Michigan had proposed a long-distance busing plan. Busing posed a moral and political dilemma. Was it simply a racist vote, as Muskie declared after the Florida primary? Perhaps, but if support for busing was the litmus test for racial tolerance, few whites would pass it. This was the one issue on race that hurt liberal candidates. Focusing on busing erased the many other indicators that whites had become more liberal since 1968. Harris polling in January 1973 found that, compared with 1968, more whites believed that blacks had difficulty getting decent housing, white collar jobs, and quality education in public schools. On the other hand, fewer whites believed that civil rights leaders were pushing too fast and fewer believed blacks resorted to violence to get what they wanted.[25]

So the question was, should busing be the litmus test? No one made the argument that involuntary busing improved education. The case for busing was that it was the only means of attaining integration, given housing patterns in the cities and suburbs. But if busing was the

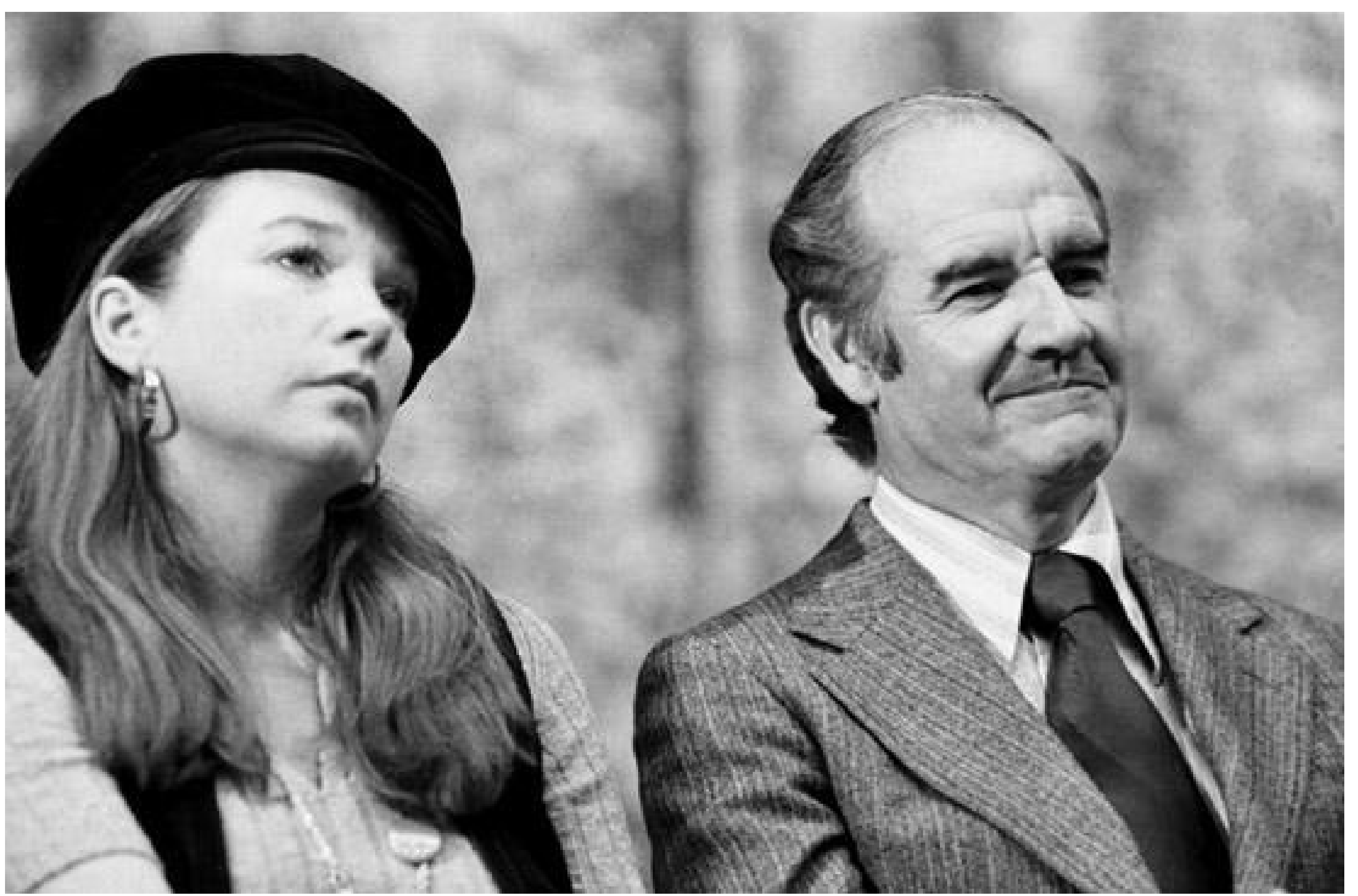
requirement of the law, then the law had moved too far from reasonable expectations of compliance. Some people supported the social goal of integration but were not convinced that busing was the best means for achieving it. Even if one concluded that such opposition to busing was simply a cover for racism, anyone looking to build a political majority would have to say that the overwhelming resistance to busing must be acknowledged for the time being. Others argued for busing on the basis of tactics. They claimed that it was necessary to risk a backlash and polarization to win white backing for increased aid to inner-city schools. Whether true or not, such cynicism injured liberal credibility. Embracing busing also tarnished liberalism by drawing a sharp distinction between the elites and the masses. Where busing worked, it was considered fair, meaning that whites of all classes were part of the solution. But no elegant justification for busing could overcome the social facts that the judges, politicians, and activists ordering and supporting busing usually sent their children to private schools or lived in all-white suburbs.

Listen to Jack Greenberg and Thurgood Marshall, both architects of *Brown v. Board of Education* and the NAACP's battle to desegregate and integrate schools. Greenberg had moved his family from Manhattan to Great Neck, a white middle-class suburb in Nassau County, New York. He admitted that "this caused not a little soul searching, but I came down on the side of the best education I could find for my children. Thurgood and Connie [Marshall] had come to similar conclusions when they enrolled their own children in Dalton, an elite private school on Manhattan's Upper East Side. We thought we wouldn't help anyone else by doing less than the best we could for our own children."[26] Greenberg never contemplated that other parents might have the same motivations. So when George McGovern said that busing was "one of the prices we are paying for a century of segregation in housing patterns," he omitted the fact that the "we" was defined by class.[27]

If the busing issue was attended to with racist demagoguery and liberal moralism, there was very little discussion about issues at all until the June 6 California primary. McGovern had been winning on thin gruel —

decency, trust, and peace. By now McGovern and Humphrey were the only remaining active candidates. Muskie had stopped campaigning on April 27. Lindsay, Hartke, and Jackson had dropped out. Wallace had been too late to enter the California race, and his bid had come to an end after he was critically injured by an assassin's bullet on May 15. But after three debates between the two surviving candidates on national television, Humphrey reduced McGovern's 15–20 percent lead to 5 percent. Humphrey did not present his own ideas, but instead attacked his opponent's.

McGovern was forced to admit that he did not know how much his $1,000 per person demogrant, his income maintenance program for the poor, cost, nor how his $31-billion defense cut would affect the many defense workers in California. McGovern's thoughts on conversion of military plants did not go beyond unemployment insurance.[28] Although his military budget was written by a thirty-one-year-old South Dakotan, John Holum, he did have some good economic advisers—James Tobin, Lester Thurow, John Kenneth Galbraith, and Robert Eisner. But McGovern threw out economic ideas like rice at a wedding—minimum tax on high income, elimination of the oil depletion allowance, new taxes on inheritance, increased capital gains, etc. His plans for income redistribution were incomprehensible because they had never been part of a coherent political or economic agenda. They were remnants of the social criticisms of the affluent society, not interventions in the current economy. While James Tobin told him that unemployment, which was at 5.5 percent, was the main issue, he chose to emphasize inflation, currently at 3.2 percent, preferring permanent controls, the solution that Galbraith had proposed many times. Why? Perhaps both of them were trapped in their romanticized memory of World War II controls. McGovern never explained his preference. The economy was his weakest area; it was too boring, too technical. He preferred issues that he could frame in terms of good and bad—like the Ludlow massacre or the Vietnam war.



George McGovern enjoyed much support from college students and Hollywood celebrities. Actress Shirley MacLaine joined him at a campaign stop at the University of Oregon in Eugene, March 23, 1972, just before the state's primary. (AP Images)

Despite McGovern's uncertain economics, he won California, which created a wave of inevitability.[29] The new rules helped him. Early on he benefited from the proportionate representation of the Iowa caucuses, winning 22.6 percent to Muskie's 35.5 percent. In the past, Iowa ran winner-take-all elections, and he would have gotten nothing.[30] On the other hand, McGovern's victory in California was winner-take-all, and he reaped an undivided bounty of 271 votes. The rules commission, over McGovern's objection, had allowed California to retain its winner-take-all rules, even though it went against the spirit of the reform process. California's political leaders strongly opposed proportionate

representation. If the big states are no longer big states, but enclaves open to personal or demographic divisions, their clout would be diminished. It is doubly ironic that McGovern, with less than 50 percent (i.5 out of 3.5 million votes), acquired all of that state's delegates.

McGovern's opponents thought that the California results could be used to prevent his nomination. Robert J. Keefe, a labor consultant, put it simply: "We thought that somebody other than George McGovern should be nominated."[31] The plan was to make certain his first ballot total was under the needed 1,200 votes, and the only way to do that was to dispute the number of California delegates awarded to him. Challengers claimed that California's electoral laws violated reform principles and that 151 of his 271 votes belonged to Humphrey. The anti-McGovern forces won the first round in the credentials committee. Predictably, it enraged McGovern and his supporters. They saw it as "an attempt to steal those delegates."[32] Thus, they supported another challenge to the Illinois delegation. A group of unelected delegates, composed of blacks, women, and young people in the right proportions, according to the new rules, challenged the slate of Mayor Daley, which had been duly elected by the people but lacked the right demographic distribution. The McGovern people were not fools and understood that they would not win Illinois without Daley. But they thought the nomination was about to be stolen from them and so supported the challenge. In the end, the convention upheld McGovern in California and Illinois. After the Daley delegation lost its seats, Frank Mankiewicz, the McGovern campaign manager appointed as a kind of ambassador to the regular party, glumly calculated, "I think we may have lost Illinois tonight."[33]

As it turned out, they would lose more than Illinois. DNC chair Larry O'Brien's convention rules leaned toward the McGovern side partly because he feared that denying McGovern would mean that his followers would not support the nominee.[34] McGovern understood that he needed the regulars. He made sure that inflexible planks in support of abortion and gay rights were defeated.[35] But McGovern also became a captive of his admirers. He hoped that O'Brien would stay on but promised to make

Jean Westwood, a mink rancher from Utah, the head of the DNC because he wanted to appoint a woman. Westwood was devoted to McGovern but had little national experience and little interest in the party. Gary Hart recognized the problem. Many McGovern people, he said, "have no basic interest in the Democratic Party as such. They consider it solely a vehicle to work within and they're in no position, if they had the will, to extend themselves beyond the McGovern base."[36] Despite O'Brien's efforts for their cause, many McGovern supporters considered him to be a hated regular. The candidate had overpromised and told the press that O'Brien, despite his pleading, had refused to be his chair.

The decision-making worsened. After numerous potential running mates turned him down, on July 13 McGovern named Senator Thomas Eagleton of Missouri as his vice presidential candidate. Twelve days later Eagleton revealed that he had been hospitalized three times for mental illness. Six days later he relinquished the nomination. The McGovern campaign claimed it had been deceived. Eagleton countered that his illness was behind him and therefore irrelevant. While there is much to be said on both sides, the controversy revealed a larger problem. No one had thought about the vice presidency until the last moment. A sprawling group—from new age actress Shirley MacLaine to campaign manager Gary Hart—met on the Thursday morning after McGovern's nomination. That no one suggested Muskie demonstrated the provincialism and fatigue surrounding the deliberation.[37] When Eagleton, who was not well known, was finally chosen, the matter did not end. That evening, the charade of openness required six other nominations, representing factions of the McGovern coalition. Not even for their own candidate would they discipline their desire. Once control was broken, delegates nominated Jerry Rubin, Ralph Nader, Archie Bunker, Mao Tse-tung, and many others. Ironically, it was the Wallace delegation from Alabama, not the McGovern group from New York, which shifted its votes to make Eagleton the vice presidential candidate. The price for this lengthy indulgence was that McGovern began his acceptance speech at 2:48 a.m.[38] Not a good beginning.

THE CAMPAIGN

President Nixon relaxed. He had feared that he would face a centrist Democrat like Muskie. The threat on his right flank disappeared after Wallace was shot. His own renomination was never in doubt. Nixon was weakly challenged on the left and right. Liberal congressman Paul McCloskey Jr. of California, perhaps hoping to repeat the McCarthy insurgency, entered the New Hampshire primaries, claiming that Nixon failed to end the war in Vietnam, which he had promised to do in 1968. Mc-Closkey represented the sizeable number of liberals in the Republican Party. Although the GOP activists were on the right, many liberals represented Northeast, Midwest, and West Coast constituencies. Even though they had not taken advantage of the Goldwater debacle in 1964 by organizing, most liberals had run ahead of Nixon in 1968. Some, like Senators Charles Percy of Illinois, Edward Brooke of Massachusetts, and Mark Hatfield of Oregon, had been elected primarily because of their opposition to Johnson's war policies.[39] Liberal Republicans were often accused of "me-tooism," and were short on theorists. They made their case on the basis of electability. But their think tank, the Ripon Society, was the architect of many Nixon administration policies: the volunteer army, revenue sharing, détente with the Soviet Union, the opening to China, and welfare reform. Most of Nixon's cabinet was from the liberal wing of the GOP and, with congressional liberals, kept him from selling the store to the backlash camp of the party. Liberal Republicans had helped defeat his nomination of conservative southerners, Clement F. Haynsworth and G. Harrold Carswell, for the Supreme Court.

McCloskey won 20 percent of the vote in the New Hampshire primary but three days later announced that he was withdrawing from the contest because he ran out of money.[40] If success in the primary was a measure of strength between left and right within the party, then the left wing was stronger. The candidate on the right, Congressman John Ashbrook of Ohio, only won 11 percent. Ashbrook was a Goldwater Republican who opposed Nixon's major foreign policy positions—détente with the Soviet

Union and the opening to China—and much of his domestic policy, including the proposed Family Assistance Plan, which would have replaced the various aid programs to poor people with direct cash payments, and the wage and price controls of August 15. He had been encouraged by the group around the *National Review,* which had declared its independence from Nixon. The right wing had trouble finding a candidate. Goldwater, whatever his views, would not challenge the president because Nixon, unlike many Republicans, had supported him in 1964, and perhaps the senator had learned a little about politics from that experience.

Nixon's road lacked obstacles. The GOP convention in Miami Beach, so different from the Democratic one in July, was orderly, confident, and complacent. On August 9, a week and a half before the convention began, former Treasury Secretary John Connally was named head of the group Democrats for Nixon. The party of Taft-Hartley now praised "the nation's labor unions for advancing the well-being not only of their members but also of our entire free-enterprise system." Ronald Reagan underscored the GOP strategy for the fall. "Our traditional two-party system has become a three-party system—Republican, McGovern, and Democrat. And, only the first two parties have a Presidential candidate in the coming election. Millions of patriotic Democrats were disenfranchised in the takeover of their convention."[41]

If Nixon knew he must fish in Democratic waters, McGovern floundered. He had replaced Eagleton with the popular Sargent Shriver, the brother-in-law of President Kennedy and former head of the War on Poverty. Shriver was an able campaigner, a Chicagoan, and friend of Mayor Daley, but the stench of the Eagleton affair could not be removed. The conscientious Larry O'Brien, even though denied his spot at the DNC, continued to work for the McGovern campaign. As if to confirm Reagan's analysis, O'Brien noticed that nowhere did the word Democrat appear in McGovern's campaign literature. He reminded the candidate, "You, George, in addition to being the nominee of the party, are supposedly the head of the Democratic Party and reservations about so

stating are troublesome." Mc-Govern had not placed himself in the tradition of Roosevelt, Truman, and Kennedy, but was running as an independent candidate. When confronted, he said, only after some reflection, "You're right. We are Democrats."[42]

McGovern's reluctance to embrace his party stemmed from his belief that the country was now divided between the comfortable and the disaffected, the Old Politics and the New Politics, or the coalition of interests and the coalition of conscience. Embracing the second of each pair explained why McGovern initially thought that he could win the Wallace voters, whom he believed were simply alienated Americans. This went further. Caddell, McGovern's pollster, projecting the views of his class onto the electorate, said, "In view of people's general disaffection with politics and their image of unions, perhaps the best thing the McGovern campaign could have done would have been to cut loose and say that these union people didn't want us."[43] The anti-union sentiment infused the whole campaign. Tom Turner, the black president of the Wayne County (Detroit) AFL-CIO Council, after visiting the Washington headquarters of the McGovern campaign, said, "I didn't mind a bit that they didn't know what I was. What bothered me is that even after they found out, they didn't give a damn."[44] To borrow from the journalist Mike Royko, any Democrat who tried to win a presidential election without the unions would "probably begin a diet by shooting himself in the stomach."[45]

The McGovern people made the mistake of thinking that the same mind-set and strategies that won them the nomination could succeed in the general election. Despite the view of Caddell and other like-minded advisers, the campaign did approach AFL-CIO head George Meany, who remained neutral, but did not object to the individual unions working for McGovern. The steelworkers union, recalling the slight of the McGovern-Fraser commission, also was neutral. When Sargent Shriver, who was genuinely popular among working-class Democrats, campaigned in the steel towns of Ohio and Pennsylvania, he was praised, but Democrats recalled the McGovern campaign's challenge of Ohio's delegates at the

convention.[46] Still, most unions—the United Auto Workers, garment, communications, electrical, machinists, and the new municipal unions—worked for McGovern. Only the construction unions and the teamsters went with Nixon.

The new constituencies did not offer enough to counterbalance the loss among labor. Jesse Jackson, a former aide to Martin Luther King Jr. and now head of Operation Push in Chicago, was part of the convention delegation that replaced Mayor Daley's. But now Jackson played hard to get. He announced on October 1, "I'm going to vote for Senator McGovern because I cannot accept President Nixon. But I'm not going to campaign for Senator McGovern." Jackson's philosophy was to play "both ends against the middle for the benefit of blacks."[47] His comment revealed the problem McGovern faced with his new political allies. Many in the black movement, feminist movement, and antiwar movement were not thinking seriously about any majoritarian project for the Democratic Party. They used the party for their own ends, which were not necessarily those of the party. Hopes for the voting power of eighteen-twenty-one year olds, newly enfranchised as a result of the Twenty-sixth Amendment, ratified on July 1, 1971, were also deflated. McGovern's appeal to students was based on his character and personality, not on his plans for students or the party. Some became disillusioned after he decided to drop Senator Eagleton as his running mate. Many registered, but only 48 percent of the newly eligible voted.[48]

As for substantive issues, the war won McGovern the nomination, but in the general election Nixon was able to impose his Vietnam narrative on the facts. The McGovern argument was that, after four years, it was Nixon's war. In the public mind, however, it never became the president's war.[49] The doves on the street and in Congress had forced the administration to withdraw U.S. forces and accept a negotiated settlement. But after that, Nixon controlled the story. In the spring of 1972, the North Vietnamese demanded the removal of the South Vietnamese government, which was headed by General Nguyen Van Thieu, and replacing it with a coalition government amenable to their

control. Because Nixon refused to abandon the Thieu government, negotiations in Paris ended in November 1971. Hanoi planned its Easter offensive in 1972 to convince the Americans. When the battle began, the South Vietnamese forces panicked and ran. Le Duc Tho, the main North Vietnamese negotiator, again demanded that the United States accept the end of the Thieu government. Nixon then gambled. The Moscow summit was to begin on May 22, and he concluded that he would have to bomb if he were to get anything from the Soviet Union's president, Leonid Brezhnev, or the Vietnamese. The president decided to mine North Vietnamese ports and to bomb all rail and road communications and other military targets in North Vietnam to cut of its military supplies to the south. He told the American people that these acts were necessary to prevent aggression (in the age of détente, he did not call it Communist aggression). Nixon told the Soviets that the two powers had a new relationship that could bring peace. He understood they had an alliance with Hanoi, but that Hanoi was intransigent.

In the short run, Nixon was rewarded. According to polls, 59 percent of the people approved of his action, 24 percent disapproved, and the rest were unsure. The North Vietnamese agreed that the Thieu regime would remain in power, and the Americans accepted the reality that North Vietnamese forces would remain in the south. And the Russians did not cancel the summit. Nixon entered the fall election season bathed in the warm light of his visit to China in February, another trip to the Soviet Union in May, and a return to the negotiating table in Paris, which yielded an agreement that ended the American engagement.[50] This picture omitted much, but it was a plausible story of the president's accomplishments. To rebut the president's case would require a shrewd attack from McGovern. But the McGovern camp lacked the intellectual power to forge one.

McGovern was exhausted and the polls were not encouraging, but he believed he would win right up until the election because he thought he was "working with a historical trend, history is going for me. This country is going to pieces."[51] He recalled that he had been behind in the

primaries, too. The press stayed with this theme, too. Having underestimated McGovern in the primaries, journalists were careful not to repeat the error. But in October the issues of the primary had vanished because of the successful selling of the president's Vietnam account. Pollster Caddell told the candidate that people were less concerned about the war or busing and more skeptical about his competence. Caddell acknowledged, "We've always been light in the idea sector, we got left without any strategy of ideas, we play one thing, then we play another thing, and it all contributes to this image, to this lack of consistency and competency."[52] The campaign was short on ideas because the candidate believed that the issues, whether they were the war, inflation, or unemployment, were symbols of a broader malaise, a "corruption of the spirit," to which "a coalition of conscience" was the answer. Whatever appeal this definition of the problem might have to college students or the peace movement, it left most Americans wondering what this man from South Dakota would do as president.

The verdict was unambiguous. Nixon won forty-seven million votes to McGovern's twenty-nine million, the largest margin in American history. Nixon's 60.7 percent of the vote was second only to Johnson's 61.1 percent landslide of 1964. McGovern won only one state, Massachusetts. He surpassed Humphrey's 1968 totals only in college towns—Berkeley, California, Ann Arbor, Michigan, and Madison, Wisconsin. With such a massive rout everyone had an explanation, and each one had some validity. However, no one argued that this was an ideological victory or a repudiation of New Deal ideas and policies.

Ideological mandates usually are accompanied by increases in voter participation. In 1972, only 55.7 percent of the electorate voted, the lowest percentage since 1948. Nixon ran as a moderate, not a conservative. On race, Nixon called for order, not the dismantlement of civil rights legislation. His aides tried to weaken the civil rights law of 1972, but he signed it. He claimed that his foreign policies would yield peace. In retrospect it seems that his troop withdrawals and distrust of the goodwill of North Vietnam were exactly where the electorate stood in

1972. This was not Barry Goldwater spewing belligerence and states rights. And, the electorate had not turned right. To the contrary, the University of Michigan's Center for Political Studies concluded that between 1968 and 1972 Americans "had noticeably shifted leftward on the issues." Gallup reported in January 1973 that 72 percent agreed with the statement that "the federal government has a responsibility to do away with poverty in this country"; 69 percent said they would be more likely to vote for candidates who stood for national health insurance; and 91 percent believed that tax laws should be changed to "ease the burden on moderate and low income but increase those on high income people and corporations." If 69 percent were against more money for welfare, 62 percent thought more should be done to help the poor, revealing a distinction that demagoguery never recognized.[53]

Nixon thought that if the issues were the bread and butter ones like taxes and prices, "the people would be for McGovern rather than for us."[54]The president was surprised that McGovern did not talk more about the economy. Significant majorities pointed to Nixon's various economic policies as failures.[55] Unemployment had risen from 3.9 percent when he took office to nearly 6 percent in 1971, but had come down to 5.5 percent at the time of the election. In short, although unemployment was still high, it was improving; so was inflation, which was now below 3 percent, thanks to the wage and price controls. It would have taken a candidate with more standing on the jobs issue to use it. McGovern lacked this credibility. In August 1972, the public believed, 59 to 35 percent, that Nixon would do a better job of reducing unemployment; it assumed, by a margin of 61 to 43, that the president would pay attention to the problems of the working man (the phrase used in 1972); and many more (52 to 35 percent) thought Nixon more than McGovern would keep big interests from having too much influence over government.[56] In short, people were dissatisfied with Nixon's policies yet believed he would do a better job than McGovern in doctoring the economy. Part of McGovern's difficulty here was his unwillingness to identify himself as a Democrat, which played into Nixon's strategy of running as the president, not as the

Republican president. McGovern failed to counter by identifying Nixon as the Republican candidate and himself as the Democrat in the tradition of Roosevelt, Truman, and Kennedy. But McGovern of course could not do this easily given his constituency, campaign, and, perhaps, beliefs.

Democratic congressional victories confirmed that the election was a verdict on McGovern, not New Deal ideology. Democrats carried both houses of Congress, gaining two Senate seats. The GOP added twelve House seats, but the winners were mostly liberal Republicans. Everywhere the president did better than his party except where he ran with liberal Republicans, who exceeded the president's totals—Case in New Jersey, Percy in Illinois, Hatfield in Oregon, Brooke in Massachusetts. On the other hand, labor, lukewarm for McGovern, worked hard in the races below the presidency. It defeated Republican Margaret Chase Smith in Maine, and ensured that twenty-nine-year-old Democrat Joseph Biden won in Delaware, Dick Clark in Iowa, and Claiborne Pell in Rhode Island. The Democrats held their own in the South. In Alabama, where Nixon won 72 percent of the vote, Democratic Senator John Sparkman defeated his Republican challenger Winston Blount, despite the efforts of a young George W. Bush. Nixon carried the city of Atlanta, but the city's congressional district, with a white majority, elected its first black congressman since Reconstruction, Democrat Andrew Young.

All you could say about 1972 is that the electorate judged McGovern incompetent. The other issues that percolated through the campaign seemed less salient. Even law and order, and the amnesty, acid, and abortion trinity that Republicans loved to mouth took a back seat to the aptitude of the Democratic candidate. This election did not ratify or initiate ideological change or realign the electorate. In the end, the politics of the affluent society prevailed, frayed but not destroyed. It would face a more profound test when new Third World power in the form of quadrupled oil prices challenged the economic arrangements of the postwar world.

CHAPTER FOUR
OPEC and the Trade Unionism of the Developing World

WHEN THE TV SERIES *Dallas* first aired in April 1978, the nighttime soap opera of feuds, love, and greed among the oil producers in Texas captivated audiences despite the critics' bad reviews. The main character, J. R. Ewing, was head of an independent company, not a satrap of a big international company. The fights between the Ewing and Barnes families over Texas oil were nostalgic returns to the years when American oil mattered. *Dallas* ignored the shortages, boycotts, imports, high prices, and strategic vulnerabilities that characterized the oil business in the 1970s. Whether *Dallas* instructed or reflected American understanding in September 1979, 45 percent of the American people at that time were unaware that the United States imported any oil at all.[1]

Fictional television aside, the quadrupling of oil prices in 1973–74 ended the golden age of postwar capitalism. The siphoning off of funds from oil importers in the industrialized world to oil exporters, mainly Middle Eastern and North African nations, produced new centers of wealth and power. Between 1973 and 1977, the earnings of oil-exporting nations grew 600 percent, to $140 billion.[2] In the United States the Dow Jones index, which had reached a high of over 1000 in 1972, plunged to 577 in 1974. Rising oil prices tested every building block of the mixed economy, from modes of transportation to modes of production. It reopened the social contract by setting off distributional struggles between capital and labor.[3] It intensified conflicts among the industrial

powers and created new ones between the developed and undeveloped worlds. The Organization of Petroleum Exporting Countries (OPEC) inspired Third World producers of other crucial commodities—bauxite, tin, copper. Although no other commodity commanded as oil did, that conclusion is easier drawn in 2010 than in 1974.[4] Finally, U.S. vulnerability reflected and furthered the decline of U.S. power, weakened by the faltering war in Vietnam and the new economic competition from Japan and Europe.

It is not fanciful to suppose that a more confident and prosperous United States would have taken a harder line on OPEC. The United States had effected regime change in Iran in 1953 after prime minister Mohammad Mossadeq threatened to nationalize the oil industry. But in 1973 most of the oil was in the hands of states, not Western oil companies. And, after Vietnam, military action was out of the question. So U.S. allies went their own way and cut deals with the oil producers. The chairman of the Petroleum Association of Japan said that the crisis facing Japan could not be resolved as long as Japan coordinated its politics with the United States.[5] Even when the alliance held, America's partners attempted to export their way out of their oil-produced trade deficits. These responses only heated up competition among the industrialized nations.

The oil revolution did not dislodge the Keynesian order. Given the dangers, governments had to do more. The international banker David Rockefeller prescribed "nothing less than serious economic planning on an international scale."[6] For that to happen, the United States would have to solidify its alliance with the other industrial powers and create new ties to the oil-producing and Third World countries, the mostly Asian and African nations that had gathered in Bandung, Indonesia, in 1955. The new oil wealth had transformed the new states from pawns to powers. Those without the black gold received loans from Western banks and access to the U.S. market. The oil problem and the oil solution taxed U.S. economic power, especially manufacturers.

FROM SURPLUS TO DEFICIT

At one time the United States and its big multinationals controlled the oil business. In the late nineteenth century Standard Oil, the Rockefeller empire, dominated the industry. Its monopoly ended in the years after World War I, owing to the Supreme Court's decision to break up Standard Oil in 1911 and the emergence of competitors in Texas. The independents included large corporations like Continental Oil and Atlantic Richfield, but also the small concerns portrayed in *Dallas.* Five American majors, mostly the offspring of Standard Oil, were giant international firms, involved in all aspects of production—extraction, refining, and marketing throughout the world. Along with British Petroleum (BP) and Royal Dutch Shell, an Anglo Dutch firm, they were known as the "Seven Sisters" and dominated the oil trade.[7] In 1948, "free world" oil production totaled 8.7 million barrels a day; in 1972 it had grown to 42 million barrels. Americans pumped more oil, but production in Iran, Iraq, and the thinly populated kingdoms of Kuwait and Saudi Arabia soared from 1.1 million to 18.2 million barrels a day. Then, new nations—Algeria, Libya, and Nigeria—entered the market.

Almost immediately the power of the oil majors was challenged. The big companies could not dominate everywhere. In 1970, eighty-one major companies produced oil in the Middle East; only nine existed in 1946. Oil exporting nations pressed the companies to expand production to earn revenues for development. They did, but at the cost of falling prices.[8]Then, as Middle East oil supplies grew, House Speaker Sam Rayburn and Senate Majority Leader Lyndon Johnson, both from Texas, used their political power to protect domestic producers from the cheap foreign oil. On March 19, 1959, President Eisenhower imposed mandatory quotas on oil imports over the objections of the big internationals. Foreign oil could not exceed 9 percent of American consumption. The quota increased American oil production and also American prices, but the United States could not produce as much as it used.

Abundant oil encouraged its use, speeding the transition from coal to oil in industrial and consumer markets. In the case of the latter, the market was not simply the often-maligned U.S. gas-guzzling automobiles, which used a full gallon to move eight miles. Throughout the industrialized world, rising incomes led more people to buy homes—which they then had to heat and cool and stock with new appliances—as well as automobiles. On the industrial side, oil was the base of the petrochemical and synthetic fabric industry, and it was the fuel of choice to run machines. Consequently, U.S. consumption of oil tripled between 1948 and 1972, while demand in Western Europe rose 15-fold (from 197,000 to 14.1 million barrels per day) and consumption shot up 137-fold (from 32,000 to 4.4 million barrels a day) in Japan. In 1955, coal composed 75 percent of all European energy use and oil 23 percent; in 1972, coal made up 22 percent and oil 60 percent.[9] Oil accounted for 45.4 percent of U.S. energy sources, compared to 75.2 percent in Japan.[10]

Ironically, the fledgling U.S. environmental movement encouraged oil use. Across the country, coal-induced smog blanketed major cities. Pressed by Mayor John Lindsay, Consolidated Edison, New York City's electrical utility, switched from coal to low-sulfur oil and natural gas to produce its power in 1968. As late as 1966, New England electric utilities burned 9 million tons of coal; by 1972, this was reduced to 1.3 million.[11]The Clean Air Act, passed in 1970, mandated stringent air quality standards throughout the nation. In essence, this meant no coal. At the same time, many activists were no friends of oil. In California, drilling operations were halted in the Santa Barbara channel in 1969 after an oil spill. Protesters stopped exploration in the Outer Continental Shelf, delayed the construction of the trans-Alaska Pipeline, and thwarted the construction of countless power plants. Rather than face down their green opponents, oil companies diverted capital from the United States to foreign areas. Nixon's price controls on oil, put in place in 1971 to fight inflation, also discouraged investment in the United States by keeping the price low.[12]

Beneath the radar, American demand was rising while domestic supply

fell. Once, excess capacity in Texas protected the West from supply disruptions. No more. The U.S. still produced more oil than any other country in 1972, 11.2 million barrels a day. But the United States was also the world's largest consumer, using 17.4 million a day.[13] Saudi Arabia produced less, 8.3 million a day, but consumed very little of it. This changing strategic balance allowed the new oil producers to flex their muscles.

The creation of OPEC in 1960 was a declaration of independence by Saudi Arabia, Venezuela, Kuwait, Iraq, and Iran from the control of the oil companies. Other nations—Libya, Algeria, Qatar—joined the original five. But aspiration alone could not remake the oil business. The surpluses in the 1960S and the reality that OPEC was a band of rivals as well as a band of brothers meant that its power was only potential. The "radical" OPEC states went further and began a nationalization movement. The big international oil companies received concessions, giving them the right to seek out, own, and produce oil in a given territory. The internationals supplied the technology and managed the national company, determining the price and quantity produced. The nations earned royalties on each barrel sold. But oil nations increasingly defined independence as control over resources. Libya's Colonel Omar Qaddafi, who overthrew Libya's monarch in 1969, began it all. Qaddafi targeted Occidental Oil, a newcomer, completely dependent upon Libyan oil. Occidental could not resist the higher oil prices that Qaddafi demanded. An American oilman predicted, "The oil industry as we had known it would not exist much longer."[14] Libya's easy victory increased the confidence of other OPEC countries. Competition between conservative and radical regimes further ratcheted up prices. The shah of Iran, fueled by grandiose hopes to create a new Persian empire and become the co-equal of England and France, was not about to allow a desert ruffian or Arabs to outdo him.[15] Rivalry between Iran and Saudi Arabia added new price hikes, especially after the 1973 Arab-Israeli war. Each state competed with the others for the prize of the highest price.[16] Countries also demanded ownership of the companies themselves. In

1975, Kuwait shoved aside British Petroleum and Gulf, taking over the Kuwait Oil Company, founded in 1934. Compensation? The two companies asked for $2 billion, and received $50 million.[17]

Qaddafi had warned the heads of the oil companies in Libya, "People [Libyans] who have lived without oil for 5,000 years can live without it again for a few years in order to attain their legitimate rights."[18] Like Libya, many of the possessors of the black gold were thinly populated and could threaten to withhold oil with impunity. The bluing and posturing worked after 1970 because supply was tight. In 1973, there was perhaps a 1 percent margin or difference between supply and demand. That margin was in the Middle East. The United States was no longer able to supply Japan and Western Europe in emergencies.[19] Saudi oil chief Sheik Yamani boasted that OPEC could pretty much "dictate the flow of oil and the price of oil."[20] What he meant was that the era when falling prices led to increased production to keep revenue up had ended. As they gained control over their resources, OPEC nations obtained more income by raising prices, not production.

Nixon was aware of a problem but was blind to it. The president gave two speeches—in 1971 and 1973—urging the development of new fuel from coal, nuclear research, deregulation of natural gas, construction of an Alaskan pipeline, and delay of clean air standards. He ended oil import quotas in April 1973, as the world price moved above the price of domestic crude.[21] Assessing the Middle East oil situation, Nixon told chancellor Willy Brandt of West Germany in May 1973 that "there were too many companies and nations fighting with each other."[22] Nixon's worldview that only big countries mattered covered up the dangers. He told French president Georges Pompidou at the end of May, "To be safe, the world requires the five fingers on the hand, which are a strong Europe, a strong U.S., Russia, China, and for the future, Japan. The rest does not matter."[23]Kissinger cautioned his aides, "Don't talk to me about barrels of oil. They might as well be bottles of Coca-Cola. I don't understand!"[24] Even Secretary of the Treasury George Shultz, who knew the difference, told a meeting of European finance ministers in June that

worry about skyrocketing demands for energy and concentration of supplies in a few countries was "an overly alarmist view."[25]

At a news conference on September 5, 1973, Nixon reiterated the conventional wisdom: "Oil without a market as Mr. Mossadeq learned many, many years ago, does not do a country much good. We and Europe are the market, and I think that the responsible Arab leaders will see to it that if they continue to up the price, if they continue to expropriate, if they do expropriate, without fair compensation, the inevitable result is that they will lose their markets, and other sources will be developed."[26] The president continued to believe that the key issue was confiscation—or nationalization, as the producers called it.[27] The United States opposed confiscation but tolerated nationalization with fair compensation. Still, fairness was in the eye of the beholder. Such questions are rarely settled by philosophers or economists. In the case of Middle East oil, the companies yielded to power, the U.S. government looked on with discomfort, muttered the old conventional wisdom, and did nothing.[28] By the end of the 1970s, Libya, Iraq, and Kuwait had nationalized their oil industries, and others like Saudi Arabia forced the companies into partnerships with the government. Whatever the legal form, the internationals were compelled to yield decisions about price and production to national oil companies. The "Seven Sisters" provided only technical services for exploration, production, and marketing.

MIDDLE EAST POLITICS

Politics, as well as the economics, enhanced the power of the oil states. The growing presence of the Soviet Union in the region, America's strategic dependence on regional powers Saudi Arabia and Iran, and the rise of Arab radicalism limited U.S. options. Demonstrating political as well as economic aspirations, Arab nations cautioned Nixon that oil would continue to flow only if the United States pressured Israel to return the territory taken after the 1967 Arab-Israeli war. The president discounted these warnings because Texas oil had blunted the unsuccessful OPEC boycott during that war.[29] He and Kissinger heard a similar warning from the petroleum companies, but U.S. presidents had been getting such advice from oilmen since 1948. The 1967 war had ended with Israel occupying the West Bank of the Jordan, the Golan Heights, and the Sinai. The Arab defeat was overwhelming, but Egypt's Gamal Abdel Nasser was unbowed. Nasser's death in 1970 made Anwar el-Sadat, a very different man, president. The unglamorous Sadat believed that Nasser had sacrificed Egypt for utopian Pan-Arab dreams. Sadat expelled his Soviet advisers, hoping that the move would set off an American peace initiative. When the United States did nothing, Sadat decided to get American attention by going to war.

Egypt targeted the adjacent Sinai on October 6, 1973. At the same time, Syria assaulted the Golan Heights. (Saudi Arabia and Kuwait financed the war, and other Arab nations like Libya, Algeria, Tunisia, and Morocco contributed money, men, and munitions.) The attack on its holy day Yom Kippur made it difficult for Israel to mobilize. The surprise worked, and initial losses made an Israeli defeat likely unless the United States sent more arms. Because the Soviets were resupplying Egypt and Syria, Secretary of Defense James Schlesinger, Kissinger, and Nixon reluctantly concluded that they would have to resupply the Israelis. Kissinger told U.S. oil executives that the American role "had nothing to do with the merit of the crisis itself," but a victory by states armed by the Soviet Union "would have had a disastrous impact on the U.S. position in

the Middle East and globally."[30]

The Soviet Union had not been consulted about the Arab attack, and when they learned of it they thought it was a bad idea. On the other hand, the Soviets championed the Arabs, whom they supposed were progressives battling the imperialists. Sadat was no Nasser, their ideal Arab leader, but the Soviets' overarching ideology blinded them to the very different course Sadat would play.[31] The Soviets walked a tightrope. They sought the leadership of the Third World, especially as China challenged their position. On the other hand, they pursued détente with the United States. Navigating these waters while saddled with a rigid view of the world was not easy.

A potential Cold War confrontation ended when the United States and the Soviet Union agreed to establish a cease-fire on October 26. By saving the Third Egyptian army, then surrounded by the Israelis in the Sinai, the United States prevented an Israeli military victory, which might have brought in Soviet forces. Kissinger believed the war gave the United States new leverage with all the parties of the Middle East. American influence over Israel was "greater than ever" because the country could not achieve military victories without U.S. armaments. At the same time, the Arabs knew that the Soviets could give them arms and the Europeans could offer favorable rhetoric, but only the United States could get Israel to return their lands.[32]

Strategic gains were overwhelmed by the more durable oil problem. In the midst of the war, when Israel was short of arms, King Faisal of Saudi Arabia warned Nixon that there would be an oil embargo if the United States resupplied Israel.[33] A week later, Nixon publicly announced a $2.2-billion military package. The next day, October 20, Saudi Arabia embargoed oil shipments to the United States and the Netherlands, also seen as excessively pro-Israel. OPEC had already raised oil prices 70 percent. The exporters announced that they would cut production by 5 or 10 percent per month until Israel withdrew to its 1967 frontiers. In December the price of crude oil had climbed 470 percent, to $11.65 a barrel, from the beginning of 1973. The historian Steven Schneider

concluded, “The oil-exporting countries had secured the greatest nonviolent transfer of wealth in human history.”[34] Put another way, about 2 percent of the GDP of the industrialized nations was transferred to the oil producers.

Sadat and King Faisal of Saudi Arabia promised to end the oil boycott after the cease-fire. But then the Syrians, speaking for the radicals, said no. On January 30, Kissinger lost his cool, telling aide Brent Scowcroft, “If I was the President I would tell the Arabs to shove their oil and tell the Congress we will have rationing rather than submit and you would get the embargo lifted in three days.”[35] Actually, the United States did not use much Arab oil; OPEC challenged American leadership and hegemony, not its oil supply. Most U.S. oil imports came from Canada and Venezuela (55 percent). Only 18 percent, 8 percent of the nation’s energy needs, came from the Middle East, and most of that oil came from Iran, not the Arab countries.[36] The U.S. shortfall was perhaps 5 or 6 percent of demand. It was hard to be precise. First, Iran kept pumping. Then there were the leakers. The biggest were Iraq and Libya, which had big appetites for revenue. Second, the big oil companies, with the Arab states not looking too carefully, redirected Arab oil to Europe and non-Arab oil to the United States. Third, extrapolating current U.S. demand from the usage of the previous year increased the shortfall because the demand for oil was affected by the rate of economic growth and the price of oil. Energy use in 1974 declined because of slower economic growth and higher oil prices. Finally, although there were gas lines everywhere during the winter of 1974, some of the deficit was the result of insufficient refining capacity in the United States. All of these variables made the determination of the effect of the boycott difficult.

At the beginning of the crisis, the oil producers, heady with their new power, tried to use it to the hilt. In November 1973, Sheik Yamani, sounding a little like Qaddafi, boasted that Saudi Arabia could blow up its wells or cut production by 80 percent and still do very well.[37] The sheik demanded the withdrawal of Israeli troops from all of the lands taken after the 1967 war, including Jerusalem, before his country would return

to the production levels of September. The kingdom had reduced its oil production from 8.3 million to 6.2 million barrels a day.[38] To underscore his point, anti-Communist King Faisal sent a congratulatory message to Leonid Brezhnev on the anniversary of the Bolshevik revolution.[39] (Saudi Arabia did not even have diplomatic relations with the Soviet Union.) But Kissinger would not link the specifics of the Arab-Israeli settlement with the oil question. "If we once begin to let ourselves be blackmailed, this weapon will be used time and time again at every stage of the negotiations."[40] King Faisal discovered that his oil would not get him Jerusalem, but the United States did begin negotiating. The tune was set by the United States, not Saudi Arabia. And it was not a march. Still, Kissinger's step-by-step strategy of negotiating first in the Sinai, then the Golan Heights, and eventually the West Bank and Jerusalem was enough to secure alliances with Egypt and Saudi Arabia, if not radical states like Libya and Iraq.[41]

The Americans learned that ending the war and initiating diplomatic negotiations did not return their power over oil.[42] After the end of the embargo, on March 18, 1974, and after Saudi Arabia's decision to increase oil production by one million barrels a day, the United States turned to bringing down the price of oil, which meant breaking OPEC. If King Faisal was key to ending the embargo, Mohammad Reza Pahlavi, shah of Iran, was the main man on price. Iran was the second largest Middle East producer, pumping 5.8 million barrels a day. In December 1973 the shah opined, "The industrial world will have to realize that the rate of their terrific progress and even more terrific income and wealth based on cheap oil is finished.... They will have to find new sources of energy, tighten their belts. If you want to live as well as now, you'll have to work for it. Even all the children of well-to-do parents who have plenty to eat, have cars, and are running around as terrorists throwing bombs here and there—they will have to work."[43] The shah was not interested in Palestine; Iran was Israel's leading oil supplier. Iran had a big role to play in the Nixon Doctrine, which declared that the United States would look to regional powers to support American interests. But the shah had

his own ambitions, and high oil prices allowed him to accumulate wealth and a cornucopia of military weapons for his country. And, he nursed his grievances. The shah was exorcizing the humiliation of Western colonialism and perhaps his own coronation by the Americans in 1953.[44]

Treasury Secretary William Simon, a former investment banker, was not interested in healing the shah's wounds or indulging his appetites. Simon wanted to force Iran to bring down the price. Kissinger quickly reminded Simon and the president about Iran's strategic role in the Middle East. It had not boycotted the United States, it had been the only regional country to refuse permission for Soviet planes to overfly its territory during the 1973 war.[45] But accepting higher prices meant accepting slower growth, greater export competition, and bilateralism. Initially, Americans were confident that their power was intact. The United States had managed the boycott and price increases without experiencing substantial economic, political, or diplomatic injury.[46] It hoped that a combination of market forces and diplomacy would destroy OPEC, prevent the non-oil Third World from allying with the oil cartel, and bring Western allies, who had distanced themselves from the United States to secure Middle East oil, back into the fold—a tall order.

Oil prices stayed high in 1974. Oil had been $2.70 a barrel in September 1973; it was $11.00 in July 1974. Even though Kissinger separated Middle East negotiations from the price of oil, the market did not, believing that any setback in the talks could precipitate another war, which would be fought with the oil weapon.[47] The Western oil companies, worried about maintaining access to supplies, dared not object to the price demands of the producing countries. (High profits went a long way to easing their anxieties.) Despite their rhetoric, most of the Gulf states had a healthy respect for Western power. But their apprehension led them to keep prices high, to get as much as they could now, before the West created alternative energy sources.

Unable to move the shah, the United States hoped King Faisal of Saudi Arabia would help lower prices. The king was the smartest of his father's thirty-nine sons despite his nuttier ideas, such as "Communism is a

Zionist creation designed to fulfill the aims of Zionism. They are only pretending to work against each other in the Mideast."[48] But the Western-educated monarch was an anomaly among the three thousand princes of the Saudi royal family. Many of them drank, gambled, and whored; he led an austere life, forged a kingdom out of warring tribes, and maneuvered Saudi Arabia to the forefront of Arab states. Kissinger kept the king informed about the negotiations with the Israelis, listened sympathetically to his rants against Zionists, praised his moderation, and tried get him to lower oil prices.[49] The United States did not bank on the whims of the king. Nixon met with the king's brother Prince Fahd on June 8 and signed a wide-ranging military and economic agreement.[50] The president enlisted the National Association of Manufacturers to partner the Saudis and other Gulf states.[51] OPEC countries spent about $400 billion from 1974 to 1978.[52] The Saudis embarked on a $60-billion, five-year industrial plan and purchased $2 billion of arms, mainly from the United States.[53] American leaders hoped that Saudi investment and consumption would create a stake in Western well-being, increase oil production, and discourage the use of the oil weapon.[54]

The Saudis tried. At OPEC meetings in Quito, Ecuador, in June and in Vienna in September, they opposed price increases advocated by radical Iraq and Libya, and by conservative Kuwait and Iran.[55] However, Prince Saud, Saudi Arabia's foreign minister, told Kissinger, "We won't break up OPEC."[56] James Atkins, the U.S. ambassador in Jidda, reminded Sheik Yamani that Saudi Arabia had the power to reduce prices because it had the same spare capacity that Texas possessed twenty years ago. Yamani agreed but added, "Saudi Arabia had to take politics into account, Texas did not."[57] The latest OPEC rationale for the high oil prices was that inflation had increased the cost of the industrial goods imported from the West, and until the West reduced its inflation, high oil prices would continue.[58] Repeating this argument did not make it true. In some OPEC countries, like Venezuela, industrial imports were few and unrelated to inflation. In Saudi Arabia and the Gulf States, inflation was related mostly to the various shortages—labor, housing, transportation—that

accompanied the huge development projects undertaken.[59]

By the end of July 1974, it was clear that neither the market nor the Saudis were bringing prices down. OPEC was cutting production, not prices. Energy chief John Sawhill worried that the high prices would continue to disrupt relations with Europe and Japan. Rates of inflation exceeding 10 percent in Organization for Economic Cooperation and Development (OECD) countries, and balance of payments deficits threatened the international financial system. The oil bill of consuming countries rose from $50 billion in 1973 to over $130 billion in 1974. This arithmetic changed a trade surplus of $15 billion into a deficit of $60 billion.[60] Sawhill now urged a range of "confrontation" tactics, designed to impress OPEC oil producers with the seriousness of the situation.[61] Action, of course, depended upon the judgment of President Gerald Ford, recently inaugurated on August 9, after Nixon was forced to resign in the wake of the spiraling revelations of the Watergate burglary.

The new president agreed and continued the policies of his predecessor. Speaking before the World Energy Conference in Detroit, Ford declared that "sovereign nations cannot allow their policies to be dictated, or their fate decided, by artificial [price] rigging and distortion of the world commodity markets." With representatives of Arab oil nations in the audience, he stated that "throughout history, nations have gone to war over natural advantages, such as water, or food or convenient passages on land or sea."[62] The United States denied that it was threatening military action but wanted OPEC to know that arms were an option. To underscore the point, Henry Kissinger said in January 1975 that force would be "considered only in the gravest emergency…. I am not saying that there's no circumstance where we would not use force. But it is one thing to use it in the case of a dispute over price; it's another where there is some actual strangulation of the industrialized world."[63] The message was received. Sheik Yamani told the U.S. ambassador in Jidda that King Faisal was "depressed" about "American threats" against Saudi Arabia. Yamani warned that occupation of Saudi oil fields would be difficult; they could be sabotaged easily.[64] Saudis cautioned the

United States not to drive the Arabs into the arms of the Communists.[65] Arab leaders outdid themselves in denouncing American threats, but when OPEC met later that month in Algiers, the ministers agreed to retain current prices for the rest of 1975. The steep recession was also a factor. Indeed, energy prices lagged behind inflation, translating into a de facto reduction in real prices between 1975 and 1978.[66] But the American aim was to destroy or at least weaken OPEC, not simply lower prices. In order to do this, threats had to be supplemented with diplomacy—first, keeping the Western allies together and then weaning the Third World from OPEC.

THE UNITED STATES AND THE ALLIES

Maintaining the cohesion of the industrial nations was both an end in itself and a means to confront OPEC. Even before the 1973 war, U.S. relations with Europe were poor. Nixon's surprise economic package of 1971 and then his détente with the Soviet Union and China made many Europeans, especially the French, feel that the train had left the station toward an unknown destination. Consequently, to repair relationships Nixon made 1973 the Year of Europe. It is too simple to name American unilateralism the culprit. The Europeans both relied on U.S. power and distrusted it. And, the EEC, in the process of expansion, was becoming more difficult to manage. In 1973 it gained four new nations: Great Britain, Ireland, Denmark, and Norway. The community's internal differences made every problem with the United States seem greater than it was.

Acrimony peaked when most European nations and Japan sided with the Arabs in the Yom Kippur war. They did so because of Middle East oil. President Pompidou of France told Kissinger, "You rely on the Arabs for about a tenth of your consumption. We are entirely dependent upon them."[67] Even though the Europeans were exempt from the boycott, they were victims of reduced production. The results first hit the European automobile industry. Europe was much more dependent than the United States on the auto. One in ten jobs rested directly or indirectly on the health of this industry. Auto sales declined 46 percent in Germany and 60 percent in the Netherlands. Immigrant or guest workers lost jobs, and many were forcibly repatriated.[68] A generation of Europeans and Japanese that had experienced robust growth, full employment, and stable prices now faced recession and feared the worst. The panicked Europeans came out publicly in support of the Arab positions on Palestine, which won Europe a suspension of the 5 percent cut in production. Europe and Japan distanced themselves from American efforts to end the Arab-Israeli war.

If the boycott divided Europe and the United States, it also divided the

Europeans. Arab producers boycotted the Netherlands because of its willingness to help Jewish émigrés from the Soviet Union. But if EEC members acceded to the embargo and refused oil transshipments to the Netherlands, they would be violating one of the basic precepts of the union, the free flow of commodities. Nevertheless, they deferred to the Arabs until the Dutch reminded them that they were a major source of natural gas for Europe, including 40 percent of the French supply—including most of that used in Paris. The Netherlands got its oil.

The United States put price at the top of its agenda, whereas the Europeans and Japanese aimed to lock in supply and cut bilateral long-term deals with Arab oil producers. Often oil was bartered for industrial plants and armaments. Iraq agreed to supply Japan for ten years in return for a $1-billion credit for a liquified petroleum gas (LPG) processing facility and a refinery, as well as petrochemical, fertilizer, and aluminum plants.[69] France negotiated a similar deal. Britain, France, and Germany contracted for Saudi Arabian oil in return for armaments.[70] Forced to pay more than the posted oil price, the industrial countries got their revenge by overcharging on the goods they delivered. The paupers paying cash got to pay the higher oil prices because the barter price became the market price. The British, banking on future North Sea revenues, also did not work for lower prices.[71] Japan, completely dependent upon Middle East oil, which constituted 80 percent of its energy mix, lacked diplomatic leverage, so it adjusted to high prices.

To counter the pull of the oil producers, the United States tried to create a consumer bloc and convened a meeting of the industrial powers in Washington on February 13, 1974. Libya nationalized three American oil companies on the first day of the conference in an attempt to intimidate.[72] Sheik Yamani warned consumers not to create an alliance against the producing countries, and many Europeans were intimidated. French foreign minister Jean Sauvagnargues told Kissinger, “You are the United States and you can afford to antagonize the Arabs.”[73] Kissinger protested, “The idea that 10 million Arabs can hold up and blackmail Europe notwithstanding its military, economic and financial strength

should be intolerable from the point of view of the Europeans themselves."[74] He reminded the Europeans that oil was not the only asset. The U.S. military in Europe and the world's most open market were also compelling. From the American perspective, each long-term bilateral deal at current prices was a nail in the coffin of higher prices. Kissinger warned the allies that unrestrained competition among consumers would produce "economic disaster," possibly world depression. On the other hand, if consumers could reduce consumption of imported oil to the point where OPEC countries would have difficulty attaining their revenue requirements, the cartel would be vulnerable to price cutting.

French prime minister Jacques Chirac and Iraqi vice president Saddam Hussein agreed that Iraq would lend France $1 billion to help pay for Iraqi oil, and in return France would deliver an aluminum plant, a military hospital, and other industrial facilities. The United States feared that such bilateral deals undermined Western unity in attempts to obtain lower oil prices. (© Bettman/CORBIS)

Some modest cooperation was effected at the Washington conference. The industrial countries agreed to act together to allocate oil in times of emergency, conserve energy, and develop all forms of energy. They promised to avoid competitive currency depreciation and strengthen international credit facilities to tackle the trade deficits resulting from the high price of the oil imports. An Energy Coordinating Group was created to develop a framework for cooperation, and this organization became the International Energy Agency (IEA) at the end of the year. But this was not the muscular consumer organization that could undercut OPEC. Bilateral deals between Europeans and oil producers continued. The French remained uncooperative, refusing to join the IEA. A heavy dose of Gaullism and perception of its own oil interests led France to follow the adage *sauve qui peut—each* for himself. But the need to cooperate was so compelling and French selfishness so transparent that the Europeans flocked to the American side, leaving France *seul* (alone), in the words of *Le Monde*.[75]

In October 1974, Valéry Giscard d'Estaing became France's president following Pompidou's death. He and his forty-one-year-old prime minister, Jacques Chirac, pursued French interests with more aplomb than Pompidou did. France continued to pursue bilateral deals with Arab nations, but it also joined Washington's IEA, something Pompidou would not do. Giscard D'Estaing invited producers and consumers to a conference in Paris to be held in April 1975. But the Paris conference adjourned without agreement. The West, led by the United States, insisted that the conference address energy only. The oil exporters, led by president Houari Boumediene of Algeria, insisted upon discussing all raw materials and restructuring the international economy, which would have taken the spotlight off the oil producers.[76] Although the United States continued to separate oil discussions from talks about other commodities and Third World issues, the United States did alter its policies across a range of issues to try to separate the OPEC nations from other developing countries.

OPEC EFFECT

OPEC cultivated the nonaligned states, whose numbers in the one-vote, one-nation UN general assembly made them a force in world politics. Despite the high price paid by undeveloped countries lacking oil, OPEC was able to convince its poorer cousins that its challenge to the West would facilitate their own efforts to control the prices of their commodity exports. In September 1974 Denis Healey, British treasury chancellor, told Kissinger that "none of the LDCs [lesser developed countries] at the Commonwealth meeting support the white Commonwealth countries view that oil prices are too high. They see the situation as legitimate exploitation of market power rather than unfair use of monopoly power."[77] The conservative Gulf States—Saudi Arabia and Iran—were not willing or able to make the connections between their new oil power and anticolonialism. But Algeria, with sterling revolutionary credentials, was a different story.

