## US-Western European Economic Relations, 1940-1973

| Date | Event | Significance |
|---|---|---|
| 1941-44 | US-UK wartime negotiations on a new international monetary and trading system | Technocratic elites in both countries negotiate in circumstances relatively free of normal domestic political pressure |
| July 1944 | Bretton Woods conference | Creation of the Bretton Woods twins, the IMF and World Bank |
| December 1945 | US loan to Britain agreed | US attempt to force Britain to accept the Bretton Woods rules |
| June 1947 | US Secretary of State Marshall announces ‘Marshall aid’ | A large step away from Bretton Woods towards direct US aid and promoting regionalism in Europe |
| July-August 1947 | British pound returns to convertibility, but this is revoked as reserves are rapidly drained | The final failure of Hull’s vision of forcing Britain to accept Bretton Woods |
| 30 October 1947 | GATT signed in Geneva | Interim agreement on trade principles, and draft agreement on the establishment of the ITO by 23 countries |
| March 1948 | Havana World Conference on Trade and Employment | Agreement on the charter of the ITO by over 60 countries |
| June 1950 | Creation of European Payments Union | Facilitated the reconstruction of European trade and payments on a regional basis, rather than on the basis of Bretton Woods |
| April 1951 | Signing of the Treaty of Paris | Creates the European Coal and Steel Community |
| March 1957 | Signing of the Treaty of Rome | Creates the EEC and Euratom, the former leading to the creation of a large trading bloc, changing the nature of GATT bargaining |
| December 1958 | European currencies become convertible and EPU dissolved | The Bretton Woods system rises from the dead, but US gold position begins to deteriorate rapidly |
| January 1959-July 1968 | Progressive internal tariff reductions within EEC | Leads to a customs union within Western Europe and the creation of the Common External Tariff |
| 1960-61 | GATT Dillon Round | Meagre results show growing limits of item-by-item bargaining and need for a new US approach |
| 1961-62 | Short-term and Long-term Agreements on Trade in Cotton Textiles | Treatment of textiles as a separate category within GATT, leading to creation of a complex set of bilateral quota arrangements. Facilitates passing of the US Trade Expansion Act. |
| 1962 | US Congress passes Trade Expansion Act | Essential pre-condition for the success of the Kennedy Round of the GATT |

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| February 1965 | President de Gaulle calls for the restoration of the Gold Standard | Hardens US opposition to an increase in the price of gold and thus indirectly leads to the gradual emergence of a de facto dollar standard |
| June 1967 | Conclusion of GATT Kennedy Round | Most successful GATT round, but lack of progress on non-tariff barriers leaves problems for the future |
| March 1968 | Two-Tier Arrangement | The effective end of the gold-dollar standard, with the private market price of gold allowed to float above official price of $35 per oz. |
| 1968 | US VER agreements on steel exports with EC and Japan | First steps towards the ‘new’ protectionism |
| August 1971 | ‘Nixon shock’ | President Nixon ends de jure dollar convertibility into gold and imposes a 10% surcharge on imports, forcing allies to negotiate under threat |
| December 1971 | Smithsonian monetary agreement | The US succeeds in having other countries revalue their currencies against the dollar, while maintaining the dollar’s gold inconvertibility |
| January 1973 | Britain, Denmark and Ireland join EC | Further expansion of European Community and growing weight in international trading system |
| March 1973 | Deutschemark floated permanently | The end of the dollar standard and shift towards a system of floating exchange rates and liberalized capital flows |
| October-November 1973 | First OPEC oil shock | Severe deflationary shock to world economy, first major post-war recession, and beginning of petrodollar ‘recycling’ |

## The United States and Western Europe:
## The Theory of Hegemonic Stability

The theory of hegemonic stability probably remains the most popular and influential theory in the subject of international political economy today. The basic proposition of the theory, that an open or 'liberal' international economic order requires the existence of a hegemonic or dominant power, retains wide support in the field and beyond. Although it has been the subject of considerable criticism and modification since its elaboration in the 1970s, it has remained central to teaching and research in the field, and in international relations more generally. This popularity is not simply due to the apparent parsimony of the theory, nor only because of its obvious appeal to contemporary American scholars concerned about the consequences of US decline. The theory remains central to the discipline at least in part because it provides a powerful and intuitively attractive account of the rise and decline of international economic order over the past century. Even for its critics, which include the present author, the theory provides a stepping stone towards a deeper understanding of the dynamics of the international political economy. For these reasons alone, one cannot but take it seriously.