The eight-year Algerian war for independence, memorialized in Gillo Pontecorvo's film *Battle of Algiers* and books like Franz Fanon's *The Wretched of the Earth,* was the exemplary struggle against colonialism. Even though the new state, established in 1962, quickly descended into one-party rule, the luster of its achievement led outsiders to look the other way. Algeria was neutral in the Cold War and aspired to lead other new nations, the "Third World." President Boumediene had requested the special session of the UN General Assembly in 1974 to address raw materials and development, in part to deflect criticism of OPEC. Boumediene blamed poor country ills on "overconsumption" and waste in the West and the high price of imports from the industrialized world. He advised raw material producers to form associations like OPEC, to obtain "fair" prices for bauxite, copper, coffee, bananas, and other commodities.[78] In the meantime, OPEC tried to buy acquiescence through grants and loans although most of its new wealth was recycled in the West.[79]

Kissinger tried to outflank the Algerians. The United States had

opposed the UN meeting, fearing a harangue on the evils of colonialism and calls for transferring wealth from the rich to the poor countries. But Kissinger addressed the UN in April 1974, pledging U.S. assistance and more favorable terms of trade while opposing cartels. He stated that raw material surpluses and shortages could be eliminated and that energy prices should be equitable. He challenged the radical view that there was an inevitable conflict between industrial and developing nations. The speech was favorably received by the ordinarily skeptical assembly.[80] The secretary managed to sound cooperative and economically sophisticated.

The UN talk was Kissinger's baptism into Third World politics. Kissinger had believed that only big powers counted in the world. The oil crisis demonstrated the folly of that view. The tilt toward the Third World can be called the OPEC effect. The secretary's aim was "to prevent a coalition of commodity producers whose objective would be a general rise of commodity prices."[81] In order to break the oil cartel, the United States wooed the nonaligned world. Domestic U.S. politics helped. Multinationals were coming under scrutiny in congressional hearings. In the wake of Watergate, the government bent over backward to avoid even appearing to act in the interests of the big companies. The United States joined with other developed nations in the OECD to write codes of conduct for multinational corporations.[82] Leading corporations now believed that the government's tolerance for nationalization sacrificed their interests for larger strategic goals.[83] By the middle of the 1970s at least 75 percent of the holdings of U.S. raw materials corporations located in Third World nations had been nationalized.[84] To woo the Third World, the U.S. government offered investment and markets, engaged left-wing governments, and even contemplated an opening to Cuba.

COMMODITIES AND TRADE PREFERENCES

Third World nations produced mainly agricultural and mineral commodities, which they believed condemned them to perpetual poverty because primary producers faced price volatility in the short run and declining terms of trade over the longer run. The way out of existing market inequalities was industrialization, which took two forms. Brazil and Mexico protected and subsidized industries, walling out imports with high tariffs. East Asians also kept foreign products out but created export economies, sending industrial goods to Western powers. But the rising demand for commodities during the boom from 1972 through 1974 and OPEC success returned commodities to the spotlight. The U.S. Chamber of Commerce glumly reported that 1972 was the year of Russia and China; 1973 was the year of Europe, 1974 the year of Watergate, and 1975 the year of commodities.[85]

Seventy percent of the raw materials used by the industrialized countries came from other industrialized countries. Nevertheless, commodity exports were the major source of earnings for many LDCs. But the rising prices and incomes of 1973 and 1974 ended in 1975 when Third World producers faced huge account deficits, reflecting the recession in the West as well as the still-high oil prices. On September 1, 1975, UN ambassador Patrick Moynihan addressed the Seventh Special Session of the General Assembly, which was devoted to economic development. Moynihan promised that the United States would stabilize the export earnings of developing countries, make capital and technology available, and restructure world trade to enhance access to Western markets.[86] Of course, the devil is in the details, but Moynihan was promising if not a new international order—the goal of the radicals—then a reformed one. The United States opposed fixed prices or OPEC-like cartels, but it was willing to work to stabilize overall export earnings. To accomplish this, the United States proposed new banks and consumer-producer forums for each major commodity.

Most of the measures the United States advocated were market-

friendly but compensatory dirigiste interventions. The proposals drove the free marketers of the *Wall Street Journal* crazy. The proposed "new international bureaucracies … in New York City would balance Mayor Beame's budget," a reference to the city's fiscal crisis.[87] Treasury secretary William Simon, sharing the *Journal*'s philosophy, led the government opposition to Kissinger's accommodation to the commodity producers.[88] Simon believed that the "'system' isn't the problem and to imply that it is can only serve to provide grist for the political mills of those political leaders both in industrial countries and developing countries who choose to excuse their own policy failures by blaming them on forces beyond their control."[89]Both Simon and William Seidman, Ford's chief economic adviser, told the president that "we are in danger of compromising our basic commitment to the free enterprise system."[90]

But the world was too dangerous to rely on the free enterprise system. Kissinger said as much at a May 2, 1976, meeting of Third World nations in Nairobi, Kenya, during his first visit to Africa.[91] He proposed an International Resources Bank (IRB) to get capital flowing into mineral resources and other sectors in developing countries.[92] The nationalizations had made private capital reluctant to invest, so the IRB would insure both LDCs and investors against noncommercial risks that might otherwise jeopardize such projects. The plan for subsidized loans was an alternative to more radical schemes to index commodities to industrial products or to set up buffer stocks of ten commodities financed by a "common fund" to keep prices stable. The United States opposed the common fund, which would buy key commodities when their prices were low and sell accumulated stocks when prices were high. (Both were ways Americans handled domestic agriculture.)

Secretary of State Henry Kissinger changed course and wooed Third World nations at a meeting in Nairobi, Kenya, during his first visit to Africa. (Illustration by Jack Davis)

Third World nations argued that the common fund would eliminate price fluctuations and allow producing nations to plan better and offer consuming nations the security that vital raw materials would be available. Of course, average prices would be higher, as they were for coffee, cocoa, and tin, commodities that already had such agreements.[93] The United States, Japan, and West Germany, the biggest raw material importers, preferred to address the specifics of each commodity and so opposed the common fund notion. But so did other, poor countries. Despite the rhetoric, there were great differences among the Third World

nations. Coffee growers, with their own well-functioning organization, were not interested in the common fund. Then, fast-growing South Korea, Singapore, and Taiwan needed cheap inputs for their industries. Even slow-growing states kept raw material and food prices low in order to promote industrialization. Resource-poor India and Pakistan opposed high commodity prices and inveighed against OPEC's soaring oil prices. Other poor countries in Africa and Asia were equally critical but were silenced by grants and loans from OPEC countries. Given this diversity in the Third World, Kissinger's proposal was only narrowly defeated, 33 votes to 31, with 44 abstentions.[94] The Nairobi meeting agreed to create a Common Fund and negotiate international agreements for at least eighteen commodities.[95] Most of the LDCs stuck together because they believed that only by doing so would they have a voice in international economic decision-making. But there was plenty of room for backtracking.[96]

In the end, both the Common Fund and Kissinger's development banks were stillborn.[97] Existing institutions, the commercial banks, the IMF, and the World Bank proved up to the task of managing the crisis, at least for the more advanced developing countries. The banks, flush with funds from OPEC nations, turned the spigot on for Third World countries, especially after the recession reduced the demand for investment in the rich countries. In the words of Citibank chair Walter Wriston the philosophy was, "Countries can't go bust." In actuality they could, but Wriston expected the IMF and World Bank to bail them out, an accurate reading of international financial policies of the 1970s. The IMF generously loaned money to developing countries suffering from high-priced oil imports and low export earnings.[98] But it was the private banks that did the most. Between 1973 and 1974, the oil import bill of non-OPEC LDCs (sometimes called NOPECs) increased by $17.3 billion. Two-thirds of the debt of Brazil, Argentina, Mexico, Egypt, Korea, and the rest was financed by U.S. banks. With banks dependent upon profits from Third World loans, debtors gained important leverage over their creditors. In 1976 Peru needed $300 million to meet interest and principal

payments on its $3.7-billion debt. The banks agreed because if they refused they risked seeing their existing loans go sour.[99]

The recession of 1975 returned the commodity route to progress to the backburner. Industrialization resumed its traditional role in the developing countries. Governments protected domestic industrial interests. Tariffs on manufactured goods averaged 74 percent for Mexico, 84 percent for Argentina, and 184 percent for Brazil.[100] Governments juggled exchange rates to make it expensive to import finished goods that competed with local production, but cheap to import capital equipment and inputs that industry needed. States generously supplied credit and subsidies to domestic industry and scrutinized the activities of foreign-owned corporations. And, governments often owned key industries like steel. These policies continued. But now Western banks financed steel mills in Brazil, shipyards in South Korea, and petrochemical plants in Mexico. The new producers looked to the U.S. market to sell their wares. Many of these goods competed with America's pressed industries. Nevertheless, banks lobbied for Third World access to American markets because that was the only way to get repayment of their loans. The new lending policies thus created new conflicts between American finance and American manufacturing.

The U.S. market had cemented alliances with Europe and Japan. Government officials now used it to woo the developing world. Earlier in 1964, the United States refused to reduce tariffs on LDC exports without reciprocity. The United States reversed its position in 1968, but the program did not get under way until 1975.[101] Developing countries should have duty-free access to the American market, without the reciprocity demanded of peers. Certain sensitive products like textiles were excluded. And, no more than 50 percent of U.S. imports of a product could come from a single country.[102] The Generalized Special Preferences (GSP), the name of the program, drew opposition from the AFL-CIO, which considered GSP another tribute to multinational corporations. In many instances, the Third World exporters were U.S. corporations.[103]

GSP did not revolutionize the relationships between the United States and nondeveloped world. The poorest countries had little to sell. Most of the benefits went to emerging industrial powers—Hong Kong, Singapore, Korea, Taiwan, Brazil, and Mexico. Although countries were supposed to graduate from the program, in 1995, 52 percent of the benefits went to aging students Malaysia, Thailand, and Brazil. Malaysia reaped the greatest percentage, 27 percent of total GSP trade, but it was not simply because of GSP. Its prime minister had come to New York earlier, in October 1971, telling investors that "Malaysia could be the answer to your problems of spiraling wages and increasing costs of production." GSP facilitated, but did not create, the export stream from East Asia.[104] In the case of Brazil and Mexico, which had not relied upon exports, the open access to the U.S. market, combined with the new private bank loans available for industrialization, created new outlets for their industries, to the chagrin of American producers.

JAMAICA

The OPEC tilt also improved relations with countries that had left-wing governments, like Jamaica. The island, once the crown jewel of Great Britain's sugar empire in the Caribbean, was now a poor country relying on the remnants of its sugar industry as well as tourism and bauxite to employ and feed its people. Most of these economic pillars were foreign-owned, mainly British, Canadian, and American.[105] The bauxite industry, which supplied about 28 percent of the world's demand, was dominated by a Canadian company, Alcan, and several American ones, Reynolds, Kaiser, Alcoa, and Revere.

High unemployment had produced a landslide victory for the People's National Party (PNP), led by Michael Manley, in 1972. The PNP was a center-left party, which became more radical during the 1960S. In 1974 it embraced democratic socialism and affiliated with the Socialist International, which included social democratic and labor parties from Australia, Britain, Sweden, Israel, and India. Manley, who trained at the London School of Economics, was both an intellectual (he occasionally wrote for *Foreign Affairs* magazine) and a mystic who could commune with Ethiopian Emperor Haile Selassie, a talent that won him the support of Jamaica's seventy thousand Rastafarians, who worshipped the emperor. Manley was a man of great skill, charisma, and ambition, but he was fated to remain on a comparatively small stage and lead an island of two million. To escape, Manley aspired to Third World leadership. But first he had to take care of business at home.

In November 1973, catching what British Prime Minister Harold Wilson called "the OPEC syndrome," Jamaica initiated the International Bauxite Association, which included a stew of states—Guinea, Guyana, Sierra Leone, and Surinam, but also Yugoslavia and Australia.[106] Unlike oil, bauxite is not openly traded. Because sales took place within integrated companies, it was difficult to fix a price. States preferred to tax production and bargain for more industrial processing to profit from their mineral wealth. Jamaica needed more revenue. Rising oil prices

increased Jamaica's energy bill by $200 million a year. So, in the spring of 1974, the government raised the bauxite levy sevenfold and announced plans for wider government ownership. The government received $175 million in 1974, compared to $25 million in 1973. The *Daily Gleaner,* the leading Jamaican newspaper, proclaimed in a banner headline: "Bauxite to Finance the Future."[107] Manley proposed to use the additional revenue to create alumina plants and light manufacturing based upon local inputs. (Bauxite was first made into alumina, which was then smelted into aluminum, produced in the developed countries. Bauxite costs made up about 10 percent of the price of the finished aluminum.) Because the nation lacked cheap energy, Jamaica planned a complex to manufacture aluminum in energy-rich Venezuela or Trinidad.[108] The government also took control of unused lands and the minerals beneath them and hoped to diversify Jamaica's markets by selling to Communist and nonaligned states.

U.S. bauxite companies asked the U.S. government to restrain the Jamaicans. But the OPEC tilt led the Ford administration to separate its interests from those of the corporations.[109] Kissinger said, "Our interest in this [bauxite negotiations] is not the companies'."[110] When the talks developed a snag, the United States sent the benign Arthur Goldberg, the former lawyer for the U.S. steelworkers and aluminum workers union and, later, a Supreme Court justice, to Jamaica. For his part, Manley took care to reassure that supplies to the United States would continue. He tried to wheedle an invitation to see the president even though he acknowledged that "Jamaica was a comparatively unimportant country."[111]

Manley's blueprint went awry for many reasons, but U.S. opposition was not one of them. The plans were nurtured by the economic optimism of the 1973–74 boom and OPEC success. But the boom turned to bust in the recession of 1975. Some of the additional revenue from the aluminum levy had to be diverted from investment to balance the budget in 1974, to pay for the increased price of oil imports. Then, bauxite revenues plummeted in the recession of 1975. Jamaica shipped n.4 million tons of

bauxite in 1975, down from the 15 million in 1974.[112] Jamaica's GDP fell 10 percent in 1976. Competing bauxite producers, like Guyana, always kept their bauxite tax a little lower than the Jamaican toll, which encouraged investment elsewhere. The Manley government made great efforts to improve the lot of the poor, but its long-term economic planning was faulty. The aluminum refinery in Venezuela never materialized, loans from OPEC countries were always less than promised, and markets in socialist countries were no substitute for the American ones. Third World economic integration was not feasible. The U.S. encouraged the IMF and commercial banks to extend more loans to Jamaica, and the funds enabled Jamaica to maintain consumption. But without viable industries for the future, these gains were short-lived.[113]

U.S. tolerance of nationalizations and state experiments continued even when Third World politics tested American forbearance. In 1975 Manley initiated joint projects with Cuba: Jamaican youth went to Cuba for a year-long course in construction methods and technology, and Cubans built schools and houses and doctored the sick in Jamaica's hospitals.[114] Jamaica's flaunting of the Cuban connection at a time when the economy was sputtering was a nonproductive substitution of ideology for accomplishments. But it did not turn the American government hostile. In January 1974 Kissinger had opened up the possibility of better relations with Cuba, part of the United States' "new dialogue" with the nations in the western hemisphere. America's Cuban policy was a thorn in U.S. relations with Latin America.[115] Many countries not only were sympathetic to Fidel Castro, they also considered the prohibition of trade with Cuba by American companies domiciled in Latin American countries and Canada to be a violation of their sovereignty. The United States lifted the restriction in 1975. Kissinger said that "any company with any imagination can sell, by doing it through its affiliates."[116]

The U.S. opening to Cuba ended after the Americans discovered that Cuba had intervened in the civil war in Angola.[117] The prize of victory in Angola was not great, but the Cuban intervention had been decisive in the victory of the Popular Movement for the Liberation of Angola (MPLA)

over a faction covertly supported by the United States. Still, the stinging U.S. defeat in Africa worsened Cuban-American relations without altering America's Jamaica policy in 1976. Kissinger spoke with Jamaican foreign minister Dudley Thompson on June 9 about Cuba, but mentioned only its intervention in the Angolan civil war, not the interactions between Cuba and Jamaica. Thompson had his own beefs. He believed that the CIA was trying to "destabilize" Jamaica by funding opposition groups in the elections scheduled at the end of 1976. He complained that Jamaica was getting bad press in the American media. True, an anti-Jamaica campaign unquestionably existed among right wing journalists in the U.S.[118] But there is no evidence that the CIA or any other government agency was attempting to dislodge the Manley government.[119] Kissinger advised the U.S. ambassador in Kingston to "discreetly" discourage any visit with Edward Seaga, Manley's opponent in the elections, even though the more conservative Seaga was preferred to Manley.[120] Kissinger himself urged Ford to resume the PL-480 food program to Jamaica, which had been ended because the program was being reserved for the poorest of the poor countries, and Jamaica no longer qualified.[121] The economic heavyweights in the administration, Alan Greenspan and William Seidman, both recommended ending it for Jamaica. But their objections were based upon their opposition to the program and had nothing to do with Cuba.

Kissinger was no economic radical, but he was no ideologue either. He supported aid to Jamaica for strategic reasons. The secretary of state told Ford that Castro was cultivating Jamaica, and Manley was suspicious of American motives. Even if the aid program did not make Manley a close ally, resuming aid would deny "Manley this pretext for attacking us in his election campaign." The new national security adviser, Brent Scow-croft, agreed that aid would "buy time with Manley … by providing concrete evidence to counter the 'destabilization' line and provide positive indication to the people of Jamaica of our continued concern for them." Ford agreed and the program continued.[122] Manley overwhelmingly won reelection in December 1976. Even when Jamaica flirted with Cuba, the

American response was to ply the country with aid. Compare that with the cutting off of aid to Salvador Allende's Chile in 1970, a prelude to more active intervention against Allende, which lead to the coup on September 11, 1973. The architects of the Chile policy were John Connally, then secretary of the treasury, and Henry Kissinger.[123] But that was before the oil crisis changed U.S. policy toward the Third World.

Differences between the rich and poor nations did not end. But after the oil price revolution, the United States accepted the legitimacy of the Third World desire to assert political authority over global forces by organizing commodity markets and establishing industry. The United States still tried to weaken OPEC, lower oil prices, and divide the LDCs from the oil producers. But in the words of the *Times of India,* the "trade unionism of the developing world" had been established, and the question was not whether Third World criticisms were legitimate but, rather, how to address them.[124] In the end, the U.S. wooed the developing world with traditional aid, but also with loans for industry and preferential, non-reciprocal trade access to the U.S. market. The new policies were taken from the old playbook. The nation's strategic interests trumped its domestic ones.

CHAPTER FIVE
1975
"CAPITALISM IS ON THE RUN"

BEFORE THE OIL PRICE REVOLUTION at the end of 1973, the United States seemed to be on the mend. The Paris Peace Accords were signed on January 27, 1973, officially ending direct U.S. involvement in the Vietnam war. The economy, after two devaluations in August 1971 and February 1973, seemed to be back on track. The cheaper dollar would encourage exports and discourage imports, ending the nation's trade and payments deficits. Thus, the government felt free to end remaining controls on foreign direct investment, begun in the 1960s when balance of payments problems plagued the country. Exports began to rise.[1] American manufacturers constructed new factories.[2] They even gained ground in world markets.[3]

Closing the book in Vietnam and rekindling economic growth yielded an era of good feelings in 1973. The new president of the Chamber of Commerce, Edward B. Rust, had some nice things to say about that scourge of American capitalism, Ralph Nader. Nader, who first became famous battling mighty General Motors over automobile safety, led numerous investigations documenting corporate misdeeds and government negligence. But now Rust concluded that Nader simply aimed to make "the free-enterprise system work."[4] Irving Kristol, the future scold of 1960S culture, took the various social changes of the decade in stride. "The 1960S made unprecedented demands on society," Kristol acknowledged. But "the 1970s will be years of assimilation and

adaptation, of ‘cooptation.’ Big government is not going to go away, any more than pornography or abortions or women’s lib will go away. These innovations are on their way to being institutionalized, to being rendered conventional, unsubversive, in the end uninteresting (though not un-influential).”[5] The editors of the *Wall Street Journal* felt secure enough to “pity the New Left,” not denounce it. They took great delight in tracking ex-yippie Rennie Davis’s journey to a fifteen-year old Indian Guru and in the bizarre National Caucus of Labor Committee’s campaign to destroy the Communist Party.[6]

The alchemy that transformed optimism to gloom and doom was oil. Initially, scandals and Watergate overwhelmed events abroad. On October 10, in the midst of the Arab-Israeli war, President Nixon accepted the resignation of his vice president, Spiro Agnew, who had been accused of accepting kickbacks while governor of Maryland. Two days later, with reports that Israel might lose echoing through the White House, Nixon selected Representative Gerald Ford of Michigan to replace Agnew as vice president. On the day the Saudis announced the oil boycott, Nixon’s attorney general, Elliot Richardson, and his chief deputy, William Ruckelshaus, resigned to protest the firing of special prosecutor Archibald C. Cox, who had been investigating the Watergate scandal. Cox had subpoenaed the president’s Oval Office tape recordings, the key evidence that would determine the president’s role in the break-in. Many Americans believed that the oil crisis had been conjured up by Nixon to distract the nation from Watergate. More Americans blamed the oil crisis on the U.S. government (23 percent) than on the Arab countries (7 percent).[7] In December, the American Petroleum Institute and the Organization for Economic Cooperation and Development (OECD) predicted that the war and even the embargo would have a minor impact on the United States.[8]

The United States was not immune.[9] Even though it did not import much Middle Eastern oil, OPEC producers determined the price paid by all. Rising prices increased the costs for every business that used oil, siphoning of consumer dollars and resulting in plummeting demand for

other goods. A recession accelerated in 1974 and peaked in the first quarter of 1975, when economic growth declined nearly 5 percent. The American stock market lost nearly half of its value between 1972 and the end of 1974.[10] When unemployment reached 9.2 percent in May 1975, traditional complaints about capitalism joined the cultural critiques common among intellectuals during the 1960s. Heath Larry, head of labor relations at U.S. Steel, predicted high levels of unemployment for the next ten years.[11] Norman Robertson, vice president and chief economist of the Mellon Bank in Pittsburgh, told a reporter that he was "not sure whether capitalism is on the run, but if it isn't it surely is on the defensive to a degree we haven't seen since the 1930S. We will see some very severe pressures for a basic change in the economic structure if we don't succeed in restoring stability soon. I think we have our backs to the wall."[12]

Whether capitalism was on the run or not, most people thought that government had to fix things. Even those who generally preferred the market embraced the state. Nixon's chief economist, Herbert Stein, said, "Maybe we need an economic planning agency like the Japanese or French."[13] Even Alan Greenspan, Stein's replacement under President Ford, thought the country might require a new Reconstruction Finance Corporation, the depression agency that lent to banks and corporations.[14] Americans alone did not confront what some called "the crisis of the west." European and Japanese economies sputtered, and class conflicts escalated everywhere. When things go wrong, reigning ideas are challenged. And, Keynesianism was critiqued from the right, as is well known, and also from the left. In the United States, a Republican president and Democratic congress fought each other to a draw. They birthed a hesitant and feeble fiscal and monetary policy that prevented the worst, but did not restore the golden years. It would take the presidential election of 1976 to determine the direction the nation would take.

FOOD

The source of the problems contributed to the gloom. Both food and oil were of the radar of American political and economic culture. John Kenneth Galbraith thought that there was a dearth of public goods, but he never imagined that basics would be in short supply. Economists worried about deficient demand for autos and houses, not scarce supplies of food and energy. The profession was at a loss to explain why the Thanksgiving turkey that cost 39 cents a pound in 1972 shot up to 90 cents a pound in 1973. The food component of the Consumer Price Index rose 20.1 percent because of a 26 percent increase in the price of raw agricultural commodities.[15] How could the United States, with its vast production, end up with meager supplies and escalating food prices?

The food business, like oil, was now global. Food consumption rose in recent years because of the economic boom in the industrialized world. U.S. GDP rose 6.1 percent in 1972 and 1973, Canada more than 6 percent, Japan almost 11 percent, the United Kingdom over 5, and so on.[16] With the entire developed world demanding more food, prices rose. So, even though the United States produced plenty of food, the global market consumed a lot of it, reducing American supplies and raising the price. Prices climbed in the United States even though the country was under price and wage controls.[17] Recall that the controls were part of Nixon's New Economic Policy of 1971. The August devaluation, plus the 10 percent surcharge on imports, and the other economic boosters tended to increase inflation. At the time, inflation was about 4 percent, a low figure when measured by price performance after 1973, but too high for the consensus at the time. So, the government ordered a ninety-day wage and price freeze and then a series of controls that gradually loosened before ending on April 30, 1974. Through most of 1972 they worked. But in 1973 food prices skyrocketed because of the rise in the price of raw agricultural products, which were not covered by the controls.

The omission was deliberate. When controls were imposed in the summer of 1971, farm prices were low. The government believed that

attempts to contain price increases would produce shortages and lead to black markets or rationing. Restraining commodity prices in the United States would have speeded exports to higher-priced world markets. The political power of the farm states was also a factor. Secretaries of agriculture were farm state ambassadors to the United States. Their mission was to keep farm income high. Since the 1930S the secretary set the number of acres in production, and this determined the size of key crops. Farmers were paid to reduce their plantings and also gained income when the diminished supply yielded higher prices. The government could support prices by buying and storing the commodities. President Nixon made certain that the current secretary, Earl Butz, understood these powers after the elections of 1970. Nixon believed that low prices had hurt the GOP in the farm states and told Butz that increasing farm incomes now would yield a good harvest of farm votes in 1972. The Price Commission, charged with reducing inflation, pleaded with Butz to reevaluate agricultural policy, especially the crop reduction program.[18] Supported by the president, he refused. In 1972 about 15 percent of the nation's cropland was "set aside" from productive use.

Mother Nature worked as hard as Butz and Nixon to reduce supplies in 1972. Bad weather devastated crops around the world, from Africa to China. A cold, dry winter reduced the wheat crop in the Soviet Union. Monsoons ruined the rice harvest in India. Disaster struck anchovy production, a key ingredient in cattle feed. The anchovies that swim off the Peruvian coast decided to go elsewhere because the algae that they feed upon were killed by warm water currents, which today we know as El Nino. American soybeans substituted for the itinerant anchovies, but the price of cattle feed rose, pushing up the price of beef, as well as soybeans.

Ordinarily, American grain reserves would have helped fatten the cattle. But the reserves had been depleted by the Russians, and at bargain prices. In 1971, with farm state votes in his mind, Nixon facilitated a sale of American corn to the Soviets. In 1972, Butz learned that the Russians needed wheat and that the United States was the only nation in the world

that had enough reserves to supply them. By the end of the summer, the Soviets had purchased—at very low prices—one-quarter of the entire 1972 U.S. wheat crop, before the shortages had translated into price rises. The government outsourced the sale to wheat-selling export companies and was unaware of its mistake in selling such a huge amount of wheat to Russia. To add to their bargain, the Soviets obtained cheap credit from the Export-Import bank and an export subsidy to boot. The subsidy was designed to maintain the U.S. competitive position in world trade. Exporters received payments for the difference between the higher domestic price that they paid and the lower world price they received. Despite the sale of such a massive quantity of wheat, the Department of Agriculture went ahead and announced a restrictive wheat program for 1973. The shortage soon became apparent. Treasury Secretary George Shultz urged Butz to increase the number of acres of winter wheat to be planted in the fall of 1972. The secretary refused, and the White House supported him, presumably because of the November elections.[19] Butz did add more acres in 1973, but it was too late. A bushel of wheat rose from $2.16 to $5.17 in the twelve months after the summer Soviet wheat sale. Chinese, Japanese, and Indian purchases did their part too, stimulated by the devaluation of the dollar.

Americans consumed fewer grains and more meat. Focusing on farmers, Butz made little effort to transform land resources into grassland for cattle herds. Then, the rising price of feed stocks brought the system to the brink.[20] Twice in 1973, after high prices precipitated grassroots boycotts, Nixon froze prices. The problem was that feed prices continued to rise, but processors, wholesalers, and retailers had to keep their prices down. With echoes from the 1930s, processors drowned baby chicks and farmers slaughtered calves—drastic measures that processors claimed were less expensive than raising the animals to sell at low prices.[21] By August even Nixon had enough and unfroze prices, producing another price explosion.

Farmers made out very well. In 1973, for the first time since such statistics were recorded, on-farm income per capita in the United States

was higher than off-farm income.[22] But food inflation was the inevitable result. High food prices were important in their own right, but they heated up distributional struggles between business and labor because food is an important component of working class spending. Union negotiators attempted to meet the higher food costs with higher wages for their members. This effort was one of the reasons why 1973 yielded the highest strike level since 1959.[23]

Mounting food prices returned the consumer to the forefront of American politics in 1973, and the government acted. On June 27, the Department of Commerce discovered that soybeans and cottonseed would be in short supply. The department embargoed exports and followed up this action with a licensing system. European nations also had used export controls to keep food prices down. The U.S. measures reduced prices but also angered foreign buyers that were accustomed to freely dipping into American stocks.[24] The government ended export subsidies for agricultural products, sold grain stocks, suspended meat import quotas, increased grasslands—in short, it did everything it could to increase supplies. In October 1974 President Ford called off a second wheat deal with the Soviet Union.[25] Eventually, food prices fell. Oil was a different story.

OIL

Extracting more oil was difficult in the near term. Also, oil price increases took more of a bite from consumer income than the food price increases did. In the twelve-month period between April 1973 and April 1974, retail food prices climbed 16.2 percent and energy directly purchased by consumers rose 31.3 percent. (Everything else increased 6.3 percent.) Rising farm incomes fostered conflicts between producers and consumers, but aggregate national income was the same because both groups were Americans. Such was not the case with oil. More of the revenues from rising oil prices went abroad. To reduce prices Congress tried to increase supply and reduce demand. It gave the green light to the Alaskan pipeline, year-long daylight savings time, and a fifty-five-mile-an-hour speed limit for trucks and buses and fifty for automobiles. Domestic oil prices were still under the controls imposed by Nixon in 1971. To encourage exploration, the government allowed the price of "new" oil to rise, at the same time it discouraged inflation by keeping the price of "old" oil low. Treasury Secretary George Shultz's preference was to let the market deal with shortages: remove all the controls and let price determine who got the oil. Those who used oil most efficiently would be willing to pay the highest price. The others would limit their use or substitute other kinds of energy. But even Shultz agreed that the government could not simply let markets determine the matter. If that were the case, hospitals could lack heat, regions might experience blackouts, and the poor could be rendered immobile. Although legislation requiring a World War II system of rationing nearly passed in the Senate, it was not a good model. In the 1940S the nation possessed clear policy goals and temporary shortfalls swathed in shared purpose. None of this was true of the current energy crisis. Only the Dutch, particularly hard-hit, used rationing, and even in this small, homogeneous country it was widely flouted.

The government did win more control over oil. Congress passed the Emergency Petroleum Allocation Act, which authorized the government

to assign distribution of crude oil and refined products, a power traditionally exercised by the oil companies. The system attempted a fair distribution of the different-priced oil within regions and industries. After defense and essential civilian services, like hospitals, industrial uses enjoyed the highest priority to minimize unemployment. The unadvertised goal was to reduce gasoline production and consumption. Inevitably the auto industry, especially the Detroit producers of big cars, was hurt, along with the workers who made them. But employment in other industries held up pretty well initially.[26] In early 1974 gasoline was allocated stingily, which angered Americans who were forced to wait hours in long lines to fill up. But the conservation measures and high prices reduced demand. By spring, drivers had plenty of gasoline.

Although the public focused on the availability of gasoline, the critical issue was the supply and price of crude oil. Nixon told the nation on November 7 that his goal was "to meet America's energy needs from America's own energy resources" and called this "Project Independence." Nixon signed legislation creating the Federal Energy Administration on May 7, 1974, which established for the first time state authority to determine the size of petroleum inventories, energy distribution and consumption, and other data. Previously, the government relied on the energy companies.

Extracting more American oil was not so easy. First, there were the Nixon price controls. "Old" U.S. oil, already discovered, represented 70 percent of American production and cost $5.25 a barrel. "New oil" cost $7, and OPEC oil cost $9.37.[27] On average, price controls sheltered Americans from the full impact of the new global price. Republicans wanted to increase the price of domestic crude oil to reflect its true cost but disagreed about what that price should be. The Council of Economic Advisers (CEA) said that this number should increase to meet the global market value, the OPEC price. If the CEA privileged efficiency, the Treasury and Energy Office, headed by William Simon, aimed to increase domestic supply. They thought that an increase to $6.50–7.00 a barrel for all domestic oil would do the trick. However, the director of the Cost of

Living Council preferred a smaller price increase so that price-wage controls would not be disturbed. Nothing was done because each of the three options had disadvantages. Everyone feared the effect of the price rise on inflation and the risk that higher oil prices would hasten wage and price increases, currently held in check.[28]

Rising oil prices offered Democrats many opportunities to exploit the issue. The party's economic agenda was in disarray because Nixon had appropriated its primary inflation fighting policy by implementing wage and price controls in 1971. Its 1972 platform had concentrated on Vietnam and neglected the economy. The McGovern loss left the party with no spokesperson and no economic agenda of its own. Instead, the party played defense. It protected the immediate interests of consumers by keeping gas and oil prices low. After that, Democratic attacks on the oil companies substituted for policy. Presidential hopeful Senator Henry "Scoop" Jackson summoned representatives of the leading oil companies before his subcommittee in January 1974 and accused the oilmen of misleading the public, creating a false crisis, obtaining "obscene profits," and being disloyal for honoring the Arab boycott and not supplying the United States Armed Services.[29] Not since the days of Ida Tarbell were oilmen raked over the coals in this manner. But the Democrats were as divided as the Republicans when it came to a program. Some advocated rationing, consumers in the eastern states liked the low prices produced by price controls, producers in the southwest wanted higher prices, others proposed a national corporation to explore for oil, and a few wanted to raise taxes on gasoline. Some even asserted that there was no energy problem at all.[30]

Democrats blocked the president's plan to raise domestic oil prices, but they could not agree on one of their own. When the president taxed imported oil on January 23, 1975, to reduce foreign oil imports and the balance of payments deficit, governors of ten northeastern states, heavily dependent upon foreign oil, hit the roof. Governor Michael Dukakis of Massachusetts accused Ford of "holding the Northeast hostage for his program" of energy decontrol. On August 11 the U.S. Court of Appeals

ruled that the president had exceeded his authority.[31]

A variety of TVA-like projects filled the vacuum. Some Republicans, as well as Democrats, wanted the government to own and develop oil in the United States or abroad, finance energy exploration, or market foreign oil. Senator Frank Church and the AFL-CIO thought the government should control oil and gas imports. Because foreign oil was now owned by sovereign states, the U.S. government would be in a better position to obtain lower prices. Vice president Nelson Rockefeller proposed a $100-billion Energy Resources Finance Corporation to underwrite, through loans and loan guarantees, energy projects that failed the market test of profitability. Ford made the plan his own and introduced it as the Energy Independence Authority Act in April 1976. Senator Jackson, too, wanted government to invest in energy projects on U.S. public lands. He and Church also wanted the state to take over oil importation and require sealed bids to maximize prospects for OPEC countries to undercut each other.[32] And finally, Senator Adlai Stevenson III offered a government energy corporation to purchase, export, and produce petroleum outside of American borders. The corporation would also have exclusive rights to develop resources on government-owned lands to redirect exploration and production away from the Middle East. Stevenson argued that the multinational oil producers had a vested interest in these areas, but the nation did not.[33]

All these efforts to get the government into the oil business were defeated, and for the same reasons. First, there were no precedents for state-owned energy corporations in the United States, and there was no convincing evidence that a state corporation would work better than current arrangements. All of the plans ignored the strategic change that had taken place in the Middle East. A government monopoly on importing would be unable to reduce prices without the support of Europe and Japan, because the United States took in only 10 percent of OPEC oil. But these other big users were accommodating OPEC oil producers, not seeking consumer solidarity. Further, the government would have to be prepared to cut back on purchases if the price was too high. Would it do

that in the midst of a cold New England winter? Many of the plans depended upon tapping U.S. resources. But it was an open question whether a public firm would be more diligent than a private one in finding oil in the United States. Some experts argued that low domestic prices inhibited exploration, while others argued that few resources remained for recovery in the United States. As it turned out, domestic oil production peaked in 1970.

The state plans lacked fervent constituencies. Conservatives opposed more regulation of the energy markets. They believed that a public corporation would threaten existing energy companies. But many liberals, the likely base of support, opposed any oil exploration because they favored conservation and less-capital-intensive technologies. Others believed that energy projects would end up in the hands of big energy companies. Environmentalism and the antigovernment penchant of the New Left and New Politics undercut state solutions.

Instead of creating new public corporations, Democrats and Republicans compromised on price. The Energy Policy and Conservation Act, signed by the president on December 22, 1975, lowered the price of domestic oil. (In 1976 domestic oil was $8.84 a barrel while OPEC oil was $13.48, much to the dismay of domestic companies.) But it permitted the president to raise the price up to 10 percent a year to account for inflation and to spur production. The bill allowed him to ration in the event of another embargo and authorized a national oil reserve at a billion-barrel level, something the oil companies had opposed in the past. The auto industry would be required to improve its gasoline mileage setting a goal of 18 miles per gallon in 1978, 20 by 1980, and 27.5 in 1985. (The president and industry had wanted voluntary standards.) And, there were many conservation incentives that helped on the margins.[34] Free marketers in the administration, like William Simon, and the American Petroleum Institute urged Ford to veto the bill, but the president, more pragmatic and realistic, signed it into law.[35] Herbert Stein's description of Nixon energy policy fit Ford's: "We somehow muddled through the crisis but we left ourselves with a terribly

inefficient, cumbersome system for the future."[36]

Prices were still controlled, but presidents could raise them incrementally; the law guaranteed another look at the whole system again in 1979. Republicans were forced to accept a major role for government, and Democrats acknowledged, if only for the future, that government price controls that tried to displace, not modify, the market were unworkable. Still, other factors were entering the equation. The crisis had ebbed. The United States was importing less oil, but that was as much due to the recession as to any action taken by the government. And the nation could not simply muddle through the recession, as it did the energy crisis.

FROM INFLATION TO RECESSION

Rising oil prices not only produced inflation and recession but destroyed the rough consensus of the affluent society. It started in the White House after Ford embraced the conservatives' view of the economy. Like Nixon, Ford came from the moderate wing of the Republican Party. Congressman Ford had represented the area around Grand Rapids, in western Michigan. Well-liked by his peers in the Congress, he defeated Indiana's Charles Halleck for minority leader in 1965, gaining the votes of liberal Republicans. Ford was more conservative than these backers. He had opposed the War on Poverty and supported the war in Vietnam. Nixon had wanted him to be his vice president in 1968, but Ford preferred to work instead toward becoming a future Speaker of the House. Nixon named him vice president after Spiro Agnew resigned.[37]

When Ford became president in August 1974, reducing inflation was at the top of his agenda, even though the rate had been falling the whole year while unemployment was rising. The judgment had more to do with ideology than the numbers. Nixon's advisers Herbert Stein and William Simon had already concluded that inflation was the major issue and accepted the unpublicized corollary that lowering the rate would require "some pain and sacrifice."[38] Shortly before Nixon resigned, Stein left the government to teach at the University of Virginia, and Alan Greenspan, who had joined the CEA only in July, became the new chair. Greenspan kept his post under Ford. A former jazz musician, he had earned an M.A. degree in economics at New York University.[39] Like his early mentor Ayn Rand, Greenspan championed capitalism, opposing not only socialism and communism, but also the mixed economy, the bible of practices used by all Western governments after World War II. Instead of completing a doctorate at Columbia, Greenspan and bond trader William Townsend started a business consulting firm, Townsend-Greenspan. The two offered economic analysis to corporations when few companies employed professional economists on their staff. His conservatism flavored his counsel. In January 1974, when the oil embargo was still in

effect, Greenspan told his clients that too much attention was being placed on oil. "Excessive concentration on the problem of energy supplies is diverting our attention from … the real threat—accelerating, expanding, federal budgets and an ominous growth in antibusiness sentiment."[40] Greenspan became one of Ford's trusted advisers. Along with William Seidman, the former head of an international accounting firm whom Ford chose as his economic counselor, and William Simon, who continued on as secretary of the treasury, Ford's top advisers were men who came from the world of business. And it showed.

On August 12, three days after he was sworn in, Ford addressed a national television audience. He declared that "inflation is our domestic public enemy No. 1" Powered by rising oil prices, U.S. inflation had peaked at 11 percent in January 1974, but then declined rapidly. This number was lower than the rate in every European country but Germany.[41] Ford did not acknowledge, however, that both GDP and employment had been falling throughout the year. His economic advisers could see the plunging consumer spending but attributed it to inflation. Greenspan thought that business investment would keep the economy growing, never considering that insufficient consumption, reduced by high energy and food prices, would decrease investment spending.[42] Indeed, investment sharply declined throughout the year.[43]

In September, the new president held a series of summits with economists, labor leaders, businessmen, and social activists. Labor and civil rights representatives were the only ones who told him that unemployment was the key issue. A disheartened labor conferee concluded, "It's still a rich man's Administration."[44] Ford offered the traditional Republican medicine for inflation—reduced government spending and high interest rates.[45] Greenspan acknowledged that these measures would not, in the short run, reduce inflation and might not work at all.[46] His proposals thus addressed what he called "underlying inflation" or "inflationary expectations," not the inflation caused by food and oil prices. Greenspan believed that government spending was the root cause of inflation.

For all the talk about the inflation menace, Ford's remedies disappointed. The heart of the plan was a temporary 5 percent tax surcharge on corporations to pay for a 10 percent investment tax credit, up from the current 7 percent. The credit was supposed to encourage investment to ease supply shortages in manufacturing and utilities. It was the administration's down payment on broad changes in the tax system to foster investment. A 5 percent surtax on the top half of the income ladder and $5 billion in cuts in government spending would compensate for removing the poorest from the tax rolls, extending unemployment insurance, and authorizing some public service jobs. Because the budget would be fiscally neutral, it would do little to contain either inflation or recession. The meager measures were aerated by a whirlwind mobilization of citizens against inflation. "WIN," Whip Inflation Now, was the slogan for this campaign, modeled upon the voluntarism of the New Deal's Blue Eagle campaign for the National Recovery Act (NRA) industrial codes, a curious model for a Republican president. Ford urged citizens to grow their own food, balance their budgets, use credit wisely —in short, to restrain their demand for goods. All this was too much for Chrysler Corporation chair Lynn Townsend. Noting that car sales were down 28 percent in October 1974 from the previous year, Townsend said, "We're seeing a direct reflection of the Administration's no-buy policy." He reported that Chrysler was planning to reduce its capital spending by nearly 10 percent in 1975. If there was no demand, why would Chrysler find Ford's investment tax credit useful? It was not just Chrysler. By the middle of December nearly a quarter of a million autoworkers were on permanent or temporary layof.[47]

Throughout 1974, the automobile and construction industries had been in a slump. The former because of high gasoline prices, the latter because of high interest rates. Ford met with auto executives and United Automobile Workers (UAW) president Leonard Woodcock in December. They wanted emission and safety requirements frozen for five years and tax cuts to stimulate car sales. Henry Ford II went further, asking the government to consider reviving another New Deal instrument, the

Reconstruction Finance Corporation, to pull the nation out of the current recession. The industry needed capital, unavailable because of the collapse of the equity markets and tight money. The construction industry was equally distressed. Unemployment among construction workers was double the national average. President Ford admitted that the nation suffered "the longest and most severe housing recession since the end of World War II."[48] He listened politely but viewed both industries' problems to be cyclical.

While the president focused on automakers, the appliance, textile, furniture, semiconductor, and television corporations were also struggling. A Gallup poll found that 51 percent of Americans expected a depression like the one in the 1930S, a sign of plummeting consumer confidence. And no one found any light at the end of the tunnel in the service or technology sectors. The president of a leading producer of minicomputers, as they were called, expected his growth rate to plummet. Texas Instruments, the nation's largest semiconductor maker, announced that it was laying off at least two thousand employees because of shrinking markets.[49]

The Ford economists had been blind to the developing recession because they missed the significance of the fall in consumption. Assuming that government spending was excessive and that too much consumption was eating into investment, they were complacent about the fall in consumer spending. In October, when Townsend was warning about trouble in the auto industry, Greenspan "strongly urged resistance to expected pressure to increase expenditures and adopt expansionary policies."[50] Inflation would be curbed by restraining the budget in 1975 and beyond. A smaller federal budget would reduce the demand for money, which in turn would reduce interest rates. Eliminating restrictions, especially those on food production, and increasing productive capacity through the investment tax credit, would end shortages.[51] This was not a recipe that could reduce unemployment, and they acknowledged it to each other, if not to the public. In December, Ford's Economic Policy Board, his chief policymaking body, asserted,

“Below capacity growth is necessary, but a deep recession is neither likely nor politically acceptable. Our primary concern is to defeat inflation while avoiding a too severe recession.”[52] The economy continued to deteriorate.

The November 1974 elections ended presidential complacency. Democrats gained forty-three seats in the House and three in the Senate, and now enjoyed majorities approaching two-thirds in both houses. Democrat Floyd J. Fithian, a history professor, won election in an Indiana district that had elected only Republicans for the past forty-two years.[53] The day after the election Ron Nessen, Ford’s press secretary, reported, “No one feels yesterday’s vote was one against the President’s economic program.”[54] Few believed him. Still, the results had many causes. In the North, new victories often came in affluent, suburban Republican districts, where voters were presumably sickened by Watergate. But in the South, the economy seemed to be the cement that brought black and white Democrats together. In North Carolina, a populist Democrat defeated a Republican challenger for Senator Sam Ervin’s seat. The state was littered with textile and furniture plant closings. A white woman from eastern North Carolina declared, “If we vote Republican in November, we’ll be eating rabbit in August.”[55] The trend in the South was the election of white Democratic moderates. Nine first-term Republicans lost in 1974, halting the growth of southern Republicanism.[56] The white moderates and the growing numbers of black congressmen made the southern congressional delegation considerably more liberal than ever before. Don Riegle, a congressman from Michigan, warned his old friend the president, “Any version of the old-fashioned southern strategy … just isn’t workable” anymore.[57]

The elections and the swift deterioration of the economy at the end of 1974 produced a Republican U-turn. From October 1974 through March 1975, the nation’s economy experienced its steepest decline since the 1930S. Productivity plunged 2.7 percent. The decline in business profits was the worst in seventeen years. Wages fell 2.1 percent. Unemployment reached 7.2 in December, at which time Congress forced Ford to sign

bills that created a hundred thousand public service jobs and extended unemployment compensation thirteen weeks.[58] On January 13, 1975, speaking to the nation, he proposed a tax cut, replacing his planned tax surcharge.

The president's actions addressed the recession, but his language did not. His belief that needed investment was being diverted into excessive consumption did not die. "Part of our trouble is that we have been self-indulgent," he said. Making it clear who was consuming too much, he declared that "for decades, we have been voting ever increasing levels of government benefits—and now the bill has come due." More passion infused plans for Social Security cuts, civil service and military retirement pay reductions, and food stamp limits, than permeated the measures to create jobs or aid the unemployed. The old agenda shaped the new one. Greenspan told Ford in February that the goal was to curb "the rise in unemployment in a manner that is consistent with the goal of preventing a resurgence of inflation."[59] These words translated into a modest stimulus of $16 billion when many economists advocated $30 billion.[60]

So when the Democratic Congress presented a bill that reduced taxes by about $23 billion, Ford thought about wielding the veto pen. He wanted more of the cut to go to the rich and to businesses, both of which presumably would invest and not consume it. The bill included the new earned income credit, seen as a way to protect poor people who do not pay any income taxes from the rising payroll taxes of social security. Ford and his advisers opposed this "new and undesirable welfare type program" but feared that something worse would replace it.[61] After all, the Democrats had huge majorities in the Congress. Simon and Arthur Burns urged him to veto. Ford and his more pragmatic advisers, including Greenspan, thought that signing the bill was the fastest way to obtain a stimulus and to draw the line on any new spending. When the president signed it on March 29, he spent most of his time warning Congress to cut spending and vowing to veto bills if it did not.[62]

The tax cuts worked. The 10 percent rebate on 1974 taxes (up to a $200

maximum), the $50 checks for the retired, mailed out in May and June, and reduced payroll withholding taxes promoted retail sales and then industrial production. The budget deficit was $66 billion in 1975, just the medicine Keynes prescribed for a recession. And the Fed followed the president. Like Ford, the Fed fought inflation, not recession, in 1974. The Fed funds rate peaked at nearly 13 percent in July 1974. Chair Arthur Burns began reducing rates at the beginning of 1975, and by May 1975, when unemployment was 9 percent, the rate was down to 5.2 percent. In the second half of the year GDP rose between 7 and 8 percent after a fall of 5 percent during the recession months; inflation fell from double digits to 7 percent, but unemployment remained at 8.5, only slightly better than the 9 percent high.[63] That high unemployment rate despite growth was the fly in the Keynesian ointment.

Ford reluctantly extended the 1975 tax cut through the first six months of 1976. The president wanted a congressional promise to cut an equal amount from the budget. But Democrats, like Keynes, believed that an equal spending cut would cancel out the effects of the tax cut that the still sluggish economy required. Ford and the Republicans countered that government spending "crowded out" private spending, a phrase coined by William Simon. The president was forced to swallow a $17-billion tax cut with only a promise to revisit the question of spending cuts the next year.[64]Inflation was down to 5.8 percent in 1976, dramatically lower than the 11 percent of 1974. Indeed, only Germany's inflation rate was lower than that of the United States among industrialized nations. But everyone agreed that unemployment would hover around 7.7 percent during 1976. So the economic debates continued.

When economies do poorly, the reigning economic paradigms are questioned. Keynesianism was in trouble, but the alternative was not evident. The Nobel Prize committee perfectly captured the impasse. On October 9, 1974, it announced that Gunnar Myrdal, the social democratic Swedish economist, and Friedrich von Hayek, the Austrian-born British free marketer, would share the prize for economics.[65] Following that script, left and right formulated alternatives for the United States.

CRITIQUE OF KEYNES — THE LEFT

Initially, the critique of Keynes from the left was more powerful because it was powered by mass movements. Labor and socialist parties, winning elections throughout Europe, implemented new and more labor-friendly economic policies.[66] The United States experienced more strikes in 1974 than in any year since World War II. The deep recession in 1975 dampened the number, but not the anger. The American labor movement believed that the outflow of capital starved American industries of capital they needed to improve productivity. The United States had removed all controls on foreign investment in January 1974. In the fourth quarter of 1974, long-term capital outflows from the United States amounted to more than $18 billion, compared with zero in 1973. Moreover, the money was going into manufacturing in East Asian countries, Brazil, and Mexico. U.S. investment in the extractive industries fell from 36 percent of all funds going to underdeveloped countries in 1973 to 18 percent in 1974; at the same time, manufacturing investment rose from 34 to 39 percent and services from 30 to 43 percent.[67]

The AFL-CIO and Senator Frank Church's subcommittee on multinational corporations thought that capital went abroad because of tax advantages and tariff barriers to U.S. exports. Capital controls and tax policy could keep capital and jobs at home. The Ford administration countered that capital went abroad because the returns to capital were insufficient in the United States.[68] The solution was to reduce domestic taxes on corporations to improve profits. William Seidman conceded that "restrictions on the outward flow of capital might result in greater investment in the U.S." However, "it would probably also result in a lower national income for the U.S. because investors would be prevented from exploiting foreign opportunities which in some cases yield a higher rate of return on capital."[69] Seidman recycled the what-is-good-for-General-Motors-is-good-for-the-country philosophy. Even if this viewpoint was true in the 1950S, was it still true in the 1970s, when American corporations produced abroad? To answer that question the

nation had to address the changing structure of the economy.

Economist Wassily Leontief, Nobel Prize winner in 1973, proposed to do just that. Leontief asserted that keeping the American "economy in good working order required more than just watching a few major statistics and making changes in the budget and money supply," the main tools of Keynes. Recall Paul Samuelson's comment twenty years earlier: "Whatever rate of capital formation the American people want to have, the American system can, by proper choice of fiscal and monetary program contrive to do."[70] It did not seem to be true. Walter Heller, who had helped make Keynesianism the state religion of the 1960S, confessed to fellow economists at the end of 1973 that "the energy crisis caught us with our parameters down. The food crisis caught us too. This was a year of infamy in inflation forecasting. There are many things we really just don't know."[71]

Leontief was co-chair of a group that drew up the Balanced Growth and Economic Planning Act of 1975, introduced by Senators Hubert Humphrey and New York Republican Jacob Javits. The legislation revisited earlier planning efforts, which had been bypassed by the robust Keynesianism of the Kennedy-Johnson era. Humphrey told Heller, "We surely need to take a look at the structural and institutional organization of our economy and know a good deal more about it."[72] Humphrey's aide added, "Macroeconomics has not borne the fruits we expected. We have come full circle from the early Sixties, and we are now looking at more sectoral problems."[73] So, affluence was not embedded in the nation's DNA. Urging a development bank, Humphrey wrote, "We have financed such banks throughout the world as part of our effort to provide more employment and to increase income in developing countries. I think it is time that we make such an effort in the United States."[74] He added, "Unlike some of my liberal colleagues, I am very concerned about capital formation. The capital requirements to boost employment in the future are going to be much heavier than they were in the past and they will not be met simply by getting the economy on its feet again."[75] Humphrey was not optimistic that he could convince Ford, but he thought that the

committee's work would be the blueprint for the Democratic president he thought would be elected in 1976.[76]

Meanwhile, Javits, with established connections to industry, tried to perfume the anti-capitalist odor emanating from the planning initiative. Javits reminded businessmen that planning need not be like the Soviet model, but could be pro-business, like the French.[77] Wall Street investment banker James Balog added, "We wouldn't run our families the way we run the economy.... Corporations plan and the government should, too. Planning could help us look beyond the next election." Balog was not the only businessman interested. Robert Roosa, partner in the Wall Street firm Brown Brothers Harriman, and Henry Ford supported it, too. AFL-CIO chief George Meany also signed on. Meany said, "We need longrange economic planning and priorities to minimize unforeseen major Developments.... The United States was not prepared for the urban crisis of the 1960's—which could have been foreseen by sensible long-range economic planning in the 1950's."[78]

The new planning went beyond Keynes. Keynesian activism was macroeconomic, focusing on aggregates—the effect of a budget surplus or deficit on the economy or the amount of demand produced by a tax cut. But aggregate measures could not equally doctor the state of Michigan, with an unemployment rate of 14.3 percent, and Kansas, with a 4.9 percent rate.[79]The new initiative was microeconomic, targeting particular sectors and sections. State planning had a history in the infrastructure industries—communications, transportation, and energy. Most others—steel, auto, computers, food processing—functioned without government direction or mandate. Because Keynesians lacked answers to the ailing food, oil, and manufacturing sectors, the planners earned a hearing. In his presidential address to the American Economic Association in 1976, Robert Gordon, one of Keynes's high priests, acknowledged that "we economists pay too little attention to the changing institutional environment that conditions economic behavior.... We shy away from the big questions about how and why the institutional structure is changing—and where it is taking us."[80]The Humphrey-Javits bill proposed to

examine environments and create an Office of National Economic Planning to oversee the traditionally regulated and the unregulated parts of the economy—both infrastructure and production.

These ideas did not come out of the blue. Sectors like steel, autos, and computers had been free from regulation in the United States but not in other countries. The American planners were well aware that the United Kingdom's Labor Party nationalized and merged fourteen weak firms to create British Steel in 1967. Every European nation but Germany owned steel mills. And, the technique was not simply employed by the left. In 1971, when venerable Rolls-Royce got into trouble, the Conservative government of Edward Heath nationalized it. While nationalization was out of the question in the United States, other forms of regulation were not. The Ford administration, unsympathetic to the European way of managing economies, nonetheless considered various industrial policies when national champion Pan American Airways lurched toward bankruptcy in 1974. Among the items considered were a cash subsidy, loan guarantees, and mergers. In the end the government decided that changes in the regulatory system would be necessary, in part because other airlines were also sinking.[81] Presumably, Humphrey-Javits's planning board could foresee industrial difficulties through ongoing monitoring and analysis.

Nobody advocated the old NRA model—direct industry-by-industry planning. The government would accumulate, collate, and analyze economic information, examine trends, and identify labor resources and financing needed to effect the plans. It would coordinate and integrate the new government mandates of the past fifteen years—transfer payments and spending for environmental purposes, as well as the subsidies that were doled out to agriculture, housing, fishing, and many other industries. Every two years, the board would submit a six-year plan to Congress. Coordination could anticipate future crises in food, energy, and other commodities, where shortages had cascaded without much warning.[82]

The legislation was introduced on May 12, 1975, when the unemployment rate reached 9.2 percent, the highest since 1941.[83] Public

estimation of business was at an historic low. In July a Gallop poll found that people had less confidence in big business than in organized labor, Congress, the Supreme Court, or the president.[84] A few businessmen were attracted to Humphrey-Javits. Michael Blumenthal, the head of Bendix and future secretary of the treasury in the Carter administration, said that "with the high level of technical competency in this country … we should be able to do a better job of sorting out goals and priorities rather than just muddling through." Nevertheless, Blumenthal stopped short of endorsing the bill. He was "well aware that some of those whose names have been associated with national economic planning are operating from a different agenda."[85] He, and businessmen less sympathetic with the idea of planning, read the names of those participating in the congressional conference "Economic Planning in a Free Society," on May 22. Yes, there was Leontief, Leon Keyserling, a former CEA chairman, the president of the NAM, and a vice president and chief economist of GM. But present, too, was Paul Sweezy, publisher of the Marxist *Monthly Review,* and a mélange of Marxist professors of economics, anthropology, and political science.[86]The White House saw "'far out,' anti-power structure spokesmen."[87]

The masses were not demonstrating in the streets for Humphrey-Javits in 1975, but they did not rally for NRA in 1933, either. In 1933 key White House officials—Adolph Berle, Raymond Moley, Rexford Tugwell—and then President Roosevelt himself supported NRA, but Humphrey-Javits had no such luck. To be fair, some of the president's advisers were interested. Robert Hormats, an economist on the National Security Council and future vice-chair of the investment banking firm Goldman Sachs, wanted the president to embrace the idea. It "could be a highly constructive Presidential initiative."[88] But Ford and his key advisers—Greenspan, Simon, and Seidman—disagreed.

The president told members of the National Federation of Independent Business that "we face a critical choice. Shall business and government work together in a free economy for the betterment of all? Or shall we slide head-long into an economy whose vital decisions are made by

politicians while the private sector dries up and shrivels away?”[89] The Chamber of Commerce agreed, assuming that the social goals of the planners would always trump economic eiciencies. The Chamber preferred Keynesianism to the new planning. “Aggregate demand management policy is preferable to supply management policies as a countercyclical device, as it does not suggest intervention in individual economic decisions.”[90]

Alan Greenspan believed that the “highly unsatisfactory performance of the United States economy during the past decade” caused the sudden interest in planning. But it was government, not the market, that produced the economic failures of the past years. Although every government and private agency could use better statistics and analysis, “the presumption that our statistical techniques will enable us to unearth areas of potential shortage or future price instability is just plain false.” And, if forecasting was not a science, then planners would set goals that were desirable politically but unlikely to be met in the real world. This would lead to greater intervention, as had been the case in Great Britain, the bogeyman of the right wing imagination. Humphrey-Javits authorized voluntary planning, but Greenspan assumed that “the real issue is mandatory planning, of which H-J is merely a stalking horse.” Such planning was redundant if not harmful, because the myriad institutions of the market system constantly adjust to changing circumstances and do so successfully if allowed to function freely.[91]

CRITIQUE OF KEYNES—THE RIGHT

Greenspan and Ford did not simply play defense and blame government for the poor economy. They injected new passion into traditional GOP complaints that overconsumption, inflationary finance, deficit spending, excessive regulation, and a tax code hostile to capital formation made it impossible for the nation to meet the investment requirements of the future. They declared that there was a capital shortage.[92] To strengthen the case, Ford appointed Burton G. Malkiel, a Princeton economist, to the CEA. Malkiel argued that the barrier to full employment was not inadequate demand, as Keynes argued, but the inadequate supply of investment capital.[93] Keynesians responded that the meager investment during 1975, when industries were operating at only two-thirds of their capacity, the lowest rate in the entire post—World War II period, was no test.[94] Who would invest under these circumstances when there was so much unused capacity? If unemployment was lower and demand robust, then there would be plenty of capital for needed investment. The Ford economists agreed that there was unused capacity but claimed that investors hesitated because they lacked confidence, fearing that government spending would reignite inflation. But with nearly 9 percent unemployment, it was difficult to convince people that inadequate demand was not the problem.

If the left wing solutions were powered by labor, the conservative ones reflected business, especially big business, which felt besieged. Between September 1974 and September 1975 top corporate executives from firms such as IBM, Exxon, Bechtel, and Hughes Tool held eight three-day meetings to explore the current and future role of business in U.S. society.[95]Most in this anxiety-ridden group believed that “the have-nots are gaining steadily more political power to distribute the wealth downward. The masses have turned to a larger government.”[96] Expansionary policies—tax cuts, budget deficits, cheap money, and the like—would inevitably produce inflation, which could be managed only by a system of wage and price controls, leading to more state controls.

The businessmen believed that the government, responding to the have-nots, controlled and allocated too much of the nation's wealth. They feared that the trend toward government financing, subsidy, and control would end up socializing investment decisions. And, on the basis of the economic troubles of the utilities, airlines, and railroads, they concluded that government regulation always ignored the imperatives of capital accumulation. Many thought that only a sharp recession would sober up their fellow citizens.

The corporate elite was mainly interested in tax and spending changes, but it embraced deregulation as well.[97] The goal of deregulation was to remove the hand of government from the alleged efficiencies of the market. Reality was more complicated, which was why deregulation was a secondary or tertiary business goal. Every market has rules created by government. Deregulation simply created new rules that gave advantages to new companies in an industrial sector. Regulatory changes are neither conservative nor liberal and have been implemented by governments on the right and on the left.[98] So the question became, could U.S. regulators meet the new economic and technological conditions? Conservatives said no, only markets can produce efficiency. Some on the left, like Ralph Nader, also said no, believing that the regulatory commissions were inevitably dominated by the industries they regulated. Senator Edward Kennedy agreed. Kennedy called "the New Deal faith in the science of the regulatory art a delusion," and said that agency independence "as a practical matter has come to mean independence from the public interest."[99] Was this theory of industry capture valid? Advocates cited Nixon's appointment of airline executives to the Civil Aeronautics Board (CAB) as a reward for campaign contributions. But Ford appointed John Robson, an airline critic. Most historians conclude that the story of railroad regulation was the story of shippers', not railroad, control.[100]

Whatever the theory, government could shape markets and technology but could not ignore them. The left often tried to transcend markets, and the right never acknowledged that all markets are created by laws and that they reflected power as well as efficiency. A U.S. mandate for low

prices for domestic oil was difficult in the face of the OPEC increases. Restrictions on entry into the long distance telephone market could not be maintained indefinitely once any significant economic barriers to entry were removed. Subsidizing local telephone rates by keeping long distance rates high was untenable when new technologies permitted substitution or bypassing of high long distance rates. Regulated interest rates could not remain far below market rates. On the other hand, unregulated markets could not guarantee energy supplies, health care, or an American steel industry. Edward Kennedy, who claimed that the regulatory art was a delusion when it came to airlines, found it fitting when it came to setting domestic oil prices. In most cases, regulation was a matter of interests and politics, not ideology. Because of this truth, deregulation was usually an ancillary solution to stagnant growth and meager productivity.

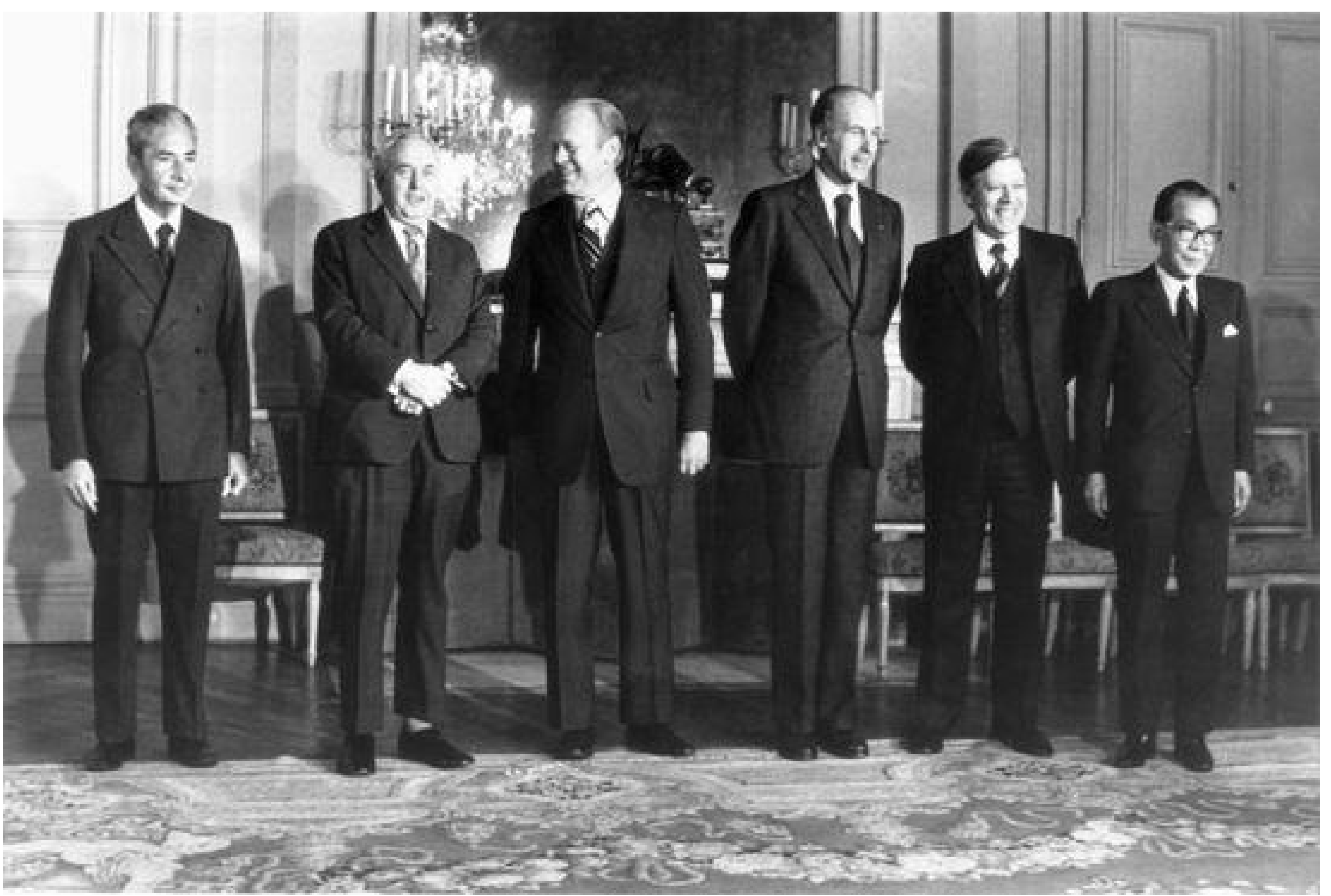
The traditional conservative arsenal of capital-friendly policies was supplemented by what might be called a New Right, promoted by a few departments of economics in universities and the editorial pages of the *Wall Street Journal.* But in the mid-1970s, this New Right was a sideshow. Milton Friedman's monetarism had been percolating through the economics profession since 1962, when he published *Capitalism and Freedom.* (Friedman received his Nobel Prize in 1976.) Monetarism claimed that the money supply was the key variable in modern economies. Inflation is entirely a monetary phenomenon, and the Fed's attempt to boost the economy using faster rates of monetary growth, which the Fed was now doing, only led to inflation. Friedman's theory was rejected by the Federal Reserve until October 1979, when the new chair, Paul Volcker, temporarily embraced monetary targets to control inflation. Friedman was a steady White House visitor during the Nixon years, but the president rarely took his advice because, whatever his virtues as an economist, he was not a good forecaster. Ford ignored him, too.[101] The supply-side ideas of Jude Wanniski, the associate editor of the *Wall Street Journal,* were also for the future. Supply-siders argued that the United States was overtaxed, which limited effort. Radical tax cutting would quickly increase the amount of goods supplied to the

economy because work incentives would no longer be shackled. In June 1975 Ford assistant Richard Cheney and White House chief of staff Donald Rumsfeld sent Alan Greenspan a Wanniski column from the *Wall Street Journal*. Cheney identified him simply as a "friend of mine."[102] Greenspan did not respond. He and the other Ford economists practiced old-fashioned Republicanism; no monetary magic or deep tax cuts for them.

Divided government could resolve neither the intellectual nor the policy questions. A feeble Keynesianism soldiered on. But divisions between Republicans and Democrats and capital and labor deepened. Until this crisis, tax laws and other economic measures generally combined ideas from Republicans and Democrats, capital and labor. The name "mixed economy" was appropriate. Democratic economists and politicians had been willing to accept tax changes to promote capital investment. They had second thoughts when Ford proposed to reduce consumption to pay for untargeted investment subsidies and tax cuts tilted to the rich in the midst of the recession. As Ford became more class conscious, labor and the Democrats did too. They returned to their argument that savings was adequate and expanding demand would provide enough incentive for investment.[103] This conviction was enhanced by unemployment, over 7 percent, which had been immune to the economic recovery that began at the end of 1975.

CRISIS OF THE WEST

Although plagued with stalemate, the United States continued its role as the ballast of the globe and market of last resort. The other industrial powers seemed to be in worse shape. The deep recession of 1975 produced the highest unemployment rates in Europe since World War II, soaring inflation, negative growth, and mediocre prospects for 1976. French president Valery Giscard D'Estaing invited the leaders of the United States, Germany, Italy, Japan, and the United Kingdom to an economic summit outside of Paris at the Chateau de Rambouillet in November 1975. The word "summit" evoked the gravity of the meetings between American presidents and Soviet chairmen. No one imagined that this would be the first of many meetings that would eventually be named according to the number of participants—the G-7, G-8, and now the G-20. France preferred to keep its distance from the United States when dealing with Arab oil exporters, but Giscard d'Estaing knew that this was impossible on economic matters. In 1975 the inflation rate in France was 15 percent, and national remedies could not be formulated without taking into account the policies of the others. This interdependence was not so apparent in the recent boom, but the recession exposed the webs that linked them.[104] Unemployment was at a postwar high everywhere; as usual, the United States led with nearly 8.9 percent in the second quarter of 1975. But over 5 percent in France and Great Britain and nearly 5 percent in Germany contrasted with rates between 1 and 3 percent in the early 1970s. World trade declined in 1975, the first such occurrence since World War II. When the meeting took place that November, U.S. and Japanese recovery was under way, but there were no green shoots visible in Europe.



Six heads of state attended an economic summit at the Chateau de Rambouillet, outside of Paris, in November 1975. This meeting was the first of what would be called the G-7 (Canada), G-8 (Russia), and today G-20. As the world became more globalized, the industrial powers concluded that coordination was the best way to resolve the global recession caused by the first oil price increase of 1973–74. Pictured, left-right): Premier Aldo Moro of Italy, Prime Minister Harold Wilson of Great Britain, President Gerald Ford of the United States, President Valéry Giscard d'Estaing of France, Chancellor Helmut Schmidt of West Germany, and Premier Takeo Miki of Japan. (AP Images)

A state department official observed, "Interdependence for Europe means a lifeline from the United States."[105] France, as always, aimed to get the United States to return to Bretton Woods. Germany was more concerned with exports—especially to the United States—on which its

prosperity depended. In Germany, 23.2 percent of GNP consisted of exports, while in the United States the figure was 7 percent and in Japan it was 12.3 percent. Recession hit trade harder than it did domestic output, and in 1975 global trade fell 10 percent. Germany, despite a package of expansionary measures, had not yet rebounded from the recession because of unsold exports, most of which were planned for the United States. The recession had sharply reduced U.S. imports. Because Germany's exports became even more important as a result of costly oil imports, Chancellor Helmut Schmidt questioned the sufficiency of Ford's fiscal and monetary stimulus.

Ford stood firm against German demands. Although he accepted the U.S. role as the market of last resort, he came to the summit with some ammunition—nearly 7 percent growth in the recent quarter. He denied that more U.S. growth would substantially affect any one country.[106] And like the United States, most countries had stimulated their economies in 1975 after the restrictive policies of 1974, which would eventually help. New measures, according to the American recipe, should strengthen the foundation for "continued stable non-inflationary growth." This meant promoting competition and ensuring sufficient capacity to meet the growing demands for oil and other commodities. And the way to do that was the "restoration of private sector confidence," not more stimuli.[107] In the end there was compromise all around. The Germans would wait, hoping to profit from American growth. Giscard d'Estaing gained enough to defuse criticism from the Gaullists. The stronger dollar, which was now at the same level as it was before the second devaluation of January 1973, met some of the French complaint.[108]

The Americans came home ecstatic. Henry Kissinger, placing the meeting in a Cold War context, said, "All this talk about the Soviet bloc being on the offensive and the democracies on the decline just isn't true. These leaders are dynamic and the West under this sort of coordinated action can handle all the problems before us easily." William Simon was equally jubilant.[109] Alan Greenspan was downright smug, concluding that the recovery was secure and that "it is not government stimulus or

monetary expansion … but a more rapid than expected improvement in the confidence of consumers and business" that produced it. "It reinforces a policy judgment made by the President early in 1975 not to pull out all the stops of government stimulation. Had that been done, we would probably already be seeing the first signs of frenetic imbalances in the economy and growing threats to the emerging prosperity that we now all see on the horizon."[110]

The exuberance of Ford and his advisers was puzzling, considering that all of the participating political leaders—including Ford—were under attack and vulnerable.[111] France's center-right government was challenged by the "Union of the Left," formed in 1972 by the Socialists, Communists, and Left Radicals, and also from the right by the Gaullists who resisted cooperation with the United States. Germany's Helmut Schmidt, a Social Democrat, faced strong opposition by a center-right coalition led by Helmut Kohl in the upcoming October 1976 elections. Japan's prime minister Takeo Miki was an accidental leader, achieving his position in the wake of bribery allegations and the inability of warring factions of the ruling Liberal Democratic Party to resolve their differences. Prime ministers James Callaghan and Aldo Moro were exposed because the economies of their countries, Great Britain and Italy, respectively, were very weak. Callaghan came to office when the Conservatives were voted out of power in the midst of the coal miners' strike. Nevertheless, the Labor Party leader got no slack when workers' wages eroded. Moro faced the likelihood that Italian Communists, who had committed to a "historic compromise" with capitalism, would do well in the upcoming election and would be offered a place in the new government.[112] In Europe's outskirts, Dutch Socialists won power for the first time in fifteen years, while Portugal ended a military dictatorship and replaced the generals with a radical Socialist government.

Ford was perhaps in the weakest position of them all. An unelected president, he was currently being challenged from the right by Ronald Reagan in the Republican primaries. If Ford turned back Reagan, he would face a Democrat whose party had just triumphed in a congressional

landslide in 1974. U.S. unemployment was high—about 7.5 percent. Although the government was content that the figure was lower than the 8.5 of the previous year, many labor and black leaders were not.[113] The legitimacy of democratic capitalist governments rested in part on their economic performance, especially employment rates. Zbigniew Brzezinski, the prominent foreign policy adviser to Democrats (currently to presidential candidate Jimmy Carter), told Kissinger that he did not think the "crisis of the west" had ended.[114] Samuel Huntington, the Harvard political scientist who always had his finger on the latest intellectual trends, agreed, wondering whether democracies were governable.[115]

Then, in the middle of 1976, U.S. growth unexpectedly paused. In response, Democrats wanted new expansionary policies. Ford disagreed: "Fiscal and monetary actions that could carry inflationary implications would be more likely to constrain effective demand rather than to release it."[116] The disagreement between the Republican president and the Democratic congress, and the stalemate over investment and consumption and equity and growth, lived on. The consensus of the affluent society had ended, and a new one had not been forged. The electorate would get its chance to speak in the presidential election of 1976.

CHAPTER SIX
1976
MORALITY AND ECONOMY

ELECTIONS in the United States are mixtures of ideology and constituency, policy and personality. For much of the voting season in 1976, ideology was neutered by the size of the Democratic primary field, the absence of Hubert Humphrey (the lone candidate who stood for a clear alternative to Ford economics), and the nonideological posture of Jimmy Carter, the nominee who squeaked through. President Ford faced a spirited challenge from Governor Ronald Reagan of California. But the president was able to deploy conservative economics more effectively than the governor did. Reagan had energized social conservatives, but they were too few to topple the president. After a Democratic sweep in November, many penned obituaries for the GOP. But Democrats had their work cut out for them, as the party had not yet agreed on a road to economic recovery. Its labor, New Left, and New Politics factions charted different courses, and the Democratic president, Jimmy Carter, had run a campaign which had ignored the economy in favor of moral and good government issues.

THE DEMOCRATS

Nearly all states now held primaries, completing the reforms begun by the McGovern Commission. The smooth Robert Strauss, chair of the Democratic National Committee, salved the divisions of 1968 and 1972. Strauss deftly empowered party and elected officials but retained the inclusion rules, now governed by affirmative action, not quotas. For the first time, campaigns were governed by a new finance law that had been passed in 1974. The U.S. Treasury gave $21.8 million to each of the two major party candidates, provided that they spent no more. It also matched the offerings of small contributors to candidates running in the presidential primaries. The goal was to prevent the financial indulgences of the 1972 Nixon campaign—the large contributions, illegal corporate donations, and the hidden slush funds that fueled the Watergate wrongs. But the law also weakened the party itself by disbursing funds to candidates. The financing reforms, plus the new primary rules, created a paradise for lawyers but left everyone else at sea. Still, the incentives for Democrats were huge. Watergate and the recession made Republicans vulnerable. Exiling big donors and distributing government matching funds encouraged the notion that anybody could run.

The presidential hopefuls together personified the history of liberalism and its social movements since 1960, which was a problem because the primary enhanced every division among the competitors and ignored the one that distinguished them all from their Republican opponent. Senator Edward Kennedy's decision not to run left a big void. The youngest of the Kennedy brothers had seemed likely to inherit the family political fortune, but in the summer of 1969 he plunged his car into a pond. He managed to escape unharmed, but the twenty-eight-year-old woman traveling with him drowned. He did not report the accident until the next day, and his tortured explanation convinced many that he was a fatally wounded candidate. Kennedy was out of contention in 1972, but after the McGovern debacle many believed that the nomination was his if he wanted it. He decided he did not. The drowning incident, a son stricken

with cancer, a wife with a drinking problem, the thirteen children of John and Robert to shepherd, and the unspoken fear of another assassination combined to keep Kennedy out of the 1976 race.

Many liberals auditioned to take Kennedy's place: Representative Morris K. Udall of Arizona, former governor Terry Sanford of North Carolina, former senator Fred Harris of Oklahoma, Governor Milton Shapp of Pennsylvania, Senator Birch Bayh Jr. of Indiana, Sargent Shriver (husband of John Kennedy's sister Eunice), Senator Frank Church of Idaho, and Governor Edmund "Jerry" Brown Jr. of California. The center was not so well represented: Senator Henry Jackson of Washington was the dominant figure, while a little further to the right was Senator Lloyd Bentsen of Texas. Also in the center was former governor Jimmy Carter of Georgia, whose views were unknown but whose rhetoric combined old-fashioned evangelical and New South themes. On the right, at least on race, was Governor George Wallace. Senators Edmund Muskie, Hubert Humphrey, and George McGovern waited on the sidelines.

The liberal candidates were for the most part seasoned legislators, reflecting an age when Washington know-how was a job requirement for presidents. All wanted to bridge the divide created by the 1972 election, but their instincts and experiences were closer to the New Politics sensibility than to the new economic issues confronting the country. The six-foot, five-inch-tall Udall was typical. He had supported Muskie in 1972 and, after the McGovern defeat, was completely convinced that the Old and New Politics needed to merge. Like other western liberals, Udall supported water projects, Indian rights, and the environment. But beyond that he was more a process than an economic liberal. He worked hard to end congressional seniority and regulate the financing of campaigns. These were important issues during the age of affluence and Watergate, but they did not address the current recession and inflation. Udall lacked the passion and, perhaps, the ego to distinguish him from other candidates. Former senator Fred Harris, the born-again populist, had both. Initially a conventional politician, thought to be a protégé of Oklahoma's oil interests, he had concentrated on Indian affairs and natural resources.

By 1970 he spoke out strongly against the war in Vietnam and added gun control to his portfolio of causes. He proposed a "new populism," a kind of war against the rich on all fronts, even though nothing in his record demonstrated a populist agenda. In 1971, concluding that the new populism could not help his reelection in conservative Oklahoma, Harris announced his candidacy for president in 1972. His wife, LaDonna, a Comanche and Native American activist, accompanied him on the campaign trail. Harris's run was short-lived. He sustained his populism with a book, *The New Populism,* a foundation, and the lecture circuit of college campuses, reformist labor unions, and the like to gather support for 1976.

Birch Bayh of Indiana was a three-term senator. He projected a farm boy image, as he did have genuine roots in the form of a degree from an agriculture school. But he went on to law school and made his mark on the Senate Judiciary Committee. Bayh was the architect of the Twenty-Fifth Amendment, laying out the path to the vice presidency in the event of a vacancy. He was the chief sponsor of the Equal Rights Amendment but met with more success with Title 9 of the Education Amendments of 1972, mandating equal opportunity for women at educational institutions. Bayh was one of the leaders of the successful campaign which rejected President Nixon's two conservative Supreme Court nominees, Clement F. Haynsworth Jr. and G. Harold Carswell.

Three other liberals entered the race. Terry Sanford, president of Duke University, had been governor of North Carolina from 1961 to 1965, during the height of the civil rights movement in the South. A liberal southerner, Sanford openly attacked George Wallace without hesitation or silence—unlike many other politicians in the South. But Sanford's resume was short on other issues. Governor Milton Shapp of Pennsylvania was the only representative of the industrial East and the only sitting governor in the race. A pioneer in the cable television industry, Shapp first ran for governor in 1966 as a New Politics candidate. He lost but ran again in 1970 with broader party and labor support, and this time he won. He was among the Democratic businessmen who believed that government had a big role to play in

policing the workplace and in providing public funds for economic development. But Shapp lacked charisma, plus he was Jewish, an unspoken barrier to the presidency. Sargent Shriver, the husband of President Kennedy's sister Eunice, kept a slight distance from the rest of the Kennedy clan. He had continued to work for President Johnson—heading the War on Poverty and accepting the position of ambassador to France—when the family worked to make Robert Kennedy president in 1968. An energetic campaigner, he earned the gratitude of the party when he stepped in after Thomas Eagleton was forced to forgo the vice-presidential nomination in 1972. Still, Shriver's candidacy was never taken seriously because he was considered a stalking horse for his brother-in-law.

The liberal candidates, with meager popular followings, hungered for the endorsement of the New Democratic Coalition (NDC), which represented the Democratic Party's reform wing formed by McCarthy and Kennedy supporters after 1968. The NDC had supported McGovern in 1972 but scattered its votes among Bayh, Udall, and Harris in 1976. The weak liberal field did not impress the newly elected governor of California, Edmund "Jerry" Brown Jr., who threw his hat into the ring before the Maryland primary in March. Brown was the son of a popular governor who unexpectedly lost to Ronald Reagan in 1966. The father was a New Deal liberal, but the politics of the son were harder to define. The younger Brown was socially liberal. An environmentalist, he was very strongly against the Vietnam war. He adopted contemporary counterculture qualities. Born a Catholic, he dabbled in Zen-Buddhism. He refused to sleep in the governor's mansion, after he was elected, preferring to use a mattress in a rented apartment. His politics seemed to follow his lifestyle. After the rise in oil prices, Brown told Americans that they had to lower their expectations of what government could do for them. This kind of "truth-telling" appealed to the press, which gave him considerable publicity. He won big victories in Maryland, Nevada, and his home state of California. Senator Frank Church of Idaho also entered late. Church was an early and effective critic of the Vietnam war. Like other western liberals, he championed conservation and the interests of

farmers. He captured Nebraska, Oregon, and his home state. Many considered Church to be too stiff and dull for national office, and he told journalist Jules Witcover that he would have stayed out if Kennedy or Humphrey had been in the race.[1]

In the center, Senator Henry "Scoop" Jackson of Washington was the last presidential candidate representing Cold War liberalism. He was a firm supporter of traditional New Deal social and economic legislation, punctuated by the environmentalism typical of Democratic senators from the West. But he was also a classic "cold warrior" when the rest of his party had forsaken a Manichean view of world politics. Jackson was an unrelenting critic of détente, and his aides—Richard Perle, Douglas Feith, Elliot Abrams, and Paul Wolfowitz—became central to the influential hawkish sect in the administration of President George W. Bush. They had not yet become Republicans, but in 1976 they were outside of the Democratic cosmos. Jackson was respected for hard work and knowledge of the issues—foreign policy, energy, and armaments. Although labor threw its chips across the board in 1976, he was the favorite of the top of the AFL-CIO hierarchy, President George Meany and Lane Kirkland, who was next in line. Jackson also won the hearts of American Jews when he visited the Buchenwald concentration camp after World War II, embraced the state of Israel, and championed the cause of Russian Jews unable to leave the Soviet Union. Senator Lloyd Bentsen of Texas shared the center although he was more conservative than Jackson on domestic issues. Bentsen had beaten liberal senator Ralph Yarborough in the Democratic primary and then thrashed Nixon's favorite, Congressman George H. W. Bush in 1970. He was a successful insurance executive, and it showed. An upper-class bearing without much legislative accomplishment made him an unlikely Democratic nominee no matter the political temperature.

And then there was the ex-governor Jimmy Carter, little known outside his home state of Georgia. He was from Plains, a tiny town in the southwest Georgia black belt. Carter graduated from the United States Naval Academy in Annapolis in 1946 and became an officer on a nuclear

submarine before he returned to the family peanut business after his father died. Believing he was meant for bigger things, the relatively unknown farmer/engineer served a brief term in the state senate and then ran unsuccessfully for governor in 1966. Undeterred, he ran again four years later and won. Carter was diligent; no county was too small for a visit. But his success stemmed from more than hard work. He embraced ideas that could bring him victory.

His main opponent in the 1970 election was former governor Carl Sanders, a liberal on racial issues. Blacks had traditionally supported Sanders. Thus, Carter courted the segregationist voting bloc. “I’ll strengthen local control,” he declared in Dixiecrat code. “I’ll make appointments based on qualifications.” Echoing George Wallace, he said, “Vote for Jimmy Carter. Isn’t it time somebody spoke up for you?” But Carter went further. Recognizing that he had no chance to get black votes, he attempted to deprive his opponent of them by having his media adviser develop radio commercials for a third primary candidate, C. B. King, a black lawyer. The Carter campaign paid for the ads, which inevitably took some votes away from Sanders. But Carter still received only 49 percent of the vote, forcing a runoff with Sanders. Now he could openly court voters attracted to Wallace and Lester Maddox, the former Georgia governor who refused to serve blacks in his Pickrick restaurant in 1964. Carter’s media adviser produced leaflets showing a photo of Sanders with some black basketball players and distributed them in white neighborhoods.[2] This time he won.

Carter was no racist, but his determination to win knew few boundaries. He took his place among a group of New South governors who had accepted civil rights, black voting, and desegregation. In Florida victorious governor Reubin Askew also reached out to white Wallace voters. But Askew constructed his appeal with an economic platform that promised higher taxes on corporations and lower taxes on working families, not demagogic racial populism.[3] So did Governor Dale Bumpers of Arkansas. But Carter was willing to play the Old Politics to achieve office, and he quickly set his eyes higher; 1972 was a little soon to seek

the presidency, even for ambitious Carter, but he hoped to be vice president. He had accumulated young, completely loyal advisers—Jody Powell, Hamilton Jordan, and Gerald Rafshoon—and would soon also attract Patrick Caddell. Ordinarily, such relatively green operatives would have no chance in the big leagues of presidential politics. But with the new rules and new finance laws, experience did not seem to matter.

Carter traveled abroad on trade missions for the state of Georgia to build up his foreign policy credentials. The New South governor with internationalist interests was asked to join the new Trilateral Commission, and he readily accepted because membership offered him more opportunity to meet world leaders and educate himself. Still, the governor's understanding of the world was patchy. He was impressed with the foreign policy expertise of the men heading U.S. multinational corporations and concluded, "If Caterpillar and Coca-Cola had cooperated with Mitsubishi before the war, perhaps Pearl Harbor could have been avoided."[4]

Despite his new foreign policy insights, Carter did not make this his campaign focus. He and his advisers, planning for 1976 even before the 1972 votes were cast, agreed that George McGovern had hit upon the right campaign theme: moral leadership. Unlike during McGovern's 1972 campaign, the full story of Watergate was now known, and so the honesty theme would be more effective in 1976. Also, McGovern never convinced the public of his leadership abilities or competence. Jimmy Carter was the superior vessel. His obscurity meant that Carter lacked the support of specific groups—blacks, labor, women—so he would have to appeal beyond constituencies, and even the Democratic Party, to the people at large. Necessity became virtue. Still, it was thin gruel. A competent but unremarkable governor, Carter needed more national exposure. Faced with unemployment after 1974, because Georgia law limited governors to one term, he volunteered to help the party in the 1974 congressional campaigns. This work introduced him to state and local leaders all over the country. It helped, but in early 1976 Carter was the presidential choice of only 2 percent of Democrats.

Meanwhile, George Wallace had not vanished from the political scene even though the would-be assassin's bullet left him paralyzed and wheelchair-bound. The party still feared his demagogic ability to tap into discontent, but now he was not so poisonous and distinctive. Wallace had begun his long string of mea culpas to the black community, and his issues had been domesticated.[5] The theme of big alien government had gone mainstream, overt racism had been slain by black voting, and bigotry had been wrung out of populism by the liberal candidates. When Wallace appeared before crowds, he was more an object of curiosity than a viable candidate.

Three others waited in the wings. George McGovern imagined he could reconstruct his 1972 coalition. He believed he had erred in 1972 by broadening his base, thus alienating his original supporters. He was the only leading candidate who did not think Democratic unity was desirable or possible. He would accumulate his majority by chasing independents and Republicans.[6] Edmund Muskie waited, too. His greatest strength was his acceptability across the political spectrum, yet that was also his weakness. If the convention deadlocked, delegates would most likely reject both McGovern and Muskie for the happy warrior, Hubert Humphrey. Humphrey had declined to enter the race but announced publicly on the Sunday news show *Meet the Press* that if no one got enough convention delegates and he was asked, he would accept the nomination.[7] President Ford expected him to be his opponent.

Humphrey had the best Democratic record on which to run a campaign in 1976. His dramatic announcement that "it was time for the nation to step from the shadows of states rights to the sunshine of human rights" had electrified the Democratic convention in 1948 and helped launch the modern civil rights movement and his own career. Humphrey was the shining emblem of liberalism in its age of achievement. Harry McPherson, an aide to Lyndon Johnson, observed that "Humphrey's heart longed for a just and humane society; his mind told him he must accept something less, some mild improvement, or no change at all in a status quo that offended him deeply…. [He] was a creative legislator, willing to

take risks."[8] But he was "not capable of the kind of ruthlessness that a great politician needs to have," McPherson added.[9]

After his presidential campaign loss in 1968, Humphrey replaced Eugene McCarthy, who retired from the Senate in 1970. Economic liberalism got a shot in the arm after the McGovern debacle and the onset of recession and inflation. Humphrey was the one candidate who had his eyes on the changes in the American economy, as well as the support of constituency groups that made liberalism a majoritarian political project. Those who believed that New Deal goals were out of date had nothing to say about the current economic situation. But Humphrey proposed legislation to heal the sick economy. He abstained from the emotionally satisfying anticorporatism, critiqued conventional Keynesianism, and offered social democratic solutions to repair the racial divisions in the party.

RACE AND THE DEMOCRATS

African Americans started voting Democratic in 1934 when the jobs and relief of the New Deal trumped the attenuated memory of Lincoln's emancipation. After a bipartisan interlude in the 1950S, blacks became firmly Democratic when the civil rights of LBJ joined the economics of FDR. Black voting ended the solid Democratic South. At a minimum, it allowed white upper-class and suburban constituencies that voted Republican in the North to do so in the South. Whether working-class whites would follow them into the GOP depended upon what national Democrats did, and this was unclear in the 1970s. Northern cities were still solidly Democratic, but faltering economies produced local conflicts between white and black Democrats that threatened to weaken the party. Many jobs and much of the middle class had moved from cities such as Detroit, Chicago, Cleveland, Philadelphia, New York, and Boston to the suburbs, or even farther away from urban areas during the 1950S and 1960S. Cities attempted to attract the middle class back with arts centers, sports stadiums, hospitals, and universities, and this form of urban renewal often destroyed working-class neighborhoods, Such victims relocated in adjacent quarters, which became overcrowded and turned run-down areas into genuine slums.[10] At the same time, the continued black migration from the South turned cities like Newark, Detroit, and Gary into majority-black municipalities. Even in cities where African Americans were not a majority, black politicians sought political representation commensurate with their numbers and thus challenged other Democrats for power. The same was true in the civil service, the one urban sector where employment was increasing. Blacks armed with new antidiscrimination laws mobilized to challenge older political and recruitment practices.

Black issues had been addressed separately during the 1960S. Whether it was the War on Poverty, affirmative action, or jobs for ghetto residents, the government acted as if, in the words of the Kerner Commission 1968 report on the causes of U.S. race riots, the U.S. was two societies, black

and white, poor and affluent. Although only 30 percent of the poor in 1964 were African American, 47.9 percent of nonwhite Americans were poor, compared with 14.2 percent of whites.[11] People disputed the origin of this difference. Conservatives blamed black culture, while liberals cited lives smothered by discrimination. But they all agreed that the black experience was poles apart from that of whites and ethnics and thus required unique measures. The term "black experience" was a singular, which implied that race overwhelmed every other human characteristic—class, gender, region. This formulation banished the economy and explained results on the basis of white attitudes or black behavior. The War on Poverty targeted youth and offered training to those whose culture or skills made them unemployable despite the buoyant economy. Especially after the urban riots, money went disproportionately to blacks in cities that had experienced riots. The original intellectual framework persisted. The programs targeted young people, not adults, and offered cultural training, not jobs. The formulation ignored the structural changes that reduced manufacturing employment in the cities. The Labor Department's Moynihan report of 1965 concluded that jobs were needed, but this point was overwhelmed by the controversy over the report's unproven contention that the black family structure was pathological.

Whatever the theory, the Democratic Party sponsored programs that increased resources—food, health, education—for African Americans. The War on Poverty and the Model Cities program, mostly centered in black areas, encouraged black businesses and fostered black employment. Particularly in the South, these initiatives encouraged the mobilization that brought blacks into the Democratic Party.[12] Yet the new strategies that enhanced black power made it difficult to promote class coalitions. Many of the initiatives were cemented by elite fear of racial disorder. The president of Western Electric Company stated bluntly: "If the cities continue to deteriorate, our investment will inevitably deteriorate with them."[13] Some black leaders feared that because of such evanescent sentiment, predominantly black programs would be unviable in the long run. A. Philip Randolph, the head of the Brotherhood of Sleeping Car

Porters, and Bayard Rustin, the civil rights strategist, were among the most labor-oriented of the black leaders. They were the architects of the 1963 "March on Washington," which was a march for jobs as well as for freedom. The pair attempted to promote cross-racial alliances with a "Freedom Budget" in 1966. It called for massive increases in spending for public works to create jobs and build housing in the cities. But the 1964 tax cut had eaten deeply into unemployment, depriving the proposal of the macroeconomic justification that could convince a broader swath of the population. In the short run, cross-racial alliances were difficult because the Democratic Party had worked to promote black inclusion but had no strategy for reconciling the resulting conflicts.

In addition, blacks needed broader alliances because of the diminishing returns of the strategies and organizations of the 1960S. The fear of racial disorder that had underwritten urban programs ebbed in the 1970s. Ford Motor Company had rushed to hire blacks in the wake of the Detroit riot of 1967, but then laid off the new black employees as well as older white workers in the recession of 1970.[14] Old arguments, rooted in affluence, did not convince in the faltering economy. Joyce Hughes, a young black law professor, summed up the state of the civil rights movement in 1975: "SCLC is only a memory, as are SNCC and CORE. PUSH [Jesse Jackson's organization, founded in 1971] is strong on rhetoric but short on delivery. The NAACP is marking time."[15] As wages stagnated after 1973, many whites resented the benefits given to poor people, which they believed came out of their wages. Eleanor Holmes Norton, who then headed New York City's human rights commission, noted that "people on welfare received a separate housing allowance, even if for often substandard housing. The poor had access to comprehensive medical care through Medicaid programs while Americans lack comprehensive coverage. A couple in the working low-income groups got $100 additional savings in taxes for each additional child while Aid to Dependent Children provided a $600 annual benefit for each child. A society that grudgingly buys benefits for its poor, while leaving out others who also cannot afford basic needs, invites class conflict."[16]

Within the Democratic cities, white and black working classes eyed each other with suspicion.

Once economic issues united Democrats; now they created fissures. Blacks lost ground during the 1975 recession, and the gap between black and white unemployment rose from 4.3 percent in late 1973 to 6.1 in mid-1975. In 1975, unemployment averaged 8.5 percent, but black unemployment reached 13.9 percent.[17] Rising unemployment not only limited black gains, it also increased racial conflicts. Economic growth was not a magic wand, but it helped. When jobs were stagnant or declining it was more difficult to produce racial progress or even maintain recent gains. Hard times produced hard cases. What do you do when plants lay of workers? According to seniority principles enshrined in working-class culture, the newest hires were the first to be let go. In plants that had recently hired blacks, this could mean erasing black gains. So, the NAACP began to challenge lay of provisions based upon seniority, arguing that these rules perpetuated the legacy of the past when blacks were not hired. A concrete example revealed the dilemma.

A Louisiana company that had begun hiring blacks in 1965, when the Civil Rights Act of 1964 went into effect, laid off half of its workers in 1971 because of the poor economy. All whites hired after 1952 and all blacks hired in recent years were dismissed. The NAACP's Legal Defense and Education Fund (LDF) challenged this decision in court, claiming that the company had violated Title 7, the clause that banned job discrimination in the 1964 act, by laying off the newly hired blacks. Maintaining an integrated workforce, it argued, was a goal of the law. The legal basis for the LDF's position was a Supreme Court ruling in 1971 that concluded that any employment practice that had a "disparate impact" on minority workers violated Title 7, unless the practice was sufficiently job-related or justified by business necessity.[18] Courts had accepted the analysis in hiring, testing, and promotion. Thus, if a high school diploma was not job-related, then requiring one, if it had a disparate impact on black hiring, was illegitimate. On the other hand, if a plant relocated to a place with fewer minorities in the labor force, then

this was considered a business necessity and not a violation. So, on which side of the scale did layoffs belong?

The courts airmed that seniority was a legitimate means of determining layofs.[19] Nevertheless, the litigation which pitted the LDF and the NAACP against progressive unions like the United Steelworkers of America made it appear that divisions between blacks and whites, racial organizations and unions, were deep. The conflict such campaigns provoked did not end so easily.[20] Thus, the bill proposed by Senator Hubert Humphrey and Congressman Augustus Hawkins in 1976 to mandate full employment was an important political project of the Democratic Party. It simultaneously reinserted African American interests into mainstream economic policy making and advanced black and white working-class interests. It fostered interracialism at the grass roots.

But the primaries fostered personal victories, not party majorities. Initially race was secondary, as the season began in "white" states. Jimmy Carter pioneered what became standard practice in subsequent years. The currently unemployed Carter announced early, campaigned endlessly in Iowa and New Hampshire (the two states that opened the primary season), and built up a personal following by pledging his integrity and honesty to a people who had been wronged by previous leaders. Those moved by this message became devoted to the candidate, which was what you needed in the new primary system. Stressing character, not creed, Carter attracted supporters who spanned the ideological spectrum.[21] Carter's campaign manager, Hamilton Jordan, admitted that "the fragmentation allowed us to get the nomination."[22] Carter won only 27.6 percent of the Iowa caucus votes; Birch Bayh received 13.1, Fred Harris 9.9, Stewart Udall 5.9, and Sargent Shriver 3.3. Actually, the uncommitted slate won the election with 37 percent.[23] Nevertheless, Carter was appropriately declared the winner. But what was the meaning of an election where a vague centrist came out on top against four liberals—and where an uncommitted slate actually "won"?

Carter repeated this performance in New Hampshire, where he

triumphed again over the same group of liberals. (Henry Jackson and George Wallace did not compete.) Benefiting from the low expectations of a newcomer, he gained that item called momentum. In primary contests the best predictor of success is often the result in the previous one because the good showing brings in money to contest the next primary. Yet the softness of Carter support became clear in Massachusetts. Here, for the first time, he had to confront Henry Jackson and George Wallace, as well as the band of liberals. Jackson won, followed by Udall and Wallace. Carter polled fourth. Carter's explanation for his poor showing was that he had not campaigned much in the state, preferring to spend more time in Florida. Coming almost immediately after Massachusetts, the Florida primary on March 9 was crucial for Wallace and Carter.

Carter beat Wallace 34 to 31 percent, and Jackson followed with 24 percent.[24] Now the race issue was front and center. Wallace was the hobgoblin of the liberal imagination. The victory over Wallace raised Carter's stock with white liberals. *New York Times* columnist William Shannon declared, "Jimmy Carter's accomplishment has been to put an end to this Wallaceite nightmare."[25] Shannon's colleague Tom Wicker went further: "The rise of Jimmy Carter … not only threatens Republican prospects in the South for 1976 but also the idea of a conservative Republican South in the future. Mr. Carter's southern victories over George Wallace symbolize the political fact—a new moderate consensus of whites and blacks, business elites and the working class, replacing racism, law and order conservatism and the old economic exploitation. If Jimmy Carter can make that consensus hold in the South, he and the national Democratic party will have left Republicans almost no place to go."[26]

Southern politics were fluid, potentially biracial, and Democratic in the 1970s. But the idea that Jimmy Carter could bring about interracial unity was incorrect. There was a vast difference between Carter's inter-racialism and Humphrey's. Carter appealed to southern whites and southern blacks separately, and for different reasons. Southern pride

drove his support among whites, demonized by the nation for the past twenty years. Carter's regard among blacks was different, starting from the house of King in Atlanta. Congressman Andrew Young, formerly Martin Luther King Jr.'s chief aide, and the Rev. King Sr., the civil rights leader's father, backed Carter, who had supported black interests in Atlanta while governor. Other southern blacks, who connected with Carter's Baptist style and racial moderation, rallied to his candidacy, but the appeal was old-fashioned, even backward, and ignored policy issues, such as employment, housing, and social welfare, that affected the black population.

Nevertheless, liberals embraced him because the liberalism of the mid-1970s was defined as racial, not economic. Few asked about his economic ideas, though the scant evidence that existed to that point was troubling. An aide asked him to endorse a bill making miners automatically eligible for black-lung benefits after thirty years. Carter refused: "I couldn't endorse these things. They are too controversial and expensive. It would offend the operators. And why should I do this for Arnold Miller [the head of the United Mine Workers of America] if he won't come and endorse me? … I don't think the benefits should be automatic. They chose to be miners."[27]

When the primaries returned to the North, Carter's weaknesses returned, too. Carter came in third in New York, with only 12 percent of the vote, although he won Pennsylvania. It was this soft support that brought Senator Frank Church and Governor Jerry Brown into the race. Everyone was talking about Hubert Humphrey. But Humphrey was noncommittal, and, just before the three final primaries in California, New Jersey, and Ohio, Mayor Richard Daley of Chicago anointed the Georgia governor. Praising Carter for his hard work, Daley said, "The man talks about true values. Why shouldn't we be sold on him?" And just in case the mayor's words were unclear, he ended speculation that he would support a Humphrey draft: "Our party isn't in bad enough shape to have to go to someone and demand him and draft him. I don't think anyone should be so honored, no matter who he is, and I don't think they

will."[28] So despite big Brown victories in California and New Jersey at the end, Carter became the Democratic nominee.

REPUBLICANS

Like the Democrats, Republicans had a contested primary, even though they had a sitting president and began any election with a two-to-one disadvantage among voters. The new primary system benefited Republican as well as Democratic challengers. Ford was unelected and vulnerable because he had pardoned Richard Nixon and presided over a poor economy, and he seemingly lacked stature, charisma, or that intangible element that people call leadership. Although the economy had recovered from the depths of the recession, the upturn slowed in the summer of 1976. Unemployment was still over 7 percent.[29] Many Republican conservatives disliked Ford's moderation on the social issues of the day. The president supported the Equal Rights Amendment. He opposed school busing but did not abandon the obligation to improve black education.[30]Neither Ford nor his surrogates embraced antibusing to mobilize voters. Unlike Nixon, he would not serve up the red meat that cultural conservatives devoured. Among Ford's challengers, only Ronald Reagan had enough popularity to mount a competitive campaign. Ford tried to fend him off by offering him various positions in and out of the government. The president asked Nelson Rockefeller, whom he had made vice president, to remove himself from the ticket in 1976. Rockefeller had earned the hatred of the Republican right after he had passionately opposed Barry Goldwater in 1964. Rockefeller reluctantly fell on his sword.[31] This move did not stop Reagan, who entered the race shortly after Rockefeller removed himself. Reagan did not challenge the president on the social issues. Like Barry Goldwater, Reagan crafted his political ideology on the classical conservative themes of freedom and free enterprise.

Reagan tried to connect his old opposition to government power to the nation's shaky economic recovery. In New Hampshire he suggested that $90 billion in social programs could be transferred to the states for management or quick death. Federalism was a popular idea in the early 1970s, championed by Nixon before his Watergate troubles. But Reagan

tried to make centralized power not just a question of freedom, but also the cause of the inflation, unemployment, and other economic woes confronting the nation in 1976. He was unable to make this connection for New Hampshire voters because of the tremendous magnitude of such a cut. At the time, the federal government paid 62 percent of New Hampshire's total outlay for welfare, and if the Reagan cuts went into effect, the state would have to cut welfare or raise taxes. These choices were unacceptable. The "Reagonomics" of 1976 lacked plausibility and demonstrated the immaturity of his economic case. The Reagan offering in 1976 was abstract; he spoke more about freedom and less about investment. Conservatives had not been able to translate the critique of the "mixed economy" they had fashioned during the age of affluence to the grim times of the 1970s. Right wing ideas of the 1950S and 1960S, like a voluntary Social Security and a private TVA, were not more popular than when Goldwater first proposed them. Reagan had no others. Ford won New Hampshire with 51 percent of the vote, despite Reagan's early lead in the polls. Another idea from the Old Right, to invest Social Security funds in the stock market, had even less traction when it was presented to Floridians, among whom were many retirees dependent on secure monthly checks. Ford accumulated 53 percent of the vote there. The president went on to win in Massachusetts, Illinois, and Wisconsin.

The life support system for Reagan's primary campaign was foreign, not domestic, policy in 1976. Reagan revived his faltering campaign by opposing the pending return of the Panama Canal to the Panamanians. The alleged "giveaway" of the canal was the passion of Republican senator Jesse Helms of North Carolina, a state that Reagan desperately needed to win if his campaign was to continue. The governor's words were up to the task. "We bought it, we paid for it, it's ours, and we're going to keep it," he stated.[32] The cheering crowds gave him his first primary victory, winning 52 percent of the vote. Reagan had not been identified with the issue before the contest and distanced himself from it after he won. The issue had been chosen for its political dividends. Still, it fit into his general theme of the decline of American global power.

Reagan marshaled every piece of evidence to prove that the United States was feeble. He had a field day when the 1973 resolution of the Vietnam issue unraveled. The North Vietnamese takeover of South Vietnam in 1975 marked the bankruptcy of the Nixon-Kissinger-Ford policy of détente, he charged. Actually, Kissinger and Ford wanted to meet the North Vietnamese offensive with new U.S. aid to South Vietnam. The Congress, Republicans as well as Democrats, had had enough. Ford's desire did not count in the right wing score card against him. Although the North Vietnamese victory did not endanger U.S. interests in Asia, it was a perfect symbol for conservatives who claimed that détente was a one-way street leading to Soviet, not U.S., successes.

Détente, the series of agreements between the Soviet Union and the United States, had few friends in 1976. Although a few liberals opposed détente because it accepted Soviet human rights violations in the name of improved superpower relations, most liberals of both parties were for détente, arguing that the obsession with the Soviet Union overshadowed global developments, such as North-South issues and majority rule in Africa. At the same time, this group also believed that alliances with unsavory regimes in Iran, Nicaragua, and the Philippines were corollaries of Kissinger's détente, and so they opposed the process, the realpolitik of the Soviet Union and the United States, especially the secrecy of Henry Kissinger. Consequently, few leaped to defend the policy when critics marshaled arguments against the very idea of détente.

After North Carolina, the battle shifted to Reagan-friendly terrain in the West. The governor registered an unanticipated big win in Texas and the caucus states of New Mexico, Kansas, and Colorado. Although turnout in the primary elections to this point had been light, in these states the numbers were high, the voters unknown to Republican officials, and the ballots cast overwhelmingly for Reagan. The Ford campaign concluded that the numbers were "the result of skillful organization by extreme right wing political groups in the Reagan camp operating almost invisibly through direct mail and voter turnout efforts conducted by the organizations themselves."[33] The loose coalition of right wing political

action committees—The Right to Work, The National Conservative Political Action Committee, Right to Life, and Heritage Foundation—were joined and empowered by Richard Vigurie's direct mail firm. (Vigurie had conducted Wallace's fund-raising in 1968.)[34] Political parties were limited by the campaign laws, but these groups could spend as much money as they could raise. The Ford campaign feared that "we are in real danger of being out-organized by a small number of highly motivated right wing nuts, who are using funds outside of the Reagan campaign expenditure limits."[35] The party got its first look at the potential of right wing organizing. And it contrasted mightily with its own.

Republican moderates ignored grassroots organizing and lacked a distinctive ideology. This historic failing was reinforced by Watergate, which weakened the centrist wing of the party. In the summer of 1976 Republican Congressman Barber Conable said that moderate suburban voters "are either going Democratic or going underground…. They felt betrayed by Richard Nixon and left the Party to the [right wing] activists."[36]Nevertheless, it would be a mistake to exaggerate the appeal of right wing Republicanism in 1976. Winning a Republican primary in Texas did not translate into winning a national race or even the Republican race. And in 1976, even the most conservative candidates accepted the major premises of Roosevelt's "welfare state."[37]

The president recovered with victories in Michigan and Maryland, but the contest became closer as Reagan swept California. Ford increased his lead after wins in Ohio and New Jersey, but neither candidate had enough to be nominated after the end of the primary season. Ford obtained 47.9 percent of the delegates to Reagan's 45.4 percent. Reagan's numbers were enhanced by new Republican rules, which distributed a third of the convention seats as "bonus" delegates to any state that voted Republican for president, Senate, House, or governor. This reduced the power of the older eastern states from nearly 30 percent of the seats they enjoyed in 1952 to less than 25 percent in 1976.[38] By enhancing the South and West, the new system overstated Ronald Reagan's national appeal. It is often

said that Reagan lost the nomination because he enraged conservatives by announcing just before the convention that he would choose as his running mate the more liberal-leaning Richard Schweiker, senator of Pennsylvania. But tactics are based upon political verities. And, in 1976, you could not win the nomination or the fall election with conservatives only. Reagan's advisers, if not his right wing followers, understood that Republican liberals were crucial to success because the political culture stamped by New Deal liberalism was still alive.[39]

Still, Reagan came close to winning the nomination. Before the actual vote on the candidates, the Reagan campaign, believing that some delegates were forced by the primary system to support Ford but actually were secretly for Reagan, attempted a rules change vote on a procedural matter to unearth this hidden Reagan strength and perhaps convince the uncommitted. This proposal would have required Ford to name a vice-presidential candidate before the vote for the presidential candidate. It was defeated by a vote of 1068 to 1180. Ford now clearly had the votes, yet it was close—1187 to 1070. The right won the platform—winning planks opposing abortion and détente—and the vice-presidential nomination. Ford selected Kansas senator Robert Dole, whom Reagan wanted Ford to select. Given Reagan's age—he was 65— many thought that another presidential run was unlikely.

THE ELECTION

Although foreign policy dominated the Republican primary, it was a minor part of the election campaign. Social issues were uncontested, too. Campaign aide David Gergen tried to inject them and told Ford that "the Democrats ran against Hoover for years, and we should do the same about the '60s."[40] But the president did not follow that script. The economy was the major issue. Ford waged a classic Republican campaign. Too much government spending deprived business of the capital it needed to invest. Inflation, caused by budget deficits, encouraged people to borrow, not save, and this inhibited investment, too. The script was not a return to laissez-faire capitalism, but the ideas did rest upon pre-Keynesian notions.

The president had his work cut out for him. After the Republican convention, polls showed Carter enjoying a 52–37 percent advantage. Ford's advisers told him that the new campaign finance law impaired the campaign: "We no longer have the previous advantage of being able to outspend our opponent." Unlike Nixon in 1972, we "can't woo voter blocs through extensive government programs and patronage. We don't have money." And, the "broken promises of 1972 made buyable voter blocs wary."[41] The campaign was more traditional than was Nixon's in 1972. Robert Teeter, Ford's pollster, declared that Ford "will win with the same coalition of states and voters within those states that other winning Republicans have had. He will not win by creating a unique constituency of various special groups of voters that Nixon used in 1972."[42] So, Ford targeted the large swing states that determined presidential elections: California, Illinois, Ohio, Michigan, New Jersey, New York, Texas, Florida, and Pennsylvania.[43]

The strategy was based on class and not ethnicity, race, or religion. Teeter aimed for white-collar and slightly higher-income good government voters; blue-collar ticket splitters, who were more conservative on social issues but who wanted more government involvement in economy; and urban ethnics who had moved up the class

ladder. Ford appealed to these voters on the basis of their class, not their ethnicity or Catholicism.[44] Even if he had wanted to, Ford could not have employed the "New Majority" strategy that Nixon won with in 1972. Any approach dependent upon winning large blocs in the Deep South could not work against southerner Jimmy Carter. Unlike Nixon, Ford did not shop around for dissident labor leaders. Teeter concluded that "fooling around with the kind of insurgent labor leaders who for their own purposes can sometimes be persuaded to support Republicans has never seemed to me to be very productive." Like Eisenhower, Ford hoped for border states like Virginia and Texas.[45] (He won the former, but not the latter.) All of these decisions reinforced class voting and made region, ethnicity, race, and religion secondary.

Not surprisingly, the Democrats also went back to their traditional issues. Determined to avoid the mistake McGovern made in 1972, the Democratic platform clearly embraced the federal government's responsibility to create a full-employment economy. The Humphrey-Hawkins full-employment bill was written into the platform despite Jimmy Carter's lack of enthusiasm for it. Democrats embraced wage and price control to address inflation. But the candidate continued the morality and leadership themes that had won him the nomination, avoiding specifics as much as the press allowed. One reason that his twelve-percentage-point margin over the president faded was his unwillingness to address the recession and anemic recovery. Carter rarely spoke about economic issues and was ill-informed about the specifics of his tax reform plan that he was certain the nation needed.[46] Carter told reporters, "I don't know how to write the tax code in specific terms." Veteran AP reporter Walter Means concluded that "he [Carter] wanted to avoid saying anything."[47]

The campaign was very close until the very end, and many issues could be said to have determined the outcome. Many pointed to a misstatement that Ford made in the second presidential debate. Although the presidential debate is a mandatory staple in American politics today, its status was not entrenched in 1976. In fact, these were the first since the

original televised Kennedy-Nixon debates in 1960. Sitting presidents had no interest in providing an opponent with equal status, and Ford accepted only because he was behind and thought he could outperform Carter. He did so in the first debate, but in the second a lapse in foreign policy halted his momentum. Throughout the campaign, détente was pummeled. Ronald Reagan attacked from the right in the primaries, and Carter did the same from both the right and the left. During the second presidential debate, *New York Times* editor Max Frankel asked, "Our allies in France and Italy are now flirting with communism, we've recognized a permanent Communist regime in East Germany, we virtually signed in Helsinki an agreement that the Russians have dominance in Eastern Europe"; did this not mean that the Soviets had gotten the best of the United States?