This chapter asks what light the theory of hegemonic stability can throw upon US-West European economic relations from 1945 to 1973. Space limitations do not allow a full 'test' of the theory here. However, if the theory is to justify its place within the discipline, it must account for the evolution of US-European relations after 1945. The argument given here is that the theory (albeit with some important limitations) is somewhat useful in accounting for the establishment of the post-war international economic system, and particularly the crucial role of US leadership. However, it is considerably less successful in accounting for change in the system over the period considered. Specifically, it suffers from two main defects. First, and predictably, as a 'structural' theory of world economic order, it pays insufficient attention to important ‘unit-level’ (i.e. state and societal) factors in accounting for change. Second, perhaps more surprisingly, even at the structural level of analysis the theory has shortcomings. Most importantly, its proponents have taken insufficient account of the relationship between economic and security relations between the major countries in the post-1945 period. The chapter argues that the course of post-war international trade and monetary relations was fundamentally shaped by the North Atlantic alliance. This was true both for the establishment of the post-war international economic order, and for its gradual erosion over the course of the 1960s and early 1970s. This suggests that other theories of international economic order are needed to understand the dynamics of systemic change, even if they cannot entirely replace the theory of hegemonic stability.

The first section provides a brief survey of the theory of hegemonic stability and outlines two main competing theories of post-war international economic cooperation, ‘embedded liberalism’ and ‘alliance leadership’. I then examine the establishment of the post-war economic system in the light of these three theories. A third section considers the role of hegemony in US-Western European monetary and trade relations during the Cold War period until 1973. It focuses upon the conundrum of the breakdown of the Bretton Woods system and the relative resilience of the GATT. In the final section, I return to the general theoretical debate and to the question the overall impact of the security structure upon US-European economic relations.

## 1. Explaining international economic openness: the theory of hegemonic stability

The theory of hegemonic stability was a theoretical refinement of a common observation in post-war international relations: US dominance or ‘hegemony’ was the linchpin of the successful world capitalist economy after 1945. In the late 1940s, not only did the US possess unrivalled power and prestige, it also had purpose. After intervening in two destructive wars in three decades, the US wished to remodel fundamentally the structure of international political and economic relations in a manner consistent with its liberal ideals and particular interests. The main legacy of the post-war power and purpose of the US was the Bretton Woods international monetary system and the GATT-based multilateral trade regime.

In the early 1970s, however, these monetary and trade regimes appeared to be threatened by growing economic conflict between the major industrial countries and associated relative US economic decline. Comparisons with Britain's precipitous decline as the leading power of the nineteenth century and the apparently disastrous consequences for the world economic system in the interwar period were rife in the literature. This led to renewed attention to the idea that an open and stable world economy was causally related to the existence of hegemony, defined as a relative preponderance of power. As one of the authors of the theory, Charles Kindleberger, put it: 'for the world economy to be stabilized, there has to be a stabilizer, one stabilizer.'[1]

At the risk of oversimplification, two main versions of the theory exist, 'neo-liberal' and 'neo-realist'. Of the two, currently the most popular version is the neo-liberal, in which the idea of international public goods play a central role.[2] In an international system in which power is well dispersed amongst states, the provision of international collective goods such as financial assistance in a crisis or well-established rules on international trade is difficult. Individual states have an incentive to free-ride rather than to bear the costs of public goods provision alone. Without international government, only a hegemonic state can provide collective goods. The hegemon will provide such goods because its size ensures that associated costs of provision are less than the economic benefits that accrue to it.

There is some disagreement over the dependent variable in the liberal version of the theory. For Kindleberger, examining international monetary history in the interwar period, the focus was upon the stability of the world economy. For most international relations theorists, the dependent variable has been systemic openness. Kindleberger was concerned with who would provide management functions in a potentially unstable system, particularly a long-term flow of international liquidity and short-term emergency liquidity in a major international financial crisis. He argued that the problem was less with the establishment of the system than its ongoing management, and hence was pessimistic about the consequences of hegemonic decline, particularly in a crisis.

Most international relations scholars following Kindleberger's lead saw the provision of liberal rules (or 'regimes') fostering openness as the core hegemonic task. The emphasis upon rules rather than crisis management led them to be more optimistic than Kindleberger concerning the possibility of post-hegemonic systemic openness. Collective action problems were more acute in the establishment phase rather than once international regimes were up and running. Keohane argued that hegemony was more important for the establishment of regimes than for their maintenance, allowing the possibility of regime-based cooperation 'after hegemony'.[3]

The neo-realist version of the theory of hegemonic stability is less dependent upon the idea of international public goods, though some realists employ similar language. Neo-realists hold that states have different policy preferences that depend upon their relative position in the world economy. A hegemonic state is most likely to favour an open world economy, as opposed to medium-sized states. This makes free trade most likely when a hegemon is able to provide carrots and sticks to other states to adopt liberal trade policies.[4] In the neo-realist version of the theory of hegemonic stability, there is an element of exploitation in the system. The hegemon structures the system for its own benefit, although it may result in significant benefits for others. The hegemon uses its power to enforce other states' compliance with the prevailing rules. Accordingly, realists tend to be pessimistic about the prospects for post-hegemonic cooperation. Hegemonic decline brings with it a declining ability to enforce compliance by others, and a declining hegemonic interest in a system operating more to the benefit of others. Hence, after hegemony, world economic closure is likely, as in the interwar period.

Common to both versions of the theory of hegemonic stability is a structural focus. The outcome, the openness and stability of the international economic system, results from the distribution of power among states. States are assumed to be rational actors, and domestic policy the product of systemic factors. Perhaps surprisingly, security factors rarely played an important role in the analysis. Realists such as Robert Gilpin did not see the Cold War security structure as significantly affecting economic relations *within* the Western alliance.[5] So too neo-liberals ignored security. To quote Keohane: 'it is justifiable to focus principally on the political economy of the advanced industrialized countries without continually taking into account the politics of international security.'[6]

Theorists ignored security factors for a number of reasons. First, the introduction of security factors would have greatly diluted the theory's parsimony. Second, the growing economic conflict between the major industrial countries in the 1960s and 1970s occurred without the significant erosion of bipolar security structure, suggesting Keohane's judgement was correct. Third, US attempts to gain leverage in bargaining on monetary and trade matters by linking them to security relations were difficult or counterproductive in a world of 'complex interdependence'.[7] Finally, if the theory was to be grounded upon more than the post-1945 American case and the comparison with Britain in the nineteenth century effective, it was best to ignore the large differences between the security structures of the late 19th century and the post-1945 era.

An alternative interpretation of post-war Western economic relations accords a central role to security factors. For the want of a better title and with some theoretical licence, I term this the 'alliance leadership' theory. In this interpretation, free trade might only be possible within security alliances, since an open international economy will produce differential gains and hence negative 'security externalities' for some states.[8] Within an alliance, common security interests reduce concerns about relative gains from open trade amongst allies. The hegemon as alliance leader may even conclude that actively promoting relative gains by allies may be in its security interest, at least if defection of such allies is unlikely. In short, security concerns shape the hegemon's economic relations with its allies, and provide all members of an alliance with an incentive to liberalize trade amongst themselves rather than with others.

A final interpretation of post-war Western economic relations focuses upon the normative rather than material foundations of international economic order. The theory of 'ideational consensus' focuses upon the role a transnational intellectual consensus over the appropriate shape of the international economic system plays in fostering regime establishment and cooperation. Its most prominent proponent is John Ruggie, with his theory of 'embedded liberalism' in the post-war economic order.[9] This theory does overlap with the theory of hegemonic stability (and alliance leadership), particularly if one stresses the role of the hegemon's culture and domestic ideology in forging such an international intellectual consensus.[10] However, there is a strong sense in Ruggie's theory that inter-state elite agreement over normative principles is only robust if these principles are consistent with the deeper alignment of social forces within the major countries.