At Helsinki in August 1975, the United States, Europe, and Soviet Union agreed to seek peaceful means to solve differences, cooperate on economic matters, and forswear intervention in another state—in essence guaranteeing the political divisions of postwar Europe. Respecting the territorial integrity of Eastern Europe was of great significance to the Soviet Union and was therefore viewed as a Soviet gain. Another list of Helsinki rights protected persons and peoples. Although these clauses became the basis for the dissident movements in Eastern Europe and the Soviet Union, at the time no one in the United States paid much attention to them. In defending Helsinki as well as his record, the president stated that "there is no Soviet domination of Eastern Europe, and there never will be under a Ford administration."

Upon further questioning, Ford dug himself in deeper, claiming that "I don't believe that the Poles consider themselves dominated by the Soviet Union." He simply meant that the Poles retained the hope of freedom, and, given Ford's anti-Communist credentials, few outside the media took note of it. But overnight the press magnified the misstatement; Ford refused to modify it and the president seemed, at the very least, a bumbler. The controversy stopped his momentum, but even before the press worked over his remarks, Carter was generally considered to have won the debate, if by a small margin. Carter then attacked Ford on the

issue to a degree that the public turned on the governor for being too strident.[48] Did Ford lose because of the Helsinki blunder? In a long, close campaign, any one remark can be seen as significant. Carter's infamous interview in *Playboy* magazine, during which he admitted that he lusted in his heart, sent shock waves through his party. Had he lost, that interview likely would have been among the list of reasons for the defeat. But he won, with 51.05 percent of the popular vote to Ford's 48.95 percent. The new president earned 297 Electoral College votes to Ford's 24L

Carter's strength was in the South and the industrial North. West of the Mississippi River was Ford country. Yet this election was not regional, as Ford won California and Carter New York by the tiniest of margins. In fact, the vote in most states was close. The election showed a return to the class voting that had been temporarily suspended in 1972. Carter's strength declined as one moved up the income ladder; he won two-thirds of the bottom of the income spectrum while Ford took a similar percentage of those at the top. McGovern won only 43 percent of those with incomes under $8,000; Carter obtained 62 percent. Carter won 63 percent of the votes of union members, a vast improvement over McGovern's 46 percent. Oddly, McGovern won 69 percent of the people who considered themselves liberal, while Carter gained 74 percent.[49] At the time of the election, unemployment was more than 8 percent and most Americans still saw the Democratic Party as the party of Franklin Roosevelt.[50]Democrats both acknowledged Carter's limits and resuscitated party tradition. An Ohio factory worker expressed this uneasy marriage: "I think we need a change; we need a change bad. I don't especially like Carter, but maybe if we get enough good Democrats in there to back him up he can do some good."[51] And, while everyone pointed to Carter's southern victories, Caddell's polling seemed to show class divisions there too. Carter carried poor whites and blacks while losing middle-and upper-income whites in the South.[52]

The new president would govern with Democratic majorities nearly as great as those of Lyndon Johnson in 1965. The election increased the

number of House Democrats by two, while the balance in the Senate remained the same. Democrats enjoyed a 292–143 advantage in the House and a 62–38 margin in the Senate. Of the seventy-nine Democratic freshmen of the "Class of 1974," seventy-eight sought reelection, of which seventy-six were victorious. Yet most Democrats ran ahead of Carter.[53] The new president lacked the credit for victory that would help him legislate. Moreover, the congressional reforms which ended the selection of committee chairs by seniority, along with the influx of young, reform-minded lawmakers, made the Congress less predictable.

The young reformers, dubbed the Watergate babies, represented suburban districts and practiced more of the New Politics of the McGovern campaign than the Old Politics of the New Deal.[54] Their key political experiences were Vietnam and Watergate. James Blanchard of Michigan said, "Clearly we don't think of ourselves as New Dealers at all—or proponents of the Great Society either." Colorado's new senator, Gary Hart, who had been McGovern's campaign manager, snickered, "We are not a bunch of little Hubert Humphreys."[55] AFL-CIO counsel Kenneth Young observed that "the freshman Democrat today is likely to be an upper-income type and that causes some problems with economic issues."[56] Many identified with the public interest movement, not with traditional labor or civil rights organizations. Ralph Nader, the father of public interest politics, had contemplated a run for the presidency in 1976, and *Nation* magazine endorsed him in 1975. Nader did not follow up with a campaign, but his interview in *Rolling Stone* magazine in November revealed the kind of left-liberalism that he and many espoused. He explained that "people first had to get it that corporations were rapacious and government corrupt." Then, he would "replace corporations, break them up," so they could be "owned by workers or better yet consumers."[57] If both corporations and government were corrupt, then how would the world improve? Lawyer knights like Nader would lead consumers. Nevertheless, Nader was quick to establish good relations with Carter after it was clear that the governor would be the Democratic nominee. The slash-and-burn rhetoric married to

opportunistic political alliances planted an antigovernment legacy that coarsened political discourse and undermined popular support for social democratic solutions.

Still, the *Wall Street Journal* and many businesses feared that Carter would act to reduce employment, resulting in rising inflation.[58] The *Wall Street Journal* had a lot to be worried about in 1977. In New York a rising conservative star, James L. Buckley, brother of the editor of the *National Review,* had been defeated by Democrat Daniel Patrick Moynihan in the Senate race. The newspaper wondered whether the GOP could survive, noting the Democratic control of the White House, Congress, and state legislatures. The *Wall Street Journal*'s first recommendation was that the big four— Ford, Rockefeller, Reagan, and Connally—should step back and let younger people in.[59] Such obituaries were not unique to the right. On the left, Wilson Carey McWilliams predicted that "we may, in fact, stand at the beginning of a period of one-party rule not unlike the years during which the Federalist party languished and died."[60] And Kevin Phillips, having predicted that the GOP was about to create a new majority in 1969, now concluded that the Republican Party was approaching "critical nonmass."[61]

CHAPTER SEVEN
International Keynesianism in a Troubled World

GERALD FORD AND JIMMY CARTER discussed the nation's economic troubles during the 1976 presidential campaign, but ignored the international connections summed up in the phrase "crisis of the west." Although the first presidential debate, held in Philadelphia on September 23, focused on the economy, not a word was uttered about the renewal of the U.S. pledge that both men embraced—to accept the exports of economically stressed allies as an aid to global recovery.[1] They again ignored foreign economic policy in their second debate—which featured foreign policy—as the Soviet Union, the Middle East, and the Panama Canal took center stage at the theater of the Palace of Fine Arts in San Francisco. Toward the end of the third and final debate, President Ford declared, "The United States is leading the free world out of the recession."[2] Carter pounced on this ambiguous claim: Ford "ought to be ashamed of making that statement because we have the highest unemployment rate now than we had at any time between the Great Depression caused by Herbert Hoover and the time President Ford took office." Both men had a point. The United States GDP grew by 6 percent in 1976, outpacing every nation in Western Europe. (Japan did slightly better than the United States.) But the U.S. unemployment rate was 8 percent, more than 3 percent higher than the OECD average. Despite his theatrical indignation, Carter conceded that the U.S. recovery had preceded Europe's, and Ford acknowledged the high rate of unemployment in the United States.

Neither Carter nor Ford rethought the U.S. practice of accepting imports to help allies in light of the relative decline of American

economic power. Once elected, Carter would attempt to get Germany and Japan to assume some of the burden, but both allies understood the 1975 recession to be a structural crisis that required industrial policies, and they were reluctant to stimulate their economies with Keynesian tools. The continuation of past international policies, even while simultaneously requesting help from Germany and Japan, was an indication that American elites did not acknowledge the new era of industrial competition.

Let us reflect on this new era. After World War II, U.S. GDP was three times larger than the Soviet Union's and six times larger than Great Britain's. The United States was the largest producer of steel, electricity, food, and oil. It held a monopoly on nuclear weapons until 1949 and led the world in new industries like computers and aircraft. Its resources determined the price of oil and sugar. It promoted European development with foreign aid and intervened covertly and overtly to alter politics in the region. American economic power was so great that it did not fully exploit its commercial advantage and allowed discrimination against its own producers in the interest of global economic stability.

The U.S. economy in 1976 remained weighty. Its GDP was three times larger than its closest rival, Japan. But its share of global GDP was down to 24.6 percent in 1976 (it had been 34.3 percent in 1950). American wells produced only 15 percent of the world's oil supply, falling from more than 50 percent after the war. Its furnaces produced 20 percent of the world's steel, down from 50 percent. The United States possessed 68 percent of all international financial reserves in 1952; in 1962, reserves fell to 27 percent, and in 1977 to only 6 percent. After World War II, the United States shipped 32 percent of world exports, and in 1976 only 11 percent. Between 1945 and 1968 the United States experienced a trade surplus thirteen times; there would be just one more trade surplus the rest of the century. Since 1947, its exports grew 7.3 percent a year while imports rose 11.4 percent. Raw materials represented just about the only positive export trend.[3]

Even as the material dominance which underlay American

internationaleconomic strategy vanished, Ford and Carter continued old ways of thinking. Ford's Treasury Department applauded a U.S. trade deficit of more than $14 billion in 1976.[4] It tracked rising Japanese exports to the United States, which was the lifeblood of Japanese recovery, and noted that developing countries in East Asia—Korea, Malaysia, Taiwan—were following the Japanese model. The Treasury Department stated, "The U.S. and other relatively strong economies must thus accept trade and current account deficits as their contribution to maintenance of a reasonably stable and orderly international economic regime. Otherwise, the open, liberal trade and payments system will not survive."[5] The American economy was playing its historic role as the market of first and last resort for the rest of the world. But the economic superiority that facilitated this policy no longer existed. The trade deficit looked different to those who were closer to the ground.

Take the specialty steel industry. Specialty steel is made of iron combined with various alloys. Consumers are most familiar with one type — stainless steel—but alloy steels are also critical ingredients for making machine tools hard, abrasive, and heat resistant. During the recession of 1975, the U.S. alloy steel industry was operating at less than half of its standard capacity after cutting its workforce of forty thousand by 25 percent. However, imports still rose dramatically. Both Japan and Europe had expanded their steel production capacities before and after the recession. Because most of the tonnage in Europe was government owned, the European industry was shielded from normal profit requirements. Where steel was privately owned, as in Japan and Germany, the industry received preferred credit arrangements. As domestic markets contracted during the recession, exporting became necessary. Japan's Ministry of International Trade and Investment (MITI) instituted forced price increases at home and an export drive, at reduced prices, abroad. When confronted with foreign protests, MITI reversed gears and limited exports to Europe, then to Australia and Canada. This move led Japanese companies to divert steel to the American market. In 1976, Japanese imports to the U.S. were 37 percent

higher than in the previous year. The Japanese price in the U.S. fell 32 percent, even though Japanese companies were losing more than $15 a ton.[6]

Under General Agreement on Tariffs and Trade (GATT) rules, countries may temporarily limit imports when they injure domestic producers. The specialty steel industry and the steelworkers' union appealed to the six-member U.S. International Trade Commission (USITC), invoking this "escape clause" (Section 201 of the Trade Act of 1974). The USITC found that the industry had indeed been seriously injured, and Ford had to decide whether to recommend relief. The president was well aware that the trade act also gave the Congress, which better voiced domestic interests, the power to override his decision if it disagreed with his judgment. After intense debate, the government negotiated a voluntary agreement with Japan to limit the quantity of specialty steel that Japan exported to the United States. The agreement also imposed three-year quotas on the European Community (EC) and Sweden, the other two principal exporters.[7] As was typical in U.S. trade discussions, politics was more important than economics. Ford reluctantly agreed to the relief because he feared that Congress, especially in an election year, would override a negative decision.[8] This time Henry Kissinger's foreign policy concerns and William Simon's ideological objections were countered with politics of reelection.[9]

The president's actions provoked strong media criticism. In a characteristic response, the opinion page of the *New York Times* condemned Ford's decision in two editorials with headlines —"Protectionist Threat" and "The Steel Steal"—that spoke volumes.[10] As most American editorial pages were populated by free traders, the press often ignored foreign subsidies or government ownership in the global steel trade. The *Times* editors believed that declining domestic profits and rising imports meant that U.S. industries were inefficient. The American elite, especially on the east and west coasts, saw industrial issues through the free trade lens, grinded by the global financial industries. Opinion in other countries evolved through the long history of

industry-bank cooperation and managed trade. Thierry de Montbrial, an economist from the Ecole Polytechnique in Paris, declared in January 1977 that "free trade is, of course, a myth (an Anglo-Saxon myth in particular!). It exists less and less. The GATT rules are no longer followed…. However, in our mentality we stick to the idea that free trade is an ideal to be achieved and think that we owe our prosperity in the last twenty years to this ideal."[11] De Montbrial and many other Europeans thought that commodity agreements and state-organized cartels, not free trade, were the way out of the international recession.

When it came to trade, little difference of opinion existed between Republicans and Democrats. Both believed that the United States must lead the world in spreading free trade, and that meant accepting deficits, even when it injured individual producers. Carter's Undersecretary of State for Economic Affairs, Richard Cooper, told National Security Council head Zbigniew Brzezinski that the trade deficit, while "large in absolute terms, is small in comparison to our ability to finance it…. Over-emphasis on our trade deficits is only likely to raise additional counter-productive protectionist sentiments in various domestic circles."[12] The White House believed that the "U.S. competitive position remains strong, and that the U.S. should not take measures which would attempt to improve our trade balance at the expense of our trading partners." But the relative American weakness and new economic balance of power began to register. The United States would urge the other Western powers, especially Germany and Japan, to use fiscal stimuli to boost their growth rates, as that would relieve some of the pressure on the U.S. market.[13]

This recipe for international economic policy was the brainchild of the OECD and the Trilateral Commission, a private organization of about three hundred representatives from Europe, North America, and Japan who came together to discuss global issues. The commission was created in 1973, partly in reaction to the unilateralism of Nixon's New Economic Policy of 1971. Founder David Rockefeller also wanted to bring Japan, whose economic power was becoming more visible, into the international

community. The European view of the Japanese was laced with condescension bordering on racism. Typically, French President Valéry Giscard d'Estaing expressed doubt "that Japan really shares the same values and has the same system that we do."[14] The commission was composed of politicians, labor leaders, and businessmen from the three regions.[15] It was knit together by academics like Brzezinski from Columbia and Henry Owen from the Brookings Institution. Owen perfectly captured the commission's worldview: "Globalism and bilateralism offer little hope for success but trilateralism does."[16] Globalism, meaning the UN, was out of the control of the Western powers—the Security Council was paralyzed by Soviet vetoes and the General Assembly dominated by the many new nations. Bilateralism smacked of special deals. Only trilateralism offered a way out of the new order that featured diminishing U.S. power.

Both the right and the left branded the Trilateral Commission a conspiracy.[17] Evangelist Pat Robertson thought that the commission was designing a world government and arrived "from the depth of something evil." To some on the left it was a "nefarious conspiracy" of international capital.[18] It was not a conspiracy, but the left had correctly fingered its economic foundation—internationally mobile capital, symbolized by Rockefeller himself. There were more bankers than industrialists on the commission, and the few representatives of goods makers, like Wayne Fredericks of Ford, came from firms that had extensive international interests. There was no emissary of capital that was primarily national, like steel or textiles. The historian Geoffrey Barraclough thought that the Trilateral Commission represented "the liberal wing of the ruling establishment."[19] Barraclough was right insofar as commission members usually preferred diplomacy to force. They spoke of world order, not national security. Members differed on the Soviet Union and the Middle East, but all were for free trade and international investment, which they thought would bring progress to all.

The commission was important, not because of its institutional power, but because twenty members populated Carter's cabinet. Both the

president and Vice President Walter Mondale were members. So were Secretary of the Treasury Michael Blumenthal, Secretary of Defense Harold Brown, and Secretary of State Cyrus Vance. Its executive director, Zbigniew Brzezinski, became National Security Adviser.

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Embracing trilateral doctrine, two days after the inauguration Carter sent Mondale abroad to convince U.S. allies to stimulate their economies, as the United States planned to do, and become locomotives for global growth. The unstated corollary was that the trade surpluses accumulated by Germany and Japan would turn into deficits, like those in the United States. In other words, the two new economic powers would share the U.S. burden by opening their markets to the poor nations who needed to pay for their oil imports. The blueprint was a variant of Keynesian multiplier-analysis.

Keynesian deficits increased a nation's GDP by increasing the demand for goods. International Keynesianism worked slightly differently. In a world of open economies, import leakage reduced the domestic multiplier of additional government spending or tax cuts. Thus, some of a U.S. stimulus would be used by Americans to purchase foreign goods, thus boosting the exporter's economy. If all of the richer countries raised government spending or cut taxes, no one nation would assume the burden, as the United States did in the postwar world. In the end, there would be more demand for the goods of poorer exporting nations that had accumulated large oil bills.

International Keynesianism was welcomed in London, the first stop on Mondale's trip, because Britain was cast as the caboose behind the three locomotives. The United Kingdom suffered high unemployment, inflation, low growth, and trade deficits. Its economy had lagged even in the halcyon boom of the early 1970s. Huge public spending and resulting budget deficits did not get the economy out of the deep recession of 1975. Having tried everything, Prime Minister James Callaghan hoped that expansion in the United States, Germany, and Japan would help British exports. Callaghan had urged President Ford to reflate more vigorously. The Carter people were more willing, planning a $30-billion stimulus package.

Germany was a different story. German growth in 1976, 5.2 percent,

was only a little less than that in the United States. However, it was the result of an almost 10 percent expansion of exports, which is why Germany ended up the year with a trade surplus.[20] The Americans wanted the Germans to stimulate their domestic economy further—either through tax cuts or spending—and accept more imports. Chancellor Helmut Schmidt, a Social Democrat, said no. Like Callaghan, Schmidt had urged Ford to reflate faster but now refused to take his own medicine. The chancellor believed that the American recipe would yield only inflation in Germany, even though its rate was under 4 percent, less than half the average in the OECD. Because exports played such an important role in their economy, many Germans lacked the American faith that increasing aggregate demand through government spending would produce long-term prosperity.[21] (In 1974 exports reached 38 percent of German GDP.)[22] Schmidt argued for structural adjustment on the supply side, not the fine-tuning of demand. Aside from the question of whether Schmidt's proposal was right for Germany, it clearly was not playing the global role that the Americans and the OECD had planned for it.

The Japanese response was similar to Germany's. The Japanese were pleased that Mondale traveled to Tokyo, according Japan the same standing that he gave European nations. Mondale mentioned the $5.5-billion trade surplus that Japan enjoyed with the United States in 1976 but, in trilateral fashion, emphasized the harmful effects of Japan's trade surpluses on the world, not the American economy. Japan's growth in 1976 was robust, but still it accumulated trade surpluses. So the prescription for Japan was to grow and import more.[23] Mondale received no firm commitments, so Carter lectured: "When we are selfish and try to have large trade surpluses, and a tight restraint on the international economy, then we make the weaker nations suffer too much."[24]

Carter's moralism did not help. His advocacy at the London summit in May, the third meeting of the industrial leaders, was compromised by the president's lack of economic expertise. Carter came into office with few ideas on the domestic or international economy. One of his speechwriters, James Fallows, subsequently wrote, "He made me feel confident that,

except in economics, he would resolve technical questions lucidly, without distortions imposed by cant or imperfect comprehension" (emphasis mine).[25] The president, who rarely acknowledged any intellectual shortcomings, told the London press that he was impressed with the "great experience that the other leaders have in economics, which I don't have…. I am here to learn a lot about it [economics]."[26] Ultimately, Carter's attempts at hectoring Germany and Japan were not particularly effective.

Still, the summit ended amicably. All opposed "protectionism" as a solution to unemployment. Germany and Japan substituted growth targets—5 percent and 6–7 percent, respectively—for promises to stimulate their economies. But the nations had previously set these numbers for themselves as goals—which they were already missing.[27] The German growth rate ended the year up 2.5 percent, and the Japanese rate reached only 5 percent. (The United States met its target with a growth rate of 5.8 percent.) Likewise, the German and Japanese pledges to "contribute to the adjustment of payment balances" were unmet. Germany continued to run a surplus of about $2 billion; Japan's was huge, $10 billion, while the United States had a $31-billion deficit.[28]

Why were Germans and Japanese less enamored of demand stimulation or Keynesianism? In neither case were free-market predilections the cause.[29] After World War II, the Christian Democrats, a center-right party, shepherded the German miracle under the banner of fiscal orthodoxy, not Keynesianism. German governments of the 1950S ran budget surpluses and maintained high interest rates. These policies depressed demand and forced companies to export. The government practiced austere finance but active microeconomics. It subsidized exports by giving firms privileged access to imports, as well as loans. In 1951, to avoid conflicts between capital and labor, Germany required large companies in coal, iron, and steel to include employee representatives on their boards of directors. In the 1950S the German state owned or controlled 40 percent of coal and steel production, two-thirds of plants making electricity, three-fourths of those making

aluminum, and most German banks. The banks had very close relationships to businesses.

The government lavishly supported its high-end jewels MercedesBenz and BMW but also the mass-produced Volkswagen (VW). Unlike Japan, it welcomed foreign investment, but it also discriminated in favor of domestic companies in sharp contrast to the egalitarian policies pursued by the British and American governments. Take automobiles. In 1945, when the American plan was to turn Germany into an agricultural country, Ford was to be the only company in Germany making autos. But when the Allies decided to rebuild the German economy, Ford and Opel, the European name for General Motors, were effectively deported. Volkswagen was awarded contracts to produce for the military and was granted access to scarce raw materials. The government in Bonn continued this preference. Volkswagen was owned by the German state, and, even when the company was privatized in 1957, the government retained the largest share, enough to prevent a foreign sale.[30] The state prohibited foreign companies from purchasing German auto companies, and that included the latest suitors, Middle Eastern investors who wanted to buy Daimler-Benz in 1975. Strategic industries obtained financial aid and protection from competition. They acquired dispensation from labor laws and the usual debt liability. Serious subsidy of industry began in the late 1960S, in the wake of the approval of the Kennedy Round tariff reductions of the GATT trade negotiations, completed in 1967. Domestic subsidies and tax allowances substituted for tariffs.[31] The results were stunning: Germany exported 11.5 percent of the autos it produced in 1950, and 46.1 in 1974; it exported 20.3 percent of its machines in 1950 and 43.5 percent in 1974.[32]

By the time it was confronted with the crisis of the 1970s, the Germans had many tools in their kit. However, the German trade unions, the base of the Social Democratic Party, were closer to Carter than to Schmidt in their views on the need to stimulate demand. They thought that tight money and tight budgets caused the high unemployment. But they also believed that Keynes was not enough and supported measures to benefit

needy regions and sectors, like steel. In short, they saw the crisis as both cyclical and structural.[33] But the Social Democrats governed in coalition with the Free Democratic Party (FDP). The FDP, composed of professionals, managers, and other businessmen, interpreted the crisis the way that American businessmen did—too much government shackling free enterprise. The two parties had allied when foreign policy and cultural issues were major fissures in Germany politics. But now, Schmidt, an economist by trade, yoked two horses going in different directions. Whether it was by personal conviction or the desire to placate his coalition partner, Schmidt's current interpretation of the crisis was closer to the FDP's than to his own party's. He chose to continue macroeconomic austerity while he reorganized and cartelized troubled industries like mining and steel.

The Japanese story is better known. Had the Japanese followed the prescriptions of classical economics, they would have capitalized on their comparative advantage, cheap labor. Although low wages made them formidable competitors in textiles, clothing, and trinkets, the government had grander ambitions. Capital-intensive industries like steel, shipbuilding, autos, and machinery produced great nations, and that was its goal. The Japanese restricted market access for foreign multinationals, forcing them to license their technologies.[34] But how would Japan acquire the necessary capital? The foreign orders generated by the Korean war were manna from heaven. A Japanese historian wrote that "it was nothing more than superb luck … that the Korean War broke out" when it did.[35] U.S. military spending erased Japan's trade deficit. The hard currency earned helped to modernize and expand plants without foreign capital.[36] The government was stingy when it came to consumer credit. People were forced to save, and the banks gathered their savings to finance favored manufacturing companies and sectors. To avoid destructive competition, the Ministry of International Trade and Industry (MITI) met regularly with corporations to plan prices and output. To avoid the tendency of cartels to relax on easy profits, the government forced the companies to compete for investment funds and demanded

good export performance in return.[37] And because of the cozy relationships among manufacturers, traders, and retailers, foreign manufacturers had difficulty selling their wares in Japan. These linkages were as effective as the tariffs and quotas that still barricaded the Japanese market.

With a protected market and high prices at home, Japanese firms increased their international market share by reducing prices below what they charged domestically. The Japanese state—mainly MITI and the Ministry of Finance—created a capitalist's paradise: plenty of funds and the safety net that allowed them to expand well ahead of market demand to launch an export machine. Japan concentrated its exports. From 1964 through 1971, Japanese exports to the United States quadrupled in value. The share going to the United States rose from 27.6 to 31.2 percent. Japanese manufacturing exports as a share of total U.S. manufacturing imports grew from 17 percent to nearly 25 percent. The U.S. trade deficit with Japan first appeared in 1962 and grew quickly. Although some of the advantage of an undervalued currency ended when the yen was revalued upward during 1971–73, the trade surplus returned, as Japan worked out of the ensuing recession with a fevered export drive.

Rising oil prices had threatened the Japanese model of growth. GDP had risen 10.3 percent in 1973; it fell 1.9 percent in 1974, recovering a bit in 1975 to 1.5 percent. Inflation peaked at 24 percent in 1974. Output fell 20 percent from 1973 to 1975, but the price of raw materials, led by oil and wages chasing higher prices, rose. Faced with declining output and rising costs, Japanese firms were in real trouble for the first time since the onset of Japan's economic miracle.[38] The severe recession was partly the result of stringent monetary policy, instituted to end inflation. As domestic demand plummeted, exports, despite the diminished world market, grew. During 1974 and 1975, the export share of GDP rose 28 percent. From 1973 to 1979, the value of exports increased 9 percent each year—a remarkable achievement considering that world trade increased only one-half of the postwar average of a 7.1 percent increase.[39]

How did Japan manage to do this? Like Germany, Japan's fiscal policy

was orthodox. But the same institutions that brought about the economic miracle now refurbished it. Like the Germans, the Japanese believed that crisis required supply, not demand, solutions. The government therefore increased research and development for new sectors, like computers, or encouraged the production of higher valued items in older sectors, like steel. Recession cartels divvied up cutbacks and set prices, ensuring that no one was hurt too badly by closures. The cartels made certain that imports did not replace domestic production while industries became more competitive.[40] Wherever possible, labor was kept on so that unemployment never rose above 2 percent. The restructuring plus domestic austerity forced producers to sell abroad. Japanese exporters accepted lower foreign profits to retain or increase market share. Prices in Japan rose in 1975, but prices of manufactured export items fell. Because Japanese exports to the EC were restricted, inevitably the United States became the destination of choice.[41]

A Yokohama pier filled with Japanese cars bound for export to the United

States in 1975. Stringent Japanese monetary policy in 1974 and 1975 yielded falling domestic demand, and the government ordered a huge export drive to rekindle Japanese growth. (© Bettman/CORBIS)

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In 1977, U.S. economic growth exceeded 5.7 percent and the trade deficit more than tripled, from $9.5 billion to $31.1 billion.[42] The unemployment rate had fallen one percentage point, which confirmed the trilateral view that the global and national interests were one. Still, because inflation had also risen about 1 percent to more than 5 percent during 1977, no one was asking the United States to stimulate more, even though American growth was expected to slow to about 4 percent in 1978. If not complacent, Carter was at least satisfied with the performance. The United States lacked an industrial policy for the sectors most pressed in the crisis. William D. Nordhaus, a member of the Council of Economic Advisers, said that, unlike the German or Japanese state, “the federal government is not in the business of telling [the steel] industry not to shut down, when to shut down, or where to shut down.” Richard Heimlich, the assistant to trade representative Robert Strauss, added that his office did not approach its work “from the standpoint of what our industry should be like.”[43] Actually, it did. In 1977 the Carter administration thought that every effort must be made to increase steel imports to keep prices down.[44] Encouraging imports was an industrial policy of sorts. Even when the steel closings at the end of the year forced Carter to act against European dumping, Carter rejected the proactive programs that the Europeans and Japanese pursued. He was deaf to Labor Secretary Ray Marshall’s suggestions to propose tax credits for pollution-control equipment, investment incentives for struggling plants, and the construction of modern rail and water networks in coal and steel areas.[45]

Carter’s advisers told him that economic conditions were worse in other countries in 1978, so the U.S. goal was “to strengthen the world economy,” in the words of Henry Owen, the architect of Carter’s summit agendas. Owen believed that “the industrial world is poised between a relapse into protectionism and an advance which will, if it is to take place at all, have to extend to growth and energy, as well as trade.”[46] Anthony Solomon, assistant treasury secretary, explained, “There is no such thing

as governments being able to 'fine tune' their national economies," a reference to the conventional wisdom of the 1960S that they could. No one, Solomon concluded, can grow and employ its population "without agreeing on and then coordinating differing national economic policies."[47] Solomon did not reject Keynesianism, but he claimed that it could work only if nations coordinated their policies. Consequently, the United States, Germany, and Japan would have to tolerate deficits. But it did not work that way. Japan and Germany ended up with large trade surpluses in 1977, despite their promises in London.[48]

This time the United States started with Japan. The Americans thought it would be easier, in the short run, to reduce Japanese exports by convincing the government to expand domestic consumption. Eliminating the labyrinth of rules and habits that shielded Japan from imports was a long-range project. If domestic demand increased, there would be less impetus to export. What's more, stimulating the economy seemed more promising after Prime Minister Takeo Fukuda brought people more sympathetic to international opinion into his cabinet. The Liberal Democratic Party had governed Japan continually after the war. The party's factions, not other parties, expressed the different policy positions that made up the Japanese political spectrum. In late November 1977, Fukuda changed his cabinet, bringing in expansionists to counter the unyielding fiscal orthodoxy of the Ministry of Finance. Fukuda, a former member of the Trilateral Commission and an economist, sent another trilateralist, Hobuhiko Ushiba, the Minister of State for International Economic Affairs, to the United States in December to explain Japanese plans.[49] Ushiba said that the government would increase spending to achieve a 7 percent growth rate, which would reduce Japan's trade surplus in 1978 and end it in 1979. After hearing the news, Robert Strauss happily concluded that the action would produce "a structural shift in the Japanese economy away from export-oriented growth … consistent with the needs of the international economy."[50]

The United States did not forget its bilateral trade deficit with Japan. On December 13, Ushiba promised Strauss that Japan would ultimately

make the Japanese market as open as the American and that Japan would immediately increase beef and citrus quotas.[51] Strauss, now more experienced with the Japanese negotiating style, warned Carter that these were promises and that the follow-through required monitoring. He also admitted that the offers were "peanuts," but they had symbolic value and were of interest to specific congressmen on key committees. Politics and not economics still ruled American trade negotiations. Less tolerant of the charade, a California electronics maker wondered if the United States was on the road to becoming a "banana republic: If we think we are trying to balance our trade imbalance with the Japanese by selling them beef and grapefruit, we'll end up killing our industrial base."[52] Carter was on the defensive. The standard reason for the trade deficit—greater American GDP growth—could not explain the Japanese surplus because the Japanese growth rate now exceeded the American.[53] Although oil imports were a factor in the U.S. trade deficit, in 1978 they fell, largely because of the availability of Alaskan oil and efforts in energy conservation. The deficit in manufacturing increased, and with it the U.S. trade deficit rose to $33.9 billion.[54]

The skeptics were right. By June it was clear that the Japanese surplus was soaring. Its exports to the United States rose 35 percent in May. Then, on July 4, the Japanese informed Strauss that there would be no changes in beef or citrus purchases.[55] Susan Schwab, the U.S. trade representative in 2008, began as an assistant to Strauss in 1978. She recalled, "We were trying to get beef into the Japanese market, and I'm still trying to do that 30 years later."[56]

At the Bonn conference on July 16 and 17, Japan switched arguments. It claimed that exports of long-term capital would reduce the surplus on the overall balance of payments, which included both trading accounts and capital items. Officials promised to restrain the export flood.[57] The new assurances did not remove the Japanese trade surplus from being the main topic of discussion at Bonn. Believing that the best defense was an offense, Kiichi Miyazawa, the head of Japan's planning agency, complained about growing protectionism in the United States, worried

about ineffective American energy policy, and decried the growing budget deficit and falling dollar.[58] German trade policies were not a big problem. German exports fell in 1977, mainly because of weak European markets. Still, Bonn ended up with a large trade surplus. The big problem was German growth, which had been barely 3 percent in 1977.

Germany had already tried to boost growth by reducing taxes and increasing spending on infrastructure at the end of 1977. The fragile Social Democratic Party/Free Democratic Party government preferred to wait for the results before considering anything more. In early 1978 the Americans were focusing on the Japanese, so Germany was of the hook. Not for long. Schmidt and most Germans, except for the trade unions, had little faith in the stimulatory effect of macroeconomic measures, like public sector expenditures, for long-run growth. They believed that such measures dealt with symptoms, not causes.[59] But Schmidt the politician offered the Americans a deal. The Germans would stimulate if the Americans limited their oil imports. Although the United States was less dependent than the other powers upon foreign oil, its oil imports rose in 1977 because of inadequate conservation measures and limited domestic production caused by controlled, and thus low, prices for domestic oil and gas. (U.S. oil imports would fall in 1978.) A comprehensive energy bill was stuck in the Congress. Although the Europeans understood the complicated politics of energy in the United States, they wanted action because the effect of rising American oil imports was to raise the price that Germany and other buyers had to pay.

The falling dollar was another concern. During 1977, the dollar had depreciated 20 percent against the Japanese yen, 10 percent against the German mark, and nearly 5 percent against the other European currencies. After ending fixed exchanges in 1971 the U.S. position was that currency rates must be allowed to reflect economic basics. Fix the fundamentals and the exchange rate problem would disappear. This American principle served other purposes, as a cheaper dollar helped the nation's exports. Americans calculated that if the Germans and Japanese refused to make the policy changes that would promote American

exports, the cheaper dollar would do the trick. In 1977, U.S. officials had tolerated the U.S. trade deficit, with the assumption that it would be emulated by Japan and Germany. When such hopes vanished, the trade issue looked different. At the beginning of 1978, Secretary of the Treasury Michael Blumenthal and CEA chair Charles Schultze thought that the U.S. trade balance would be unlikely to improve over the next two years, so "we do not want to close the door on gradual exchange rate adjustment as a means of ultimately reducing the deficit."[60] On June 19, Blumenthal told the president that U.S. export performance was "disappointing."[61] By the summer it was grim. Schultze reported that manufactured imports rose 37 percent; exports only 9 percent.[62] Refusing to use the microeconomic measures of other nations, they concluded, as Nixon did in 1971, that currency depreciation was the best means to fix the trade deficit.

The Japanese and Germans preferred the fixed currencies of the Bretton Woods era, which was also the age of the overvalued dollar. They feared that the cheaper dollar would cut into their export surpluses and urged the United States to support its currency by buying dollars or raising interest rates. If not, the Germans hoped that a balanced budget and an energy policy that reduced imports would prevent further decline. If the dollar continued to fall, Schmidt proposed strengthening EC monetary cooperation to stabilize European rates and reduce the impact on Europe of the depreciation of the dollar. The French, fortified by their traditional antipathy to the dominant position of the United States in currency affairs, agreed. The British were ambivalent. The sinking dollar would make U.S. goods more competitive than British ones; on the other hand, measures that strengthened the dollar would also limit U.S. growth, which would hurt British exports. Prime Minister Callaghan supported American efforts to work on the Germans to increase its economic growth.

The summit ended harmoniously, in part because everyone stressed areas of agreement and ignored zones of conflict. Declaring that the number one problem was "worldwide unemployment," the seven nations

cast different countries in different roles to produce "steady noninflationary growth." They decided to forgo the precise numerical pledges that went unfulfilled at the London summit last year.[63] Japan, however, did promise a 7 percent growth rate. The Germans pledged a substantial stimulus, "up to 1 percent of the GDP," even though they continued to dissent from the Keynesian theory on which it was based. Even France, Italy, and the United Kingdom promised to reflate some. The United States played a different role this year. In 1977 the nation was the locomotive's engine; this year it was its brake. Carter promised to reduce inflation, which implicitly meant slowing growth. Carter also agreed to raise U.S. energy prices to world prices by 1980 and reduce U.S. consumption of oil by 2.5 million barrels a day by 1985. Everyone at the conference knew that he was having great difficulty getting his energy package through the Congress, but they applauded his promise to try harder.

The key decisions in Bonn were macroeconomic. For the first time in postwar German history, a government decided to stimulate an economy that was growing, albeit not at a rate that the other six nations thought sufficient to effect world growth. Schmidt's stimulus package thus broke with the single-minded anti-inflationary policies followed by German governments after World War II. As a result, German growth rose to 4.2 percent in 1979 and unemployment fell to 3.8 percent. After a couple of years the trade surplus ended, too.[64] Japan did not do so well. In December 1978 Prime Minister Fukuda was replaced by Masayoshi Ohira, who made it known that Japan would not achieve the 7 percent growth target set by his predecessor at Bonn.[65] The Japanese trade surplus remained because it was reinforced by structural, as well as macroeconomic, walls. Still, for the next couple of years Japanese growth, which reached 6 percent, was led by increased domestic consumption and investment, not exports.[66] To describe these actions as a triumph of Keynesianism misses the other half of the story.

Both Germany and Japan viewed the oil crisis as a structural crisis altering every part of the economy. Both tried to compensate for meager

domestic demand with exports. Both used industrial policies to enhance energy saving and promote new industries while they subsidized investment in energy-using industries like steel, facilitating their move to higher value products. Only then, under pressure from the United States and the other industrial powers, did they stimulate their economy. The small stimulus only supplemented the traditional, microeconomic ways of producing the prosperity. As we shall see in the following chapters, the United States remained wedded to macroeconomic solutions and to its hegemonic role of providing markets for the poor oil importers. But that role taxed the U.S. economy. Rather than following the microeconomic path of Europe and Japan, the United States chose to challenge the targeted measures, industrial policy, that the other nations used to address the oil crisis. The Americans were the main force behind the so-called Tokyo Round of trade negotiations, which attempted to rein in the subsidies and other special industrial policies that Europeans and Japanese had used to prosper in the low-tariff, recessionary era of the 1970s.

TOKYO ROUND

Every nation approached the Tokyo Round, begun in 1974 and completed in 1979, with its own interests front and center. The behavior contrasted sharply with official trilateralism, a variant of the theory of comparative advantage, which had dominated academic and policy thinking about trade since British political economist David Ricardo formulated it two hundred years ago. Both the first and modern version posited free trade as the obvious policy for national well-being. The durability of the theory is striking, especially when its original assumption—a world of small-scale enterprise—disappeared many years ago. But some economists have transported trade theory from the eighteenth to the twenty-first century. They conclude that the notion that markets or climate encoded economies is untenable. Many industries require large-scale operations and mount high entry costs to preserve them, and nations acquire industrial proficiency through active government. The experience of Japan, which transformed itself from a nation with abundant cheap labor to a technological powerhouse, required rethinking the old verities. Yet American economists took many years to explain the way Japan, and other nations, changed their industrial mix and trading.

The new trade story finds world commerce to be inevitably conflictual because one nation's gain can be another nation's loss. William Baumol, a professor of economics at Princeton and New York University who was considered for a Nobel Prize in 2003, and Ralph E. Gomory, a PhD in mathematics who became a vice president at IBM, challenged the conventional wisdom with economics, mathematics, and business experience. They concluded that it is a "mistaken impression that maximizing world output automatically maximizes national prosperity…. The common view of many noneconomists … that improvements in productivity in a foreign industry can be damaging to one's own country is, under these circumstances, exactly what our analysis confirms."[67] Nobel Laureate Paul Samuelson and Princeton economist Alan Blinder have also begun to question orthodox trade theory.[68]

Ironically, government officials privately acknowledged that a conflict existed between national and global interests. Henry Owen told Carter that "others will look to you to speak to the common interest, to the need for according it priority over more parochial concerns, and to the US willingness to play its full part in mutually reinforcing actions to this end."[69] Those parochial concerns were national interests, like the specialty steel industry. Although Owen thought that the price was worth paying, he understood that it was a price. This was not simply an American conclusion. Two British scholars in 1976 wrote that "postwar trade liberalization has been a beneficial exercise for America's trade partners, and … if any country could be said to have 'lost' within our given time horizon it was the United States itself."[70]

But as many more industries were threatened by imports, American elites could not avoid responding to "parochial" industrialists and union leaders. From 1960 through 1968 there were only eleven positive determinations of injury under the Anti-Dumping Act; from 1969 through 1977, there were sixty-five.[71] Although the Congress gave the president authority to conduct a new round of trade negotiations in 1974, the price was regular consultation with Congress and private-sector representatives. Most of the issues on the current trade agenda were put there by the United States, which aimed to eliminate what were called nontariff barriers —subsidies, preferences, and various industrial policies that deliberately or inadvertently either discriminated against imports or advantaged exports. The Europeans and Japanese who employed these industrial policies were satisfied with the status quo and yielded as little as possible without alienating the United States.[72]

The two most important areas were subsidies and government procurement. Americans wanted to control foreign subsidies that damaged U.S. exports as well as injured its domestic import-competing industries. A Canadian attempt to develop Nova Scotia illustrated the problem. In 1974 the United States imposed a countervailing duty on Michelin tire exports from Canada on the grounds that two new plants in Nova Scotia were heavily subsidized in 1969 and 1971. No one disputed

that they were. The federal government provided a $16-million grant and an accelerated depreciation allowance for investment; the province of Nova Scotia granted a $50-million loan and spent $7.6 million for training; the local government donated the plant sites and reduced the property tax rate. No one disputed that the plants were built with the understanding that 80 percent of their output would be exported to the United States.[73] The Canadians stressed that their action was motivated by domestic goals; the United States said that, whatever the motivation, the assistance was a bounty that had adverse international trade effects.

The matter had no easy resolution. The subsidies code negotiated in Tokyo required injury to be "material," meaning "harm which is not inconsequential, immaterial or unimportant." To obtain the code, the United States was forced to yield its own law that mandated countervailing duties without the proof that a producer was injured by the subsidized item. Tokyo further stipulated that the penalty for subsidies must be authorized by the signatories of the code, not unilaterally. The same compromises and ambiguities inhabited the procurement code. The objective of the code was to extend national treatment to foreign firms bidding on official contracts. The EC and Japan had clear practices, often unwritten, that the government sector will purchase from domestic suppliers whenever possible. The United States had its own Buy American Act, passed in 1933 during the Great Depression, but its provisions and applicability were small in comparison, except for military procurements, which every nation preserved for its own industries. It was a sign of the new order that the United States gave up its principle of nondiscrimination. Under the "most favored nation" rule, if the United States and the EC agreed to lower tariffs on European oranges entering the United States, Japanese oranges would receive the same low rate. The Tokyo procurement and subsidy codes affected signatories only. The United States hoped to limit the ability of other nations to obtain a free ride for their goods into the American market.

What did the four-year trade negotiation add up to? Like the Kennedy Round, the Tokyo agreement was oversold. The president stated that

“obstacles to American goods going overseas will be removed or drastically reduced.” Robert Strauss’s deputy Alonzo McDonald said, “We have estimated that the [government procurement] code will increase U.S. exports by between $1.3 and $2.3 billion over the next three to five years and U.S. job opportunities by between 50,000 and 100,000.”[74] In 1987 a House subcommittee found a “clear and incontrovertible pattern” of American exclusion “in the home markets of virtually all of our trading partners.” A study by the House of Representatives in 1994 found that the U.S. government opened up four times more of its government market than all of the other signatories combined.

The Tokyo agreement continued to reduce tariffs on industrial goods and enhance the access of developing countries to Western markets. The developing nations in question were the new industrial powerhouses Hong Kong, South Korea, Taiwan, and Malaysia. Although the United States accounted for only 40 percent of the combined GDP of industrial countries, in 1978 the United States took more than 52 percent of developing countries’ manufactured exports to the rich countries. U.S. economic growth after the global recession of 1975 benefited the non-oil-developing countries, whose exports to the United States grew much faster than they did to either Japan or the EC. Although the Congress was much more skeptical than in the past, the Trade Agreements Act of 1979 passed Congress with little opposition.[75] The trilateralists had kept domestic interests at bay.

The premise of the locomotive strategy was faulty. Additional international demand, it was argued, was needed, because OPEC surpluses would be unspent or withdrawn from the world economy.[76] Actually, OPEC nations went on a huge shopping spree—new industries, infrastructure, high-tech hospitals, telephone systems, weapons. Overnight Saudi Arabia went from camels to Datsun pickup trucks. A Nissan executive explained, “It is very expensive to maintain camels; it is cheaper to keep a Datsun.”[77] In 1974 OPEC had a $67-billion surplus. By 1978 the surplus had turned into a $2-billion deficit. OPEC revenues had

been reduced, too, because of the recession and Western conservation.

If unnecessary for the global economy, did the domestic stimulus in the United States and export policy of Japan and Germany tax the United States? The U.S. unemployment rate was over 6 percent at the end of 1978, higher than any other industrial nation, and its inflation rate reached double digits. Was the inflation propelled by West Germany and Japan's failure to reflate, resulting in a situation in which the United States' stimulus drew in the world's imports more than it stimulated its own production? Was the inflation driven by low American productivity? Productivity increased only 0.6 percent in 1977 and would turn negative by 1979.[78] Why was investment meager? The percentage of GDP devoted to investment was only 9 percent when 12 percent was needed to sustain adequate economic growth; was this because U.S. corporations outsourced more of their operations?[79] These troubling questions eroded belief in domestic Keynesianism, the stimulus that Carter's advisers prescribed for the United States.

CHAPTER EIGHT
Labor to Capital
DOMESTIC KEYNESIANISM ON THE ROPES

CARTER'S principal economic adviser during the campaign was Lawrence Klein, a professor at the Wharton School of the University of Pennsylvania and a leading Keynesian. Klein would win a Nobel prize in 1980 for econometric models that charted business fluctuations. Such models, like the Wharton Forecast, which he created for the United States, facilitated Keynesian planning.[1] In December 1976, the month before Carter took office, the Wharton Forecast was "bearish." GDP was rising at about 4 percent, but after the deep recession of 1974–75 the economy would require several quarters of 6 or 7 percent growth to bring down the unemployment rate. Klein recommended an economic stimulus. Mindful of the world economy, he said that the stimulus would "generate additional demand for imports" and thus help "our partners."[2] Like Carter's other advisers, he believed that Japan and Germany would emulate U.S. activism. Carter followed Klein's advice and asked the Congress to act, and Congress unenthusiastically proceeded to pass a small stimulus. The president himself was more interested in tax reform than in the stimulus, so in 1978 he offered a reform that was reasonable but ignored the ailing economy. Financial interests and Wall Street filled the policy void, convincing a Democratic Congress to pass tax legislation that discarded historic principles of interclass equity and methods of promoting business investment by simply sending money to the rich. Not only was the reduction of the capital gains tax a wasteful method of

increasing investment, it was also paid for by increasing the middle-class tax burden and thereby fed a tax revolt that made governing much more difficult for Democrats.

STIMULUS POLITICS

Like Klein, the other men and women who advised Carter were experienced Keynesians. Charles Schultze, the president's selection to chair the Council of Economic Advisers (CEA), had headed Lyndon Johnson's Bureau of the Budget and then returned to the Brookings Institution, a liberal think tank. Secretary of the Treasury W. Michael Blumenthal, another economics PhD, had worked in the State Department and Office of Trade Representative in the 1960s. He then moved into the business world, heading Bendix, a successful multinational corporation. A Jewish refugee from Nazi Germany, Blumenthal was the kind of Democratic businessman who believed that you could do well by doing good.

Balancing Blumenthal was Secretary of Labor F. Ray Marshall, another PhD in economics. AFL-CIO chief George Meany had urged Carter to appoint John Dunlop, the Harvard labor economist who had been President Ford's secretary of labor. Dunlop had resigned after Ford vetoed labor reform legislation that he had pledged to sign. Believing that robust collective bargaining was the essence of industrial democracy, Dunlop was the consummate negotiator. But representatives of blacks and women did not believe he was committed enough to airmative action, which would have made him a problematic pick for Carter.[3] Marshall, whose southern origins added to his appeal, seemed better on airmative action because he had written about racial discrimination and manpower policy. (The disagreement was not a gulf: Marshall had been Meany's choice for chair of the CEA, and the labor leader became a great admirer of Marshall's work as secretary.) The final PhD was Juanita Kreps; a labor demographer and then vice president of Duke University, she was the first woman to serve as secretary of commerce. Two liberals completed the group that advised Carter on economic issues. Vice President Walter Mondale was Carter's passport to the liberal north. Stuart Eizenstat, a young lawyer from Atlanta, had worked briefly in the Johnson White House. Eizenstat signed on early to Carter's campaign and

was rewarded with the top domestic policy post in the White House.[4]

Despite the many southern accents, these were mainstream Democrats whose ideas clashed with Carter's campaign oratory. Candidate Carter had attacked Republicans and Washington equally. The tax code became Carter's symbol of corrupt Washington politics, and he repeatedly referred to it as "a disgrace." Calling for sweeping reform, he ignored the fact that tax changes were the strongest weapons that the U.S. government could wield to influence the economy. Exceptions and deductions were not simply expressions of special interests, but the way the government kneaded the economy to produce efficiency, growth, and fairness. Carter's campaign themes—trust, honesty, and integrity—floated above an economy that suffered from high unemployment, low productivity, and a faltering recovery. The Treasury Department worked on Carter's comprehensive tax reform, which would be offered later in the year, but Carter was forced to offer first a stimulus to reduce the economy's 7.5 percent unemployment.

The stimulus conformed to political requirements. It totaled $31 billion for two years—less than 1 percent of GDP—a modest sum compared with the Kennedy tax cut of 1964 and the Ford cut of 1975.[5] The $50 individual rebate was the quick boost economists wanted. Schultze was not eager for a jobs program, but Marshall was, and the labor secretary convinced the president.[6] The plan included both public service jobs (organized under the Comprehensive Employment Training Act [CETA] of 1973) and local public works.[7] Treasury added a higher standard deduction for the income tax, which both worked as stimulus and made the tax code slightly more progressive. Last, business was given a choice: 2 percent added to the 10 percent investment tax credit or a jobs credit equal to 4 percent of payroll taxes on new employees. The first was geared to the industrial sector, the second to the service and sales economy.[8] It was a reasonable package: something each for labor, blacks, business, and economists. There was an appropriate mix between short-term goals (the rebate) and long-term needs (investment tax credit).

But the old-time religion lacked believers. Liberal Democratic

representative Charles Vanik quipped that the $50 rebate was “medicine from President Ford’s medicine chest.” Republican congressman William Ketchum asked why a rebate would work now when it did not during the Ford years. Businessmen wanted tax cuts to be permanent, not temporary, so they could plan accordingly. Many economists believed that temporary tax reduction would not stimulate consumption. And the AFL-CIO opposed any tax cut at all, believing that direct job creation was the order of the day. The rest of the package likewise faced stiff objections. Many Democrats did not want the rebate to go to upper-income individuals; Ways and Means Chair Al Ullman had his own way of offering credits for jobs. Liberals, who did not much like the investment tax credit, now questioned whether it was appropriate to place it in a short-run stimulus.

Carter’s inability to unite congressional Democrats behind the package was partly the result of what speechwriter Hendrik Hertzberg called the president’s “Jesus in the wilderness mode of decision making.”[9] Though the president listened to arguments, he kept his own counsel. Once he had determined the proper course, he expected others, including members of Congress, to accept his judgment. Congressional reforms also presented a challenge, as they reduced the power of committee chairs, which, like the McGovern party reforms, democratized politics but also fragmented power. Reform helped Carter win the nomination but made it more difficult for him to govern.

Nevertheless, Democrats wanted a Democratic president to succeed. But on April 14, when the compromises were in place, Carter suddenly dropped both the rebate and business tax credit. Data from the first quarter showed that unemployment fell slightly, from 7.5 to 7.4 percent, while consumer prices rose a little. (The revised figure for inflation, 6.58 percent, was slightly lower than the 7.15 percent of the previous quarter.) Carter, who had reluctantly accepted the rebate as castor oil, simply used the new figures to get rid of it. The new stimulus totaled $23 billion over two years, less than the original $31 billion.

Carter’s first tax battle demonstrated intellectual and strategic uncertainty. The AFL-CIO believed that Carter had exposed his

conservative nature by preferring to battle inflation rather than create jobs. Congressional liberals, who had reluctantly swallowed the rebate, judged the president unreliable. Businessmen applauded the withdrawal of the rebate, but they too were divided on the kind of tax relief needed to increase investment. At the heart of the disarray was orthodox liberal economics. Each Keynesian tool—individual tax cuts, investment tax cuts, government spending—was found wanting. Lacking conviction, Carter permitted short-run statistics to be the proverbial tail wagging the dog. Still, as Nixon's 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 20 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."[10]

The erosion of consensus made it difficult to negotiate the compromises necessary to legislate. Carter acted as if the country faced a cyclical downturn. So did the labor movement. But the high unemployment and anemic investment that accompanied the weak recovery were telltale signs of a structural crisis. Stimulus, the usual American medicine for a sluggish economy, seemed ineffective. Without consensus, the major players looked to their immediate self-interest. Labor and blacks wanted government jobs, lacking faith in long-term solutions; business pushed for supply-side measures and an end to redistribution, unwilling to acknowledge that reducing unemployment was a necessary part of economic policy. Even the administration was divided. Mondale, Marshall, and Eizenstat were closer to labor, Blumenthal and Bert Lance, who was Carter's friend and budget director, to business. Schultze remained in the center, leaning a little to the right.

THE GERMAN MODEL: LABOR REFORM

Because there was little agreement on the big questions, Secretary of Labor Marshall suggested that creating a labor-management advisory committee, as President Kennedy had in 1961, would help forge a consensus. But the president told him, "We don't need an Exec. Order or a formal structure."[11] Instead, Carter suggested a small "unpublicized" meeting to address a major subject, such as inflation. If successful, it might be repeated in some form. A small committee composed of eight major corporation executives and eight labor leaders already met regularly, but no government officials were involved.[12] Pollster Patrick Caddell's findings reinforced Carter's disinterest in creating economic consensus. In the age of media politics, pollsters became policy experts. Caddell told the president that postwar affluence had produced more "haves" than "have-nots" and that the major issues confronting American voters were cultural and social.[13] If that was the case and the United States remained an affluent society, then government did not need a new economic strategy.

Carter's relationship with the AFL-CIO was correct, but distant. The president governed as he had campaigned, independent of what he considered the "special interests," which included labor. Some of his aides, including Alfred Kahn, who headed Carter's anti-inflation effort, went further and were hostile to unions. To Kahn, "Congress and Labor were our natural enemies."[14] But the constituencies of the Democratic Party, particularly labor, would require some indication that the party remained faithful to its New Deal past if they were to accept the short-term restraints that Carter advocated.

The president could have followed the actions of Chancellor Helmut Schmidt, head of the German Social Democratic Party (SPD). The SPD had begun as a workers' party, and trade unions continued to play a critical role in party affairs. Schmidt had a strong and personal relationship with the German Confederation of Trade Unions (DGB). Like Carter, Schmidt opposed the robust stimulus that labor advocated.

But the German threw his weight behind a labor reform that the trade unions wanted very badly, extending the principle of codetermination. German trade unionists, by law, sat on the board of directors of coal and steel corporations. They wanted to extend the law to other sectors. None of this cost the government any money, so Schmidt fought hard to win the reform which the corporations opposed. Labor did not get the complete package but it did get something, and the chancellor's effort ensured that he got a hearing when he presented the unions with his austere fiscal program.[15]

Unlike the SPD, the Democratic Party was never a labor party. Although the modern labor movement and Democratic Party were born together during the New Deal, the AFL-CIO had no assigned role in the party and party leaders did not think of themselves as representing the working class. The party was organized by states, which underrepresented the AFL-CIO because two-thirds of its members lived in ten states. Nevertheless, the mainly Democratic labor movement was the most significant mass organization associated with the party. Labor's electoral and legislative muscle partly compensated for the party's diminished power after the government takeover of social welfare functions in the 1930s and the reforms of party rules in the 1970s. However, Carter did not have the personal chemistry with labor leaders that Schmidt had with German trade union leaders. Eizenstat explained: "There were no unions down there [in Georgia] when he was growing up. And so these were groups and organizations which were alien to his background and to his style of governing." Then, "the southern political system was a white versus black system. It was not an ethnic system."[16] Nor was the eighty-three-year-old Meany an easy man to embrace. Nevertheless, Carter needed labor support to achieve his legislative and, especially, his economic agenda, to keep Congress Democratic in 1978, and to win reelection in 1980. Like Schmidt, he had an opportunity to support a labor reform that would buffer labor's criticism of his austere fiscal leanings.