The chart opposite summarizes the main claims of the four theories outlined. Before proceeding, it is useful to clarify how each theory understands the relationship between power and interests in the international political economy. The neo-realist version of hegemonic stability theory sees interests as deriving from the position of individual states in the world economic structure. Countries with small open economies prefer free trade, as does the hegemon because of its comparative advantage in leading industries, while middle-sized and developing states tend to prefer protection. There is also a dynamic element in neo-realist theory, since the erosion of the hegemon's economic preponderance reduces its 'structural' interest in an open world economy. In contrast, the neo-liberal version has a more static conception of state interest. Neo-liberals presume that all states have a long-run self-interest in an open world economy, but that it may be in the short-run interest of an individual state to protect (i.e., free ride). Hegemonic power, through the provision of regimes, allows a more enlightened self-interest to surface and cooperation to become sustainable. There is no necessary reason why the long-run interest of states will change over time. The possible exception is the hegemon, which as it declines, finds its ability to provide new public goods and to maintain existing ones diminishes. While its long-run interest in openness may not alter, the hegemon too may be tempted to free ride, and the short-run interests of other states may shift in turn.

In the theory of ideational consensus, the definition and elaboration of state interest is dependent upon the formation of a domestic social consensus concerning the relationship of domestic to international economic policy. State interest may evolve over time, but is likely to result from deeper changes at the societal level rather than from the shifting balance of economic power at the international level. Finally, alliance leadership theory considers state economic interest to be a function of a state's national security posture. A state will have an interest in economic cooperation with alliance partners, and this interest could change over time should the military alliance erode or should the security options of a country shift.

I now turn to consider how the theory of hegemonic stability performs as an explanation of the construction of the major post-war regimes relevant to US-West European economic relations after 1945.

| | HEGEMONIC STABILITY THEORY | | ALTERNATIVE EXPLANATIONS | |
|---|---|---|---|---|
| **PHASES** | **NEO-REALISM** | **NEO-LIBERALISM** | **IDEATIONAL CONSENSUS** | **ALLIANCE LEADERSHIP** |
| **1. Crisis Phase** | Great power struggle for preponderance | Collapse of previous international regimes | Breakdown of previous transnational societal norms | Breakdown of old balance of power |
| **2. Regime Creation** | Hegemonic power imposes order | Hegemonic leadership overcomes collective action problems | Based upon the achievement of a new set of norms to govern international and domestic policy | Solidification of new alliance structures produces intra-alliance regimes |
| **3. Regime Compliance and Cooperation** | Power-based (hegemon enforces compliance with carrots and sticks) | Regimes enhance transparency & reduce costs of cooperation (existence of common interests), plus hegemonic 'crisis management' | Mutual acceptance of normative principles reduces conflict | External security threat and alliance leadership by hegemon |
| **4 Hegemonic Decline** | Regime erosion and collapse as hegemon reacts to consequences of relative decline (but 'lags' may occur) | Some regime erosion is likely as hegemon adjusts to reduced power, but collapse is difficult to predict | Relative hegemonic decline may produce some normative conflict and regime erosion | Hegemonic decline may result in intra-alliance burden-sharing disputes, disrupting economic relations between allies |
| **5. Multipolarity** | 'Oligopolistic competition' produces closure of world economy (even if small states prefer openness, collective action problems exist) | Regimes may be self-perpetuating due to common interests (but absence of hegemony may be fatal in a crisis) | If normative principles are robust and social divisions limited, regime-based cooperation may persist | Multipolarity produces enhanced relative gains concerns and probably the fragmentation of the world economy |

## 2. The US, Europe, and the establishment of the post-war economic system

How and why was the Bretton Woods international monetary system and the GATT international trade system established in the 1940s? Both neo-realist and neo-liberal versions are correct in stressing the importance of US hegemonic leadership in establishing Bretton Woods and the GATT in the 1940s. Nevertheless, this section argues that there are two main difficulties the interpretation offered by the theory of hegemonic stability. First, as Ruggie argued, a normative consensus within and between the major countries facilitated agreement on the basic principles. Second, even if one downplays this as a factor, the regimes were largely a product of American-British negotiations in which the US made major concessions to British demands.