In 1977, about 25 percent of workers were union members, a 10 percent decline since the mid-1950s. Southern numbers were worse,

reaching only 10 percent. The AFL-CIO hoped to enhance labor's power and staunch the bleeding by unionizing the South and the Sunbelt, where the nation's economic growth was most vigorous. They chose to begin with the bill vetoed by Gerald Ford.[17] The Common Situs Picketing Bill legalized joint strikes of different craft unions on a common construction site. Strikes in support of other unions, or secondary boycotts, had been outlawed by the 1947 Taft-Hartley Act. The building trades unions argued that in the construction industry, where contractors typically subcontracted work to different employers, joint action was really a single action against one employer, who had an integrated business relationship with subcontractors. For those who worried that the bill would promote strikes, the law also established a national committee—composed of labor, industry, and public officials—that could assert jurisdiction in local construction disputes. Believing that a law passed in 1975 would have no trouble in 1977, labor leaders did not ask for Carter's support and it was not volunteered, although Carter promised to sign the legislation.[18]

But labor underestimated anti-union organizing, led by Associated General Contractors, which assembled a grassroots movement and a united business lobby. On March 23 the House of Representatives killed the bill, 205–217. Neither the labor movement nor the Carter administration had been fully aware of the increasing militancy of business. The National Association of Manufactures had moved its headquarters to Washington in 1972 and came close to merging in 1976 with the Chamber of Commerce.[19] For the previous ten years, business had been on the defensive. In the two years after the oil crisis, normally sober businessmen had imagined the collapse of the system or its radical transformation. When the economy improved in 1976, businessmen sensed an opportunity. This first big victory over labor in many years was intoxicating.[20]

Chastised, the AFL-CIO prepared better for a second piece of labor reform, one that had more appeal to other workers and the public at large. The rest of the labor movement and the public viewed the construction

workers who sought the "common situs" law as parochial at best and racist and conservative at worst. Liberals remembered their "hard hat" demonstrations in support of Nixon's invasion of Cambodia. Blacks recalled that these unions were often resistant to integrating their ranks. The second bill aimed to empower the powerless, a more politically appealing group, particularly southern workers. The South was the bastion of anti-unionism. The journalist Harry Golden declared that the people of Charlotte, North Carolina, would "elect Cassius Clay mayor if he would promise no unions and no collective bargaining."[21] Aggressive anti-union tactics and corporate violations of the labor law were a major reason why unions that had won 60 percent of representation elections, were winning only 46 percent now.

The proposed reform would make it easier for workers to unionize by amending the National Labor Relations Act of 1935 (better known as the Wagner Act, after its architect, Senator Robert Wagner of New York). The law promoted the organization of workers by prohibiting actions used by employers to obstruct unions, such as firing union workers. It also created the National Labor Relations Board (NLRB) to administer the act. In 1947 and 1959 less labor-friendly Congresses passed laws that regulated and limited the activities of unions, as well as those of employers. Labor found one provision of the 1947 Taft-Hartley law especially irksome. Section 14b allowed states to pass so-called right to work laws. Subsequently, twenty states, mainly in the South and Sunbelt, outlawed the union shop and other forms of mandatory union membership. A union shop clause did not require membership in order for an individual to obtain a job, but once a union was certified, workers would have to join. It was a solution to the free-rider problem, where workers benefited from a contract without contributing to the support of the union that had negotiated it. The new labor law would repeal 14b, making union shops once again possible in areas where they had been outlawed.

The second reform would certify unions without an election. Canada had such a law, which recognized a union if it produced signed cards

from 55 percent of the workers. Although the Wagner Act did not require elections, traditionally elections had been used to determine the wishes of workers.[22] But an army of consultants now trained managers to defeat union drives through such tactics as mandatory employee meetings, antiunion messages, and strategic firings. The costs, delays, and employer-created obstructions of the election process led union leaders to seek other ways of determining the workers' preferences.

A third reform would require new owners of a business to honor old union contracts. Labor thought that this clause was necessary in an era of increased mergers and bankruptcies. Finally, the law included other provisions that would expedite resolutions to labor disputes by enlarging the NLRB, setting time limits on elections, and increasing the penalties for noncompliance with the board's rulings.

Compelling stories breathed life into the proposed changes. Seventy-seven-year-old Thelma Swann traveled to Washington from her home in Darlington, South Carolina, to go before a congressional committee and testify that her company, Deering-Milliken, closed its mill in 1956 after she and her fellow workers decided to unionize. The case went to the NLRB and the Supreme Court, which ordered the company to compensate Swann and her fellow workers for back wages. During the past twenty-one years, no worker had collected.[23]

The poster child of anti-unionism was J. P. Stevens, a major North Carolina textile maker.[24] In 1974, after a long and arduous struggle at a Stevens mill in Roanoke Rapids, the Textile Workers Union of America won an election to represent the workers. After three years, the workers still had no contract because Stevens refused to bargain. The company had been cited fifteen times for violations of the labor law and had paid more than $1.3 million in fines and back wages to employees it had fired for union activity. Still, Stevens was awarded many government contracts, including one for $3.4 million by the Defense Logistics Agency. The union did not call a strike because Stevens had eighty-five other plants in the South and could weather a Roanoke strike indefinitely. Instead, it called for a nationwide boycott of Stevens's goods and

attempted to convince the public to strengthen the nation's labor laws. The AFL-CIO enlisted religious and civil rights organizations, to good effect. (Two years later, *Norma Rae,* a film about unionizing textile workers, won two Academy Awards.)

Textile worker Crystal Lee Sutton was a representative of the Amalgamated Clothing and Textile Union, whose major target was the J. P. Stevens Co. The movie *Norma Rae* was based on her story. The film and the union campaign were successful, but the attempt to reform the labor law to make it easier to form unions failed in 1978. (AP Images/Lennox McLendon)

This time, the Carter administration and the AFL-CIO worked together. Marshall, Mondale, and Eizenstat all urged Carter to embrace the bill.

Eizenstat told the president, “It is difficult to overestimate the importance of this matter in terms of our future relationship with organized labor. Because of budget constraints and fiscal considerations, we will be unable to satisfy their desires in many areas requiring expenditure of government funds. This is an issue without adverse budget considerations, which the unions very much want. I think it can help cement our relations for a good while.”[25] Carter’s legislative aide Frank Moore added that labor reform was labor’s “Panama,” a reference to the president’s passion for the canal treaties.[26]

Still, Carter was cautious. He did not consider that labor reform could help both him and the Democratic Party in the South. Carter viewed the law as special legislation for labor, something a Democratic president was obliged to support. He consulted with the Business Roundtable as well as with the AFL-CIO.[27] The price for the president’s support was the removal of the three potent provisions—14b repeal, card check, and contract continuity. (The Roundtable opposed the three.) The AFL-CIO had wanted the three clauses to remain so that a strong bill could weather the inevitable congressional compromises. But, having lost the picketing bill and requiring presidential support, labor acquiesced. The bill still contained numerous changes that would speed up elections, stiffen penalties for labor law violators, and make certain that union organizers had access to workers.

In early July, Carter publicly embraced the principles of labor reform but not the reform bill itself. He advocated sped-up elections, expansion of the NLRB from five to seven members, and measures penalizing law-breaking companies with both double back pay for illegally discharged workers, and debarment from federal contracts. He was silent on a provision that gave unions equal access to employees if employers addressed workers on company time or property. Another provision that did not please the president allowed strikers who were replaced by strikebreakers to return to their old jobs if the strike was over an initial contract. According to existing law, strikebreakers could retain their jobs in normal strikes over economic issues, but not in representational

elections. But often firms that lost a bargaining election, like Stevens's, then refused to bargain over an initial contract. Because most newly certified unions were weak, many thought that giving unions this extra protection would help, especially in the South. This first contract was much more like a representation election than the normal strike for wages. Carter's economic advisers convinced him that the provision would be inflationary and upset the balance between labor and management. Finally, Carter refused to meet publicly with the bill's sponsors, Senators Jacob Javits and Harrison Williams and Representative Frank Thompson.[28] Nevertheless, on October 6, 1977, the House passed the bill, 257–163, with thirty-six Republicans swelling the majority. Business opposition was limited to the "Cro-Magnon types," the traditional right-to-work groups.[29]

Because timing often determines legislative success or failure, Meany asked Carter to schedule labor law as his first priority for the 1978 congressional session.[30] The president, however, wanted to begin the Senate session with the controversial Panama Canal Treaty. Many of his advisers had urged him to hold off on the treaty debate, a few arguing that it should be pursued in his second term. But Carter insisted, and the lengthy debates on the treaty gave business time to mobilize against labor reform. The Business Roundtable had been divided. It was much more interested in defeating the proposed Consumer Agency and moderating environmental mandates than in marshaling against labor reform.[31] Some of the Roundtable firms, such as GM, GE, and U.S. Steel, were already unionized; others, like IBM and Du Pont, offered wages and benefits good enough to immunize them from unions. Still, they feared that the law would make it "most difficult to maintain as nonunion such groups as engineers, technicians, branch banks, or retail units, etc."[32] But until the House passed the bill, big business had stayed on the sidelines. Carter thought that removing the repeal of 14b and card check certification from the bill had tranquilized elite business.[33] He was wrong. The Roundtable eventually voted 19-II to oppose labor law reform. After the House passed the bill, it had plenty of time to mobilize "the grass roots."[34] Even

firms like GE, which had preferred neutrality, joined the battle. Its CEO, Reginald Jones, was a friend of Carter's, and this relationship raised questions about the president's commitment to the law.[35]

By early May, a Senate majority was behind the bill, but the sixty votes needed to overcome a filibuster were less certain. The opposition was led by the new senator from Utah, Orrin Hatch, whom the AFL-CIO called "the most articulate and intelligent right-winger we have."[36] It was energized by the dogged Jesse Helms, who had extensive connections to antiunion businesses and law firms in North Carolina. The bill's later place on the Senate schedule made certain that some moderates, like Republican Senator Howard Baker of Tennessee, would not vote for cloture. Baker had gone out on a limb to support Carter on the Panama treaty and had to "redeem" himself among conservative Republicans.[37]

Carter now began to put his face on the law. He appeared at a labor reform breakfast on May 9, six days before the beginning of the Senate floor debate.[38] He pledged his support for cloture in the event of the expected filibuster. Nevertheless, the president did not twist arms or woo opponents.[39] Carter was often said to be unskilled with these tools of persuasion—yet he certainly showed such talent in the Panama Canal fight, when he offered public works projects and an emergency farm bill that the administration had previously opposed as inflationary as a quid pro quo to obtain Senate support for the treaty. One official remarked, "I hope Panamanians will get as much out of these treaties as some United States senators."[40] But when it came to labor law reform, the president focused not on how to win passage of the bill, but on labor's slights. He was miffed because the AFL-CIO was giving him no credit for his help, despite his going against the Business Roundtable, which had urged him to be neutral.[41] At the same time, he and Meany were at odds over his anti-inflation program, which asked labor to restrain wage demands, pending a drop in prices.[42] The delayed vote hurt here, too. By July, the inflation issue reemerged. The more sophisticated business opponents of the law now argued that, by encouraging unionization, the legislation would increase wages and thus inflation.[43]

The National Association of Manufacturers (NAM) commissioned studies that "proved" that the legislation "will be highly inflationary and thus singularly inconsistent with the President's announced objective of reducing the current alarming high rate of inflation."[44] Economic arguments had helped labor in the 1930s, when its sponsors had argued that unionization would increase purchasing power, which was precisely what the depressed economy of the 1930S needed. In the 1970s finding such economic virtues in the legislation was more difficult. Yet this does not mean that the legislation lost because its opponents convinced the majority that it would worsen inflation. The bill passed both houses and fell one vote short of the sixty votes needed for cloture. If there was any message in the vote count, it was that the South and Sunbelt were doggedly anti-union.

When the bill was filibustered, forty-four Democrats and fourteen Republicans voted for cloture; sixteen Democrats and twenty-four Republicans voted against. The bill was dead—and the critical issue behind its failure was not inflation, but unionization.[45] Where voting was not partisan, it was regional. Fourteen of the sixteen Democrats who opposed cloture were from southern states, while the two non-southern Democrats were from Nebraska and Nevada, both right-to-work states. The fourteen Republicans who voted for cloture were from the northeastern and Pacific states, where unions were powerful.[46] Wherever the labor movement was weak, especially in the South, Democrats voted with business with electoral impunity. Democratic Senator Richard Stone of Florida explained that it would "impede the progress of the sunbelt to attract jobs." Democrat Lloyd Bentsen of Texas said the bill "goes too far."[47] Democrats Dale Bumpers of Arkansas and John Sparkman of Alabama also voted no.[48] Although the AFL-CIO did not blame the president for these votes, many labor leaders did. Carter had been told how important his support for the law was, and he had given it. But his advocacy had lacked the conviction of his support for the Panama Canal Treaty. Given the closeness of the cloture vote, that comparative nonchalance probably was decisive.

The failure of the bill also highlighted the administration's mistaken belief that a moderate bill would neutralize business opposition. Associations of small businesses still dredged up cartoonish images of union bosses. Furthermore, big business did not buy Carter's notion that the bill merely restored neutrality or promoted efficiency. The Business Roundtable feared that the law would empower labor.[49] For many corporations the political power of unions and not their collective bargaining power was objectionable. They saw unions as the engine driving the increased regulation of the 1960S and 1970s. One oil-industry lobbyist believed that the law would unionize the South and that "the South would go the way of Ohio … due to the political strength of labor."[50] Ohio had once been a reliably Republican state but had become a reliably Democratic one because of unionization. Unionizing the South would transform the nation's politics, the lobbyist feared.

Moreover, some liberals supported the law only with reservations. If the movie *Norma Rae* indicated that liberals were still for the underdog, the 1978 film *Blue Collar* demonstrated liberal misgivings of even "progressive" unions. *Blue Collar,* directed and written by Hollywood liberal Paul Schrader and starring Richard Pryor, Harvey Keitel, and Yaphet Kotto, tells the story of three friends who are union autoworkers. The men have numerous financial and personal problems, which they attempt to resolve by stealing money from the union. In the process they discover a notebook which documents their union's corruption. Although the union is unnamed, it is clearly meant to be the United Automobile Workers of America (UAW), once the darling of the left. The film's message is that unions have been corrupted and co-opted and cannot help the workers they represent. This New Left vision contributed to the culture of anti-unionism. Meanwhile, in the real world, the head of the UAW, Douglas Fraser, resigned on July 17 from the informal labor-management committee, charging that big business was waging "a one-sided class war in this country" and discarding "the fragile, unwritten compact previously existing during a period of growth and progress…. I cannot sit there seeking unity with the leaders of American industry,

while they try to destroy us and ruin the lives of the people I represent.”[51]

THE POVERTY OF LIBERAL ECONOMICS

Other reforms did not even come as close as labor law reform to passage. Imagining that control of both branches of government gave them unlimited opportunities to extend and complete the welfare state, Democrats overreached. The UAW and Senator Ted Kennedy attempted to hammer out a national health care bill. Ralph Nader's public interest empire had been working since 1969 to establish a consumer agency. Each measure failed for many reasons, but underlying it all was the faltering economy— which was front and center in the eyes of the electorate but beneath the gaze of the liberal politicians. Their only success was the Humphrey-Hawkins full employment law, and even this victory was more a tribute to Hubert Humphrey, who had died of cancer in January 1978, than a blueprint for action. In fact, it underscored the poverty of liberal economics.

Humphrey-Hawkins was a lightweight version of the Humphrey-Javits bill, which was a full-blown planning bill. Humphrey-Javits had been introduced in the midst of the recession of 1975, when it seemed that the economy needed a major overhaul. It included new forms of sectoral, or "micro," planning to ensure full employment. When the economy picked up in 1976, its sponsors dropped it. Because unemployment was still high, Humphrey then joined with Augustus Hawkins to introduce new legislation to guarantee full employment. Humphrey-Javits had provided new tools for the government; Humphrey-Hawkins relied upon traditional macroeconomic techniques, supplemented with government jobs.

During the 1976 campaign Carter had unenthusiastically endorsed Humphrey-Hawkins. In the summer of 1978 the Congressional Black Caucus convinced him to accept a weakened version, which set the legislation's economic goal forward to 1983, omitted specific steps from the plan (such as the creation of more government jobs), and excised the provision that made government the employer of last resort.[52] The revised law also added a mandate to contain inflation.[53] Even though the explicit planning component had been removed, Humphrey asked his old

comrade Jacob Javits to support the legislation. Humphrey told him that the bill was a step toward a "more rational and longer-term planning of our nation's economic policy."[54] Javits agreed and signed on.[55]

But when the hearings took place at the beginning of 1978, the unemployment rate had fallen to 6.4 percent, down from about 7 percent in the middle of 1977. Some argued that legislation was unnecessary because the market was reducing the rate. But at least half of the decline after June 1977 was the result of the 300,000 new Public Service Employment jobs created. With other government programs, like college work-study and on-the-job training, approximately two million persons were taken of the unemployment rolls. In other words, without these programs the jobless rate would not have been 6.4 percent, it would have been between 8 and 8.5 percent. The private sector was still not creating enough jobs.

Most businessmen opposed Humphrey-Hawkins because they opposed national planning for employment goals and thought that the 4 percent target was too low and inflexible.[56] Business leaders attributed the high unemployment rate to demographic changes (especially the increased numbers of women and youth in the labor force), industrial shifts, and technological change. Believing that the social and structural changes were inevitable—and benign in the long run—the Business Roundtable thought that voluntary action by socially conscious groups like the National Alliance of Businessmen, along with some public service and public works jobs, and training programs, could adjust the workforce to the new circumstances. In the end, more investment was the long-term solution for unemployment.[57] Mandatory goals would produce only inflation, more government spending, and greater intervention in the economy.

The nation's leading manpower economist, C. C. Killingsworth, countered that the law was a first step toward a rational labor policy. Consumption-led stimuli brought trade deficits and inflation more than investment and growth, and Killingsworth argued that public jobs were less inflationary than tax cuts. He was correct, especially if job recipients

were drawn from the ranks of the unemployed.[58] Like many liberals, though, he assumed that the public jobs would supplement a healthy economy. But the economy of the 1970s was faltering, not simply job-deficient. Ignoring the structural changes and growing internationalization of the American economy, the legislation mandated unemployment goals without analyzing the cause of the shortfall.

Meanwhile, the law that Carter signed on October 27, 1978, required the president and the Federal Reserve Board to formulate and communicate policies that would achieve 4 percent unemployment by 1983, labor's goal, and a 4 percent inflation rate, the White House and business's objective. The black leader Bayard Rustin correctly predicted that "the inclusion of the 'inflation goals' will lead many government officials—particularly economic policy makers—to regard the employment goals rather casually."[59] Just as White House opposition was the crucial barrier to Humphrey-Javits, White House indifference yielded a stillborn Humphrey-Hawkins. Because Carter considered the law to be a political obligation, not a political opportunity, Killingsworth's hopes of serious evaluations of economic policies to produce full employment never materialized. Despite the anemic recovery and relatively high unemployment, the president and the Democratic Party acted as if they were still doctoring a robust economy.

THE DEATH OF KEYNESIAN TAX REFORM

Labor law reform and Humphrey-Hawkins were sideshows for Carter in 1978. Senate ratification of two treaties transferring the Panama Canal to Panama occupied his time and commanded his emotions. Central Americans as well as Panamanians deemed American control of the canal a perfect symbol of imperialism. Because the U.S. Joint Chiefs of Staff and the State Department believed that the American enclave was not so important militarily, and that it invited terrorist attacks, not to say anti-American propaganda, both advocated returning the Canal Zone to Panama. Although Carter skillfully put together a coalition that included military men, Democrats, and moderate Republicans—including Henry Kissinger—the noisy opposition from the Republican right made the result a cliffhanger. The treaties, requiring the approval of two-thirds of the Senate, passed by one vote in April. Carter could now concentrate on his number one domestic issue, tax reform. As soon as he was inaugurated, and while the nation was debating the stimulus, Carter had ordered the Treasury Department to begin work on reform.

The idea of tax reform is most appealing to middle-class liberals and easiest to legislate when the economy is doing well. In hard times, issues of simplicity and neutrality take a backseat to economic stabilization and growth. Still, Carter persisted. The story of Carter's tax reform is the tale of a reasonable bill, thoughtfully calibrated and recalibrated in the White House, that was first ignored in the Congress and then replaced by a bill that not only eliminated Carter's reforms, but discarded historic principles of interclass equity and methods of promoting business investment. The Revenue Act of 1978 was not simply a triumph of capital, but of financial capital, which was assuming a prominent role in U.S. politics. Yet it passed not because Wall Street dominated the political process in 1978, but because Carter had not offered an alternative to doctor the economy's ills.

Carter's tax reform assumed that the incentives and exclusions of the tax code were loopholes, ways of escaping the tax law. If loopholes were

closed, the new revenue could yield tax reduction for most Americans. The major hole to be plugged was the capital gains tax on the profits from selling any asset, such as real estate, stocks, and bonds, but also art and race horses. Since 1921, sales of these assets had been taxed at rates lower than ordinary income, wages, interest, and rent. The rationale was that capital, machines, tools, etc., are essential to the production of income. Nonetheless, the rates varied. In 1969, the Congress raised the maximum to 49 percent, the highest level since 1921. Still, that rate was lower than the rate on wages and dividends, which had a 70 percent maximum. Under the Carter plan, capital gains would be taxed as any kind of income, a promise he made during the campaign. It was a goal of many economists, too. Economists love to treat all income the same so that individuals and corporations do not make economic decisions on the basis of the tax benefits. Capital should be deployed on the basis of market principles. But writing a tax code is not done blindfolded. Eliminating the capital gains differential would also raise the taxes of the upper class.

To compensate, the Treasury planned to reduce the top rate from 70 to 50 percent and end what was known as the double taxation of dividends. Corporate dividends were taxed twice: first as corporate income and again as individual income of the person who received the dividend. Companies had incentives to raise money through debt, not stock, because the interest paid was fully deductible and returns were not doubly taxed. Also, inflation permitted future obligations to be met with cheaper dollars. Treasury expected that the increased revenue from capital gains tax reform would make up the loss of integrating corporate taxation. But reforming dividend taxation created another problem. If the relief were given to individuals, corporations would be greatly pressured to pay out more dividends, and that could reduce investment. Corporate leaders preferred that the relief went to the company. Wall Street thought it should go to individuals, so that financial institutions could invest the money.

Tax simplification was not so simple after all. Effecting principles of fairness, simplicity, efficiency, and growth was no science. Still, some of

Carter's aides groused that the tax reform was not "comprehensive, total, sweeping, and bold." Speechwriter Jim Fallows spit back Carter's words at the Democratic convention: "All my life I have heard promises about tax reform, but it never quite happens."[60] Carter, if not Fallows, was beginning to learn why not.

The proposed tax changes revolutionized the way government promoted business investment. The customary method of business aid was the investment tax credit, offered to those who added to the stock of physical assets. The Treasury substituted rate reductions to rich individuals. It gave money to savers, not investors. In other words, instead of giving benefits to factory builders, it gave money to wealthy people with the assumption that they would invest, according to market signals. Labor had accepted the investment tax credit because it was not a gift to the rich, but a reward for new factories. Second best was tax reduction for corporations. Senator Edward Kennedy made this case to Carter, saying that if $2.5 billion "is to be given to business, I would urge that it be provided in a simple way that promotes capital formation—by a larger corporate rate cut, for example…. Surely, the vast majority of the business community would be happier."[61] The least useful was to give money to rich individuals with no guarantee that the money would be invested productively if at all. Returning money to individuals increased investment less than liberalizing the investment credit.[62] Yet the Treasury plan transferred $2.5 billion in tax relief—the dividend changes and the reduction of the highest rate from 70 to 50 percent, minus the ending of special capital gains preferences—to the wealthiest persons in the country without requiring anything from them.

The neutrality principle stopped when it came to multinationals. Carter had wanted to end the deferral of taxes on the profits of overseas companies until they were repatriated. Labor agreed but for different reasons, believing that the tax promoted investment abroad. Secretary of Commerce Juanita Kreps agreed with the labor analysis but used that as an argument to retain it. If repealed, "it would discourage U.S. investment in low tax countries (often LDCs)."[63] For Kreps, like many in

Carter's cabinet, the international trumped the domestic economy. In the end, Carter's plan extracted a little more from foreign subsidiaries, but not much.

There were two axes of dissent within the government. One was Treasury versus Commerce and the Council of Economic Advisers (CEA). Treasury was determined to allow market forces, not government, to make business decisions. Commerce and the CEA preferred changes that had the best chance of promoting investment. The other conflict was between Treasury and Carter's domestic staff. Domestic advisers wanted changes that were more progressive, meaning that they wanted less money going to wealthy people and corporations. In the end a revised plan was introduced as a compromise, offering a little on dividend integration to individuals, reducing the corporate tax rate, raising the investment credit, and ending the low tax rate for capital gains income. The package was also made slightly more progressive by transforming the personal exemption into a credit to help low-income taxpayers. But as economist Joseph Pechman observed, the end product was merely "a complex combination of different approaches," which offered an "open invitation" to Congress to do its own fine tuning.[64] In short, the compromise lacked logic, a rationale which could fend off the inevitable changes that would be offered.[65]

And then the economy intervened. So far, the debate was about simplicity, fairness, and theories of investment. But how would the changes affect the actual economy in 1978 and 1979?[66] On October 15, 1977, CEA chair Schultze warned that without "additional measures to stimulate growth, the rate of expansion will fall well short of our 5 percent target for next year."[67] In December he cautioned that the economy would be harnessed in 1979 by the recently approved social security tax increase and the additional taxes the government would collect from individuals pushed into higher brackets by inflation. The additional revenue totaled $25 billion for 1979. The revised Treasury tax package totaled about $20 billion worth of reductions. Each canceled the other so that there would be no stimulus, which the economy needed in

1979.[68] Moreover, energy imports, slowing U.S. exports, and state and local government budget surpluses would take more money out of the economy. As economic stabilization now took center stage, the carefully composed tax reform package seemed of key.[69] The economy required more stimulus. Carter "reluctantly" agreed.[70]

Treasury Secretary Blumenthal, with his ear to businessmen, declared that tax reform could not preempt measures to stimulate the economy. Although the White House made it clear that Blumenthal was speaking for himself, he was closer to political reality than Carter was. So the bill was changed again. It now offered some loophole closing—tightening up deductions for business expense accounts and medical expenses, a modest reduction in foreign tax deferral, ending deductions for state and local sales and gasoline taxes—and this increased revenue by $10 billion. But it also restored the preferential treatment of capital gains and deferred addressing the double taxation of dividends. The bill reduced corporate and individual rates, and offered targeted investment incentives to increase productivity. The new bill was fiscally neutral because the tax cuts barely made up for the increased social security payroll taxes.

Most believed that the package would do little, so it had no champion. Labor did not like the business tax relief and wanted more economic stimulus; the National Urban League claimed it would do little for blacks and the cities; good-government groups complained it did not reform enough; business did not like the remaining reforms, which increased the taxes of foreign subsidiaries and reined in deductions for business expenses. Ralph Nader endorsed the revenue-raising measures and opposed the business tax cuts.[71] Groups targeted specific parts; for example, the restaurant and hotel industry claimed that thousands of jobs would be lost as a result of ending some of the deductions for business expenses, the so-called three martini lunch. Underlying the whole process was the crisis in Keynesianism. Initially, Carter had introduced a tax reform package that did not intersect with the actual economy. When growth issues entered the tax package, the government hesitated and faltered. No one had faith that this kind of fine tuning could get the job

done.

Having decided upon their package at the end of 1977, Carter and his aides, preoccupied with the Panama Canal treaty negotiations, did not try to convince the public or the Congress. The president seemed to think that the public supported his program because he had campaigned on tax reform and won the election. When the House Ways and Means Committee received the much-revised tax bill in April 1978, Carter learned the unpleasant truth. Committee chair Al Ullman was relatively new to the job, replacing the long-serving Wilbur D. Mills (who resigned in disgrace after the police found him driving drunk with a stripper) in late 1974. In describing the difference between the former and the new chair, one Republican said, "We have gone in a single year from the tyranny of one-man rule to a state of anarchy."[72] Ullman improved in his position but remained retiring and shy. From a mostly rural district in Oregon, the former real estate developer was a process and not an economic liberal. Streamlining the budget process, a reform enacted several years earlier, was one of his proudest moments. Even if he had been more forceful, new rules had reduced the power of chairs. The first committee votes—to abolish deductions for state and local sales taxes and property taxes—went against the president. Carter's rhetoric against special interests worked against the three-martini lunch but not against the deduction of local taxes, which middle-class taxpayers had enjoyed. Carter argued that citizens would more than regain their losses in the general rate reduction that was also a part of the package. But not many people believed him. The math for those earning $25,000 to $30,000 a year was not so clear when calculated with the social security increases. They would each average a benefit of less than $25 per year, which would be eroded by inflation.

After the bill had been in his committee for a week, Ullman told Carter that the loophole reforms that would raise $10 billion were dead.[73] Even though this made the law a revenue loser, the president hoped to preserve the $25-billion cut, for macroeconomic purposes, include as many reforms as possible, and defend against new special privileges, measures

that “dereform” the tax code.[74] Now even that minimum was in trouble. In March Schultze warned that inflation, which had been down to 6.5 percent, was accelerating because of a 16.4 percent rise in food prices.[75] On April 11 Carter announced that the key economic problem was now inflation, although at an April 25 press conference he declared that a $25-billion tax cut would not be inflationary. But having released the inflation genie from the bottle, Carter was on the defensive. Ironically, the criticism came from G. William Miller, the former CEO of the conglomerate Textron, whom Carter had made Federal Reserve chair in December to replace the uncooperative Arthur Burns. Miller claimed that a $25-billion tax cut would only worsen the budget deficit, which he said was the mainspring of inflation. He urged the president to move the tax cut ahead to January 1, 1979, from October 1978, the planned date.[76] There was no consensus about what was causing the inflation. Schultze, an inflation hawk, told Carter that the federal deficit was not the cause of inflation and that the scheduled October tax cut would be needed for 1979.

Assistant Gerald Rafshoon could not alter the image of a vacillating Carter after he sacrificed first tax reform and then an economic stimulus on May 21, 1978. Eventually, Carter accepted a tax bill that reduced the capital gains tax, at the cost of broad middle-class tax relief. (copyright by The Herb Block Foundation.)

Critically, business was divided in a manner that would become increasingly salient. Miller had responded to the bankers, the people who were most threatened by inflation, which reduced the value of their asset, money. Joining Miller were Edwin H. Yeo III, vice president of First National Bank of Chicago; Robert Roosa, a partner in Brown Brothers Harriman; Henry Kaufman, partner and chief economist for Salomon Brothers; Norman Robertson, chief economist at the Mellon Bank; and Irwin Kenner of Manufacturers Hanover Trust. U.S. industry did not agree. Reginald Jones, head of General Electric and the Business Roundtable's task force on taxation, and David Grove, chief economist for IBM, dissented strongly. So did economists associated with the KennedyJohnson years, like Andrew F. Brimmer, currently an economic consultant who was appointed by Johnson to serve as the first African American governor of the Federal Reserve, and the venerable Walter Heller, head of the CEA under Kennedy and Johnson. The AFL-CIO, which had been silent, endorsed the tax cut, too.[77]

Carter then changed his mind. Seventeen days after he said that his tax cut would not be inflationary, he said that the tax cut could be delayed until January and also could be smaller than the $25 billion on which he had been insisting.[78] A rationale for the tax plan no longer existed. Schultze told Carter that if he did not yield at least partially, the Fed would increase the already rising interest rates, so much so that it would lead to a recession in 1979.[79] First tax reform, and now macroeconomic stabilization, was discarded. In the vacuum, new interests inserted themselves into the process and completely transformed the legislation.

CAPITAL RETURNS

Carter's tax bill became rudderless as it wended through Congress. About the only thing left on the Carter agenda was preventing the growth rate in 1979 from falling below 3 percent. Because he had ignored the major economic brake to growth, falling productivity, Carter lost control of taxation. Productivity had declined during the 1970s. After World War II, productivity had risen about 3 percent annually, but it had slowed in the late 1960S and plummeted in the 1970s. From 1973 to 1976 productivity actually fell 0.54 percent.[80] In 1978 it registered a meager 0.6 percent rise. (Japan's productivity increased 6 percent while West Germany's increased 3 to 4 percent).[81] Achieving higher wages, higher profits, and lower inflation rates depended on increasing productivity. But how did one raise it? Keynesians addressed aggregate demand.[82] But many no longer believed that increasing aggregate demand would stimulate investment. Structural changes in the economy required other measures. The rise of energy prices reduced the productivity of much invested capital. Investment was needed to clean up the environment. And, many American policies promoted foreign production. Despite home markets of similar size, European multinational re-exports to the home market amounted to $260 million in 1978, compared with $4.1 billion for U.S. firms.[83] During the 1970s the American share of the world market for manufactured goods declined by 23 percent. Demand management would not fix these matters and might produce more inflation and imports than it would more factories. Carter and his advisers vacated this intellectual space, which was filled by radical new solutions, capital gains reduction and supply-side tax cuts.

Congressional Democrats reduced the capital gains tax in 1978; supply-side tax cuts would require the Republican victories in 1980. As discussed above, Carter had wanted to completely end the preference in the interest of tax neutrality. Wall Street had viewed Carter's pledge to get rid of the special rate as a major threat. The American Council for Capital Formation, founded by Charls Walker in 1973, sprung into action.

When Carter retreated and decided to retain the capital rate differential in his April package, the council turned defense into offense and now aimed to restore pre-1969 levels of taxation. Walker claimed that stock prices were low because taxes were paid on the difference between selling and purchase price without adjusting for inflation. This reduced the return on equity and locked in existing holdings. Lowering the rate from its 49 percent maximum would free up capital for new investment. It was not the mainstream business lobbyists who led the charge, and the *Wall Street Journal* attacked the NAM for its lack of ardor.[84] The NAM was interested in corporate rate reduction and ending the double taxation of dividends, but "the sudden emergence of the capital gains initiative overwhelmed integration [of dividend taxation] and set it aside," explained one official.[85] Similarly, Business Roundtable chair Reginald Jones urged business tax relief but did not advocate changing the capital gains rate.[86] The capital intensive big companies acquired investment from retained earnings and debt, not new stock offerings. Wall Street, individual investors, and smaller firms were the main champions of capital gains reductions. But moderate and even liberal politicians also were for it. Their initiative was critical.

Republican William Steiger of Wisconsin introduced the measure. Steiger was a liberal, not a right wing, Republican. He was the sponsor of the Occupational Safety and Health Act (OSHA) and a supporter of legal services for the poor and of environmental regulation. He was troubled by the decline in productivity and innovation. A discussion with an electronics industry spokesman convinced him that capital gains reform would revitalize the economy. Steiger admitted that most of the benefit would go to big investors. But reducing the tax would contribute significantly to "capital formation," investment in new factories, machines, and other productive facilities that created jobs. Steiger claimed that such economic activity would more than make up for the loss in revenue and would reduce the federal deficit.[87] The Steiger amendment attracted many liberal Democrats, including Ullman, Senators Alan Cranston of California, majority whip Harrison A.

Williams Jr. of New Jersey, Daniel Moynihan of New York, and Patrick Leahy of Vermont. Keynesian solutions were losing their appeal among liberals as well as conservatives.

Keynesian economists believed that capital gains reductions would simply transfer assets that had little to do with productivity-raising investment, such as real estate commodity futures, livestock, and art. Both Blumenthal and Schultze thought that Carter's proposals to lower corporate tax rates and liberalize the investment tax credit would generate more investment for the revenues given up.[88] Nevertheless, the Treasury did not have plausible studies to counter the conclusions of the sponsored research of the American Council for Capital Formation. Subsequent research found that capital gains tax reductions did not increase venture capital, its purported goal. The reason is that over 70 percent of the money flowing into new ventures is from tax-exempt sources such as pension funds, endowments, trusts, and foreign companies. Tax code changes have no effect on this group. Similarly, corporations often invest in new research and technology for reasons other than monetary purposes.[89] But, at the time, the Carter people were intellectually, as well as politically, unprepared for the challenge.[90]

On June 26 Carter declared the Steiger capital gains proposal "a step backward" that "provides huge tax windfalls for millionaires and two bits for the average American." But as capital gains reduction took center stage because it seemed to answer the productivity question that Carter ignored, the administration switched tactics from opposing to modifying it—making it smaller and more tailored to the middle class.[91] The House modified the bill, reducing the capital gains tax from 49 to 35 percent, when Steiger had proposed 25 percent.[92] In the Senate the Business Roundtable now got on board, even though Reginald Jones thought that corporate rate reduction and the investment tax credit would be more potent.[93] Because of the $2.5-billion capital gains reduction, the law included less corporate rate reduction, which most economists thought would yield more investment. (The rate was cut from 48 to 46 percent.) The investment credit was made a permanent 10 percent.

The capital gains reductions were paid for with reduced tax relief for the broad middle class, those earning $10,000–$50,000. When the House and Senate versions were reconciled in conference and representatives were faced with the final budget choice of cutting back on capital gains reductions or on middle income tax relief, the representatives chose the latter. As a result of the Revenue Act of 1978, the middle class share of the tax burden increased, and, with rising social security taxes in 1979 and inflation, its tax bill actually increased. The Democratic congress fueled the fires of the tax revolt of 1978.[94] The only real winners, Schultze declared, were the "working poor and the very wealthy." And, he added, "from the standpoint of investment stimulation, the capital gains cut is relatively wasteful and from an income distribution standpoint it is regressive."[95]

Carter briefly considered vetoing the bill. But the macroeconomic need for a tax cut for 1979 and the popularity of tax reductions made such a course economically and politically difficult. A veto would allow Carter to propose a better tax cut, embodying anti-inflation principles. Rolling back social security taxes and rebating local sales taxes could reduce inflation by 1 percent. But Carter had been arguing all year against reducing social security taxes over the objections of many House Democrats. To veto the bill would embarrass liberal Democrats. Many had been under pressure to support the three-year, $80-billion Kemp-Roth tax reduction. They told critics that they voted for a responsible tax bill within reasonable budget limits.[96] Indeed, the only virtue of the current bill, costing about $20 billion, was that it was within budget limits.

The Kemp-Roth bill was the other popular tax cut. It proposed across-the-board cuts in tax rates, yielding a reduction of about 33 percent for individuals and 3 percent for corporations over three years. The measure was based on a novel theory. Keynes had argued that tax cuts worked by increasing aggregate demand. In the case of the Kennedy-Johnson tax cut of 1964, this was accomplished by releasing $10 billion of consumer purchasing power and another $3 billion of corporate funds. The theory behind Kemp-Roth, formulated by economist Norman B. Ture, was that

deep tax cuts would restore incentives to work, save, and invest, going a long way to restoring productivity levels. Ture predicted that in one year GDP would increase by $170 billion and investment by $113 billion (over 30 percent in real terms), and would produce two million new jobs. Critics replied that changing marginal tax rates would not change individual decisions about working and saving. Because the cuts would not elicit equivalent supply, the extra demand would simply produce more inflation. Both liberal and business economists agreed that the plan did not add up.[97] Nevertheless, it was very popular and seemed to be populist as well. This was not a giveaway to business, but a sweeping rate reduction for everyone. Two hundred members of Congress from both houses co-sponsored the amendment. As the Keynesian economists admitted failure, the way was open for men like Ture, who filled the void. Still, reason did not completely go to the wind. Kemp-Roth achieved its best vote total when combined with cutting expenditures and balancing the budget. In 1978, however, even when married to spending reduction, it did not attract a majority.

Because mainstream Keynesian economists lacked answers, they lost their monopoly on economic discourse and opened the door for outsiders. Successful capital gains reduction and unsuccessful Kemp-Roth tax reduction were symptoms that new men were gaining influence. Carter began his tax cutting with the stimulus of 1977, a conventional Keynesian technique. He put together a tax reform plan that was full of his own conceptions of fairness and ended up with a reasonable reform program that had little to do with current economic woes. The proposals opened a hornets' nest of business opposition, which both parried Carter's changes and countered with oferings, purporting to restore productivity. The Revenue Act of 1978 embodied pre-Keynesian principles. As a result, Carter ended up with the worst of all possible worlds. The tax bill gave businessmen and wealthy individuals more money, but with no guarantee that they would invest it in the United States. Neither Carter's stimulus nor Republican tax reduction stopped the flow of foreign investment. During the Carter administration American banks and corporations

almost tripled their foreign investments, to $530 billion.[98] The revenue act increased the overall tax bill for the middle class, when the increased social security taxes and bracket creep from inflation are included, and this outcome swelled anti-tax sentiment. And, despite the Democratic president and Congress, a full menu of reform legislation—labor law reform, national health insurance, a consumer agency—went down to defeat. As long as growth persisted and inflation was contained, Democrats and labor absorbed their defeats and muddled through. But the second oil crisis, beginning in December 1978, placed additional weight on the Keynesian system and forced both labor and the president to chart new routes to progress.

CHAPTER NINE

From Virtuous Circle to Perfect Storm

OIL CRISIS, II

PRESIDENT CARTER and the Democratic Party assumed that the new oil politics and global industrial competition had shocked but not transformed the dynamics of the American economy. Consequently, they had applied traditional Keynesian medicine to the patient. The results to this point: GDP grew 5.5 percent in 1977 and 3.2 percent in 1978. The rate of unemployment fell from 7.1 to 5.9 percent. Inflation was under control. The OECD average was 8 percent for 1977, compared with a U.S. rate of 6.5 percent.[1] The real price of imported oil declined because of stable OPEC prices plus dollar depreciation. The American stimulus and recovery lubricated the upturn of the rest of the world. Satisfied with the state of the economy in 1977, Carter set out to doctor the world, negotiating the Panama Canal treaties and the Camp David accords, which produced an Israeli-Egyptian peace treaty in 1978. The laundry list of proposed Democratic reforms—a consumer agency, national health insurance, full employment, extensive urban plans—reflected the belief that the economy was on the mend and that there was plenty of money now to complete the social agenda of the 1960S. Looked at this way, the Keynesian world was seemingly born anew.

But the economy also revealed surging imports, balance-of-payment deficits, a falling dollar, and, critically, low productivity. Consumed by the tinkering necessary to stabilize the economy, Keynesians had no answers to these troubling signs and allowed conservatives to fill the intellectual void with solutions, mainly transferring capital from

government to rich individuals, who would presumably invest to improve plummeting productivity. The Revenue Act of 1978 was the first victory of this new school, if it can be so named. For his part, Carter, with characteristic diligence, attacked each problem—the falling dollar, the trade deficit, inflation, energy—as if each had a technical solution. He might have succeeded had the old system been intact. But it was not, and statistics that once formed a virtuous circle now produced a perfect storm.

The quadrupling of oil prices in 1973–74 had increased industrial costs at the same time that international competition made it difficult to recover those costs with higher prices. With global capacity at all-time highs and demand shrinking, profits tumbled. Capitalists were less likely to invest in new plants and equipment for fear that they would lie idle. Investors were skittish in the developed countries, but elsewhere they were eager. During the recession of 1975, industrial production in developing countries—South Korea, Taiwan, Mexico, Brazil—increased 8.5 percent.[2] And, they were selling in the markets of advanced countries, especially the United States.[3] The newest manufacturing competition produced a dilemma for the industrial powers. Capitalists lacked incentives to invest at home. During the four Carter years, American banks and companies nearly tripled foreign investments.[4] But domestic investment was the key to reviving productivity, competitiveness, and growth. Without growth, unemployment could not be reduced—the very reason that, unlike the United States, Germany and other European countries and Japan employed industrial policies and kept out goods from developing nations. The U.S. trade deficit jumped from $9.5 billion in 1976 to $31.1 billion in 1977 and $34 billion in 1978, despite a cheaper dollar.[5] The increased openness of the U.S. economy—integrated finance, floating exchange rates, global trade, unencumbered capital flows—reduced the potency of Keynesian policies on the domestic economy. Some portion of the U.S. stimulus stimulated foreign economies. The United States was left with budget deficits, inflation, and rising imports.

When imports flooded the U.S. market as a result of these policies,

government blamed industry. Critics claimed that high prices and high wages made domestic goods uncompetitive and caused inflation. Carter was part of this growing anti-industrial or postindustrial army in the Democratic Party. Oligopoly, pollution, and now inflation were the trinity of industrial sin. Carter believed that "trade can play an important role in the fight against inflation."[6] Council of Economic Advisers (CEA) chair Charles Schultze recognized that business investment was anemic but believed that "it is not a problem because of ample capacity abroad."[7] And, if it was not ample, the United States would help—abroad, not at home. The Export-Import Bank approved a $17.9-million loan to South Korea's government-owned steel company to finance equipment for a new mill. The policy of welcoming imports and ignoring job loss was at the heart of the problem the Carter administration had with the labor movement during its first two years. But then the December 1978 Iranian revolution doubled the price of oil, yielding inflation rates of 11 percent, and forced Carter to rethink his policy. This new inflation could not be blamed on industry or labor.

As a result, Carter fashioned a new energy plan that focused on production, not the conservation he advanced in 1977. The plan would reap benefits in the future. Because he was in political trouble and was facing a primary challenge from Edward Kennedy, he also embarked on a new politics by crafting a new deal with labor. He promised that the latest inflation surge would not be fought with recession. For its part, the AFL-CIO acknowledged that inflation was an issue. In September 1979 the president and the labor movement signed a National Accord, a revolutionary change from the first two years. Although business was not part of the agreement, the new working arrangement had the potential of moving the nation beyond Keynesianism.

ENERGY BEFORE IRAN

When Carter took office, energy was at the bottom of everyone's list of priorities, and it appeared on the president's list only accidentally. Most Americans believed that the oil crisis of 1973–74 was a one-shot affair. Imported oil made up only 20 percent of U.S. energy requirements, and the United States was the only country which increased its use of imported oil from 1973 to 1977. In 1973 Americans imported 6,255 million barrels; in 1977, 8,710, almost one-third higher. Western Europe reduced imports from 15,405 to 13,295 million barrels, while Japan stayed at nearly the same level.[8] Increased U.S. demand for oil after 1973 raised the international price for oil, which made reducing American oil imports an international issue as well as a national one. Per capita oil use in the United States fell slightly in the industrial sector, rose about 1 percent in the residential sector, and increased 4 percent in transportation, mainly because of the return to larger, gas-guzzling autos.[9] Transportation accounted for 25 percent of oil use in Western Europe, 50 percent in the United States. Small car sales were up, yet so were the sales of recreational vehicles such as campers and motor homes, which had poor gas mileage and therefore slumped sharply in 1974. But sales recovered and in 1978 they passed their 1972 peak. Because the price of domestic oil was still capped, American consumers were partly sheltered from the OPEC price increases and had less incentive to conserve. Americans wanted to save gas money, but this translated into self-service stations, which were rare before the price rise in fall 1973. Americans now pumped 40 percent of the gasoline they used.[10]

To make matters worse, American domestic production fell 10 percent, which led to some of the import growth. Because the price of domestic oil was capped, domestic producers had less incentive to explore in the United States. Many state-owned foreign oil companies had no interest in exploration either. Iran used oil profits to buy 25 percent of Germany's Krupp iron and steel empire, not explore for new sources of oil. New supplies in Alaska, the North Sea, and Mexico would become available

only in the early to mid-1980s. Still, overall demand fell as a result of the global recession. Between 1974 and 1978, world crude oil prices ranged from $12.21 per barrel to $13.55 per barrel. When adjusted for inflation, prices declined moderately.

The energy issue receded as real prices did, and the more pressing issues produced by the recession of 1975 took center stage. During the 1976 presidential campaign, Carter criticized Ford's program, urged conservation, efficiency standards, coal use, deregulation of natural gas rates, and other measures but without a sense of urgency. The issue returned at the time of his inauguration when the nation suffered a record cold wave and natural gas shortage. It was so cold that ice brought traffic on the Mississippi River to a halt, and factories and schools closed. This crisis and the advocacy of several advisers, especially that of his old navy counselor Admiral Hyman Rickover, convinced Carter that American dependence on fossil fuel was suicidal.[11] The issue was well suited to an engineer and president determined to represent the public interest, transcending the numerous groups that had stakes in energy matters. Two weeks into his presidency, Carter, wearing a cardigan sweater in a chilly oval office, addressed the nation. The president said that energy was a moral issue and that the nation needed to husband American and world resources. His new revelation was not accompanied by specific policy preferences. Carter left the details to James R. Schlesinger.

Schlesinger, who had a PhD in economics from Harvard, was director of strategic studies at the Rand Corporation when he joined President Nixon's Bureau of the Budget. The president made him head of the Atomic Energy Commission in 1971, director of the CIA in 1973, and finally Secretary of Defense. He opposed Kissinger and détente, and was not shy about making his views known, and President Ford fired him in November 1975. Carter made him his special energy adviser and later the first secretary of energy when the post was created in August 1977. The president gave Schlesinger three instructions: create a plan in ninety days, make it comprehensive, and keep the details secret. The two men agreed that the goals should be conservation, preservation of

environmental regulations, energy efficiency, reduction of oil imports, and valuing energy properly, which meant raising domestic prices to world prices.

The National Energy Plan was presented to Congress on April 20, 1977. It consisted of 113 proposals—tax incentives and regulations for efficiency, money for research and development, and higher prices for oil and natural gas. America would use less oil by rewarding efficiency and raising prices to reduce demand. Instead of ending price controls immediately, which would have enraged most Democrats and frigid northeasterners, it was to be done gradually, and, when domestic prices finally reached world levels, the government would impose a "crude oil equalization" tax on sales, to be returned to the consumer in the form of tax credits. The plan's major tool was promoting conservation, not increasing supplies. Energy prices would be gradually raised, but then profits to producers taxed away. On the one hand, it brought domestic prices up to world prices. On the other hand, it returned the windfall profits to consumers.

The attempt to please all pleased no one. Secretary of the Treasury Blumenthal thought the complicated pricing plan would simply delay getting to the goal, achieving par with world oil prices. Vice President Mondale did not like the idea that Democratic constituencies would have to pay higher prices. Business and Republicans wanted more supply-side measures. The Chamber of Commerce opposed a program that "focuses on reducing energy demand and does little to encourage greater energy production."[12] The president of General Motors, Thomas Murphy, attacked the so-called gas-guzzler tax on cars with poor gas mileage. The public opposed the new gasoline tax. Only environmental and consumer groups supported the plan.

The cacophony of voices was harmonized by Speaker Thomas "Tip" O'Neill, who created an omnibus committee in the House to consider the legislation, instead of subcontracting it out to the numerous committees that claimed jurisdiction on energy issues. As a result of O'Neill's shrewd decision, the essentials of the bill passed easily in the House,

despite the criticism. But in the Senate, majority leader Robert Byrd refused to follow O'Neill's lead and divided the plan into six individual bills. The decentralized deliberation allowed lobbyists to remake the bill. The National Association of Manufacturers had tried but failed to get the House to deregulate natural gas immediately, but it succeeded in the Senate.[13] The crude oil equalization tax and gas-guzzler tax fell by the wayside.

The House and Senate bills were reconciled nearly a year later, in November 1978. In the end, money for research and uncontentious conservation measures, such as appliance efficiency standards and tax credits for conservation measures, became law. But the Senate was unwilling to discourage consumption through taxation. It eliminated a gasoline tax, reduced the gas-guzzler tax, and rejected a tax on industrial users of oil and natural gas. The crude oil equalization tax was completely eliminated. Like the criticisms that would be aimed at the Clinton health care reform effort in 1993, many faulted Carter for drafting a bill in secret and failing to consult and lobby the Congress effectively. There is some truth to the indictment. The bill was also hampered by the abrasive Schlesinger, who had notoriously poor relations with the Congress. But the real problem with the energy bill was not special interests, legislative innocence, or personality. The bill was at war with itself. The thrust of the program was conservation and alternative energy. Carter, like Ford, approved huge amounts of money for research and development devoted to commercializing new technology for alternative energy. Even before the law was passed, the government had spent nearly $2 billion on non-nuclear-energy research.[14] If these efforts were to contribute to the nation's energy supplies, they would have to compete with oil and natural gas. But if the price of fossil fuels was controlled and kept artificially low, the new fuels would compete at great disadvantage. The law disregarded the truth that one can shape markets but cannot ignore them. In the end, decontrolling prices and changing energy policy required a greater sense of national apprehension, which came suddenly and unexpectedly, after another oil crisis.

OIL CRISIS: SECOND ROUND

The second crisis, like the first in 1973, had political as well as economic origins. To Americans today, the Iranian revolution is synonymous with the 444-day hostage crisis, which began on November 4, 1979, when five hundred students stormed the American embassy in Tehran, capturing sixty-one. But the revolution took place nearly a year before. The hostage crisis tugged at Americans' hearts, but the revolution hurt their pocketbooks. Crude oil prices rose 150 percent between December 1978 and December 1979. On December 25, 1978, Iranian oil exports ceased, to be minimally resumed the following March. If it was any consolation to Americans, Iranians were also deprived of oil supplies and long lines formed to obtain gasoline and kerosene, the standard fuel for cooking.[15]

Social conflicts and strikes, especially among the strategically placed oil workers, had raged throughout 1978 in Iran. Still, few imagined that the ferment would turn into the revolution that forced the shah to flee the country on January 16, 1979. In November 1978, one month before the revolution began, National Security Adviser Zbigniew Brzezinski passed along to Carter "good news" on Iran from the CIA, which had concluded in August that "Iran is not in a revolutionary or even pre revolutionary situation." Brzezinski believed that the military supported the monarchy.[16] Intelligence information about Iran was distorted by information acquired from official channels. The State Department was preoccupied with the Camp David talks between Egypt and Israel, and with the Salt II arms reduction negotiations with the Russians. The shah was a popular figure among American diplomats, congressmen, and the president himself. Carter came to appreciate the shah, who reversed his traditionally hawkish position and worked to restrain OPEC oil prices. As both the second largest oil exporter and a bulwark against Soviet and anti-Western forces, Iran played a key role. The shah had even made some progress on human rights.

Mohammad Reza Pahlavi, shah of Iran, imagined himself a reformer in the image of Mustafa Kemal Ataturk, the father of Turkish

modernization. But the shah had alienated key interests without rallying his people. He expanded education but did not allow intellectuals the freedom to criticize. He divided the land of the great landowners, which included vast holdings by the mullahs, but did not provide credit, aid, or tools to the peasants. Iran was forced to import food. Not only did the shah take away the land of the religious orders, but he stripped the mosques and religious foundations of their monopoly in education, marriage, and divorce. He undermined the traditional traders by opening the country to a flood of foreign imports. The many foreigners working in the country brought in films, nightclubs, liquor, and other pleasures that enraged the now impoverished clergy and rural Iranians. This furor was evident in August 1978, when some five hundred moviegoers were burned alive when the theater was set ablaze and the doors bolted by fundamentalists.

If the masses had benefited from the shah's modernization, he would have had something with which to counter his cultural opponents. But he built turbo trains, nuclear power plants, heart transplant centers, and a multibillion-dollar naval base on the Indian Ocean. None of the benefits of these projects trickled down to the masses, and all were greased with corruption. In the process, the shah had tripled the rural-urban income gap of the country. After 1975, the relative decline in oil prices ended the economic boom, and the shah slashed subsidies to the Shia religious establishments, rubbing salt in the wounds of his opponents. The opposition was secular and religious, but the most potent dissenters had turned to Mohammad, not Marx. The sight of university women veiling themselves puzzled the world.[17]

In early December, two Democratic elder statesmen, George Ball and Clark Clifford, transmitted a more realistic and pessimistic analysis of Iran to the president. And Brzezinski, tracking the assertive role that the Soviet Union was playing in Afghanistan and the horn of Africa, now placed Iran in an arc of crisis "similar to the one in Europe in the late 40's." He inserted Iran into the Cold War.[18] Schlesinger did too, telling the oil minister of Kuwait that events in Iran "followed recent events in

the two Yemens and Afghanistan."[19] At the time, the Western consensus was that religious leaders could not govern, and the Americans concluded that the Soviet Union, seemingly on the move, would reap the fruits of a post-shah Iran, not the Iranian Shiite leader, Ayatollah Khomeini.

Liberals, too, misread the Shiite opposition. UN Ambassador Andrew Young predicted that Khomeini "would eventually be hailed a saint."[20] Carter's press secretary, Jody Powell, quickly informed Young that the "United States is not in the canonization business."[21] Princeton professor Richard Falk took Khomeini at his word when he pledged freedom to Jews and leftists. Falk believed that "Iran may yet provide us with a desperately-needed model of humane governance for a third world country."[22] The American left was prone to see its own aspirations in the new regime. For many, the ayatollah's vocal anti-imperialism was the only passport he needed to enter progressive circles. Even those in the region were of the mark. Hamsa Abbas, head of the Central Bank of Kuwait, stated categorically that "Khomeini is not a leftist," but he also believed that despite the "revolutionary fervor," Khomeini "would need to get his economy going again, which means he will have to reach some agreement with the U.S."[23]

Khomeini was a more interesting and reactionary figure than his detractors and admirers made him out to be. He had some acquaintance with Western philosophy and modeled his ideas of government on Plato's, with all of the elitism that the choice implied. Forced into exile in Iraq, he was expelled by Saddam Hussein as a favor to the shah in October 1978 and was savvy enough to direct affairs in Iran from Paris. Khomeini was dead set against any compromise with the shah. The ayatollah's eccentricities, which he exhibited in forms such as making the playing of chess a capital crime because of its monarchical pieces, were irrelevant for Americans. More important, the theocratic philosopher king did not care a whit for oil production, which fell from 5.9 million barrels per day in 1978 to 1.3 million in 1980, just before the start of Iran-Iraq war.[24]

Although the loss of Iranian production was modest, about 4 or 5

percent of the noncommunist world total, a huge price increase—150 percent—followed.[25] As occurred in 1973, prices were driven by panicked responses to small losses in production. Saudi Arabia and Kuwait eventually filled the gap and, by the third quarter of 1979, oil production was higher than it had been the year before, but the doubling of prices endured.[26] On March 28, 1979, after the failure of a pump and a valve at the Three Mile Island nuclear plant near Harrisburg, Pennsylvania, prices rose again. Hundreds of thousands of gallons of radioactive water poured into the building housing the reactor. There were few new nuclear plants in the American pipeline, but nuclear energy was a magic bullet for the French, Japanese, and Germans, and the failure at Three Mile Island enhanced global gloom. Like the 1973 crisis, consumer cooperation took a backseat to gaining access to oil supplies and currying up to the Arab producers. Like in 1973–74, the West sent another 2 percent of GDP to the oil-exporting countries.

Because the cartel acted like any seller with market power and raised its price, the United States concluded that it could no longer subsidize domestic oil prices. Domestic oil made up 55 percent of U.S. oil consumption. Energy legislation passed in 1975 had extended price controls until 1979. At that point the president was given the authority, good until 1985, to end the controls. Carter had already pledged at the Bonn summit in 1978 to bring U.S. prices up to the world prices. The United States could not renege because, in return for American action on oil prices, Germany and Japan had promised to stimulate their economies. Consequently, Carter faced the question whether to decontrol quickly or gradually and then settle on the kind of tax he would levy on oil company profits.[27] It was a difficult choice because higher oil prices, however necessary to conserve energy and honor foreign pledges, would in the short run add to inflation. In March, Schultze estimated that the inflation rate for the 1979 would be 8.5 percent. (As it turned out, inflation rose over 11 percent.) Again, it was not simply oil. Food, especially livestock and vegetable prices, rose about 9 percent. In 1973 and 1974, domestic oil prices remained controlled in part to keep up

consumer purchasing power. Now, containing inflation was the best argument for price control.[28]

If one decontrolled oil gradually until 1985, the immediate impact on the inflation rate in 1979 and 1980 would be smaller. Already discovered "old oil" was about $10 a barrel lower than the current world price of $21 a barrel, so the sums involved were considerable. But Carter had pledged to decontrol oil completely by the end of 1980 at the Bonn summit of 1978. That promise made the second choice, eliminating the difference by September 30, 1981, attractive. Foreign policy obligations would be fulfilled if the deed was done by 1981, late by only one year. The domestic inflation watchers in the government—Schultze, OMB director James McIntrye, and Alfred Kahn, chair of the Council on Wage and Price Stability—opted for either 1981 or 1985.

Those who wanted to encourage investment in energy advocated immediate decontrol. Treasury secretary Blumenthal urged complete decontrol on June 1, 1979, the first date possible according to the 1975 law.[29] Schlesinger and most of the president's foreign policy advisers agreed. They thought it would encourage production, improve the balance of trade, and strengthen the dollar. They also wove the inflation argument into their policy preference. Immediate decontrol would be less inflationary than alternatives because it would boost conservation and production. Stretching out decontrol would only extend the complaints, complexities, and misallocations that were typical of the control program. Most resistant to any decontrol were those who attended to the Democratic Party's constituencies, Eizenstat and Mondale. They were unhappy with the whole project.

Carter chose gradual decontrol because he judged the inflation issue to be the critical one.[30] On April 5, 1979, he announced his decision to decontrol gradually over twenty-eight months, opting for the longest period of time that was consistent with the Bonn pledge. He also asked Congress to pass a windfall profits tax of 50 percent to be levied on revenues attributable to decontrol or future increases by OPEC. These funds would help low-income families pay for fuel and subsidize mass

transit and energy investments. The decision to decontrol was his alone, but he needed congressional approval for the windfall profits tax, which he received in April 1980. The decision to decontrol outraged labor and consumer groups and many congressional Democrats, but a vote in the House to retain controls lost, 135 to 257.[31]

Still, Carter's decisions did not alter the price of oil, which continued to rise during the turbulent summer of 1979.[32] Carter was in political trouble. Even before the higher oil prices raised the inflation rate to percent, they raised the ire of Americans forced to queue for gasoline, the price of which rose 55 percent from January to June 1979. The lengthy waits were partly a function of the gasoline allocation system, rigidly based upon the past usage. There was no solidarity on the gas lines. Angry truckers took their frustration to the Long Island Expressway in New York, where one hundred of them blocked traffic for thirty miles, enraging tens of thousands of rush-hour motorists. While Americans waited for gasoline, Carter met with the other G-7 leaders in Tokyo at the end of June to decide what to do about energy. There was no solidarity here either. The big countries all agreed to limit their use of imported oil, but they could do little in the short run to reduce oil prices.[33]

POLITICAL SALVATION: NATIONAL ACCORD

The summer of 1979 was "the worst of times" for the president.[34] Carter would have to reframe issues and strengthen political alliances if he was to have any chance of winning reelection in 1980. The president did two things, the first being well known. After spending several days at Camp David with his advisers and an assortment of intellectuals and politicians, he gave what became known as the "malaise" speech to the American people on July 15. Less well remembered was his National Accord with labor, announced in September.

The gasoline crisis had sent the White House into a tailspin, despite Carter's decision to decontrol the price gradually. In the midst of Carter's Tokyo meetings, Eizenstat sent him an SOS, telling him that for the first time his likely Republican opponent, Ronald Reagan, was ahead of him in the Harris poll and that his primary challenger Edward Kennedy's "popularity appears at a peak." But "the worst of times" might be an opportunity, so he offered a recipe for seizing the initiative. Carter should skip a planned holiday in Hawaii and demonstrate leadership on energy.[35] Carter returned home immediately, met with aides, and prepared to give an energy speech—which he then abruptly canceled.

Carter had already decontrolled oil prices and had given four speeches devoted to energy issues, so he had lost much of the nation's attention. Instead, Carter invited politicians, businessmen, labor leaders, civil rights leaders, heads of nongovernment organizations, and intellectuals to meet with him at Camp David to figure out what was wrong. For ten days he listened to about 150 "consultants." Given the cast of characters, determining the main theme of these meetings was a Rorschach test. Some believed the nation needed to exorcise the "traumas" of Vietnam, Watergate, and the economic and energy crises. A Democratic senator thought that Carter "seems to feel if we could get together on energy, it could be the cutting edge in an effort to revive ourselves as a nation." Many believed that Carter was the problem. Representative Toby Moffett

of Connecticut said, “We were talking to a person in deep political trouble, who knows he’s in deep political trouble and who’s trying to do something about it.”[36] Thirty-two-year old Arkansas governor Bill Clinton urged the president to be more relaxed and freewheeling in his television speeches.[37]

The purpose of the week-long consultations was to focus the nation’s attention on the speech that would be the final act of the political-psychological drama staged at Camp David. When Carter came down from the Maryland mountain on July 15 and gave his speech, he offered no new revelation. Although the speech would be referred to as the “malaise speech,” the president did not use this specific adjective, though he did talk about a “crisis of confidence” in government and other institutions. Carter’s pollster, Patrick Caddell, had read Christopher Lasch’s best-selling *Culture of Narcissism* and convinced the president to read it too. Perhaps because it dovetailed nicely with the nation’s rising gasoline use, Carter offered a critique of consumption and materialism, which he connected to the malaise. It seemed that the people were not so good as he made them out to be in 1976 when he promised a government as good as the people. Still, the good people had lost faith in the institutions of government because of the “agony of Vietnam,” the “shock of Watergate,” and the “murders” of the Kennedys and Martin Luther King Jr. The list of causes absolved him, implicitly attributing his governing failures to earlier events and the larger culture, yet Caddell’s polling data had demonstrated a cynicism and pessimism that developed in just the past six months. If the causes predated Carter’s tenure, why did the change suddenly appear?

Carter’s six-point action plan, offered in the final third of his speech, promised to limit oil imports to 1977 levels, 8.7 million barrels, which he could do alone on the basis of the 1975 energy legislation. But the long-term goal was to cut American oil imports in half, to 4.5 million barrels a day by 1990. Congress was already considering legislation supporting alternative energy technologies. Now Carter asked Congress to create an Energy Security Corporation to replace 2.5 million barrels of imported

oil through the development of alternative energy sources. The funds would come from the windfall profits tax. Most of the estimated $17-billion revenue from the windfall profits tax of 1979 would be invested by the new energy corporation. The 1977 plan had tried to force energy conservation through taxation and tax incentives. The proposed windfall tax of 1977 would have returned all of the money to consumers to restore their purchasing power. The 1979 plan stressed production, new technology, and the development of American natural resources. It would fund investment at the expense of consumption. Still, with so many details unclear, it was difficult to assess its economic impact. Because most of the proposed investment would be going to the western states, from taxes paid in the eastern ones, the plan reinforced the growing Sunbelt weight.[38]

Despite the psycho-cultural analysis of the energy crisis and the many questions raised by his solution, the vigor, determination, and focus of the president were contagious, and the public overwhelming applauded the speech.[39] But shortly afterward Carter fired Secretary of Health, Education, and Welfare Joseph Califano, Secretary of the Treasury Michael Blumenthal, Secretary of Energy James Schlesinger, and Secretary of Transportation Brock Adams, causing the public's goodwill to dissipate. Califano had irritated the president from the beginning. He had opposed the new Department of Education that Carter proposed and had his own ideas about national health insurance and much else. Blumenthal posed other problems. He liked the limelight and claimed that he was the architect of economic policy. Adams was forced out because he was not a supporter of transportation deregulation. He preferred intermodal transportation planning. Schlesinger and Attorney General Griffin B. Bell had indicated that they wanted to leave, but Carter included them with the men who were fired. Carter then made his thirty-four-year-old aide, Hamilton Jordan, White House chief of staff.

Not only did the energy story take a backseat to the political story, which was a lot more appealing and comprehensible to reporters, but the public could wonder about the soundness of an energy plan which was put

together by men who were then fired.[40] Nevertheless, the Congress embraced the energy program, approving the Energy Security Corporation in June 1980. Containing something for everyone—incentives for oil shale, alcohol fuels, geothermal energy, solar, etc.—the corporation would guarantee loans, support prices, buy fuel, and even own production facilities. Funded up to $88 billion by a windfall profits tax, it seemed both self-financing and guaranteed to provide an elusive energy security. By 1985, the United States was 25 percent more energy efficient and 32 percent more oil efficient than it had been in 1973. Although the promise of synthetic fuels was not realized, increased efficiency, new supplies from Alaska, the North Sea, and the Soviet Union, as well as a recession in the early 1980S, produced an oil glut by the mid-1980s.[41] None of this helped Jimmy Carter in 1979.

At the same time his energy program began its journey through the Congress, the Commerce Department announced that second-quarter GDP fell at an annual rate of 3.3 percent and that the inflation rate was over 13 percent.[42] Unemployment figures, which had been falling, were projected to rise to 6.9 percent, and possibly to as high as 8 percent.[43] Carter's political and economic problems now merged. The president and his advisers were worried that Kennedy's full-throated liberalism would attract the labor movement. Machinist union head William Wimpisinger, once considered an ally of the president, led the labor campaign to draft Kennedy. The United Auto Workers did not join the machinists. Doug Fraser preferred Kennedy, but with auto contracts expiring in the fall, Fraser was not going to sever ties with the president.[44] Large numbers of rank and file workers were for Kennedy no matter the position of their leaders.

To change labor's politics Carter would have to change his own, especially on inflation. In 1978, when inflation was about 6 percent, among the lowest among the OECD nations, the president asked labor to restrain their wages before the inflation rate fell. In October, the government set a 7 percent limit for wage increases when inflation was a little over 8 percent. Government contractors would have to follow the

guidelines, which made them less voluntary than the president made them out to be. Labor Secretary Ray Marshall preferred a more sectoral approach to inflation. Because inflation was not the result of wage increases but of rising prices in key sectors—energy, food, housing, and health care—Marshall argued that limiting wages and prices was not the best way to reduce inflation.[45] He was overruled by Schultze.[46] The president's policy was aimed at "the major unions," which "have to be brought back into line with the rest of the economy," according to Barry Bosworth, director of the Council on Wage and Price Stability (CWPS), the monitoring agency.[47] So the weight of any government wage and price controls fell on the industrial sector, already burdened by energy costs and foreign competition.[48] Industrial labor was in the crosshairs of the government's inflation policy.

AFL-CIO head George Meany was incensed. The state of relations between the White House and labor can be measured by an AFL-CIO lawsuit which argued that requiring government contractors to accept Carter's anti-inflation numbers was unconstitutional, lacking statutory authority.[49] The wage maximum was arbitrary. It gave the impression that labor was the problem because employers were content with standards that did their work of keeping wages down. Unlike the Nixon controls, fringe benefits were to be charged against the 7 percent. These benefits had been treated differently because they did not enter the income stream immediately and so were not inflationary. Most of this money constituted savings and was available for investment. And Carter's plan made no provision for catch-up wages for workers whose standards of living had been eroded.

The CWPS monitored price increases more gingerly. There was no single number to limit increases, and coverage was not universal. Permissible price increases were computed on the basis of individual company price histories, not on the public record, so no one could know whether a company was in compliance. But the greatest problem with the inflation program was that the price of food, housing, energy, and medical costs, items composing over 60 percent of the average worker's

budget, rose from 8.2 to 12.7 percent, and they were untouched by the president's program. In short, the most inflationary elements in the Consumer Price Index (CPI) were excluded from inspection—agricultural and industrial raw materials, including petroleum and natural gas, imports, exports, and interest rates. Moreover, CWPS did not have enough staff to monitor the program. Although it had economists, it had few accountants. These devilish details, invisible to the public, were why the whole labor movement opposed the president's program. Failing to control the four necessities of family life—food, housing, energy, and medical costs—the anti-inflation program was inequitable, as it was meant to be.

Carter was probably not surprised by Meany's vehement opposition, but he had hoped to obtain support from a group of unions which his advisers called "progressive." Hamilton Jordan believed that the "progressive unions—the UAW, the Machinists, CWA [Communications Workers of America], etc…. represent our real base of support in labor."[50] This division of the labor movement was common among liberals. The UAW had left the AFL-CIO in 1968 over Vietnam and assorted issues. First Walter Reuther, and then, after his death in 1970, Leonard Woodcock and Douglas Fraser were opponents of Meany. Fraser had supported Carter in 1976 before the other unions, which by definition made him progressive. The machinists were headed by William Wimpisinger, a Socialist. The CWA had been based in telephone operators and repairmen and had moved into various other fields, organizing white collar and technical workers, whom some saw as the future of the labor movement.

But Carter found no allies in his "progressive" camp. Carter's aides now referred to Wimpisinger as that "self-declared Socialist."[51] Glenn Watts, the president of the CWA, told Alfred Kahn, the new head of CWPS, that "labor can not and will not bear the brunt of fighting inflation by taking lower wage increases while prices and profits continue to rise. Thus, policies which primarily focus on wage restraint are misguided."[52] The debate ended with the Teamsters negotiations, involving three

hundred thousand truck drivers and associated workers.[53] No one considered the International Brotherhood of Teamsters a progressive union. It had been expelled from the AFL-CIO in 1957 because of corruption. Still, its dissident caucus, Teamsters for a Democratic Union was, with its leaders, opposed to the president's guidelines. After a partial strike and then a lockout, the government yielded on its rigid 7 percent to get a contract, which the parties signed on April 11, 1979.[54] The White House three times amended the pay guidelines to exclude from the pay standard one part of the trucking settlement. In each instance, the decision was reasonable. But the concessions contrasted sharply with the government's hard line at the end of 1978. What was granted to the Teamsters could not be denied to the rubber-, electrical-, and autoworkers, whose contracts were expiring in 1979.[55] This was not a good sign for the future of the standards, now computed by what was called "guidelines math."[56]

As the White House struggled, accommodation with the labor movement became more politically attractive. Initial steps were taken in January 1979, when the president met with labor leaders, including Meany, and agreed to talk with the AFL-CIO periodically on policy matters. The people doing the consulting were Landon Butler, Carter's liaison to labor, domestic policy adviser Eizenstat, and Marshall, not Kahn and Schulze.[57] The AFL-CIO continued to oppose the 7 percent standards and believed that Schultze and Blumenthal still determined Carter's inflation policy. Both men's notion of consultation was obtaining "support for our basic approach," not bargaining with the various groups or even trying to forge a new consensus.[58]

But 13 percent inflation meant that the government could not enforce the 7 percent standard. The government was in the midst of revising the standards, but the old ideas persisted. The permissible wage standard would be deliberately pegged below the inflation rate to prevent the current inflation, which was believed to be temporary, from permanently inhabiting the wage structure.[59] But now labor would be consulted. Walter Heller, the dean of Democratic wage and price guidelines under

Kennedy and Johnson, intervened. Heller believed that the greatest danger was that the explosive increases in food and energy prices would get built into wage settlements. The task was more difficult than it was in the 1960s, when inflation was mostly steady at 3 percent. Heller urged the White House to "strike a bargain, or form a social compact, with labor by offering a meaningful quid pro quo of wage insurance coupled with boosts in take-home pay through payroll tax cuts."[60]

The man bargaining with the White House was Lane Kirkland, who had occupied AFL-CIO's number two position for a decade. Although Meany's formal resignation was announced later in October 1979, it was Kirkland who met with the White House throughout the year. He was a southerner, which helped with Carter. Originally from the Masters, Mates, and Pilots Unions, Kirkland had graduated from the U.S. Merchant Marine Academy and held a B.S. degree from Georgetown University's School of Foreign Affairs. His family was middle class, but his experience as a merchant seaman during World War II bred a strong sympathy for the working class. He threw his life into the labor movement after hearing AFL chief William Green give a speech at Georgetown opposing the Taft-Hartley law of 1947. He started as a researcher but became a union troubleshooter. Although he smoked thin cigarettes, not cigars, and delivered words in complete paragraphs, not short phrases, he always claimed that he and Meany were alike and that if his policies differed from Meany's it was because the times were different. Perhaps, but Kirkland seized those different times. If not the first labor leader to recognize the end of the classical Keynesian period, he certainly was the first one who acted upon it. His goal was the American equivalent of a European social contract—concessions on policy questions in return for the cooperation in a voluntary wage guideline program.

Kirkland and Carter jointly announced the National Accord on September 28. Labor agreed that the war against inflation must have a high priority and accepted seats on the Pay Advisory Committee that was to chart the course of wage restraint. In return, the president promised

Kirkland, Doug Fraser of the UAW, and Frank Fitzsimmons of the Teamsters that the administration would not use unemployment or a recession to solve the inflation problem.[61] The labor leaders also won protection for low-income workers. The agreement was nearly derailed by Charles Schultze, who wanted the pay board to operate under a tight set of principles that would be determined by the administration alone. Marshall opposed, but most of Carter's other economic advisers supported Schultze. Only William Miller, who had replaced Blumenthal as secretary of the treasury, supported the agreement and helped untie the final knots.[62] Unlike most of Carter's advisers, Miller came from industry, not the academy, and so understood the give and take of collective bargaining. In the end, Carter's political advisers convinced him that the reelection in 1980 rode on the agreement with labor.[63]

The AFL-CIO would fill five of the fifteen seats on the new Pay Advisory Committee. Another five seats would go to business, and the remaining five would represent the general public. One of the public representatives was John Dunlop, the ultimate collective bargainer.[64] The committee would advise the CWPS on pay standards. Whether the council was required to adopt the suggestions was deliberately left fuzzy. Kahn claimed that "their power is only to recommend." Marshall replied, "There is an implied agreement that its advice will be followed."[65] Still, the price of AFL-CIO acceptance of the anti-inflation program was that there would be no single guideline figure, like the 7 percent of 1978. There would also be a price advisory committee, to be composed of nine public members.

By the end of 1979, both the president and the labor movement had shifted gears. Faced with rising inflation and forecasts of a coming recession, the president entered an ill-defined, but genuine national accord, with labor. He had agreed to share authority on wage standards with labor. On the other hand, the AFL-CIO, with a new leader, accepted the fact that stimulating aggregate demand was not going to create prosperity, as it had done in the past. In the end, that was the meaning of accepting, in principle, some wage restraint. The agreement brought the

United States in line with other Western nations, which negotiated new compacts to confront the circumstances of the 1970s.

Still, this mode of governing faced obstacles. The most important was that business was a reluctant and often hostile player. Business's assault on labor reform in 1978 had dispelled what hopes Kirkland entertained about a compact with business. Labor had left the labor-management group in 1978. Like Douglas Fraser of the UAW, Kirkland questioned the value of social compacts with the "Dr. Jekylls of corporate enterprise while their Mr. Hydes are busy in Washington preserving the power of certain companies to add to their profits by breaking the law."[66] Nothing in 1979 altered this analysis. After the accord was signed, it was denounced by Richard T. Lesher, president of the Chamber of Commerce, who said it gave labor "exalted status" and "power to help fix the course of the country's economy." Even Irving S. Shapiro, chair of Du Pont and a close friend of Carter's, refused a place on the pay committee, giving the lame excuse that active business executives should not serve.[67] Still, there was some indication that business was seeking a rapprochement. In the GM labor negotiations concluded in September, CEO Thomas Murphy agreed to automatic union certification for workers in most new GM plants. In addition, pay board head John Dunlop had the respect of management as well as labor.

The accord suffered from the lack of power each side brought to the table. Unlike many European labor federations, the AFL-CIO could not bargain for its subsidiaries or force them to accept any agreement on pay scales. National unions in the United States were autonomous. More than fifteen hundred major agreements covered a thousand or more U.S. workers.[68] Carter also lacked power to implement his side of the bargain. The president had promised that if the recession deepened, government programs would "shelter the poor and needy," public works would provide jobs while also contributing to anti-inflation objectives such as public transit, and the housing industry would not be starved of capital by high interest. Such programs would trump the conservatives' desire for a balanced budget or budget surplus to fight inflation. The president could

not guarantee that Congress and the Federal Reserve would embrace his agenda. Finally, the accord directly addressed a narrow range of issues—wages and prices—impinging upon inflation. The dramatic fall in productivity in the past few years—plummeting to 0.5 percent in 1979—was a key element in the inflation picture. Despite government complaints, wage agreements were moderate. But labor costs rose because of the fall in productivity. This subject was not addressed in the anti-inflation machinery. Nevertheless, the accord was a beginning. After two and a half years of sparring, the signing opened up possibilities for both Carter and labor. Although neither phrased it this way, it was an opportunity to reform the classical Keynesianism that at this point seemed impotent.

CHAPTER TEN
1979–80
"THE GNOMES OF ZURICH GOT THEIR WAY"

"THE GNOMES of Zurich got their way," lamented Arthur Okun, economic adviser to presidents Kennedy and Johnson, referring to the Federal Reserve Board's decision to raise interest rates in November 1978.[1] But one year later, when the unsatiated gnomes demanded more, he agreed: "They had to do something in the tightening direction."[2] That something was a revolution in Fed operations that produced very tight money and a year of volatile rates. First the Fed raised the discount rate — the fee it charged banks for borrowing—by a full percentage point, to 12 percent. Then, the superbank raised mandatory reserves, which limited a bank's ability to lend. But the novelty in 1979 was the Fed's decision to adjust its portfolio of securities to achieve weekly goals for the money supply, instead of setting interest rates. Because the purpose was to restrict, the goals were spare. And, as night follows day, less money would raise interest rates. At an unprecedented Saturday night press conference on October 6, Fed chair Paul Volcker announced the decisions and implied that the board wanted interest rates to continue to rise. In 1978 Okun had fingered European bankers. One year later the bankers were still pushing, but Keynesians like Okun were uncomplaining. How did this happen?

Many believe that this question is irrelevant. According to conventional wisdom, inflation was so high, over 13 percent in the fourth quarter of 1979, that radical action was necessary. But the inflation rate

in 1947 hit 14.4 percent without transforming monetary policy, so this cannot be the complete answer. Moreover, the Fed governors acknowledged that their high interest rates were as much a cause as a solution to inflation in 1980. The man behind the decision, Paul Volcker, became chair by happenstance. His unlikely accession was set in motion following the termination of Treasury secretary Michael Blumenthal, who was among the group of cabinet secretaries fired during the summer of 1979. Lacking a ready substitute, Carter returned to the well and named William Miller, whom he had appointed chair of the Federal Reserve in March 1978, thereby creating another hole. In the Keynesian world, fiscal policy was the sun and monetary policy the moon. The secretary of the treasury was a more significant post than leader of the Fed.

Richard Moe, Walter Mondale's aide, ran the selection process to name the new Fed chair.[3] The heads of major corporations, such as Xerox, Du Pont, and General Electric, and three banks, Chase, Bank of America, and Brown and Harriman, were in the running. Other candidates were economists who moved easily between the private and public sectors, like Walter Heller, former presidential adviser and now professor at the University of Minnesota, Bruce MacLaury, who had chaired the Fed in Minneapolis and currently headed the Brookings Institution, and New York Fed chief Volcker, who had started out working for Chase.

Although the list was lengthy, the genuine choices were not. Most of the businessmen had businesses to run. Okun nixed any banker. He remarked, "Even the Republicans don't appoint a big banker as chair of the Fed." Fed governor Nancy Teeters opposed David Rockefeller, head of Chase, because it was a "very badly run bank." Although labor and traditional Democrats were enthusiastic about Walter Heller, moderates and conservatives believed he "would send the wrong signal." Marina Whitman, member of the Council of Economic Advisers in the Nixon administration, thought that Heller was "living in the '60's," a remark that was not intended as a compliment. The last man standing was Volcker, who had been passed over for chair when Miller was named.[4]

Critics and advocates alike stressed his international orientation. Reginald Jones of GE thought that Volcker "could straighten out the dollar" because he "has the confidence of Europeans." All of the businessmen consulted thought he would be a good choice, but Mondale and AFL-CIO chief Lane Kirkland strongly disagreed. Heller, both a candidate and a consultant, remarked that Volcker, though qualified, was "rigidly conservative." Okun agreed. He was "very right wing" and "dominated by international concerns." Teeters added, Volcker "would be preoccupied with the international aspects of monetary policy and pay no attention to domestic economic needs." Council of Economic Advisers member Lyle Gramley also thought that he was "very conservative and would give heavy weight to international considerations in running monetary policy." OMB director Jim McIntyre found the same qualities compelling. Volcker was "highly regarded in U.S. and international financial circles." Only McIntyre placed him at the top of his list.

Carter did not know Volcker but agreed that he fit the bill. After studying economics at Princeton, Volcker went to work for Chase Manhattan Bank. He served in the Treasury Department under Kennedy, Johnson, and Nixon and in 1975 became head of the New York Federal Reserve Bank. Volcker told the president that he was concerned about inflation and, if appointed, would be independent of the political branches of government.[5] These words were standard idiom at these interviews.

After he was confirmed, Chairman Volcker met frequently with Carter and his aides, as his predecessor William Miller had done. Still, Carter was surprised when Volcker fought inflation with the battle plans of the international financial world. The president was disappointed that Volcker's monetarism did not reduce inflation. And, as many predicted, the domestic economy lost out. At the midnight hour, as Carter faced defeat in the November elections, he returned to the National Accord with labor that he had ignored for a good part of the year, but his conversion to new ways was halting, incomplete, and tardy.

“BURNING DOWN THE HOUSE TO ROAST THE PIC”

High inflation was not unique to the United States. Every industrial country except Japan and Germany suffered double digit inflation in 1979–80.[6] After the first oil crisis, central banks attempted to maintain purchasing power by keeping rates low. Not now. Frank Morris, the president of the Boston Federal Reserve, told colleagues on the Federal Open Market Committee (FOMC), “Wherever I go I sense that there is less willingness this time around to accommodate the OPEC shock monetarily.”[7] The new goal was to prevent the oil price rises from entering the wage/price structure and to avoid the squeeze on profit margins of the sort seen in 1974–75.[8] But did that mean interest rates of 10, 15, or 20 percent? Economics was not science. The numbers were the result of competition, not deliberation. Every nation had removed controls on capital, which amounted to utopia for speculators. When one country raised interest rates, others followed to prevent capital flight.[9] It was an interest rate war.[10] By spring 1980, the Europeans discovered that the high American rates that they had been demanding were attracting money from Europe. They responded by raising their own interest rates, to levels charged by “mafia loan sharks,” in the words of the *Economist*.[11] In the end, rates everywhere were higher than intended.

The novel part of Volcker’s October announcement was not constraint, but the decision to control the quantity of money, not interest rates. Traditionally, the FOMC each month set a short-term interest rate goal (the Federal funds rate for banks), and during the month the Fed increased or decreased reserves available to banks as needed to reach that target. The state of the economy, the actual growth in the money supply, the international situation, and other factors helped determine the interest rate goal. The Fed now operated closer to the ideas of the economist Milton Friedman, who had popularized the virtues of keeping the money supply within a predetermined range based upon past history. If the

demand for money outstripped the targeted supply, the Fed would not add bank reserves to satisfy the demand for money, so interest rates would rise, often rapidly.

Most Fed officials believed that monetarists were simplistic, calling them “the chiropractors of modern economics.”[12] Fed governor Henry Wallich disparaged Friedman, who “implies that there are no fluctuations in the real economy that need affect monetary policy—no investment boom, no housing boom, no oil shocks. We should simply supply a steady growth of money.” Robert Mayo, president of the Fed bank in Chicago, remarked, “We have found no magic formula” to make “monetary policy as simple as some of our academic friends believe it can be made.”[13] Volcker was not a monetarist, either. Thirteen years later, he said he acted only to give notice that the Fed meant business.[14] It was the psychological, not technical, virtues that appealed to Volcker.

Initially Volcker had raised rates the old-fashioned way. Since his appointment in early August, the Fed had raised rates to a record 11.5 percent.[15] The most recent rate increase, in mid-September, won board approval by the slim margin of 4–3. The dissenters believed that after months of increases, the Fed should wait to see what the results would be. Raising the interest rate had a delayed impact on the economy. In addition, the earlier tightening was already slowing the economy. GDP for the second quarter grew at a miniscule 0.4 percent and was expected to fall.[16] Unemployment was rising, and many factories were barely producing. Henry Reuss, chair of the House Banking Committee, asked “whether it really makes sense to throw men and women out of work and businesses into bankruptcy in order to ‘rescue the dollar’?”[17] Allen Sinai, a senior economist at Data Resources Inc., estimated that the September interest rate rises would reduce economic growth in the coming year by one-half to one percentage point, but would cut inflation only by about a quarter of a point.[18]

Economists were not single-mindedly fixated on inflation. Council of Economic Advisers chair Charles Schultze assembled a diverse group on September 28, and they all forecast a shallow recession, slow recovery,

rising unemployment, and modest improvement in the inflation rate. Consumption and savings had declined, which meant that purchasing power would tumble in the coming months. The group anticipated that a $25-$30-billion tax cut in 1980 would be necessary to restart what they predicted would be a recessionary economy.[19] Volcker agreed that tax cuts could be appropriate.[20] Inflation was not so bad. On September 18, two weeks before his grand change, Volcker told his Fed colleagues, "I feel a bit reassured by most recent trends" on the inflation front.[21]

However, at the end of September, currency traders believed that an interest war had broken out between Germany and the United States, and, by virtue of its lower inflation, Germany would win. With rumors flying, including one that Volcker was resigning, traders dumped dollars and other currencies for gold, silver—practically anything.[22] Volcker was worried. On the flight to an International Monetary Fund (IMF) meeting in Belgrade, he told his colleagues William Miller and Charles Schultze about his new monetarist plan, but "they were not enthused."[23] Helmut Schmidt was. The trio had stopped over in Germany and met with Schmidt, who believed that the Americans had not done enough to combat inflation. The chancellor's opinion was weighty because Americans needed the Germans to put together a package of support for the dollar, as they had done at the end of 1978.[24] But the price of German aid was tighter money.[25] The falling dollar irritated America's trading partners who kept their reserves in dollars. What's more, the cheaper currency made U.S. exports more competitive against German products.

In Belgrade, Volcker won more German approval. The director of the Bundesbank, Otmar Emminger, said that "it would help if the United States would take further steps to restrain expansion of money and credit."[26] Emminger thought that Volcker's new method to control the money supply would do the trick.[27] The Fed chair left the IMF meeting early to plan a course of action. Because the Fed move followed the Belgrade trip, many Americans concluded that the European pressure was decisive, and it probably was. On October 6, the day the Fed decided to act, Volcker informed his colleagues "about the attitudes of foreign

countries and the price of a coordinated package to support the dollar." He then turned of the tape recorder, so we lack a verbatim record of what the Europeans had actually said. After the recorder was turned back on, Volcker said that "an international package [to support the dollar] is impossible without strong action by the Federal Reserve. We will have cooperation, I think, from our foreign partners on gold or on intervention to the degree they feel that we have done something here."[28] The Fed could have continued raising rates, but Volcker thought a bold new plan would better convince the Europeans and the financial markets than would more of the same.[29] Because the dollar had appreciated in anticipation of new measures, Volcker did not want to disappoint.[30]

Volcker felt freer for other reasons. He believed that a recession was unlikely after unemployment declined 0.2 percent, to 5.8 percent in September.[31] It was therefore reasonable to conclude that the economy was not so bad, a finding Volcker was eager to confirm. Although one month does not a trend make, there was enough positive data to allow the Fed chief to focus on inflation. Volcker convinced his colleagues to embark upon the experiment. A few were skeptical, but in the words of one, "If I may be so crude, the patient has been constipated for a long time and Ex-lax will no longer work."[32] Still, Volcker was aware of the radical character of his action and the uncertainty of success. Money supply targets could be missed, monetary demand miscalculated.[33]

If the Europeans bolstered Volcker's resolve, they did not convert Schultze and Miller. Both feared that the rigidity of Volcker's monetarism would drive the economy into recession. Carter did not put up much of a fight, believing his weak political position made it impossible to resist.[34] By making inflation his number one economic issue, he had little intellectual space for criticism. Everyone ignored a study by economists David Levine and Neal Kaplan that no relationship existed between the size of nonborrowed reserves and the money supply. The pair concluded that interest rates would gyrate widely, an excellent forecast of what happened in the United States in the next year.[35] And Massachusetts Institute of Technology economist Robert M. Solow

predicted that the tight monetary policy would reduce production and employment more than it would inflation. To reduce inflation “by squeezing the economy is possible but disproportionately costly. It is burning down the house to roast the pig.”[36]

Some of the governors agreed with Solow. Mark Willis, president of the Minneapolis Federal Reserve, said that OPEC, Congress, and a thousand other things affected inflation, so the “experiment” would not lead to “predictable” results.[37] Governor Nancy Teeters thought so, too.[38] And, the psychological shock that Volcker anticipated did not occur. The economy did weaken, and small businesses and consumers were hurt. Big corporations and banks, which could obtain funds from abroad, weathered the storm. So did the financial and commodity speculators that the Fed was really targeting. And the truce in the interest-rate war that Volcker had negotiated with the Germans in Belgrade ended. The German bank raised rates, which buffered the Fed’s moves.[39] Higher oil prices persisted because of OPEC but also because of Carter’s decontrol of oil prices.[40] Food prices continued to rise. And Volcker’s soaring interest rates did their part in raising the inflation rate.

"A MOST WASTED YEAR"

Carter himself thought that government frugality could reduce inflation. The only new spending in his 1981 budget was $4 billion for defense, added after the Soviets invaded Afghanistan in December 1979; on the revenue side no attempt was made to offset the fiscal drag that pushed people into higher tax brackets. Consumption was further restrained by higher social security taxes. But the president aimed in the wrong direction. Higher energy prices—oil more than doubled, to $24 a barrel—and 17 percent interest rates produced an inflation rate of nearly 20 percent at the end of February. But like Godot, the recession was slow in coming. Growth was feeble but still not in negative territory. An economist from Morgan Guaranty Trust Company called it a "peekaboo" recession and stated in February that "there seems to be no compelling reason to expect the recession to emerge in the current quarter."[41]

After the experts ruled out a steep decline, the government panicked because of the high inflation numbers, which exceeded 14 percent in February and March. No one should have been surprised. Schultze had informed Carter in December that the "CPI will be rising rapidly over the next few months because of recent increases in mortgage interest rates."[42] Also, energy prices spiked sharply. But an alarmed Carter decided on March 14 to present yet another inflation program. His advisers were divided. Caddell agreed with Schultze and added that the pressure to do more came from the financial community, which was "very excitable," "almost impossible to please," and "often wrong." Caddell opposed cutting expenditures and raising revenues, believing that "the balanced budget is clearly about to become the synfuels program of 1980."[43] But most of his other advisers were for it. Stuart Eizenstat, usually a defender of Democratic constituents, fell into line.[44] In case the American public did not get the message, Miller ruled out a tax reduction if a serious recession developed as well as business tax cuts aimed at increasing investment and improving productivity.[45] (Both had been contemplated at the end of 1979.) Carter refused to work with some

Democrats and Republicans who wanted a modest reduction of social security taxes, which were due to rise the next year, and depreciation reform, to improve productivity, both non-inflationary acts.[46]

The new budget slashed $13-$14 billion from expenditures and equaled that sum with new taxes. Because the plan did not instantly stop inflation, Democratic senator William Proxmire of Wisconsin groused that it was "too timid, hesitant and really inadequate." Proxmire thought a $30-billion spending cut was needed.[47] He did not volunteer cuts in the huge subsidies his state's dairy farmers obtained. On the other side, New York banker Felix Rohatyn denounced the strategy, which slashed funds going to states and cities, to "superimpose a national recession" on the troubled Northeast "for little benefit for the rest of the country."[48] Edward Kennedy, contesting Carter in the primaries, said that the plan was "too little, too late, too unfair."[49] The leading Republican challenger, Ronald Reagan, dismissed it and, saying that "the real answer is to increase productivity," urged a 30 percent across-the-board tax cut.[50]

Foreign bankers and governments were the only ones behind Carter. The *Financial Times* of London praised the president's "sheer political courage." The German Minister for Economic Affairs said that "these are decisive steps in the right direction." The head of a major London bank said, "The package is a highly significant political action in an election year and a clear recognition that inflation has become a greater short-term danger than unemployment."[51]

The White House proceeded with a tighter budget, and the Fed, prodded by the president, came up with still more measures that restricted consumer and retail credit. On March 14 the Fed announced emergency credit controls, limiting not only commercial banks but money market mutual funds and retail companies that issued credit cards. Banks could increase their credit offering only by 9 percent, when they had expanded 17 percent in February. Panic did not abate. Eizenstat told the president, "We truly are on the verge of an economic crisis…. There is a growing national sense that things are out of control—a feeling exacerbated by the continuing escalation in interest rates at every

level."[52] By mid-April both the prime rate and the Federal Funds rate reached 20 percent. Albert Sommers, chief economist of the Conference Board, a business research organization, estimated that the "March package added four percentage points to interest rates and made borrowing unprofitable for everyone,"[53] not simply the little guys. In this Alice in Wonderland world, the solution was the problem. Fed governor J. Charles Partee acknowledged that "the thing that would bring the inflation rate down the quickest in the short run would be lower interest rates because the CPI is being affected so greatly [by] mortgage costs and other indirect costs of higher interest rates."[54]

Both the president and the Fed, wearing anti-inflation goggles, were blind to the slowing economy. As late as April 8 Schultze thought, "It is a bit early to … say 'Yes, we are in a recession.' "[55] At an April 11 breakfast meeting, Volcker told Schultze that he was worried "about the longer-term effects of tight money on construction, the livestock sector, and the thrift institutions (among others)." But Volcker feared to act *"before* there are definite signs of recession or an actual reduction of the inflation rate" because "it would be interpreted by the financial community as a sign that the Fed was 'quitting 'premature.' "[56] By mid-April, business economists were forecasting a deep recession. At his April 17 news conference, the president acknowledged that the country "has probably entered a period of recession," but added that it would be "mild and short."[57] Unemployment climbed to 7.0 percent in April, a 0.8 percent rise, the largest one-month increase since January 1975.[58] The economic picture deteriorated rapidly. GDP fell 7.8 percent in the second quarter and investment plummeted 31.4 percent.[59]

The failed hostage rescue on April 24 briefly changed the story line, but the steady stream of bad economic news eclipsed the aborted mission. Schultze, who had been predicting a short and mild recession, told the president on May 1 that the downturn would be "more serious than we forecast in the March budget update." In short, the analysis that produced the stringent inflation plan of March 14 had underestimated the economic weakness. Schultze told the Business Council on May 10 that "most of

the statistics indicated a steeper decline in April than called for in our official forecast."[60] No economic sector was exempt. Sales of once hot-selling small foreign cars declined along with those of gas guzzlers. "The bottom is really falling out of almost everything right now," said economist Larry Kimbell.[61] The effects of the deteriorating economy were not limited to just the consumer. Business spending, the elixir of long-term revival, plummeted.[62] Unemployment hit 7.8 percent in July. Money was disappearing as consumers paid off debts and assumed no new ones. According to monetarist theology, the Fed should create new money by buying government securities to maintain monetary aggregates. But that would reduce interest rates.

The Fed faced its moment of truth. It had allowed rates to rise high earlier by refusing to create more than the agreed-upon amount of monetary aggregates. Would it allow rates to fall by increasing monetary aggregates up to the baseline? Some of the inflation hawks on the Fed balked, arguing that the markets would interpret this as easing up on inflation, still in double digits. Governor Teeters had had enough. "You know Paul, I'm a little disturbed by the fact that when [the funds rate was] going up nobody was concerned about the speed at which it went up. It ratcheted up over a period of about six weeks. And if we are really going to follow this [monetarist] policy, then we're going to have to let the market determine how rapidly it comes down."[63] The Fed was in a bind of its own making. Its actions were not based so much on monetarism, but on the conviction that it needed to convince financial markets that the government was determined to reduce inflation. A chorus of Cassandras urged the Fed to continue. Clifton Garvin, chair of Exxon, opined at the Business Council meetings taking place at a luxury resort in Hot Springs, Virginia, "The fight against inflation must continue, even as recession takes hold."[64] Representative Al Ullman, chair of the House Ways and Means Committee, stated that despite the recession and a projected unemployment rate of 8 percent, "there are not going to be any tax cuts this year."[65] When Volcker mentioned that there would be an early end to consumer credit controls, the "gnomes of

Zurich” saw evidence of easing monetary policy and began selling dollars.[66] This was the first postwar recession that was met with procyclical fiscal and monetary policy, action that deepened the decline.

Governor Partee now worried that the Fed would look “like the Open Market Committee of 1930.”[67] That did it. Conventional wisdom was that Fed’s restrictive actions either caused the Great Depression or deepened it. So, the Fed began to pump in money. With shrinking monetary demand because of the recession and growing supply, interest rates began to fall. The federal funds rate, nearly 20 percent in early April, fell to 8.5 percent in June. On June 12 the Fed reduced the discount rate by a full percentage point, taking the rate back to where it was before its October 6, 1979, moves.[68] The Fed was forced to lower the rate because those in the private market were much below its own number. The attempt to control the money supply, as the monetarists prescribed, was a failure on the way up and down. Monetary growth ranged from minus 17 percent in April to nearly plus 23 percent in August. The roller-coaster ride of 1980 did little for the economy. The uncertainty engendered by wildly fluctuating rates fostered more financial speculation than investment.

When the economy began recovering in the summer, partly because of the ending of the March credit controls, the Fed sat tight and did not increase reserves. Interest rates began rising again.[69] On September 26 the Fed increased the discount rate by a full percentage point again, concerned more about the dollar than about the domestic economy. Volcker later explained that “the already precipitous decline in interest rates might be misread as … a lessening of our resolve to fight inflation [and] could have complicated our task further by undermining confidence i n the dollar on foreign exchange markets.”[70] The bank was now overreacting in the other direction because it had pumped in too much money in the spring. Schultze found it “hard to get Volcker to focus on the relationship between his policy and such things as output, employment and prices.” Unfortunately, “monetary policy is driven more by the mechanics (short-term fluctuations in the money growth) than by consideration of what is going on in the economy itself.”[71] Then, in

October, the big banks raised the prime rate from 13 to 14 percent, higher than Schultze thought proper.[72] He preferred silence, but Carter had had enough.[73] Volcker's "strictly monetary approach" was "ill-advised," he exclaimed.[74] Defusing, or perhaps confusing, the matter, Volcker agreed that the banks' decision was uncalled for.[75]

Volcker meant that inflation should first be addressed, to appease the international bankers, before addressing employment, productivity, and investment. But the Fed failed on all counts. If monetarism had been graded at the end of 1980, it would have received an F. Many people told Volcker, "If this is what dealing with inflation means, I'd rather have inflation."[76] He wavered: "The main reason the money supply has been fluctuating is that the real economy has been fluctuating. That may be partly due to our policies."[77] In 1994 he acknowledged that 1980 was "a mostly wasted year." But he blamed the president, who convinced him to institute the consumer credit controls. Volcker said that, without them, the economic decline would not have been so steep.[78] The Fed knew that high interest rates would not yield more oil and beef or auto and steel. The recovery would be weak, with "little growth overall during 1981."[79] And the governors even predicted little progress on inflation, expecting energy, housing (because of interest rate hikes), and food prices to rise.

So what was behind the policy? Volcker had told the House Committee on the Budget that the key problem was the "vain attempt to achieve and maintain levels of real purchasing power that simply cannot be sustained in an economy experiencing higher real energy costs and virtually no growth in productivity."[80] It was not just the Fed. Treasury secretary William Miller believed that "long-term reductions in inflation will have to come from reduced growth in wages, salaries."[81] But these were already reduced. The OECD concluded that U.S. wage settlements in 1979 and 1980 were "a restrained response to the acceleration in consumer prices."[82]

If the Fed's fight against phantom wage inflation aimed at the wrong target, it injured the real economy. By limiting the growth of money, the Fed made wage increases impossible and raised unemployment rates. At

the same time, high interest rates and subdued demand hobbled industries requiring capital to improve the anemic productivity that Volcker had fingered as critical. A recession is bad not only for workers. The Business Roundtable believed the only solution to inflation was to "improve productivity."[83] It wanted tax changes, not austerity, because there was no fixed relationship between inflation and growth.[84] Labor agreed. In August the AFL-CIO concluded that fixing the nation's industrial base would require "large amounts of capital."[85] It did not support the specific tax cuts that business advocated but was open to tax cuts that would modernize industry. This was a new position for labor. Under the favorable conditions in the immediate postwar period, capital formation was not problematic. But after the end of cheap oil, and mounting European and Japanese economic competition, it was front and center.

The Fed assumed that once inflation was reduced, the economy would perform as it always did. In short, the new era did not require new approaches. It followed only half of the German model. Yes, the government of Helmut Schmidt pursued tight money. But it was active in the microeconomy, ensuring that its industries were able to thrive in the new conditions. Just as the Fed did, Carter initially focused simply on inflation. But Republican Ronald Reagan and primary challenger Edward Kennedy argued that Carter had no real plan to improve the economy, and they were right. The upcoming election forced him to face the nation's problems that the Fed could ignore.

CHOOSING CANDIDATES IN HARD TIMES

Ronald Reagan emerged from a large field of Republican contenders who sensed the president's vulnerability in 1980. Perennial candidate Harold Stassen thought that his time was now. Congressman John Anderson of Illinois ran for president in 1980 because he had become too liberal for his Rockport district. Anderson began his career as a conservative Christian in 1961. The civil rights struggles of the 1960s propelled Anderson leftward. He now opposed most new weapons systems and was pro-choice and pro-civil rights. Anderson also voiced the new psychobabble that masqueraded as profundity. His 1975 book *Vision and Betrayal in America* claimed that "our political system suffers a crisis in its soul." He had much to say about the American spirit, but his words on the economy were faint.

Two candidates from the Senate—President Ford's running mate, Senator Bob Dole of Kansas, and Tennessee senator Howard Baker—completed the roster of legislators. Of the two, Baker had a better profile. He was highly intelligent, knowledgeable, and personable. Baker made a name for himself when he turned against Richard Nixon at the Watergate hearings and demonstrated a brave bipartisanship by backing Carter's Panama Canal treaty. Yet the very qualities that made him appealing to good government groups and the media made him unattractive to Republican primary voters. John Connally and George H. W. Bush divided business support. Connally, the former Democrat and Nixon treasury secretary, was uninvolved in Watergate. But he was tried for accepting a bribe in a milk price fixing case in 1975. Although he was acquitted, he could not remove the odor of corruption about him. His Democratic ancestry and Nixon connections kept many Republican voters away. At the same time, many businessmen found him charismatic, the quality that had attracted Nixon to him.

George Bush, the scion of an elite New England family, owned the best resume of all of the candidates. The son of a Connecticut U.S. senator, Bush had been a distinguished Navy fighter pilot during World War II

and had graduated from Yale. During the 1950s he moved his family to Midland, Texas, to reap the rewards of the state's oil boom. He entered Texas politics and became Houston's congressman but lost elections for the U.S. Senate twice, in 1964 and 1970. He received a series of appointed posts—U.S. ambassador to the United Nations, head of the Republican National Committee, envoy to China, and then director of the CIA in the last days of the Ford administration. If experience counted in 1980, Bush was the man. He was the preferred candidate of the Eastern establishment, which had dominated Republican politics. Bush supported the equal rights amendment and opposed a constitutional amendment banning abortion. He mouthed conventional Republican economic nostrums —low taxes and balanced budgets. But he had the reputation of being "too light" on the issues, too preppy in style.[86]

Ronald Reagan was the front-runner. Born into an Illinois family of modest means, he forged a successful movie career from a genial personality and appearance. After the war, Reagan headed the Screen Actors Guild and successfully battled Communists for control of the union. He then hosted the General Electric Theater, a popular television show in the 1950S, and worked for GE itself, offering inspirational talks about capitalism to plant employees. Such work weaned him of his New Deal outlook. He began to read conservative journals, like *Human Events* and *National Review,* and formally became a Republican in 1902. Reagan worked hard for Goldwater in 1964 and then confounded experts two years later by beating the formidable incumbent California governor, Pat Brown. Governor Reagan sent the National Guard to restore order at Berkeley, but he also signed the most liberal abortion law in the country and raised taxes. The governor was more pragmatic than the candidate.

In 1980 Reagan managed to knit his lofty rhetoric of freedom with the mundane economics of the day. Freedom was a staple in U.S. campaign rhetoric, but Reagan's definition harked backed to the nineteenth century. New Dealers had believed that the main threat to freedom came from big business; the counterculture of the 1960S supposed it came from an oppressive society. Reagan assumed it came from the state, as did

Friedrich von Hayek, whom he had read in the 1950s. The governor combined this classical definition of freedom with a winning personality, self-deprecating humor, and engaging campaign style. These skills nearly unseated President Ford in the 1976 Republican primaries. At that time, with the economy apparently on the mend, Reagan had stressed foreign policy—greater defense spending and opposition to détente with the Soviet Union and the proposed Panama Canal treaties. His economic policy had offered the conventional Republican balanced budget. Against Carter in 1980, Reagan made his economic arguments front and center. He forged his notion of freedom into a weapon for combating current economic woes. Balanced budgets took a backseat to a more dynamic program of across-the-board tax cuts for individuals and corporations.

Still, many businessmen believed that, at sixty-eight, Reagan was too old and too conservative. He was helped by the moderates, who eliminated each other. George Bush won in Iowa but then faltered. John Anderson did well in New England and became the darling of some liberals. GM heir Stewart Mott, who had given George McGovern $400,000 in 1972, now crowned Anderson. But Republican voters discovered that Anderson had signed fund-raising letters for senators McGovern, Culver, Bayh, and Church, four liberal Democrats. Reagan easily prevailed in the Illinois primary. Anderson won a majority of crossover votes from Democrats and independents but only a quarter of the total votes, and so was effectively out of the race. After Illinois, Bush was Reagan's only opponent. The governor won Wisconsin, and Bush triumphed in Pennsylvania and Michigan. Reagan's simultaneous win in Oregon gave him the minimum number of delegates needed for the nomination. Bush yielded, releasing his delegates, a gesture that secured his vice-presidential nomination even though Reagan did not like him. Reagan's primary performance convinced doubters that he was vigorous and competent enough to be president. He cleverly included both the supply-side tax cuts beloved by the New Right and the corporate tax cuts that traditional business preferred. His sunny optimism banished notions that current economic ills were systemic. He rejected the premises of stagflation and the politics of malaise.

Carter could not concentrate on his Republican rival because of opposition within his own party. Edward Kennedy, viewing the plunging Carter approval numbers, decided that it was now or never. In the summer of 1979 only 34 percent of Democrats approved of Carter's performance.[87] In November, Kennedy threw his hat into the ring. But his announcement was overshadowed by the taking of the hostages on November 4. Kennedy charged that Carter was too close to the shah, but he realized he needed to pull back once he saw that his critique blended with the words of Tehran crowds, who were chanting "Death to America" and "Death to Carter." The crisis produced a wave of patriotism and support for the president. In December the Soviet invasion of Afghanistan offered another opportunity. Kennedy opposed Carter's grain embargo and decision to boycott the Moscow Olympics. Kennedy sensed correctly that Carter was vulnerable. But what did the senator offer? In Iowa, Kennedy promised a balanced budget, defense increases, and leadership, but it was not enough. Carter beat him two to one in the Iowa caucuses. After the loss, he moved to the left of Carter. Where he had flirted with the Coalition for a Democratic Majority, the institutional arm of the Democratic cold warriors Henry Jackson and Daniel Moynihan, Kennedy now moved to woo labor.[88]

Labor had opposed Carter's austerity budget. Directly affected, the American Federation of Teachers and AFSCME, the public workers union, endorsed Kennedy. The Massachusetts senator also won the backing of United Auto Workers head Doug Fraser, but AFL-CIO head Lane Kirkland was neutral—that is, "neutral for Carter."[89] Kirkland criticized Carter's budget cuts, which violated the National Accord between the president and the AFL-CIO by reducing "counter-cyclical" moves to aid people hurt by the economic downturn.[90] But because he was determined to preserve the accord, he lacked room to maneuver.[91] To Kirkland, the accord provided a model for governing, even though in the short run the returns were limited. The tripartite Pay Advisory Committee had moderated the zeal with which the economists recruited by Alfred Kahn fought what they considered inflationary wage increases. And,

however dissatisfied labor was with Carter's performance, Kennedy's prospects gave them few reasons to abandon ship. Historically unsentimental, most labor leaders did not believe that he could dislodge the president. The idea of a Kennedy candidacy was always more compelling than the actual candidacy. The senator's perennial syntax difficulties did not help, and Democratic women in particular were mindful of stories of Kennedy's womanizing and of the Chappaquiddick incident. Certainly labor's judgment sealed his fate. When most unions decided to stay on the sidelines, Kennedy lacked the popular force to counter Carter's presidential power and organization.

Media-savvy militants mock President Carter outside of the U.S. Embassy in Tehran, Iran. Hostages had been taken four days earlier, on November 4, 1979. The anti-Americanism of the demonstrators elicited domestic support for the president, making it difficult for challenger Edward Kennedy to launch his campaign. (AP Images)

Kennedy won in New York, only because the primary took place in March, the cruelest month for Carter. The effects of the president's stringent budget announcement and credit controls, plus an unfortunate UN vote on Israel, combined to give Kennedy 59 percent of the vote. But after New York, Kennedy faltered. He barely carried Pennsylvania. He won California and New Jersey, but by June Carter had enough to secure the nomination. The president prevailed in twenty-four of thirty-three primaries and accumulated 51 percent compared to Kennedy's 37 percent of the primary vote, plus nearly two-thirds of the delegates from the caucus states.

Still, the Massachusetts senator fought on, evidence of the bitterness that had developed between the two men, but also of Carter's plummeting approval rating (28 percent in July, 1980). The sharp recession plus inflation made the economy the key issue. Foreign affairs offered Carter no lifeboat. A rescue mission to free the Iranian hostages failed miserably. Fidel Castro mocked the U.S. human rights offensive by permitting any Cuban to leave; 120,000 did, including a large numbers of prisoners released from Castro's jails. Carter tried to stop them. Not an easy task under any circumstance, but in the context of the president's other failings it was seen as yet another sign of weakness. France and Germany opposed U.S. sanctions against the Soviet Union following its military intervention in Afghanistan.[92] The administration's numerous graduates of the Trilateral Commission looked on helplessly as U.S. relationships with Europe deteriorated sharply during the spring.

The president's troubles kept Kennedy's hopes alive, but the post-1968 reforms snuffed them out. The key change was the decision to allow primary voters, not party officials, to select candidates. However, the rule binding delegates to their pledged choice through the first ballot had to be confirmed by the convention itself. Eliminating the rule would be the only way for Kennedy to win. But the many who thought Carter could not win in the fall were themselves divided. Henry Jackson, Edmund Muskie, and Governor Hugh Carey of New York all waited in the wings. Their followers would not vote for an open convention if it anointed Kennedy.

And, Carter shamelessly used the reform ideology he had mastered so well. To allow the convention to ignore the primary vote, his aides lectured, smacked of the old boss-dominated convention that they all had rejected. On the first day of the convention the vote on changing the rule failed, 1390.6 to 1936.4.

It was over for Kennedy, but not for his ideas. He had run on the left, claiming that Carter was a "pale copy" of Reagan. Kennedy embraced the old time religion—New Deal Keynesianism and the social additions of the 1960S. He privileged employment over inflation and embraced energy price controls and an economic stimulus, as well as litmus tests for social issues like the Equal Rights Amendment. But his choices did not address the current economy. Kennedy stated that "programs may sometimes become obsolete, but the ideal of fairness always endures." The goal of fairness was appropriate for an economy that was performing well but unequally. It was not a formula for a nation needing an economic strategy. Kennedy said that "the poor may be out of political fashion but they are not without human needs. The middle class may be angry, but they have not lost the dream that all Americans can advance together."[93] He returned to his brother's recipe for the War on Poverty, rooted in the noblesse oblige of the affluent, but he lacked the intellectual, perhaps emotional, aptitude to construct a politics that bonded the middle class with the poor in the new economic environment.

Carter's acceptance speech celebrated his deregulation of the airlines, trucking, and financial systems, which "put free enterprise back" in these industries. The president claimed his deregulation was the greatest change in government relations since the New Deal. While this was probably true, it did not help Carter retain the New Deal constituencies he needed to win in November. Celebrating his "hard decisions," a euphemism for policies prescribing high interest rates and meager budgets, could not compete with Ronald Reagan's promises of liberating and productive tax cuts. In an attempt to battle Reagan more effectively, early that summer his aides began to put together a more targeted program to improve the economy, so that Carter could run on milk and

honey, not castor oil.

Mondale aide Richard Moe told Hamilton Jordan at the end of July, "By far the largest difficulty we currently face is that large numbers of people … believe they have no stake in our reelection."[94] Caddell added that Carter could not win without telling people "where he wants to take the country" during his second term.[95] The president resisted. Carter's "eyes would glaze over when you talked about reelection politics."[96] In 1976 he had touted his honesty and integrity, personal qualities. He governed as a process president, aiming for efficient government. These virtues did not add up to a vision or program for an ailing economy. His inflation policy of wage restraint, meager budgets, and high interest rates was not working. Even if it had brought down inflation, growth and productivity would not have improved.[97] Carter had the misfortune to be a Keynesian president with pre-Keynesian instincts in a post-Keynesian era. Managing aggregate demand to stabilize the business cycle was no longer sufficient. Addressing long-term supply-side problems and raising productivity in the new global environment required new thinking and perhaps new institutions.[98]

Meager productivity was not simply an American problem. It fell in all OECD nations, from 5.2 percent (1969–73) to 2.8 percent (1973–79). In the United States it declined from 2.4 to 1.4 percent, sinking to less than 1 percent in 1979.[99] Other than the United Kingdom the United States had the lowest amount of gross fixed capital formation as a percentage of GDP. Other nations used macroeconomic policy to address inflation, and industrial policy to raise the low productivity that afflicted their many pressed industries. The EC created a steel cartel—minimum prices and production allocations—and disbursed subsidies, as overcapacity and low prices threatened every national industry. Japan improved productivity in export industries with cartels and cheap credit. To pay for higher-priced oil imports it restricted less vital ones and dumped subsidized exports at any price.[100]

Not Americans. Vice President Larry Fox of the National Association

of Manufacturers explained in 1979, “Industrial policy is only a problem for the United States because only the United States doesn’t have industrial policy. We usually see these issues in trade terms—foreign subsidies and unfair trade practices.”[101] Other countries protected producers in advance of injury. Americans tackled dumped and subsidized imports through a labyrinth of trade laws. The aggrieved party initiated lengthy proceedings to demonstrate a material injury from an unfair trade practice. In the end, the president decided whether to permit relief and that decision often reflected international politics, as much as the merits of the case.

It was becoming more difficult for presidents to sweep complaints under the foreign policy rug. What were called nontariff barriers multiplied, as duties fell after the Kennedy Round. The Tokyo agreement, completed in 1979, reduced tariffs to below 5 percent. States had replaced tariffs with government procurement preferences, subsidies, and regulations to shelter domestic producers. The new protections were also responses to the faltering domestic demand after the recession of 1975 and 1976. Yet the OECD found that “the United States has … the lowest ratio of subsidies to GDP and, unlike [that of] other countries, the U.S. ratio has declined since the late 1960s.”[102]

The United States had tolerated foreign subsidies in the interest of the postwar recovery of its Cold War allies. But as the American economy weakened in the late 1970s, industry and labor increasingly objected to subsidized imports. Initially the president was deaf to the complaints. The Carter administration was populated by trilateralists, who believed that the country must sacrifice domestic interests for global prosperity.[103] The White House believed that “free access to U.S. markets is a matter of ranking importance for our allies and almost all the developing countries of the world.”[104] In the case of steel, in 1977 U.S. steel consumption was the third highest in history. But steel mills were operating at only 78 percent of capacity, and imports had taken 20 percent of the U.S. market. European and Japanese steelmakers had sharply increased capacity in the early 1970s. Despite the 1975 recession,

they increased that capacity. The EC subsidized closures, extended loans for new plants, set minimum prices, negotiated import quotas, and effectively closed its borders by imposing antidumping levies on Japan, Canada, South Korea, Spain, and east European countries. The Japanese dumped, selling below the cost of production. Faced with foreign complaints, the Ministry of International Trade and Industry (MITI) warned steelmakers to cease "offering their products for export at cheaper prices than for domestic customers for whom they have recently raised the price."[105] The Japanese agreed to limit their steel exports to the EC, Canada, and Australia in 1976. In 1977, the only open market in the world was in the United States.

Because European dumping was greater than that of the Japanese, Americans targeted EC steel. (The Germans lost an estimated $42 and the French $76 for every ton of steel sold in the United States; the Japanese lost an estimated $15.)[106] The EC commissioner for industrial affairs, Etienne Davignon, acknowledged that European steelmakers were dumping. However, Davignon argued, after looking the other way for a long time, enforcing the law in effect created new rules. He had a point, but so did American steelworkers and companies.[107] Carter acted only when confronted with a wave of mill closings in August and September. More than twenty thousand steel jobs were gone. As it did in the past, the United States produced a trade remedy.

Undersecretary of the Treasury Anthony Solomon set up minimum prices for imports. The price was based on the costs of the most efficient foreign producer, Japan. Actually, the Japanese were prepared for quotas and were amazed that Carter demanded only minimum prices. Under the trigger price mechanism (TPM), prices lower than the minimum price would activate a fast track investigation to determine whether dumping occurred. But the price allowed the Europeans and many developing countries to dump with impunity because they could sell at the Japanese price, which was below their own cost of production.[108] Initially, Solomon believed that the TPM would be enough to return the industry to profitability, so it could modernize and invest in pollution control.[109] But

by 1979 Solomon wondered, "Should we fight 'em or join 'em?" He said that the "single most important strategic issue for U.S. international economic policy over the next 5–10 years is *to what degree we join or fight the global trend toward increased government intervention in trade/investment etc. activities.*"[110]

A steel crisis erupted again in 1980. Solomon, who had been named president of the New York Federal Reserve in May, was out of the picture now, and his 1977 experience was lost. Because of heavy dumping, U.S. Steel and Republic filed suits against European steelmakers, which in theory would end the TPM, a substitute for the suits. Even the Europeans acknowledged that they were selling steel in the United States at prices much below the cost of production. But foreign and domestic policy interfered with a resolution. Because the United States needed European cooperation on Afghanistan and Iran, Carter was reluctant to act. Some of his aides urged a genuine industrial policy for steel, not simply minimum prices for foreign steel. The president was uninterested. In March the White House panic over inflation framed the steel question. Carter refused to increase the trigger price, even though the Europeans had suggested this. Instead, he suspended the program, so the suits proceeded. On May 5 the U.S. International Trade Commission found that the industry had been injured, the first step in the proceeding. By July the steel industry, also affected by sharp declines in auto and housing, operated at 50 percent of capacity. Foreign tonnage declined, too, but the import share of the market rose.

The Europeans were concerned, even if Carter was not. They were prepared to accept voluntary quotas because they knew that they were dumping and feared that they would lose the suits and be shut out of the American market. The European steel cartel had allocated 10 to 12 percent of its output for export, mostly to the United States. But the cartel had broken down in the summer of 1980 as domestic demand plummeted. A wave of price cutting, combined with higher production costs, threatened the entire industry, which was losing $20 million a day. Commissioner Davignon acknowledged that the "EC would not be able to

compete with prices charged by the domestic [American] steel companies." Thus, to keep the TPM Davignon would accept a small rise. Carter ignored the industry but acted on the EC's request. He reinstalled the TPM in September at a figure about 12 percent higher than it had been, after which the industry dropped its suits. Like the original TPM, the new one aimed to protect European steelmakers as well as the Americans. The new TPM still allowed them to sell steel below their costs of production. Carter decided not to look too closely at European subsidies or trade diversion, like the EC-Japan agreement of 1976. Although he was forced to compromise, his inflation priorities contrasted very sharply with the industrial concerns of the EC.[111]

The campaign of Ronald Reagan (center), shown here campaigning in the closed Campbell Works of the J & L Steel Co. in Youngstown, Ohio, forced Carter to propose an industrial policy. The United Steelworkers worked to reelect Carter (note the steel-worker holding sign in support of Carter behind the governor) even though the union and its workers were

disappointed with the president's steel policies. That discontent cost votes; Carter carried the area with 50.9 percent, ten points lower than the 60.5 percent he received in 1976. (© Bettman/CORBIS)

Steel was not the only issue. In the second quarter of 1980, investment had plummeted 31.4 percent, and in the third quarter it sank another 27 percent.[112] Something was very wrong. The country confronted not the shortcomings of affluence, the want of fairness, but the imperfections of capitalism. The nation was ahead of the president. On June 30, 1980, *Business Week* published a special issue titled, "The Reindustrialization of America." The *New York Times* followed in August with a five-part series titled "Reviving Industry," discovering "in corporate boardrooms, union meeting halls and all kinds of economic forums, the talk is of 'reindustrializing America'—of somehow piecing together a consensus for a national industrial policy to rebuild the country's productive base."[113] Congress was not far behind. Senators Adlai Stevenson, Lloyd Bentsen, and seven others introduced legislation that would create a bank for "sunrise" industries, noting that governmental "risk absorption can improve the efficiency of private capital flows and stimulate economic growth."[114]

Even so, it was the presidential campaign that pushed Carter beyond his anti-inflation program. To distinguish Carter's candidacy from Reagan's, Moe thought the president needed "a modest anti-recession policy to deal with the short-term effects of unemployment and an industrial policy to deal with the long-term health of the American economy…. For the first time in this century … a Democratic administration has been forced to run for re-election in the midst of a serious recession created while it was in office."[115] Because Reagan was more popular than Ford in the South, the campaign would need more of a "northern industrial strategy than we did the last time." But Carter's economic advisers opposed any form of industrial policy. Schultze even denied that the country was losing its industrial base.[116] "With two

exceptions [autos and steel] individual American industries had not suddenly turned into problem children."[117] The United States lacked "reliable economic data at the sectoral level."[118] Schultze could have asked for better statistics but used the poor data as a reason for rejecting the policy.[119] He kept his foot on the brake throughout the whole exercise.

The president's plan, unveiled on August 28, was a start, but it cut no new ground. It would simplify and liberalize depreciation to encourage investment. Carter then proposed an 8 percent credit for social security taxes to ease the burden of the scheduled increase of January 1981, something he had refused to do all year. Because the credit would reduce labor costs, it would be anti-inflationary. To address current dislocation, the plan offered a 30 percent refundable investment tax credit to firms that needed investment but lacked the profits to make use of the investment tax credit. The package included modest increases in research and development, supplemental unemployment benefits, and job training. These items were not industrial policy per se. The tax breaks would go to all industries, not selected winners; the monies would not be contingent upon producing desired results.

The White House would have been content with simply giving this package new wrapping paper (called "revitalization") and offering it to the American people. But Lane Kirkland, now a crucial player in the upcoming election, wanted more. Kirkland had opposed Carter's initial approach to the election, a negative campaign that tallied Reagan's failings. Only a robust economic program to mobilize the labor vote would produce victory, he told the president.[120] The labor leader believed that industry needed capital but was not willing to gamble that the corporate tax cuts offered by the president would result in investment at home or in needed areas. Even investment tax credits, spent at home, would not be enough. Kirkland wanted a semipublic corporation to mobilize private, pension, and public funds. The bank, an updated version of the Reconstruction Finance Corporation of the 1930s, would have tripartite membership. Projects funded would have to meet market tests

of economic viability. While the bank would not be "picking winners," it would make judgments about critical industries.

Carter had already agreed to an Economic Revitalization Board to advise him on industrial matters. But after listening to Kirkland, the president decided to allow the board members to determine whether they wanted to create a bank. The contest now was over personnel. The kind of people appointed would determine whether an industrial bank would be created. Irving Shapiro, CEO of Du Pont, and Lane Kirkland were the announced co-chairs. The rest of the board would be named afterward.

Shapiro and Kirkland wanted John Dunlop and Felix Rohatyn. Dun-lop, the labor economist from Harvard, was the father of tripartite arrangements. Rohatyn, an investment banker, had been a strong proponent of industrial policy as well as an architect of the financial package that prevented the bankruptcy of New York City in 1975. That plan had used union pension funds, which Kirkland wanted to employ in the new bank. But there was strong opposition to Dunlop and Rohatyn from the opponents of industrial policy, the classic Keynesians. Schultze snapped that there was "*no* evidence that we needed a *new* and vastly enlarged federal role in channeling investment among industries or locations."[121] He, Treasury officials, and Stuart Eizenstat preferred the orthodox Wall Street banker Henry Kaufman to Rohatyn.[122] This opposition was augmented by the deregulators inside and outside the administration.

The battle over personnel was a miniwar between two tendencies in post—New Deal liberalism. The first was the antigovernment strain from the New Left and New Politics. The second was the social democratic impulse from the unions. Alfred Kahn and Ralph Nader represented the first and Lane Kirkland the second. Kahn and Nader's suspicions of government rested upon Samuel Huntington's theory of agency capture, offered in an article in the *Yale Law Journal* in 1952.[123] Huntington argued that regulatory agencies were compromised by the ability of regulated industries to dominate their actions. Reality was more complicated. Shippers, not the railroads, had captured the Interstate

Commerce Commission, which was why the railroads advocated deregulation. Even the airlines had come to support deregulation by early 1978, and this deregulation was effected by the agency that was, according to the theory, handcuffed by the industry. Trucking seems to be a better example of the theory. But again, the story is more complicated. The history of deregulation does not verify the capture theory. In most instances, deregulation was supported by some businesses and opposed by others.

Nevertheless, deregulation was part of the 1970s antigovernment movement, which had advocates on both the right and the left.[124] The right supported deregulation because it opposed government intervention in markets. The left, including Kahn and Nader, supported deregulation because it thought that corporations and unions dominated the agencies, which hurt consumers and drove up prices. There were differences between the two men. Kahn had faith in the market to do the policing; Nader believed his lawyers could fix things. But both viewed tripartite forms of decision-making with suspicion and loudly opposed the appointments of Dunlop and Rohatyn to the Carter board. Kahn feared the "cartelization," or "syndicalization," of the economy, like the Italian and German economies of the 1920S and 1930S. Today, some historians view the National Industrial Recovery Act (NIRA) of 1933 as a leftist critique of capitalism.[125] Kahn saw fascism, forestalled only by the New Deal shift from NIRA to competition in 1935. He admitted that the analogy was a little hysterical, but he passionately opposed what he believed was the alliance between business and strong unions. Kahn reminded the president that the alliance had fought trucking and airline deregulation. Now the culprits were the auto and steel industries and their unions. Kahn preferred an Economic Revitalization Board composed of people like Archibald Cox, distinguished but without industrial experience. For his economist he named Robert Solow or Gardner Ackley, both Keynesians who were neoclassical when it came to the microeconomy.[126]

Ralph Nader opposed the Economic Revitalization Board for similar reasons. Nader's principal animus was the corporation.[127] Because he

believed that corporations dominated government and corrupted labor, he also opposed tripartite modes of governing. Such collaboration would be at the expense of the consumer. Nader's politics substituted consumers for the traditional working class as agents of change. Nader did not organize consumers. His various public interest groups were not mass organizations but groups of activist lawyers. Nader's anticorporatism was a mindset, not a political program. In the final analysis, both Kahn and Nader believed that competition would solve all economic problems. With conservatives, they opposed social democratic solutions to U.S. economic woes.

The issue was not resolved because everyone understood that, if Carter was not reelected, "this thing is academic." Shapiro said that the White House would be unable to recruit "top quality" business members for the board until he won reelection. Businessmen supporting Reagan might not want to help Carter, and Shapiro thought it would be better to have both Republicans and Democrats on the board.[128] The warring parties accepted a cease-fire. Had Carter been reelected the fight would have continued. Although we cannot know with certainty what would have happened in a second term, Carter's handling of the auto industry emergency in late 1980 illuminated his thinking about industrial policy. Because Carter wrestled with the auto issue at the same time he formulated his industrial policy, his actions flesh out the inevitably sketchy general principles.

AUTOMOBILES

Despite record auto sales in 1977 and 1978, rising gasoline prices following the Iranian revolution and rising interest rates were bad news for Detroit. Car makers sold 9.3 million autos in 1978, 8.3 million in 1979, and 6.5 million in 1980.[129] The weakest of the Big Three, Chrysler, required $675 million in federal loan guarantees to avoid bankruptcy. Auto companies closed forty assembly plants and shuttered fifteen hundred dealerships in 1980. By June, 40 percent, between seven hundred thousand and eight hundred thousand workers in auto and auto-related industries had been laid off. Only 58.5 percent of U.S. capacity was in production.[130] Bad times spread beyond the industry because one of every twelve manufacturing jobs was directly tied the industry—56 percent of the demand for rubber, 24 percent of the demand for steel, and 15 percent of aluminum, and still more in automotive sales and services.[131]

The auto crisis began with a surge of imports. In 1980, as U.S. production plummeted, imports grew to 26.7 percent of the market. Japanese small cars became desirable after the gasoline price upsurge. In early 1980, Japan sold more vehicles in the United States than in Japan.[132] Small cars, foreign and domestic, constituted nearly two-thirds of the U.S. market, up from just over one-third in 1970.[133] For the first time in its history, Detroit confronted foreign competition.

After World War II, American car makers dominated domestic markets by catering to consumers who preferred large cars because of the long distances driven in this country and the availability of cheap gasoline. Most European cars were smaller, produced for a market where high gasoline prices made big cars luxury items for the rich. The full-sized cars in Europe, Mercedes and BMW, were costly gas guzzlers. Without a sizable local market, Europeans could not produce large cars efficiently enough to be competitive in the United States. On the other hand, American auto companies produced a variety of cars internationally, but they were disciplined by the Cold War's trade rules.

Auto tariffs declined after the war, but unwritten rules allowed each country to develop a domestic auto industry, even if foreign cars were cheaper. A corollary to the rule was that companies wishing to sell cars in a foreign nation instead invested in local production facilities. Nonetheless, there was no requirement that foreign companies be treated equally with domestic ones. Great Britain chose equality; France and Germany each preferred its domestic producers. And, there was no rule requiring foreign investment at all. Japan excluded foreign imports and foreign producers during its drive to build a major auto industry. Orchestrating the whole show, the United States took the lead in reducing tariffs and refrained from pressing other nations to abandon the protection they used to build up their own industries even when they violated the General Agreement on Tariffs and Trade (GATT) rules.[134]

The same exceptions to "free trade" governed the U.S.-Canada auto trade. Canada did not want to produce a Canadian car but it did wish to increase auto employment. The auto pact, signed by the two governments in January 1965, was more than the free trade agreement that the Johnson administration trumpeted. The treaty allowed the Big Three American auto firms to trade vehicles and parts without tariffs, but the Canadians insisted that an appropriate share of production be located in Canada. The companies had to manufacture enough models and parts in Canada for export to the United States to offset 95 percent of the value of the models and parts it manufactured in the United States for sale in Canada. Over time, the companies shifted much production north of the border, producing a U.S. automobile trade deficit with Canada.[135] The auto trade was a managed traffic. The goal of achieving a national industry or domestic auto employment trumped principles of comparative advantage everywhere. Given the superiority of Detroit's cars and their dominance in the U.S. market, the issue of foreign cars at home had been nonexistent until the 1970s, at which time the oil crises coincided with the coming of age of Japanese auto exports.

Initially, Japan built cars for its own market. In 1951 its Ministry of International Trade and Industry (MITI) prepared a package of support,

including 40 and 50 percent tariffs on foreign imports and investment controls, that prevented foreign facilities from being established in Japan. This protection, along with cheap loans, favorable tax treatment, and direct subsidies, allowed Japanese firms to develop high-quality, cheap, small cars. Although the protection ended by the early 1970s, nontariff barriers—inspections, standards, and the like—continued to preserve the Japanese market for Japanese companies. In 1970 the president of Toyota said that securing the domestic market "has clearly been a basic tenet of the motor industry's philosophy as well as the Government's."[136] It was out of that impregnable but stagnant home market that Japanese companies began to export. Toyota started to sell abroad in the 1950s and finally triumphed in 1965 with the Corolla. The government promoted building large ships to reduce transportation costs.

But the big export drive began in the 1970s, in the wake of the oil crisis, when export earnings were so crucial. The government offered an array of incentives, financing, insurance, information, and other help. Unlike the Americans, the Japanese did not build plants in other nations. In 1979 Japan did not have one plant in the United States or in Europe. Japanese exports exceeded home consumption by a ratio of 1.2 to 1. Autos were the nation's single largest export, and more than half the exports came to the United States. The Japanese had targeted the U.S. market early because it was the only open one. European governments limited the numbers of Japanese cars that could be imported. Italy's quota allowed only 2,200 per year, which GATT considered legitimate retaliation for Japan's exclusion of Italian cars in 1962. In 1978 the French government announced it simply did not want Japanese cars to exceed 3 percent of the market. When more came, French officials refused to let them pass through customs until Japan respected the limit. Even liberal Britain limited Japanese imports to 10 to 11 percent of the market, using the oxymoronic "voluntary import restraint" agreement. During the 1970s Western auto production stagnated while Japan's grew by nearly 60 percent, its share of global production rose from 18 to 30 percent, and its exports tripled, from 2.1 to 8 million.[137] Americans, like

the Europeans, could have limited Japanese imports because of Japanese restrictions of U.S. autos. But the unspoken rule of global trade policy was that the United States would look the other way when Americans goods were discriminated against.

But when the U.S. industry was in deep trouble, the rule was in deep trouble. It was not simply the near-bankruptcy of Chrysler. Ford's North American operations were in the red, too, although its overseas operations kept it profitable. GM still turned a profit at home, but barely. The administration at first downplayed the problem. In March 1980 trade representative Reuben Askew said that domestic content legislation, which the UAW advocated, "would restrict imports and violate GATT, though a number of less developed countries have such requirements." He did not tell the president that Canada and all of the EC nations had such requirements when they did not limit imports outright. It would not have mattered. Carter was strongly against any restrictions, mandatory or voluntary, of Japanese autos.[138] Like the steel crisis, the auto crisis was viewed through the lens of inflation policy.

By May, when the economic meltdown produced by the Fed's new credit controls transformed the auto problem into the auto crisis, UAW and congressional pressure escalated. Still, Carter refused to seek Japanese restraint. "God, the Japanese could not believe it," recalled Alonzo McDonald, a White House trade negotiator. Economists had "lost all touch with reality; it's heart surgery handled by a biologist. The economist may know everything about the policy and its workings, but there's something lacking in the skill of his fingers."[139] Carter's decision was propelled by his Council of Economic Advisers and the Treasury Department and fortified by his foreign policy advisers. Henry Owen, in charge of the G-7 summits, reminded the president, "We would appear to be backing away from the [June] Venice [summit] anti-protectionist pledge within weeks of having made it … U.S. credibility generally, would be weakened." There was more. Restraining Japanese imports "would affect European, as well as Japanese imports, and bring the U.S. nearer to a US-European trade war."[140]

As a result, Carter refused to ask the Japanese to restrain auto imports.[141] Instead, the president proposed to encourage Japanese investment in the United States and open up the Japanese market to American autos and auto parts.[142] Even if successful, these were long-term projects. Moreover, the Americans were so hesitant and apologetic that this minimum program yielded little. Honda announced that it would make autos in the United States, but Toyota would agree only to study the possibility.[143] Toyota officials believed that American unions were too militant, and they also had intricate supply networks in Japan which they did not want to break. But mostly they were concerned that, by the time the plants were built, American companies would have gained the capacity to produce small cars and reduce the Japanese share of the market. Although it seems hard to believe today, Toyota feared competing directly with GM without the advantages it enjoyed at home.[144]

The Japanese government told the Americans that they could not require its auto industry to buy U.S. auto parts. McDonald thought otherwise. "I know they have an arsenal of persuasive tactics that dwarfs anything we can imagine."[145] Then it was revealed that the Japanese export surge was accomplished with unprecedented overtime, and automakers planned large future additions to capacity. The United States was the only market that was totally open to imports, and Carter now concluded the Japanese had crossed a line.[146] He had to do something. A *New York Times* poll in June found that 71 percent of Americans were in favor of "protecting jobs at the cost of higher prices on foreign products." Only 19 percent preferred lower prices, if unemployment was the result.[147] So the president's advisers put together a new auto program. It created a tripartite committee and offered aid to communities affected by plant closings, federal retraining, loan guarantees for auto dealers (including minority dealers under the Small Business Administration), eased emission standards, and accelerated depreciation deductions. The committee addressed adjustment to closures, not investment or planning initiatives.

Having failed to get the president to act, the UAW and Ford filed an escape clause suit in June. The U.S. International Trade Commission (ITC) would determine whether Japanese imports constituted the principal cause of injury to the domestic industry.[148] The decision was announced on November 10, after the presidential election, and, despite earlier predictions, it denied relief by a vote of 3–2.[149] ITC chair Bill Alberger, who himself drove a Toyota, acknowledged that "increased imports made it difficult for U.S. firms to conduct the transition to smaller vehicles, thus impairing their competitiveness and inhibiting a faster shift to meet changing demands. But by far the greatest explanation of the damage suffered in the past 18 months has been the recession itself."[150] Although the government had produced that recession with high interest rates, it claimed that it could do nothing to help the industry. But even the commission recognized the unstated rule of the auto trade. ITC commissioner Michael Calhoun had voted with the majority, but he conceded that imports had been a "significant thorn in the industry's side." The "integrity of the international trading system required a certain sensitivity" on the part of overseas suppliers "to avoid achieving their success at too high a cost to the host society." He "found a disturbing absence of such regard and sensitivity on the part of particular foreign automobile manufacturers."[151]

Carter's auto policy revealed his approach to industrial questions. He showed concern, helped disadvantaged communities and workers, offered a few incentives to the companies, but never reached the key issues. The Keynesian-dominated government saw the problem as cyclical, the result of the recession and high interest rates and the short-term inability to produce enough small cars. Secretary of Transportation Neil Goldschmidt raised the longer-term issues which Carter was blind to and warned that "over the long term our concern should be that foreign auto imports not create a situation which jeopardizes the fundamental health of the US auto industry and places it and its supporting industries and work force in a position from which there is no recovery."[152] Commerce secretary Philip Klutznick spelled out some of those dangers. Klutznick feared that

encouraging the Japanese to build plants in this country would yield a glut of automobiles. The Japanese government's long-term, low-cost financing and other forms of assistance that American companies do not get would give Japanese firms an advantage in the U.S. market. Requiring the Japanese firms to produce in the United States would not erase either competitive or comparative advantage without a strategic U.S. government intervention in support of domestic firms.[153] Carter made no commitment.

The American industry, shaped by the incentives and requirements to produce, not sell, abroad, also contributed to the difficulties. Eizenstat feared that some of the companies, particularly Ford, might decide to serve the U.S. small car market by placing its investment overseas, not in the United States.[154] Overseas operations of American automakers were large and growing. Both GM and Ford spent between one-quarter and one-third of their investment budgets abroad. Partly to hurdle European tariff walls in the 1950S and 1960S but also to produce cars specifically for the EC market, U.S. car makers made small "European" cars that met the competition and then some. Ford was the third-largest producer of autos in Europe in 1980. Together, Ford and GM held over 20 percent of the European market. One-fourth of Ford's investment expenditures were abroad. Not to be outdone, in June 1980 GM announced it would build new plants in Austria and Spain, having received incentives from both countries. Mexico, Australia, and Venezuela were also recipients of new plants. And, much of the foreign capacity was for fuel-efficient engines and transmissions. GM was even working on an automobile in Brazil that operated on alcohol.[155]

Investing abroad was hardly consistent with a maximum effort to retool and make small cars in the United States. The U.S. strategy was to downsize existing vehicles to conform to fuel economy standards, not to design new smaller cars. U.S. automaker creativity was transported abroad. There was also the question of foreign sourcing. In 1980 only 3 percent of the value of U.S.-produced cars came from foreign plants. But outsourcing was growing, especially in the small car field. Ford

announced that its small Erica would be assembled from components made in Mexico. Off-shoring was the alternative to industrial policy.[156] Temporary import restrictions, loans, and an auto industry commitment to design and make small cars in the United States would have been a reasonable package to present to the industry. Carter offered nothing.

Decisions made in 1980 shaped the future industry. In 1981 the Reagan administration, with a very different governing philosophy, negotiated a voluntary restraint agreement with the Japanese but demanded nothing from the companies. As a result, the Japanese learned that they could dominate the American market from the United States as well as from Japan, and the American car companies yielded the U.S. small car market. American workers received assembly-line jobs but less-skilled work. Japanese multinationals performed differently than the American ones. Most of the value in American autos made in Europe came from the host country. But the only local value in Japanese cars made in the United States during the 1980s was stamping and final assembly. Basic manufacturing processes, casting, forging, machining, and components production remained in Japan, as well as research and development.[157]

For nearly a year after October 6, 1979, when the Fed began tightening according to monetarist formulas, Carter was silent, as the gyrating rates wreaked havoc on the economy. His technocratic habit of mind—focusing on problems independent of their relationship to others—delayed his understanding. The Fed and Carter at every turn weighed the financial market's concern with inflation more than they considered the real economy. Every time Carter confronted an industrial question, he saw only its implications for inflation. As the November election neared, the president needed something more concrete to offer the people. Pushed by the labor movement and his political advisers, he cobbled an industrial policy in the fall, making him the architect of his fate. Neither the president nor his key economic advisers, all classic Keynesians, fully embraced it.

THE VOTE

Carter's fate was clear. Caddell confessed, "There was no way we could survive … if we allowed it [the election] to become a referendum on … the Carter administration."[158] So the campaign tried to change the subject by running against a frightening Reagan future. TV ads featured ordinary citizens saying, "I think it's a big risk to have Reagan as president. Reagan scares me."[159] The election was a decision for "war or peace."[160] Efforts to make Reagan into the Barry Goldwater of 1964 failed. Reagan always appeared genial, friendly, and warm. He shrewdly embraced FDR, Truman, and Kennedy, claiming that, between him and Carter, he was the real Democrat. Both men did well at the October 28 presidential debate, but Carter needed to demonstrate that Reagan was a frightful warmonger. A Carter aide admitted, "Since he [Reagan] didn't walk out on stage and act like Dr. Strangelove, it was a boost [for Reagan]."[161] For his part, Reagan simply asked the electorate whether the people and the country were better of than they were four years ago.[162] The media make most elections horse races at the very end, but the results of November 4 were never in doubt.

Reagan's victory was substantial. He won 44 states and 489 votes in the Electoral College. Only FDR in 1936 and Richard Nixon in 1972 did better. Merely 52.6 percent of the eligible voted, and Reagan tallied just 51 percent of this vote, but he accumulated more than a majority in a three-way race. John Anderson won 7 percent of the vote and possibly deprived Carter of New York and Massachusetts though not the election itself. If his victory was not accompanied by increased voter turnout, Reagan made inroads into every demographic slice of the pollsters' pie, except blacks. Women, ethnics, Jews, Hispanics, Catholics, and blue-collar workers all voted more Republican than they had in the past. He won decisively in the West and solidly in the industrial North and Midwest, but barely in the South. His victories in Alabama, South Carolina, Mississippi, Tennessee, Arkansas, and North Carolina were slim. In no southern state did Reagan exceed 50 percent and in none was

his margin greater than 2.1 percent. Reagan did best in the outer southern states—Texas, Virginia, and Florida, suggesting that his wins were produced by traditional Republican voters.[163]

If Reagan's victory in 1980 was sizeable, the Republican victory in the Senate was an earthquake. The GOP gained twelve seats, the largest increase since 1946, and Senate control for the first time since Eisenhower's 1952 victory. Very conservative men—Orrin Hatch, Strom Thurmond, and Jesse Helms—now headed key committees. Democratic senators George McGovern, Birch Bayh of Indiana, Frank Church from Idaho, John Culver of Iowa, Gaylord Nelson of Wisconsin, John Durkin of New Hampshire, and Warren Magnuson of Washington were defeated.[164] Democrats retained control of the House, but the GOP gained thirty-three seats. Some of the losers were process and foreign policy liberals who were from conservative states and who had previously been elected by the slimmest of margins.[165]

Many in his party blamed Carter for the defeat of western Democrats. The outcome of the presidential election became apparent well before all the polls had closed, and at 9:52 p.m. eastern time, despite a plea from House Speaker "Tip" O'Neill to wait until all polls had closed, Carter gave his concession speech. It is difficult to say whether the speech significantly depressed Democratic turnout in western states, where polls were still open, but the decision exposed the disarray within the party. On the other side, the Republicans ran as a team. Captain Reagan had appeared with several hundred Republican congressmen and candidates on the steps of the Capitol on September 15 pledging the "Capitol Compact" to promote inner-city jobs, eliminate waste, cut taxes, encourage investment, and strengthen defense.[166] The contrast between Democratic division and Republican unity was striking. Democrats had run out of ideas and lacked common purpose.

CHAPTER ELEVEN
Age of Inequality

PRESIDENT Ronald Reagan transformed the economy and politics. A new recipe for economic growth prescribed freeing capital from taxes and unions and liberating markets from government rules. Reagan reduced taxes on capital, dismantled business regulations, privileged the fight against inflation, tolerated high unemployment, fought unions, promoted an expensive dollar, and championed free trade. His policies altered the composition of the U.S. economy. They promoted financial services and real estate and injured manufacturing. They benefited affluent workers more than poor ones, reinforcing the inequality that began in 1973. Although the president did not produce a Republican majority, GOP affiliation rose from 24 to 33 percent of the electorate between 1980 and 1990, while Democratic affiliation declined from 41 to 38 percent. Reagan's changes were both ideological and partisan. He transformed Democrats as well as the nation.

This future was not apparent immediately after the 1980 election. Most analysts concluded only that Reagan had triumphed over a weak opponent unable to manage the economy. "The election of Ronald Reagan by a landslide does not necessarily indicate a widespread shift to the right by the American people," judged the editors of the Republican *Chicago Tribune.* The liberal *Los Angeles Times* agreed that it was "not a sudden shift to the right…. By the end of his [Reagan's] campaign, his appeal was directed to the center."[1] The *New York Times* added that just "11 percent say they voted for Reagan because he was conservative; 38 percent of them because it was time for a change."[2] Even the *Wall Street Journal,* quarterback for the new right wing team, did not discern an ideological mandate. The Reagan triumph "was a simple anti-Carter reaction."[3] Exit polls confirmed that it was Carter, not his creed, that lost

the election.[4] The economy was the top issue, outpolling foreign policy by 56 to 32 percent.[5] During the campaign, Reagan's blueprints had been opaque, even among his supporters, like Reginald Jones, head of General Electric and the Business Roundtable. Jones was one of those businessmen whom Carter consulted regularly. Jones nevertheless went with Reagan in 1980, though he did not foresee radical change. "[T]he dialogue between business and labor will continue."[6] He was wrong.

RIGHT TURN

The new president did not hesitate to interpret the victory as a rejection of Keynesian liberalism, the mixed economy. Initially Reagan allowed subordinates to deal with foreign policy. He knew that he wanted to increase defense spending, but the details of diplomacy and the pros and cons of defense strategies and weapons did not interest him.[7] The social issues, abortion and airmative action, were obligations, not passions. They were handled by appointees. The economy was different. For nearly thirty years Reagan believed that taxes and spending were too high and now he had the opportunity to do something about them. In an address to the nation on February 5, 1981, Reagan laid out his blueprint for economic restoration. The nation's ills were rooted in a bloated federal government that overtaxed and overregulated and generated inflation by spending too much and printing too much money, which discouraged work, risk-taking, saving, and investment. As a result, industries suffered low productivity and sagging sales in world markets. Four measures would fix things: reducing the money supply to cut inflation, ending regulations that diverted resources from productive purposes, reducing government spending so that funds could be used more fruitfully, and, most important, instituting a large tax cut for business and individuals that would change incentives and make capital available to create jobs for Americans.[8]

The keystone was tax reduction. Reagan rejected Keynesian finetuning. U.S. society was too complex to be managed and markets were so rational that they anticipated and thus annulled government interventions. Taxation "must not be used to regulate the economy or bring about social change. We've tried that, and surely we must be able to see it doesn't work."[9] Under the Reagan plan, individual tax rates were cut 5 percent for the first year and then 10 percent a year for the next two years—a tidy sum that was also intended to offset the bracket creep of the past five years. The proposal was orchestrated with supply-side flourish. Congressman Jack Kemp said, "Frankly, it is my belief that at lower,

more efficient rates of taxation, we'll get more revenue." Reagan agreed: "Even the government winds up getting more money at the lower rates."[10] The people would get to spend more and so would the government. America's long-term needs were not ignored, either. The tax bill would encourage investment through corporate rate cuts and generous increases in depreciation for corporations. The proposal departed from the targeted and technologically based benefits of the past. It simply transmitted money to corporations, without requiring anything in return. That fall a partisan bidding war brought back the targeted investment tax credit and safe harbor leasing, which permitted firms with no tax liability to sell to and then lease back assets from firms capable of using the investment tax credit.

Over five years the cut totaled $750 billion. The key question was whether slashing taxes would increase revenues. The plan projected a budget surplus of $28 billion by 1986, according to the Treasury Department, which Reagan had populated with supply-siders Beryl Sprinkel, Norman Ture, and Paul Craig Roberts. Most legislators distrusted the budget numbers produced by "Ms. Rosy Scenario," as did White House moderates James Baker and Richard Darman. They were right. The plan produced a deficit of $1.193 trillion.[11] The error resulted from supply-side ideology, bad economic forecasting, and wishful thinking. Reagan had predicted GDP to rise 5.2 percent in 1982, but it fell over 2 percent, the worst downturn since the Great Depression. This future was not difficult to foresee because the Fed continued to shrink the money supply to reduce inflation.

Because the true believers were few and the fear of deficits was great, the Congress wrote a new tax bill in 1982 which raised $98.3 billion over three years by removing some of the largesse, especially business benefits, of the 1981 law. Reagan was always more interested in the individual income tax cuts. The Business Roundtable preferred to keep the business cuts and raise rates on personal income. In populist disguise, Secretary of Treasury Donald Regan retorted, "It's somewhat ironic to hear $200,000 executives saying, 'Don't give a tax cut to $20,000

workers.'"'[12] The investment tax credit and safe harbor leasing were gone. Still, the effective corporate tax rate, which had been 33.3 percent in 1980, declining to 4.7 percent in 1981, was 15.8 percent in 1982.[13]

Reagan's solution for inflation required less work from the White House. Unlike Carter, who had formulated wage/price plans and had cut the budget, Reagan outsourced the work of inflation reduction to the Federal Reserve. He agreed that the way to decrease inflation was to contract the growth of the money supply. But Paul Volcker's experiment that had begun in October 1979 had not worked. Inflation was 13.5 percent in 1980. During the first quarter of 1981 it was still about 10 or 11 percent. Feeling spooked, the Fed kept its foot on the brakes for over a year. From November 1980 to October 1981 the Fed funds rate was above 15 percent, mostly in the 18–20 percent range.[14] Even at the end of 1981, when it was clear that the nation was in a recession and unemployment hit 8.5 percent, the Fed did not let up. Only in the summer of 1982, one year after the recession officially began, did the Fed begin to ease. The economy continued to decline until November 1982, when unemployment peaked at 10.8 percent. By then the inflation rate had fallen to 3.8 percent.[15]

Today, the recession is forgotten, and Volcker is praised for his inflation fighting. But during 1982 GDP fell 2.2 percent and he did not look so good. Unemployment rates were the highest since the Great Depression. The economy lost $200-$300 billion in output, many workers never found jobs again, and seventeen thousand companies went out of business. High and volatile interest rates caused the biggest collapse of financial institutions since the Great Depression, as more than a thousand thrifts with assets over $500 billion failed. Given this record, it is useful to examine the relationships among the Reagan tax cuts, monetary policy, and the worst recession in postwar history.

Obsessed with inflation, the Fed's Open Market Committee interpreted the data to confirm its preference for stringency. In July 1981 Fed governor Fred Schultz, anticipating the huge Reagan fiscal stimulus, told his colleagues, "It is vital that we have a continued policy of monetary

restraint." And, "We have another tax cut coming on October 1 and we have continued heavy defense spending, [both of] which I think are likely to prove to be a support underneath the economy if it should get much weaker than I would anticipate."[16] Henry Wallich went further. He thought there was a "danger of a great boom as these tax cuts take hold later in '82."[17] The more moderate Lyle Gramley agreed: "We have an enormous amount of fiscal stimulus coming along in the latter half of next year."[18] By 1982 such talk ended. Some Fed governors blamed themselves for the recession. Gramley said, "I think the state of the economy is principally the consequence of monetary restraint—principally our responsibility, not that of anybody else."[19] Nancy Teeters, the one governor who had questioned the new policy from the beginning, said in May that "it seems to me utter foolishness to have 9.4 percent unemployment and a 15 percent federal funds rate.… I've had it with the monetary experiment."[20] The Fed did not act immediately. But in July it cut the discount rate and increased the money supply. The governors were moved by the many bank failures and the debt crisis in Mexico, whose economy had been wrecked by the high interest rates the Fed had initiated. Because most of the Mexican loans were held by big U.S. banks, the crisis threatened to bring down the system. The Fed, the Treasury, and the IMF arranged a huge bailout. And, quietly, the Fed abandoned its monetarism.

Monetary policy might have been less stringent, and therefore the recession less severe, had Reagan's fiscal policy been more restrained. The rate of inflation would have fallen more slowly, but with less cost to individuals and businesses. Moreover, the declining inflation rate, from 10.3 percent at the beginning of 1981 to 3.2 percent at the beginning of 1983, was also produced by moderating food prices, the sharp deceleration of oil prices (from $70 a barrel in 1981 to $29 in 1983 and $20 in 1986), and the huge appreciation of the dollar from 1980 to 1985. There was no relationship between the supply of money and inflation, contrary to the monetarists and the Fed. Economist Benjamin Friedman concluded that "the double-digit average [monetary] growth rate

maintained for five years following mid-1982 represents the most rapid sustained money growth the United States has experienced since World War II, yet these same years also saw the strongest sustained deceleration of prices in the postwar period."[21] Robert Lucas's rational expectations school did not do better than the monetarists. Lucas had predicted that the negative effects of controlling inflation—unemployment, diminished output and income, and lower profits—could be avoided if the Fed publicly announced money growth targets. Both schools believed that the anchor of monetary certainty would produce results that were superior to the more activist "fine-tuning." The 1982 recession demolished that argument.

The old nostrums recession and unemployment explained the falling inflation rate. Volcker let the cat out of the bag when he said that "the most important single action of the administration in helping the anti-inflation fight was defeating the air traffic controllers' strike."[22] In August 1981, thirteen thousand members of the Professional Air Traffic Controllers Organization (PATCO) walked off their jobs. Reagan then fired them, and they were replaced by managers and air controllers from the military. The president's act stiffened corporate resistance to workers' demands. There were fewer strikes in 1982 than in any postwar year. When Greyhound and Eastern Airlines workers walked off the job in 1982, the companies defeated the unions with "replacement" workers, which big companies had not used in the past because it was considered bad public relations. No more. Political morality had changed, and private sector unionization plummeted from 20 percent in 1980 to 12.1 percent in 1990. No longer were consensual agreements between workers and employers necessary.

The Fed's high interest rates, producing recession and unemployment, completed the job of driving down labor costs. Wage packages shrunk as workers scurried to protect jobs. In January 1983 twenty thousand people lined up to apply for two hundred jobs in an auto-frame factory in Milwaukee. And, unlike past practice, the government did not offer a jobs program. Everybody knew that you could get rid of inflation by

producing a steep recession. What was different after 1979 was that the people in power were willing to accept the costs. Still, in 1982 Reagan's approval rating fell to 35 percent, and less than 20 percent thought that the economy was improving.

WHAT REAGAN WROUGHT: CONSUMPTION, HIGH DOLLAR, AND TRADE DEFICITS

The economy grew briskly after 1982. GDP rose from its — 2.2 percent rate in 1982 to 4.5 in 1983 and 7.2 percent in 1984, and averaged between 3 and 4 percent for the rest of the decade. What kind of a recovery was this? Reagan stated that the tax cuts would increase savings and thus investment to improve productivity and growth. But the recovery was led by consumption, not investment, and radically altered the composition of the economy, promoting nontradable sectors like real estate, financial services, and defense and hobbling tradable manufacturing and agriculture.

Business investment was anemic, contrary to supply-side theory. In February 1982 Fed governor Partee observed that "none of the alleged effects of cuts in tax rates is working in terms of stimulating savings. So, therefore, consumption remains high relative to after-tax income."[23] The trend continued. Every form of saving—personal, business, and public—fell during the 1980s.[24] Investment did not rise. During the 1970s investment was 18.6 percent of GDP; in the 1980s it was 17.4 percent.[25] Spending for plant and equipment fell from 12.1 percent of GDP in 1981 to 10.3 in 1986. From 1986 to 1989 it averaged about 10 percent, compared with 11.6 during the Carter years. Continuing the lackluster trends of the 1970s, productivity rose only 0.8 percent.[26]

The tax cuts produced budget deficits, which rose from 2.6 percent of GDP in 1981 to 5.4 percent in 1985. Reagan countered that revenues had increased—true, but only if one included the proceeds from social security taxes, which were raised in 1983. Tax-generated revenues fell and total expenditures rose, which produced the deficit. As Reagan promised, domestic expenditures, especially outlays to the poor, fell. Housing subsidies for low-income families had been $84.7 billion in 1979; they fell to $26 billion in 1984.[27] Defense spending rose. Carter's

last budget allocated 5.4 percent of GDP for defense; in 1986 it peaked at 6.2 percent.[28]

Martin Feldstein, chair of Reagan's Council of Economic Advisers (CEA), believed that the budget deficits absorbed more than half of net domestic saving, putting upward pressure on real interest rates.[29] Nominal interest rates fell during the decade, but real interest rates, factoring in the decline of inflation, remained historically high. Interest rates averaged 0.5 percent from 1960 to 1980, but 4.9 percent in the 1980s.[30] They would have been even higher but for foreign investment.[31] The high interest rates of 1981 and 1982 were produced by Federal Reserve stinginess; those after 1982, when the Fed expanded the money supply, were produced by the federal budget deficits. High interest rates attracted funds from abroad. To facilitate overseas borrowing, Treasury officials made it easy and profitable for foreigners to buy U.S. securities. Had the capital controls of the postwar world been in place, Reagan's fiscal expansion and the Fed's tight money would have canceled each other out and the recovery would have been stillborn. But in the new world of capital mobility, expansive fiscal policy was financed by foreign borrowing.[32]

The high interest rates yielded a high dollar, which priced U.S. manufacturing out of world markets. Instead of fingering the dollar, pundits questioned U.S. industry's ability to compete with foreign companies. But unlike the government and the service sectors, productivity in manufacturing increased over 5 percent in 1984 and 19 85.[33] The expensive dollar aborted an industrial renaissance. The dollar's overall value rose 63 percent from 1980 to March 1985[34]—the equivalent of taxing U.S. exports by 63 percent and providing U.S. imports with an equivalent subsidy. Non-oil imports rose from 5.9 percent of GDP in 1979 to 7.5 percent in 1986. On the other hand, exports fell from 9 percent of GDP in 1979 to 7.2 percent in 1986.[35] Capacity utilization actually declined in the recoveries of 1985 and 1986.

The government did not seek to destroy industry, but officials preferred to focus on the positive side of the situation. Feldstein argued

that the rise in the dollar was a safety valve that reduced pressure on domestic interest rates.[36] Treasury Secretary Donald T. Regan and Reagan celebrated the strong dollar, citing beneficial effects on U.S. inflation and foreign confidence in the American economy.[37] Only in 1985 did the new secretary of the treasury, James Baker, convince his colleagues that the expensive dollar was not a sign of strength and, with Paul Volcker, negotiated a gradual decline with American trading partners. Between the first quarter of 1985 and the first quarter of 1987, the value of the dollar fell 36 percent.[38] Many economists believed that the cheaper dollar would bring back manufacturing. But the real world did not behave according to mathematical equations. The merchandise trade balance barely paused in its ascent from $31 billion to $138 billion between 1980 and 1988.

It was not only the expensive dollar that injured manufacturing. Tax legislation in 1986 played its part.[39] Initiated by Democrats Senator Bill Bradley and Congressman Richard Gephardt, the bill, a modified flat tax, eliminated various loopholes benefiting the rich in return for reducing the top marginal rate to 29 percent and eliminating the special treatment of capital gains income. Reagan's chief of staff, James Baker, feared that candidate Walter Mondale would use tax reform in the 1984 election.[40] (He did not.) The Treasury Department began working on a tax reform, completed after the election. Revenue-neutral, the law reduced the highest marginal rate from 50 to 28 percent, and more than four million people were completely exempted. The top corporate rate was reduced from 46 to 34 percent. The bill made up for this revenue loss by raising the capital gains tax from 20 to 28 percent, lengthening depreciation lives, eliminating the investment tax credit, and ending or reducing tax breaks for particular industries.

The law both completed and clarified the Reagan program. Its essence was to get rid of "tax code socialism," the targeted provisions which gave benefits in return for a government-determined objective.[41] Secretary Regan believed that the bill, by eliminating such items as the investment tax credit, would reverse past taxation policy, which "favored

manufacturing over services." A reporter from *Fortune* believed that the bill was "pro-consumption and anti-capital investment, one destined to accelerate the nation's already powerful shift from a manufacturing to a service economy."[42] The law demonstrated the intellectual confusion of the Democrats. On the one hand, they argued that the bill took many poor people off the tax roles, removed shelters for the rich, and thereby raised corporate taxes. But by accepting the notion of broad rate reduction, with its supply-side rationale, and renouncing the notion of targeting and encouraging specific investment, Democrats yielded many of the tools they had once used to shape the economy in the interests of their constituencies.

DEMOCRATIC RESPONSE

Democratic disarray was conspicuous. Many Democrats were intimidated by Reagan's victory or half-agreed with his program. These "new realists" derided AFL-CIO head Lane Kirkland's critique of the Reagan tax plan, delivered before the House Budget Committee in 1981. Kirkland testified not simply for the AFL-CIO but for the NAACP and for women's, environmental, and senior citizens' groups. He said, "Tax cuts loaded on the side of the rich ignore the evidence of history that such cuts do not produce the type of investment society needs most and do not trickle surely down to enhance the general welfare." Representative Leon E. Panetta, a California Democrat, replied: "We came through a November election in which the issue of growth in government, tax burden, and deficits were major issues. I think it is generally accepted that President Reagan won the victory he did largely based on the frustrations of the people with a lot of what government has been doing over the years. Your proposals generally endorse doing more of the same." Democratic chair James R. Jones of Oklahoma added, "I am troubled by the overall context of your testimony. It is basically 180 degrees from what others have recommended to this committee."[43] Kirkland had not been arguing for a replay of the 1960S and 1970s. He understood that the world had changed and the Keynesian techniques required revision. He had pushed Carter to announce an industrial policy in 1980 precisely because he knew that 1960s demand management was inadequate. But he did not believe that giving money to the rich would solve America's problems.

Democratic contenders for the party's nomination in 1984 also corseted the choices. Senator John Glenn of Ohio asked rival Walter Mondale, "Will we offer a party that derides the Reagan policies of the nineteen-twenties and promises to replace them with the programs of the nineteen-sixties? If that's the alternative we offer, I tell you we will meet the same fate in 1984 that we met in 1980."[44] Senator Gary Hart of Colorado told steel-workers in Youngstown, Ohio, "The Carter-Mondale

administration had four years to put this industry back on its feet and it didn't do so."[45] Hart was disingenuous. He was right about Carter's failings and wanted to marry Mondale to them. But Hart represented the wing of the party that opposed an industrial policy for steel, believing that the future lay in new, postindustrial sectors. These so-called Atari Democrats, named for a video game manufacturer, championed free markets and high tech to create jobs and prosperity.

Democratic elites attacked Reagan's budget deficits. They voiced the opinions of economists and affluent Democrats, those uninjured by Reagan's policies. Mondale had been with these "new realists" until the recession of 1982 convinced him to return to New Deal politics. Still, he embraced deficit reduction with tax increases. Although he was caricatured as the captive of the constituencies, Mondale had not consulted with Lane Kirkland or civil rights leaders or feminists. He took the advice of a small group of white male advisers including Wall Street fundraisers Robert Rubin and Robert Altman.[46] Deficit reduction neither attracted Democrats nor effectively assailed his opponent.

Without a critique of Reaganomics, identity politics took over. Jesse Jackson was the first serious black candidate for the presidency.[47] Mixing symbolism, substance, and demagoguery, Jackson understood that his white male opponents would treat him gingerly, fearing that an attack could alienate black voters. Once Mondale had the votes to secure the nomination, Jackson refused to endorse him, claiming that he had not gotten his due or, as he put it, respect.[48] In similar fashion, Democratic women urged Mondale to choose a woman as his running mate. Attending the convention of the National Organization for Women (NOW), he was greeted with chants of "Run with a woman, win with a woman." NOW was not threatening to stay home if a woman was not chosen, but it promised a floor fight "if necessary." Mondale was annoyed, but as the lead that Reagan enjoyed lengthened to 14 percent, he concluded that choosing a woman might save him by shaking up the dynamics of the election. But if a woman was considered, why not a minority? As the process developed, the only genuine candidates were minorities and

women. Senator Lloyd Bentsen of Texas was thrown in as the token white male, but he was so conservative that he was really not in contention, even before he withdrew.

Mondale chose Geraldine Ferraro, an Italian-American, three-term congresswoman from Queens, New York. He continued to spar with Jackson, but his main problem was that he lacked an argument for his candidacy. In addition there was the South, which was not attracted to two northern liberals. Mondale wanted to fix this southern problem by appointing President Carter's friend and budget director Bert Lance to head the Democratic National Committee but retreated before a storm of opposition. The notion of naming a southern banker damaged by scandal and identified with an unpopular president demonstrated Mondale's tin ear. It was another instance of the Democratic attempt to attract white southern voters with symbols, not policies.

Many whites had left the Democratic Party in the South, but those who remained had characteristics similar to Democratic whites in the rest of the nation: older, Catholic, union member, blue collar, working class, less educated, and less affluent.[49] During the 1970s, southern Democrats learned to represent biracial constituencies. The addition of black voters and the departure of more affluent whites made white Democrats more liberal than their predecessors on economic matters. Carter was weakest and Reagan the strongest in the white suburbs and other affluent communities.[50] The South was still in play during the 1970s. But national Democratic leaders did not stress biracial, class issues. Carter's victory in 1976 combined the whites and blacks of the South, but separately. And this continued in 1980. A Democratic field commander in Texas said, "We did what we were supposed to do in getting out the black and brown voters."[51] But you could not win in the South with only black and brown voters. The party did little to attract working-class whites in the South or, as it turned out, in the North.

In 1984 Reagan again defeated Carter-Mondale. Winning 58.8 percent of the vote and losing only Mondale's home state of Minnesota and the District of Columbia, Reagan was rewarded for low inflation (3.5

percent), declining unemployment (7.2 percent, down from 9.6 percent), and economic growth (7.2 percent). Once again the voters did not reject the welfare state. In September 60 percent had preferred Mondale's ideas about helping the needy; only 25 percent preferred Reagan's. But whatever their ideas about the poor, they believed that Republicans could better manage the economy.[52] The post-New Deal consensus that Democrats produced prosperity had ended. Mondale was a wooden campaigner who oscillated between the "new realism" and "compassion." But as Bill Clinton realized eight years later, it *was* the economy, stupid. As the improved economic state of the nation took center stage, Mondale was easily tarred with Carter's performance.

Democrats had better opportunities in 1988. Although the macro numbers on inflation, economic growth, and unemployment continued to be good during Reagan's second term, the wrenching effects of deindustrialization produced an edgy electorate, which returned the Senate to the Democrats in 1986. Big cities and their industrial suburbs were ravaged by job loss and a crack cocaine epidemic. There was a consensus that crumbling infrastructure, poor education, and inadequate child care needed to be addressed. Yet there was no sense of crisis or urgency to solve the problems, certainly if it meant increasing taxes. The Democrats divided on the question of whether the new black poverty was rooted in discrimination or culture. Both sides ignored the role of the decline of manufacturing in the production of poverty, black or white. Indeed, the party was weighted by the postindustrial wing, which welcomed the decline of manufacture and looked forward to what some called "the information age."

The anxieties of the land propelled Democratic nominee Governor Michael Dukakis of Massachusetts to a 17 percent lead in the polls over Vice President George H. W. Bush in July. Dukakis bested a host of Democrats, led by former Colorado senator Gary Hart. But Hart self-destructed after the press discovered his relationship with a young model. Although Richard Gephardt, with labor union support, won Iowa, a strong attack by Dukakis accusing him of flip-flopping did him in. Gephardt had

been moving to the left since the early 1980s and his record was easily caricatured by opponents. He was the only defender of labor and manufacturing. Jesse Jackson, running again, did well in Iowa and New Hampshire and then swept the "Super Tuesday" primaries in early March. Set up to give the mostly southern, more conservative states a chance to influence the nominee, it instead allowed Jackson to gather up the large African American vote. He then won Michigan, shocking the party establishment, which now united behind Dukakis.

Dukakis was a high-achieving second generation Greek-American who tried to parlay the rise of high-tech Massachusetts out of the ashes of the Reagan recession into victory. Dukakis had the good government instincts of early twentieth century progressives, marinated in a soup of self-regard fostered by degrees from Swarthmore and Harvard Law School. Instead of gathering the ills of the Reagan reconstruction, Dukakis ran on ability and brains. "This election is about competence, not ideology," he said in his speech to accept the nomination.

The Republican candidate, Vice President George H. W. Bush, inherited the Reagan legacy. Bush allayed GOP conservatives' doubts by admonishing them to "read my lips," which avowed "no new taxes." Although Bush would later regret these six words, for the moment the pledge halved Dukakis's lead. And, then there was the Bush campaign. Lee Atwater, a southern politico, and Roger Ailes, a media consultant, were the pit bulls of GOP campaigning. They would do and say things that the more genteel Bush would not. Nevertheless, Bush okayed each assault on Dukakis. The governor was accused of being a "card-carrying member" of the American Civil Liberties Union. He was pilloried for vetoing a bill passed by the Massachusetts state legislature that would have required teachers to lead their class in the Pledge of Allegiance. Bush asked, "What is it about the Pledge of Allegiance that upsets him so?"[53] Having co-opted the flag, Bush picked the scabs of white fear of black crime. Willie Horton, a convicted murderer on furlough from a Massachusetts prison in 1987, traveled to Maryland and broke into a home, pistol-whipped and cut the owner, and raped his fiancée. Horton

became a symbol of alleged Democratic tolerance of criminals. Dukakis was too arrogant to respond to the charge, seemingly unable to believe that such demagoguery could be successful. When the governor had a chance to humanize his high-minded liberalism, he failed. At a presidential debate on October 13 in Los Angeles, moderator Bernard Shaw of CNN asked: “Governor, if Kitty [his wife] Dukakis were raped and murdered, would you favor an irrevocable death penalty for the murderer?” His answer, a cogent explanation about why capital punishment did not deter violent crime, was not the problem. But he responded in a matter-of-fact tone, lacking passion, outrage, or feeling. However smart he was, this detachment doomed his candidacy.

Bush won 54 percent of the popular votes and 426 electorate votes to Dukakis’s 112. The turnout was the lowest since 1924, and Bush received 5.4 million fewer votes than Reagan had in 1984. Only 10 percent of the voters thought that the candidates addressed their concerns, and two-thirds would have preferred the choice of two different candidates. But for the first time in twenty-eight years, the Democrats gained seats in both houses of Congress despite losing the presidency. Their margin in the Senate was 55 to 45, and in the House in was 262 to 173. Reagan had not effected a Republican realignment.[54] The congressional races even demonstrated voter preference for shifting resources from defense to domestic social programs.[55]

FALTERING RECOVERY

During the Bush years foreign policy successes initially overwhelmed a faltering economy. The fall of the Berlin Wall in 1989, the rapid ending of the Cold War, and the disintegration of the Soviet Union in 1991 satisfied. The first Gulf war, repelling Saddam Hussein's annexation of Kuwait in 1991, demonstrated that high-tech American weapons were potent, but the glow of victory dimmed quickly. A desert triumph could not compete with industrial decline, Japanese competition, rising unemployment, and growing inequality. Between 1973 and 1990, GDP grew 1.06, compared with 2.45 from 1950 to 1973.[56] The rapid gains after the 1982 recession did not continue and savings, investment, and productivity stagnated. Deregulation spawned the savings and loan crisis, not entrepreneurship.

Balanced budgets now replaced tax cuts as the latest elixir, promising low interest rates and high investment. From 1980 to 1989, the budget deficit averaged 3.9 percent of GDP. During the 1970s the deficit was 2.1 percent, and in the 1960s it was 0.8 percent. In 1985 Congress passed the Gramm-Rudman-Hollings Balanced Budget Act, which required incremental steps toward a balanced budget for 1993. The act helped reduce the deficit, which fell from 4.8 percent of GDP in 1985 to 2.8 percent in 1989. But George Bush's pledge of no new taxes made it impossible to achieve the mandatory reduction for the next year's budget, so eventually he yielded. A deal was struck with Democrats, producing a package of $500 billion in deficit reduction measures including spending cuts and $150 billion in tax increases, which affected fewer than 10 percent of all taxpayers. Bush's move angered GOP conservatives, including the three-quarters of the House Republicans who voted against the package, which passed in October 1990.

Though not related to the military action, a recession arrived the same time that Saddam Hussein invaded Kuwait in August 1990. Reagan's 1982 recession was mainly a blue-collar affair, but this one included supervisors as well as workers. Layoffs hit white-collar suburbia, as large

corporations fired middle managers. In June 1991 unemployment reached 7.8 percent. Nevertheless Bush, reflecting the Reagan ideology on labor, vetoed more benefits for the unemployed, claiming that the budget deficit precluded the expenditures. He tried to keep the recession on the back burner. Not until December 1991 did the White House officially acknowledge the economic woes. Even when Bush faced challenger Patrick Buchanan in the 1992 New Hampshire presidential primary, he imagined that he was assaulted by the moralists of the GOP—those opposed to abortion, gun control, gay rights, etc. But Buchanan, who moved easily between social and economic issues, was onto something. The president won only those voters who felt they were better off in 1992 than they four years ago; those who believed they were about the same split between the two, but those whose problems were greater than in 1988 chose Buchanan by a margin of 57 to 39 percent.[57] Buchanan ended up with 38 percent of the votes. Even after New Hampshire, Bush continued to overestimate the social issues and appeased the cultural right wing of his party. At the Republican convention Bush allowed Buchanan, who switched from his economic critique of Bush to a social attack on the Democrats, to declare that America confronted "a cultural war, as critical to the kind of nation we will one day be as was the Cold War itself."

Democrats, too, were slow to pick up the economic issues. After Mondale's defeat in 1984, southern and moderate Democrats created the Democratic Leadership Council (DLC) to distance the party from the constituency groups—civil rights, labor, feminist, peace, etc.—that they blamed for Democratic debacles. Founder Al From, who had worked on Capitol Hill and in the Carter administration, believed that these groups preferred their own causes to the cause of Democratic victory. There was a small truth to this critique, but From and the New Democrats aimed for more substantive changes. After Dukakis's loss they created a think tank, the Progressive Policy Institute (PPI), to promote their ideas. PPI embraced "free markets, free trade, and fiscal discipline."[58] It was closer to business than to labor. It supported cuts in spending, not tax increases

to reduce the deficit. Government policy would aim for economic opportunity, not security. Markets, not the state, would solve problems. Economic incentives, not mandates, would clean the environment and provide health care. Vouchers would improve the schools, law and order would reform the criminals, and two-parent households would elevate children. PPI believed that Democrats would not win until Americans no longer viewed the party as anti-family, anti-American, and anti-religion.

In 1992 the DLC's candidate was Governor Bill Clinton of Arkansas. Born in Hope, Arkansas, in 1946, Clinton attended Georgetown University, then Oxford, and finished up at Yale Law School. Clinton returned to Arkansas as a professor in the state's law school. In 1976 he ran unopposed for attorney general and then was elected governor in 1978. The only election he ever lost was his bid to win reelection in 1980 after he had supported an unpopular tax. Bringing in consultant Dick Morris, Clinton recalibrated and was reelected in 1982. To enhance his national profile, he became chair of the National Governor's Association in 1986–87. He was a leading member of the DLC and served as its head in 1990 and 1991.

Figuring out the true beliefs of Bill Clinton is not easy. In the words of historian William C. Berman, Clinton was "ideologically ambidextrous."[59] He entered national politics when the DLC was ascendant, and he hitched his wagon to its star. When he threw his hat into the presidential ring on October 31, 1991, he promised to transcend partisan division and establish a new balance between rights and responsibilities, government and individual effort. That translated into tough crime policies, welfare reform, a tax cut for the middle class, and vaguer measures to spur economic growth. Clinton was fortunate that better-known politicians—such as senators Al Gore of Tennessee and Bill Bradley of New Jersey, House majority leader Richard Gephardt of Missouri, Jesse Jackson, and New York governor Mario Cuomo—chose to forgo a race against Bush, still basking in the glow of the successful Gulf war. Clinton did have competitors. Senator Bob Kerry of Nebraska promised national health insurance, Governor Paul Tsongas of

Massachusetts pledged deficit reduction, and perennial candidate Jerry Brown offered a succotash of campaign finance reform, a flat tax, and new technology.

Clinton was a strong second in the New Hampshire primary, despite revelations that he had a twelve-year affair with Gennifer Flowers and had acquired a national reserve slot to avoid the Vietnam draft. On Super Tuesday, March 10, Clinton swept the South. Still, many Democrats, even those who voted for him, had doubts about his integrity and electability. These reservations increased after the entry of computer services billionaire Ross Perot, running on a new Independent Party ticket. Perot tapped into the economic discontent. He cried, "We are no longer the No. 1 economic superpower in the world." By May 1992 he was the choice of 34 percent of those polled, with Bush and Clinton at 30 percent each. In Oregon Clinton beat Jerry Brown, but exit polls showed that Democratic voters preferred Perot to Clinton by 57 to 43 percent. Republicans liked Perot, too; 15 percent of Oregon's Republican voters wrote in his name in the primary. Yet Perot was temperamental and authoritarian. In June he patronized a convention of the NAACP. A few days later, his campaign manager, Republican Ed Rollins, quit, and a month later the candidate himself bowed out.[60]

With Perot out of the race, Clinton repaired his image. He shrewdly declared, "It's the economy, stupid," which was exactly what was on voters' minds. Even when the mercurial Perot returned to the race on October 1, this time touting a balanced budget, Clinton maintained his own. Clinton won 370 of the 538 electoral votes, amassing majorities in states all over the country. Although he won with only 43 percent of the popular vote, Clinton exceeded Bush by more than 5 percent and did better than Nixon in 1968 when George Wallace likewise made it a three-way race. Perot captured 19 percent of the vote.[61] Unlike the Wallace vote of 1968 or even the Anderson vote of 1980, Perot voters lacked demographic uniqueness. They were Republicans and Democrats, but most had shallow political roots. They were dissatisfied with politics and distrustful of politicians.

DEMOCRATS IN GLOBALIZING AMERICA

Despite Clinton's economy-focused campaign theme, his specifics were vague.[62] Clinton had constructed his ideas in the 1980s, when the economy was growing and many Democrats believed that their party needed to accommodate Reaganomics. The party's main criticism of Reagan's doctoring, the budget deficit, offered no solution to the recession of 1990–91. The downturn was the last act of the high interest rates in the early 1980s, the tax reductions of 1981, and the financial deregulation that began in the Carter years. After the savings and loan bailout and partial reregulation, bank lending policies were cautious, too cautious.[63] Investment plummeted for a year, beginning in the third quarter of 1990.[64] Fighting the last war, one Fed staffer remarked, "We can't go out and create a recession to control inflation, but we can try to take advantage of any little recessions that happen to come our way."[65] So even though inflation was negligible, the Fed was slow to reduce interest rates.

When the economy began growing at the end of 1991, it was a "jobless recovery." Unemployment was 7.3 percent when Clinton took office in January 1993, and the first quarter registered growth of only 0.5 percent. The numbers were pulled and pushed by tumultuous global challenges: the United States was now the world's largest debtor, it suffered an enduring trade deficit, and it faced competition from Japan and a cohesive European Community. Russia, China, and Eastern Europe were now part of the global economy. As governor of Arkansas, Clinton had no need to reflect on these developments. His campaign slogan "Putting People First" and understanding of the global economy were lifted from his Oxford friend Robert Reich's *Work of Nations* (1991).

Reich thought that the changing nature of labor (from production to symbolic manipulation) and the globalization of production meant that ending income inequality and stagnant wages required helping Americans obtain the (high-tech) skills that corporations, whether American or foreign, needed. Globalization was inevitable and progressive, if workers

improved their proficiency. Because it did not matter if Americans worked for domestic or foreign corporations, Reich opposed industrial policies, which he renamed corporate welfare. He supported "free trade" treaties. Focusing on education, which Clinton had championed in Arkansas—and which George Bush promoted, too—reinforced the conventional wisdom. If the uneducated worker was the cause of rising inequality, then public schools and even the worker himself were at fault.

But was Reich's vision of global dynamics accurate? Reich assumed that corporations required better-trained workers for the new technology. Yet economists found that the admired Japanese lean production relied on workers who demonstrated dexterity, enthusiasm, and ability to "fit into the team," but not on high educational and vocational qualifications.[66] Put another way, Caterpillar emerged victorious from the United Auto Workers' long strike in November 1995 because temporary help could replace its striking workers.[67] Training can help individuals. But it is utopian to imagine that education can generate secure, well-paid, and high-skilled jobs. Reich assumed that the growing wage gap between college-and high school-educated workers was the result of the former's skill. But changes in government labor policies, which led to declining minimum wages and union membership, were more responsible for the wages of high school graduates. Structural factors such as the shift from high-paying manufacturing to low-paying service industries—steel to fast-food restaurants—and increased trade competition with low-wage countries explained the growth of wage inequality better than education did. After all, why didn't Europe experience growing income inequality despite its use of technology? Moreover, inequality increased faster from 1977 to 1992, when growth, productivity, and technical change were meager. Finally, after 1989, compensation for CEOs increased 100 percent while that for jobs related to math and computer science rose only 4.8 percent, and engineering fell 1.4 percent.[68]

Robert Kuttner, whose book *The End of Laissez Faire* (1991) was published at the same time as Reich's, found globalization more problematic. Kuttner believed that international markets were not benign

and that the changing exchange rates, new technologies, and global investments destroyed jobs and communities as well as created opportunities for symbolic workers. Unlike Reich, he argued that neither the Europeans nor the Japanese practiced global liberalism. The Japanese conglomerate was and will always be Japanese, which meant that even when forced to produce abroad, it keeps the best jobs at home. America's free-market obsession had allowed massive foreign penetration without a quid pro quo. Jimmy Carter permitted foreign firms to take advantage of its deregulated telecommunications market without equivalent access. The U.S. government intervened often but with a hodgepodge of ineffective measures. Ronald Reagan imposed import quotas for Japanese cars without planning for Detroit's revival. Kuttner embraced an industrial policy to support highwage jobs in the United States. But he also believed that the world economy needed new rules, stronger global institutions to penalize countries that ran chronic trade surpluses, and common standards for international investment. He supported managed trade like the global Multi Fiber agreement for textiles and advocated a similar one for steel.

CLINTON CHOOSES

Not surprisingly, Clinton preferred Reich to Kuttner. Reich's ideas were more in tune with the president and with the party's recent past. Reich and Clinton accepted the results of markets and trade and concentrated on social policy. But without an alternate way of producing economic prosperity, they had no intellectual defense against the deficit hawks who dominated the Democratic Party. The hawks argued that reducing the deficit would lower interest rates and free up capital for investment. They implied that wherever that investment went, it would be good for the United States. Their leader was the soft-spoken Robert Rubin, the former head of the investment bank Goldman, Sachs, who was Clinton's chief economic adviser and then secretary of the treasury. Rubin had advised Mondale and Dukakis to tackle the deficit first and offered the same advice to Clinton. Rubin was no antigovernment ideologue. Unsympathetic to unions, he had a soft spot for the poor. He pioneered the new brand of affluent Democrat—market oriented, but open to compensatory spending for the victims of change. Clinton subsequently wrote that he reluctantly chose to reduce the deficit first, even though it might produce a "short-term slowdown."[69] He might have been reluctant, but he had already appointed deficit hawks to the most important economic positions in the government: Lloyd Bentsen at Treasury, Robert Rubin as head of his new National Economic Council, and Leon Panetta and Alice Rivlin at OMB. The four appointments revealed how dependent the Democratic Party had become on Wall Street-friendly expertise.

Clinton constructed a five-year, $500-billion package of spending cuts and tax increases. (A $16.3-billion stimulus package was defeated in April.) The bill raised the top income tax rate on persons with an annual income of $250,000 to 39.6 percent and added a small gas tax.[70] It cut the military budget $112 billion over five years and trimmed entitlements by $144 billion. The House passed the budget 218–216, without one Republican vote. In the Senate, Vice President Al Gore had to break a 50–50 tie. Clinton was fortunate that budget bills were not subject to

filibuster. The president signed the bill into law on August 10.[71] Between 1992 and 1996, the deficit as a percentage of GDP fell from 4.7 to 1.4 percent.[72]

Deficit reduction failed to impress Fed chief Alan Greenspan. In 1994 another idea of the 1980s kicked in. GDP rose from 2.7 to 4 percent, bringing unemployment down from 6.9 to 6.1 percent during 1993.[73] Economists believed that you had to slay inflation before you could see it. Because it took six months to a year for monetary changes to work, early action was imperative. This is true, but another assumption—that high inflation damaged long term growth—was not. Only nations that had rates much higher than the United States ever experienced were injured. Another misleading idea was that inflation quickly became uncontrollable.[74] At the beginning of 1994, even though inflation had fallen from 3 to 2.6 percent during 1993, the Fed raised interest rates because it believed that an unemployment rate below 6.2 percent would set off inflation. And it was necessary to nip it in the bud, as the theory prescribed. If it was right, the U.S. growth rate could not rise above 2.5 percent.

The Fed began raising interest rates in early 1994 when unemployment was 6.1 percent. By February 1995 the funds rate was at 6 percent—double where it had been less than a year earlier.[75] The increases reduced economic growth to about 1 percent in the first half of 1995. Still, unemployment fell to 5.5 percent without higher inflation. But 5.5 percent was not enough to tighten the labor market to permit wage increases. Between 1990 and 1996 the growth of real compensation was less than zero.[76]

The sluggish economy and stagnant wages did not help Clinton in 1994 and 1995. Most Americans did not believe that the economy was better, despite improving numbers. Between 1978 and 1995, the top one hundred U.S. companies fired 22 percent of their workers.[77] Further, announcements of layoffs still filled the airwaves. Clinton lacked popular credibility because he had spent his first two years enacting a Wall Street agenda. His deficit plan was followed by signing the Bush-initiated North

American Free Trade Agreement (NAFTA) between Canada, the United States, and Mexico, over the objections of most of the Democratic Party. The NAFTA was misnamed and had little to do with free trade. The key provisions made foreign investments in Mexico more secure, precluding expropriation of property and restrictions on repatriation of profits, and extending U.S. patent and copyright protections. The pact hit employment in the textile and apparel industries especially hard. Of the job losses in the U.S. textile industry between 1941 and 2002, 36 percent occurred after NAFTA was passed.[78] Then, in April 1994, the Uruguay Round trade talks ended, which opened up trade in banking and insurance and created the World Trade Organization. Clinton's deficit reduction and free trade, and the Fed's inflation-fighting, fulfilled the agenda of international business.

When it came to measures that the base of his party wanted, Clinton faltered. He failed to obtain an economic stimulus, and then his health care plan imploded. Clinton had made the NAFTA a priority over health care, and this allowed the Republican opposition to mushroom, just as the privileging of Carter's Panama Canal treaty allowed opposition to labor reform to grow in 1978. And then there was the plan itself. Clinton offered a New Democrat proposal that emphasized, through HMOs, the centrality of market forces. Desperate to avoid the "tax and spend" label, Clinton played down the costs of insuring everyone and created a byzantine mechanism to control expenditures without raising taxes. Initially, Clinton's plan was backed by insurance companies, industrial corporations with high employee costs, hospitals, and physicians. But at the first sign of opposition from those who would bear greater costs, face higher risks, or have their freedom constrained, Clinton's business allies abandoned ship. Republicans used the filibuster to prevent any bill from passing in order to deny the Democrats the political dividend that would come from passing comprehensive health insurance.

Scandal continued to keep Clinton on the defensive. Paula Jones, an Arkansas state employee, announced on February 11, 1994, that Clinton had propositioned her and exposed himself in a hotel room in Little Rock

in May 1991. In July Congress began hearings on allegations that the Clintons had illegally profited from investments in a real estate deal. An independent counsel—Kenneth Starr, who had been advising Paula Jones on her sexual harassment suit against the president—was later appointed to investigate the charges. Public humiliations added to the private ones. American soldiers, part of a UN plan to restore democracy in Haiti, had to retreat in the face of pro-military gunmen. In another part of the world, eighteen American soldiers were killed on a UN peacekeeping mission in Somalia begun by President Bush. Clinton's poll ratings plummeted to 40 percent in the late summer of 1994.

Lacking achievements that could mobilize Democrats, Clinton had little ammunition to fight a new offensive led by Republican House minority leader Newt Gingrich, who represented a suburb of Atlanta, Georgia. Nationalizing the congressional elections, his "Contract with America" demonized Clinton and pledged to end the "scandal and disgrace" of the Democratic Congress. The contract promised a balanced budget amendment, super majorities for tax increases, capital gains and other tax reductions, and term limits. Gingrich had maneuvered his way up the GOP House leadership in hopes of achieving his goal of becoming speaker. To get there he would have to sharpen and simplify the party's message. Most House Republicans, a perpetual minority, compromised to gain influence, but Gingrich used confrontational tactics to overthrow the Democratic majority. In 1989 he had forced the resignation of Democratic House Speaker Jim Wright by showing that Wright used the sales of a book he wrote to evade the House's limit on speaker's fees. Gingrich ousted House Republican leader Robert Michael, too.

Although a Gallup poll found that only 34 percent of the electorate had heard of Gingrich's contract, 52 percent of those earning more than $50,000 a year knew about it. Of these affluent voters 68 percent supported the contract while 16 percent opposed it. Only 18 percent of those earning less than $20,000 had heard of the contract. These numbers correlated with the growing disapproval of Bill Clinton among affluent voters during 1994, which turned the midterm elections. The percentage voting Democratic among the bottom third of whites declined 6 percent,

among middle-income whites the number was 13 percent, and among the top third it was 15 percent.[79] For the first time since 1952, the Republican Party, picking up fifty-four seats, now controlled the House, 230–204. The GOP also won control of the Senate with a 52–48 majority, which later became 54–46 after two Democrats switched to the GOP. The anti-Clinton tide ran everywhere, mowing down powerful and popular Democratic officials, including Governor Ann Richards of Texas, Governor Mario Cuomo of New York, Speaker Tom Foley, and Ways and Means chair Dan Rostenkowski.

The Republican victory fortified Clinton's New Democratic tendencies. Guru Dick Morris, who had saved Clinton in Arkansas, told him that he must co-opt GOP programs on welfare, crime, and the balanced budget. Clinton signed a welfare reform bill in July 1996, despite his widely shared judgment that the bill had serious defects. States were required to get recipients into jobs within two years and could set lifetime maximum benefits of less than five years. The bill assumed that jobs would be available for recipients to earn enough to support families. Morris told him that he would lose in November if he vetoed the bill.[80] Passed in the spring of 1996, the law ended the sixty-year-old New Deal principle that the federal government would support impoverished mothers as a last resort.

Whatever the role of Morris on wedge issues like welfare, Clinton needed no tutoring in economics. Deregulation had been embraced by New Democrats, who believed that outmoded or intrusive rules were inefficient, impeding productivity and growth.[81] In 1996 it was the telecommunications industry's turn. The existing law, passed in 1934, had been designed for a binary world of long distance and local telephone service. The new world of the Internet, direct broadcast, satellite TV, and cell phones required new rules or, as some argued, no rules. Long distance phone service had been opened to competition in the 1980S. Local service was regulated because it was still a monopoly. The 1996 law allowed companies to provide both long distance and local service as long as there was adequate local competition. But the companies also

knew that initially there would be no competition and that those who got in first could win it all. Representative Edward Markey from Massachusetts put it well: “Companies want the best of both worlds, that is to retain monopolies in their own market places while competing in other areas of telecommunications.”[82]

Mergers helped big companies like Verizon, and new players were able to borrow huge amounts of money to offer broadband service. Companies followed the Microsoft and Intel models—in technology, early advantage may produce a lucrative monopoly. They unleashed a torrent of new investment, believing that they would be able to capitalize first, before competitors were allowed in. From 1992 to 2001, the telecommunications industry provided two-thirds of the new jobs and one-third of new investment in the United States.

The telecommunications investment drove the economy of the late 1990s, and the buoyant economy helped Clinton in 1996. Unemployment fell below 6 percent, and he was getting some credit for the results. The president’s approval rating rose to 50 percent in early 1996. Still, many believed that the Fed’s fear of inflation was keeping unemployment up. The Fed’s vice chair, Alan Blinder, a Princeton professor who wanted to sit in Greenspan’s chair, believed that more growth would not raise inflation. After Clinton decided to reappoint the chairman, Blinder chose to leave.[83]

The professor was not an outlier on the growth issue. Many business leaders believed that there was no danger of inflation. Some Democrats pressed Clinton to appoint another liberal to replace Blinder. Their first choice was New York investment banker Felix Rohatyn, who had challenged Greenspan’s views on growth: “Global competition as well as new technologies has set new parameters on every aspect of the economy,” Rohatyn asserted. “A 3 percent-to-3.5 percent growth rate is not only an achievable national objective; it is an economic and social necessity.”[84] With stature in the financial world, he could have challenged Greenspan. Treasury secretary Robert Rubin, enjoying excellent relations with the Fed chairman, opposed Rohatyn. But it was a

Republican senator, Connie Mack, a member of the banking committee and chair of the Joint Economic Committee, who led the attack, assailing Rohatyn's belief that government, not the market, should determine growth rates. Mack spit back Clinton's state of the union address—the "age of big government was over." He added, "It would be difficult to find a nominee more at odds with Bill Clinton's rhetoric."[85] The president toyed with a twofer—Greenspan and Rohatyn—but chose the more compliant Alice Rivlin for vice chair.

Growth was sufficient for reelection. In 1996 GDP rose 3.7 percent, unemployment fell to just over 5 percent, almost a twenty-year low, and the inflation rate was only 3 percent. Clinton had outfoxed Speaker Gingrich, who thought that two government shutdowns in November 1995 and January 1996 would be blamed on the president. Gingrich had offered a budget that would produce balance by 2002. It eliminated the Department of Commerce and more than one hundred federal programs. It converted Medicaid into a block grant, in essence turning over the health care of the poor to the states. It cut the growth of Medicare. Despite the radical surgery, Gingrich included $227 billion in tax cuts, achieved partly by reducing the Earned Income Tax Credit, thus raising taxes for the working poor. Believing that the accommodating Clinton would yield, the speaker overplayed his hand when the president did not and government shut down. Surprising everyone, Clinton had the public with him. By early January the Republicans capitulated, which ended the Gingrich Revolution. Nevertheless, the GOP forced Clinton to accept a seven-year goal to balance the budget and, by implication, erased the significance of Clinton's own efforts in 1993. Although the public believed that the Republicans had gone too far, the ideology of balanced budgets and tax cuts triumphed.

Clinton was reelected with less than a majority of the votes (49.2 percent) because Perot ran again, gaining only 8 percent this time. The president's victory over Senator Robert Dole of Kansas was decisive, 379 electoral votes to 159. Republican congressional margins were cut but the party still controlled the two houses. Clinton's campaign had emphasized

small, feel-good items—protecting children from sex and violence on TV, and school uniforms. The president's victory was built on the improvement of the economy and the hubris of the Gingrich Republicans but did nothing to dislodge the Reagan ideology of tax cuts, deregulation, and free trade. The only item that Clinton added was the idea of deficit reduction, which the Gingrich Republicans converted to a mandatory balanced budget.

NEW ECONOMY?

The president had accepted Gingrich's goal of a balanced budget in seven years, but he and the speaker sharply disagreed about how to get there. The booming economy and declining health care costs saved the day. The Dow rose from 3400, when Clinton took office, to over 10,000, levitated by the high-flying NASDAQ, the home of Microsoft, Intel, and numerous wannabes. Unemployment fell to 4 percent and the economy was growing at rates above 4 percent a year. For the first time since 1973, productivity and wages began to rise. The budget for fiscal year 1998 revealed a $75-billion surplus. Despite the prosperity, proposals such as universal health care, which seemed fiscally possible, did not return to the political agenda. Instead, in 1997 Congress passed, and the president signed, the largest tax cut since the 1981 Reagan cut. The bill reduced capital gains (from 28 to 20 percent) and estate taxes and offered a $500 per child tax credit to most middle-and lower-income families. Gingrich, now Clinton's pal after the budget fights of 1995, proclaimed that "people want tax cuts. We won the argument."[86] They had.

Supply-side economics was alive. Democratic opposition was meager; Democratic Senator Paul Wellstone cast the only negative vote in the Senate. The financial services industry, riding high, got its capital gains tax cut. It would complete its wish list by obtaining the Financial Services Modernization Act in 1999, which swept aside key provisions of the Glass-Steagall Act of 1933. The new law removed the last firewalls among commercial banks, insurance companies, securities firms, and investment banks. The following year the president signed the Commodity Futures Modernization Act, which exempted many financial products, like credit default swaps, from government regulation. This agenda was propelled by the increasing influence of wealth on public policy. In a study of congressional elections of the late 1990s, scholars found that 81 percent of donors earned more than $100,000 a year and only 5 percent earned less than $50,000.[87]

Clinton could not enjoy the dot.com prosperity. The goodwill between

Clinton and Gingrich did not extend to the right wing Matt Drudge. On January 17, 1998, the Drudge Report Web site reported that, during the 1995 government shutdown, Clinton had had sex with a White House intern. The unknowing intern, Monica Lewinsky, had confided in her Defense Department colleague Linda Tripp, who secretly recorded the words that documented the liaison. Clinton denied the charges and shaded the truth in sworn testimony before a judge in the ongoing Paula Jones case. The Republican-led House impeached him on charges of obstruction of justice and perjury in December 1998. The Senate acquitted him in February, and the six-year Whitewater investigation ended, clearing the Clintons of all criminal wrongdoing on September 20, 2000. But these scandals sucked the oxygen from a domestic agenda.

Still, there is the question of the boom itself. Clinton attributed it to his 1993 deficit reduction package, which he believed had kept interest rates low, making money available for investment. But long-term bond rates had already been falling for four years before the Clinton budget plan, despite the deficits of the Bush years. The ten-year Treasury bond, which had been 8.55 percent in 1990, was down to 5.87 percent in 1993 before Clinton even started. Bond prices declined mostly because of the weak economy and low inflation; the inflation rate in 1993 (2.6 percent) was the lowest since 1966. Interest rates reflect many things: current and expected inflation, the state of the economy, and the willingness of foreigners to buy U.S. stocks and bonds. The economy of the 1980S grew along with the deficit, and there is no evidence that the decline in the deficit produced recovery in the 1990S. Even Robert Rubin, the adviser who pushed heavily for deficit reduction, hedged a bit in his 2003 memoir. He said that deficit reduction affected "business and consumer confidence" more than they did the interest rates.[88] On the other hand, Gingrich and most Republicans claimed that the boom was produced by the tax cuts and deregulation. But the massive Reagan tax cuts did not increase productivity, and the productivity upsurge beginning in 1995 came after both Bush and Clinton raised taxes.

What was unique about the boom of the late 1990S was that

productivity and then wages rose. Productivity had been growing at the tortoise pace of 1.4 percent a year since the mid-1970s; from 1995 to 2000 it grew to 2.5 percent a year, and then 3.1 percent from 2000 to 2005. Increased productivity is the mother's milk of higher living standards. And although wages did not rise proportionately, between 1995 and 2000 hourly wages increased 1.8 percent when they had grown only 0.1 percent from 1989 to 1995 and 0.4 percent from 1979 to 1989.[89] Real median family growth increased 2.2 percent annually. Income for blacks, Hispanics, and single-mother families improved even more.

Employers do not willingly increase workers' wages. It was the tight labor market of those years that compelled employers to share productivity growth. Economic historian Gavin Wright argued that the increased use of information technology (IT), beginning in 1995, required an incentive. That incentive was the mid-decade rising price of labor, partly caused by the Fed's willingness to allow unemployment to fall below 6 percent.[90] Wright showed that retail operators like Wal-Mart had been using IT to calculate inventory and delivery costs for many years, but they employed IT to increase labor productivity only when the price of labor began to rise. Historically, years of rapid productivity growth have also been periods of strong upward pressure on wages.[91] Wright's explanation matches the characteristics of the 1990S upsurge. Nevertheless, the conclusion of the 1990s was that deficit reduction and trade, financial, and technological liberalization were the primary ingredients of prosperity. This ideological stew was promoted at home and also abroad, where it was known as the "Washington Consensus."

CAPITAL REMAKES THE WORLD: U.S. FINANCE VS. U.S. MANUFACTURING

The ending of the Cold War led many Americans to conclude that the nation's economic interests would replace strategic goals at the center of foreign policy. But a nation's interests are never predetermined. Joseph Stiglitz, a member of Clinton's CEA, recalled, "We in the Clinton administration did not have a vision of a new post-Cold War international order, but the business and financial community did: they saw new opportunities for profits."[92] Eastern Europe, Russia, and China needed investment, and China offered a huge, cheap workforce. The president came to believe that extending trade and financial liberalization abroad was in the nation's interests. Whether he adopted the views of advisers like Robert Rubin or came to this conclusion himself, Clinton assumed that markets and democratization went together like love and marriage, and that both would enhance U.S. economic growth.

Clinton did not break new ground. After the debt crisis of the 1980s, developing countries modified restrictions on foreign investment, mainly because they could no longer borrow and so required equity investment from abroad. In 1985 Secretary of the Treasury James Baker added what was called structural adjustment to IMF injunctions. Baker believed that the liquidity problems of debtor countries had structural causes. The solution was to shift to export-led growth, reduce the role of the state, and open up the economy to foreign capital. This was not simply a Washington project. The Europeans and IMF bureaucrats were equally enthusiastic and began encouraging developing countries to liberalize capital as well as trade accounts.[93] The premise was that low savings and weak financial markets hampered development. Access to funds from abroad would boost investment and growth. After the demise of the Soviet Union, leaders of the developed and developing nations were giddy with expectations that free markets, global connections, and new technology could transform the world.

A crisis in Mexico in 1994 should have been the canary in the coal

mine. Clinton oversold the NAFTA, and American banks, especially Robert Rubin's former firm Goldman, Sachs, poured huge amounts of money into the country. When the bubble burst and investors began withdrawing their money, Mexico lacked the cash to redeem the bonds, and the U.S. government came to the rescue with a loan. The lesson was not learned; $240 billion in private capital flowed out of the industrial core nations into the developing ones in 1996. More than 25 percent of the investment went to the fast-growing economies of east Asia.[94] American investors jilted Mexico for Asia.

The U.S. government viewed the Asian tigers (South Korea, Malaysia, Singapore, and Taiwan) as paragons of capital-friendly, export-led growth, in contrast to the dirigiste inefficiencies of Latin American nations. The narrative omitted the subsidies and below-cost pricing to gain foreign markets, protection to build domestic industries, cartels to produce order, and domestic content laws to promote employment. But businessmen are never as ideological as Washington politicians. Investors felt secure because the local currencies were tied to the dollar. But as the dollar rose after 1995, many east Asian exports became uncompetitive and overinvestment at home doubled the trouble. Thailand's baht fell sharply in July 1997. Thai businessmen had borrowed foreign currencies and now had difficulty paying back their loans. Foreign lenders pulled money out by refusing to renew loans. Panic spread to South Korea, Malaysia, the Philippines, and Indonesia. On October 27 the Dow Jones average fell 554 points, 7.2 percent.

Fed chair Alan Greenspan, Secretary of Treasury Robert Rubin, and his deputy secretary, Lawrence Summers, now changed the east Asian narrative. Instead of exemplars of free-market capitalism, the Asian tigers were icons of "crony capitalism." In return for loans, the IMF demanded that nations cut government spending, increase interest rates to lure back private investors, pay back the worthless loans to Western banks, and ease the foreign purchase of domestic companies. But these measures worsened the recession, and Asian economies stagnated into 1998. IMF medicine had been the prescription for "bad" government

decisions in relation to the usual suspects—budget deficits, high tariffs, inflation. But there were no inflationary pressures in east Asia, and the nations had enjoyed low fiscal deficits. The problem was not the government but the private sector—both foreign and domestic. If the states erred, they were sins of omission, mainly the failure to regulate the financial sectors properly. And if, as the IMF argued, corruption, concentration of ownership, and excessive levels of government involvement were the problems, why were China and India insulated from the Asian crisis? Neither country was "transparent," but both had spurned financial market liberalization.

High interest rates, offered to lure back foreign capital, drove highly indebted firms into bankruptcy.[95] Over a million people in Thailand and twenty-one million in Indonesia became impoverished in just a few weeks, as personal savings and assets lost value. Gains in living standards accumulated through several decades of growth melted away in one year. In the late summer of 1998 the crisis spilled over to Russia, which defaulted on its debt on August 17, and then Brazil and elsewhere. Investor panic caused the American and other stock markets to plunge. The U.S. hedge fund Long Term Capital Management, which had invested heavily in Asia, collapsed and required a $4-billion bailout from other Wall Street firms.

Fearing a global meltdown, Clinton urged the major powers to stimulate their economies to restore growth. As was the case in the Carter years, the other powers were not enthusiastic, so the United States acted alone. On October 15 the Fed reduced interest rates and cut twice more in November. Greenspan had earlier told Congress that both the stock market and economy might be expanding too rapidly, but the Fed, like the president, acted to heal the global order, whatever the domestic costs. Vice chair Alice Rivlin said, "The Fed was in a sense acting as the central banker of the world."[96] Just as the Mexican crisis of 1994 was solved by exports to the United States, so would the east Asian crisis be solved the same way. East Asian exports had stagnated partly because Japan was in the economic doldrums and unable to help. Historians Alfred Eckes and

Thomas Zeiler concluded, "In effect, the central bank shifted the burden of adjustment to import-competing U.S. industries. As Asian exports to the United States rose to facilitate debt repayments, more and more U.S. apparel plants closed their doors and moved machinery to Mexico, Pakistan or China, where wages were lower."[97] It was not simply textiles. Cheap steel and technology products flooded the U.S. market.

U.S. demand was the locomotive that allowed Clinton to replay Carter's playbook of 1977, making the U.S. economy the market of last resort. Economic ideology had shifted since the late 1970s. It was the Fed's low interest rates, not the president's fiscal stimulus, that expanded the U.S. market and drew in imports. But the effects were the same. The deficit in goods rose from $198 billion in 1997 to $248 billion in 1998, rising again in 1999 to $347 billion and to $415 billion in 2000.[98] The number of manufacturing jobs peaked in February 1998. Over the next two years, 670,000 jobs (5.2 percent of all jobs in manufacturing) vanished. The Mexican and Asian crises demonstrated conflicting interests between finance and production, but at the end of the day it was agenda of the banks that became U.S. policy.[99]

THINGS FALL APART

Good macroeconomic numbers and the tech boom overwhelmed the trade deficit and manufacturing doldrums. There were other conflicting trends. By the end of the Clinton years, unemployment fell to a twenty-year low. Wages rose, poverty rates fell sharply, but CEO earnings skyrocketed. In 1980 CEOs at large companies earned forty-five times as much as ordinary workers. By 1995 the ratio rose to 160 times as much. In 1997 it reached 305, and by 2000 it rose to 458.[100] The stock market boom was also a stock market bubble. The ratio of price to earnings had traditionally been 14.5. In 2000, the ratio reached 30, as investors imagined that, despite current earnings, each tech corporation was a future Microsoft. Then the overinvestment in telecommunications led to a collapse, which erased $2 trillion in value and threw half a million people out of work in 2002.[101] Global Crossing consumed $12 billion from 1997 until 2002, when it went bankrupt.[102] WorldCom lost even more after it went under shortly afterward. Transgressions became transparent. The corporate scandals—Enron, WorldCom, Global Crossing—broke during George W. Bush's presidency, but they were created during the bull market and deregulation of the Clinton years. The collapse reduced investment and then employment, producing a negative GDP in the first quarter of 2001. The September 11 attacks were hard on the tourist and airline industries, but the economy had already been in a recession for six months.

The ideology and practices of the age of inequality were still alive. President George W. Bush's tax cuts were solutions looking for problems. Candidate Bush originally proposed tax cuts in 1999 to compete with Steve Forbes for the support of the right wing of his party. During the presidential campaign Bush said that the cuts would return the budget surplus back to the people.[103] When a recession arrived at the end of 2000 and the surplus vanished, Bush's rationale was that the cuts were needed to end the recession, despite the fact that most of the cuts were long-term. Only the $300 income tax rebate, a provision put in by

Democrats, was a recession-fighting measure. Nevertheless, the Republican Congress passed a huge ten-year tax cut in early June 2001. Most of the money went to people earning more than $200,000 per year. (The 15.5 percent payroll tax is the main tax for four of five Americans and this was not touched.) In 2006 median income workers paid a higher combined rate in payroll, income, and sales taxes than they did in 1966.[104]

Bush was determined to avoid the mistake of his father and follow through on his promise to cut taxes, no matter what the economic situation was. Big business was not happy because the tax reduced marginal rates and the estate tax. Little was offered to corporations. But Bush assured them that their time would soon come.[105] He was true to his word; two years later taxes on capital gains and dividends were reduced. In all, 40 percent of the reductions in income, capital gains, estate, and dividend taxes went to the richest 1 percent of the population.[106]

Because Bush ran as a moderate in 2000, the ideological outpourings surprised many. For a president who did not win a majority of the votes and probably would have lost the electoral tally had the Supreme Court not stopped the counting in Florida, he acted boldly, helped by the Republican Congress. When an electricity shortage in California turned out to be caused by wholesalers rigging the market, Bush proposed more drilling in Alaska. In the wake of terrorists armed with box cutters, he ordered heavy weapons and a missile defense system. The president planned to privatize Social Security. After a rash of corporate scandals, he chose William Webster, the choice of accounting industry lobbyists, to head the Securities and Exchange Commission.

But tax cuts and deregulation did not work the second time around. Although the recession officially ended in November 2001, the economy had not made up for job losses at the time of Bush's reelection campaign of 2004. The recovery was puny. In the eight years of the Bush presidency, the economy grew over 3 percent in only one year. Job growth slowed, too. In previous business cycles, the economy added jobs at a rate of 2 percent a year; during the period 2001–7, this rate was only

0.6 percent. Wage growth stalled too, falling from 1.5 percent a year in the late 1990s to 0 percent by 2003. The median hourly wage plummeted by more than 1 percent from 2003 to 2005. Only 3.4 percent of the workforce had increased earnings. During the 1980s family income did not decline, despite lower wages, because more family members worked. Not any more. Between 2000 and 2005, despite productivity growth of 3.1 per year, median family income fell 5.4 percent. Without wage growth, consumption grew through borrowing, which soared during the Bush years.

The Fed, to counter the bursting of the stock bubble, lowered interest rates eleven times, producing the lowest rates in fifty years. Too much of that money was going into the housing sector because U.S. policy over twenty years had outsourced the manufactured goods that Americans consumed. The goods deficit had skyrocketed during the 1990s. In 1992 it was nearly $97 billion; it rose steadily and peaked at $838 billion in 2006. The collapse of the Soviet Union and the opening up of China and India doubled the global labor force. The American financial services industry bankrolled factories that employed these workers, weakening organized labor and sending a flood of cheap imports to the United States. Corporate profits soared as productivity increased but wages did not, except for the period 1995–2000, and banks extended credit so that Americans could continue consuming. Funds from China and other east Asian countries resulted from their huge trade surpluses with the United States. Most Asian nations decided to keep large amounts of dollar reserves as insurance against another withdrawal of foreign investment. The decision reinforced their export-led economic strategy. East Asians purchased U.S. Treasury and other government bonds with their dollars, which kept interest rates low. Cheap money made it easier for Americans to buy houses, despite stagnant incomes. Economist Paul Krugman wrote in 2005, "These days Americans make a living by selling each other houses, paid with money borrowed from China."[107]

From 1996 to 2006, home prices increased by more than 70 percent after adjusting for inflation. In the previous century, from 1896 to 1996,

housing prices had just kept even with the overall rate of inflation. At a congressional hearing in 2006, Democratic senator Jack Reed demanded more effort from Fannie Mae, the quasi-government agency that purchased mortgages so that low-income people could own homes. "When homes are doubling in price in every six years and incomes are increasing by a mere one percent a year, Fannie's mission is of paramount importance."[108] Rising home values could not make up for the low wages that both political parties accepted as the inevitable result of globalization. Plummeting housing prices and the financial crisis of 2007–8 demonstrated that there was a limit to this model of growth. Debt-based and asset-inflated consumption was no substitute for wages and productive investment.

Finance is the web of intermediation binding economic agents to one another, across both space and time. Beginning in the 1970s, new financial products emerged to hedge the risks that emerged from currency, trade, and investment instabilities. They soon became the master and not the servant of production in the United States. The financial services industry originated more than 20 percent of U.S. GDP, compared with about 12 percent for manufacturing. The industry's share of corporate profits rose from 10 percent in the early 1980S to 40 percent in 2007.[109] Almost a quarter of the Forbes four hundred richest people in 2006 owed their fortunes to finance, compared with less than a tenth in 1982.[110] The financial industry's agenda—deregulation, free trade, and low taxation— has dominated the nation during the past thirty years.[111] The new financial instruments, like the credit default swaps, were more like casino wagers than insurance against risk. They were ways of making high returns in an era of low interest rates. And they nearly took the system down. In October 2008 "the world [was] on the edge," in the words of the *Economist* magazine, or on "the edge of the abyss," in the language of the *New York Times's* Krugman.[112] The crisis spread to Europe and Asia— everywhere. A total of $50 trillion in global wealth was erased during the first eighteen months of the recession, which began at the end of 2007.

NEW AGE?

The financial crisis of 2007–8 ended the growth model charted by President Reagan. The paralysis of the credit markets occurred one month before the presidential election, which surely helped elect Barack Obama president. Nevertheless, because Obama ran on vague items like change and hope, the future is opaque. As this is written, he has capitalized the banks with government funds and guaranteed loans. But the bad assets, renamed legacies, are still on the books. The goal seems to be to restore the status quo ante or, in Krugman's words, "to muddle through the financial crisis, hoping that the banks can earn their way back to health."[113] The president has legislated an $800-billion stimulus package to provide the demand that business and consumers are withholding, and vowed to reform health care and promote the transition to a green economy less dependent upon fossil fuels.

Even if all of these goals are achieved—a huge assumption—the replacements for the housing and financial services sectors that assumed so large a role in the economy have not been identified. The president's chief economic adviser, Lawrence Summers, stated that the nation will need to grow without the asset price inflation and debt-fueled consumption of the recent past.[114] Stronger exports must be the foundation for sustainable expansion, Summers concluded. He did not name the exports. But if the United States is to export enough to pay for its imports, it will have to begin making things again. If it is to avoid debt-fueled consumption, wages will have to rise. The president not only will have to regulate Wall Street, but will also have to discard the global agenda of Wall Street, which promoted the policies that hobbled production and wages. The country will have to alter a foreign policy which binds allies with unreciprocated access to the U.S. market.

Some imagine that such an agenda is either unnecessary or impossible to effect.[115] Instead, the United States is a postindustrial nation and should stress the high-tech business and professional work that IBM does. These kinds of jobs do exist and compose about 20 percent of service

exports, exactly the same amount as tourism. The notion that making beds and waiting on tables require the high skills that the Obama administration, like its predecessors, claims the nation needs to compete is another question. Another chunk of services are the port fees that accompany imports to the United States, which the consumer eventually pays. Put another way, in 2006 the U.S. had a goods deficit of $838 billion; it had a services surplus of about $84 billion.[116]

There is no substitute for making things, as long as Americans use computers, wear clothes, drive autos, build with steel, play video games — in short, do everything. The trade deficit exploded because Americans consumed these items but did not make enough of them. Debt, not wages, allowed Americans to continue to consume. The rest of the world, beginning with Europe, Japan, the Asian Tigers, and now China did not mind because U.S. demand was their growth machine. This cannot continue. But to return to making things will require new investment, labor, and trade policies. It will require American creditors—like China —to modify their export-led growth model, increase wages at home, and build a domestic market. It will not be easy. Only 5 percent of China's 2009 stimulus was intended to increase consumption. The rest of the money went to state enterprises to boost production and to cities to build infrastructure, which will decrease the role of consumption. Exporters have received huge tax breaks and other assistance while the government has intervened heavily in currency markets to hold down the value of the renminbi to cheapen Chinese exports. Actions, not words, demonstrate that Beijing has decided to export its way out of the global downturn.[117]

The modern Democratic Party may not be up to the task, even though Obama told the participants at the September 25, 2009, meeting of the G-20 nations in Pittsburgh that the global economy could no longer rely on the huge borrowing and spending by Americans and massive exports by countries like China. Beginning in the 1980S, the financial services industry found a home in FDR's party. Despite popular outrage, the industry blocked legislation in the Democratic Congress prohibiting usury. Usury used to be illegal, but in 1980 Jimmy Carter and the

Democratic Congress repealed all interest rate controls and the national law prohibiting usury. This repeal is what makes it possible for credit card companies to charge 30 percent interest and lenders to make the notorious "payday" loans that charge desperate people a real interest rate of more than 500 percent. Legislation capping rates at 15 and 18 percent failed to pass the Congress and the Senate in early 2009.[118] Banks blocked a law, once championed by Obama, to allow bankruptcy judges to lower the amounts owned on mortgage loans.[119] The financial services industry is probably more concentrated than it was before the crisis. Since the recession began it has lost 7.7 percent of its jobs, while manufacturing has lost 14.6 percent and construction 31.6 percent.[120] Many of the biggest banks, like Goldman, Sachs—a recipient of billions of dollars of government assistance—are doing well and plan to distribute outsized bonuses to top employees. Banks have continued to use their political power to prevent the regulation of many of the practices, like the trading of derivatives, that contributed to the crisis.

Power in the Democratic Party has shifted to the coasts, especially to California, where affluent, postindustrial liberals are strong. No one in the congressional leadership—including Nancy Pelosi, Henry Waxman, Harry Reid, Richard Durbin, Charles Schumer, and Christopher Dodd—has demonstrated interest in industries which can alter the U.S. trade deficit. Despite his words, Obama has shied away from policies that could rebalance the global and American economy. He failed to convince other developed countries to promote domestic consumption at the G-20 meetings in April 2009. Unless they do, the U.S. stimulus will increase the trade deficit, as Carter's and Clinton's did. Although he has promised to sign legislation making it easier for unions to organize, Obama has not made it a priority. Instead of unionization, he seems to believe that his health care reforms, by reducing costs, will increase worker's wages. This is a very big assumption. Obama, who grew up politically during the 1980s, when labor was weak, lacks the experience and imagination to understand that increased union membership would help him legislate his agenda. As of August 2009, the recession has destroyed 5 percent of the

nation's jobs, the worst loss percentage since World War II. The unemployment rate hit 9.7 percent. The president's response is to repeat the ideological cliché, "Jobs tend to be a lagging indicator. They come last," as if he can do nothing to alter the situation.[121]

The president's industrial policies do not address the imbalances at the root of the crisis. He has recognized that the two main Keynesian tools, the budget and interest rate, need to be supplemented with micro-economic measures. But the restructuring of GM in bankruptcy closed twenty factories and eliminated at least twenty-one thousand jobs. Initially the government blueprint set out to double production in Mexico, South Korea, and China, for sale in the United States.[122] Union pressure has forced production of small cars in at least one factory in this country. How this will play out is still unclear. But the strategy to shutter factories and reduce costs basically looks a lot like the old order that got the nation into trouble.

GM and the other domestic producers have been downsizing since 1980. It was that downsizing and outsourcing that produced the huge health care and pension liabilities that dragged GM down. GM had half a million retirees and sixty thousand active workers when the financial crisis brought the industry to the brink. Still, in late 2007 GM's market share was edging up. But by the end of the year the plummeting housing market caused many to postpone buying a car. Then gasoline prices topped $4 per gallon. After Lehman failed, the frozen credit market made it impossible for GM to sell its bonds. Overreliance on trucks and SUVs was not simply a GM sin; Toyota was equally exposed and suffered unprecedented losses. But Toyota, sustained by decades of strong profits, will not go bankrupt.[123]

The auto executives made mistakes in the past, but so did the U.S. government and its citizens. The criteria used to save the banks should be used for the auto industry, because it is crucial for America's future. The goal of the government's $50-billion investment should not be to make GM "viable," profitable at any cost. That was the old way—first capital (GM) and then labor (autoworkers) will prosper. The aim should be to

enhance U.S. manufacturing capacity. Solving industrial problems by downsizing, yielding the American market to foreign automakers, and outsourcing jobs were principal industrial strategies of the age of inequality. No auto industry in any nation has ever successfully employed such a strategy.

Obama's goal "to get GM back on its feet, take a hands-off approach, and get out quickly" addressed critics who oppose a government role in the industry and imagine that the intervention aided the auto union.[124] The president may not want to run GM, but he has changed the collective bargaining agreement, reduced the number of brands, removed its CEO, mandated new fuel-efficiency standards, sent GM into bankruptcy, downsized the company, and probably done other things that we cannot know at this point. These decisions promise to increase unemployment and continue to tax manufacturing.

The question that the government faced in the auto industry and will certainly face in others is not whether the government will manage, but whether the principles will come from the age of compression or the age of inequality.

NOTES

PREFACE

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3. Beth Bailey and David Farber, eds., *America in the 1970s* (Lawrence: University Press of Kansas, 2004), 2.

4. Rick Perlstein, *Nixonland: The Rise of a President and the Fracturing of America* (New York: Scribner, 2008), 747–48.

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Making America Conservative in the 1970s (Cambridge, Mass.: Harvard University Press, 2008), 3–4.

8. Thomas B. Edsall and Mary E. Edsall, *Chain Reaction: The Impact of Race, Rights, and Taxes on American Politics* (New York: W. W. Norton, 1992), 154. In contrast, Thomas Edsall's earlier *New Politics of Inequality* (New York: W. W. Norton, 1984) attributed the New Politics to business mobilization and labor weakness, which had nothing to do with race. For a critique of Edsall and Edsall, see Larry M. Bartels, *Unequal Democracy: The Political Economy of the New Gilded Age* (Princeton: Princeton University Press, 2008), 64–97.

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12. Between 1947 and 1973, productivity rose 103.5 percent; between 1973 and 2003 it rose 71.3 percent. Robert Kuttner, *The Squandering of America* (New York: Alfred A. Knopf, 2007), 21.

13. In the 1980s, every group lost out to the top fifth. This pattern continued up to the present, except for the years from 1995–2000, when the lowest fifth outpaced the top fifth. Still, even in the second half of the Clinton presidency, the top 5 percent did better than everyone else. Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America, 2006–2007* (Ithaca, N.Y.: Cornell University Press, 2006), 58; Ian Dew-Becker and Robert

Gordon, “Where Did the Productivity Growth Go?” paper presented at the Eighty-First Meeting of the Brookings Panel on Economic Activity, Washington D.C., Sept. 8–9, 2005, 72.

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15. Robert W. Stevenson, “Capitalism After the Fall,” Week in Review, *New York Times,* Apr. 19, 2009.

CHAPTER 1. "THE GREAT COMPRESSION"

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2. Claudia Goldin and Robert A. Margo, "The Great Compression: The Wage Structure in the United States at Mid-Century," *Quarterly Journal of Economics* 107 (Feb. 1992), 1–34. Using slightly different data, Thomas Picketty and Emmanuel Saez find that most of the decline of the wealth at the top came during World War II when taxation was high and progressive and there were wage controls. But after the war, until the 1970s, the top did not retrieve its wealth. Like Margo and Goldin, they attribute the continuation of egalitarian results to labor market institutions and social norms. "Income Inequality in the United States, 1913–1998," *Quarterly Journal of Economics* 118 (Feb. 2003), 1–39.

3. Gilbert Burck, "American Genius for Productivity," *Fortune* (July 1955), 87.

4. Jack Metzgar, *Striking Steel: Solidarity Remembered* (Philadelphia: Temple University Press, 2000), 37.

5. Kenneth T. Jackson, *Crabgrass Frontier, The Suburbanization of the United States* (New York: Oxford University Press, 1985), 283–84.

6. Simon Kuznets, *Share of Upper Income Groups in Income and Savings* (New York: National Bureau of Economic Research, 1953); Joint Economic Committee, *Productivity, Prices, and Incomes,* 89th Cong., 2d sess. (Washington, D.C.: Government Printing Office, 1967).

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57–58.

8. Microeconomics, which until Keynes was synonymous with economics as a whole, investigated the role of prices in the allocation of resources. For Keynes, price changes allocated, but did not determine, national income, employment, or investment, as classical economists had believed.

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10. Robert F. King, *Money, Time, and Politics: Investment Tax Subsidies and American Democracy* (New Haven: Yale University Press, 1993), 147.

11. Robert Skidelsky, *John Maynard Keynes, 1883–1946: Economist, Philosopher, Statesman* (New York: Penguin, 2003), xxx.

12. Robert Skidelsky, "An Impossible Crash Brought Keynes Back to Life," *The Times* (London), Oct. 23, 2008.

13. Most economists believe that the New Deal never spent enough to produce the necessary recovery until 1939, when defense expenditures increased radically.

14. David Vogel, *Fluctuating Fortunes: The Political Power of Business in America* (New York: Basic, 1989), 120.

15. Barry Eichengreen, *The European Economy Since 1945: Coordinated Capitalism and Beyond* (Princeton: Princeton University Press, 2007), 1–14.

16. Jeffry R. Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (New York: W. W. Norton, 2006), 280.

17. Ibid., 281.

18. *Economist,* Sept. 25, 2004.

19. Eckes and Zeiler, *Globalization and the American Century,* 143.

20. "Record of Third Meeting of Joint U.S.-Japan Committee on Trade and Economic Affairs," Tokyo, Jan. 24, 1964 (Morning), 4, file 11/63–4/64, I, box 250, Country File, Japan, National Security File, Lyndon Baines Johnson Library and Museum, Austin, Tex.

21. The new financial order departed from the gold exchange standard in three fundamental ways: 1) Pegged exchange rates became adjustable, subject to special agreements. 2) Capital controls were permitted to limit the volatility of international capital flows. 3) The IMF could monitor national economic policies and extend balance of payment financing to countries at risk.

22. The British wanted to complement trade liberalization with full employment policies and escape clauses to protect economies from balance of payments pressures and deflation. Instead, the GATT reflected the internationalists in the State Department and took little consideration of domestic concerns. Nitsan Chorev, *Remaking U.S. Trade Policy: From Protectionism to Globalization* (Ithaca, N.Y.: Cornell University Press, 2007), 50–53.

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24. Melvyn P. Leffler, *A Preponderance of Power: National Security, the Truman Administration, and the Cold War* (Stanford, Calif.: Stanford University Press, 1992), 161–63.

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41. According to the GATT, items could be excluded for reasons of "overriding national interest," which the Japanese interpreted quite liberally.

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CHAPTER 8. LABOR TO CAPITAL

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