The intellectual consensus at the heart of the post-war economic regimes was real and important, and countries other than the US, particularly Britain, but also other Western European countries, were instrumental in its achievement. For all industrial countries in both Western Europe and North America, the interwar and wartime experience had made a full restoration of laissez-faire capitalism and the Gold Standard politically unacceptable. It also made some degree of state intervention in the economy necessary. Even so, most countries, particularly Britain and the US, had a considerable interest in the restoration of a stable and prosperous world economy, and in preventing a relapse into the disastrous 'beggar-thy-neighbour' policies of the 1930s. The only viable compromise was some balance between state interventionism at home and liberalisation of international trade and payments abroad. This compromise was necessary both within British and American societies, as well as between their governing elites: weakening support for the New Deal in America meant that Britain tended to be a more staunch supporter of state intervention in the economy. The international institutions that emerged reflected this compromise.

### *2.1. The international monetary negotiations*

Negotiations on the shape of the post-war international monetary system began between the British and American governments in the depth of the war. The history of these negotiations leading up to the Bretton Woods agreement of 1944 provides only qualified support for the theory of hegemonic stability. US hegemonic leadership was a crucial ingredient in the process, but the need for consensus between the US and British governments gave Britain more influence over the outcome than its economic position allowed. However, nor is an amalgam of the theory of hegemonic stability and embedded liberalism fully convincing as an explanation of the shape of the post-war monetary order. As we shall see, the international monetary arrangements agreed at Bretton Woods proved completely inadequate by 1947. They were replaced by a set of *ad hoc* arrangements that owed much to alliance leadership by the US.

Early British proposals on international monetary arrangements dating from 1941 took shape by 1942 in the so-called 'Keynes plan' for an International Clearing Union. It was a radical conception, aiming at the collective management of international money by a world central bank. This, Keynes felt, could guarantee plentiful international liquidity for current account deficit countries like Britain, while preventing surplus countries like the US from pursuing policies that could result in a global liquidity shortage. However, the US government understood that the potential American liability under such a system would be unacceptable to Congress, and it rejected the Keynes plan as too radical and potentially inflationary. The US Treasury's 'White plan', named after Secretary Morgenthou's deputy in charge of the negotiations, became the basis of the negotiations. The White plan envisaged an International Monetary Fund (IMF) made up of member contributions of gold and foreign exchange. Countries would be able to borrow very limited amounts from the Fund on a conditional basis to finance temporary balance of payments deficits. Nevertheless, the IMF was still a radical departure from what had gone before.

Compelled to accept the White plan and its relatively tight liquidity constraint, the British government demanded and gained a series of concessions from the American side reflected in the agreement at Bretton Woods. First, the US offered the famous ‘scarce currency clause’, allowing the rationing, through the IMF, of any currency that was in scarce supply. Second, while discriminatory trade and exchange restrictions should be avoided in principle, they would be allowed in an unspecified ‘transition period’ after the end of the war. Even after this transition period, countries would be expected to adopt currency convertibility for current account transactions, but not on capital account. Both US and British negotiators accepted restrictions on short term capital movements (against their domestic financial interests) as a necessary prerequisite for domestic monetary control in a system of pegged exchange rates.

Third, Britain successfully insisted upon a greater degree of national sovereignty over the exchange rate than was initially envisaged by either side. The mutual concern to avoid a repetition of the competitive devaluations of the interwar period had at first led negotiators to propose considerable supranational control over exchange rate policies. The British argued that par values should be fixed but adjustable. In the event of a ‘fundamental disequilibrium’ in the balance of payments, only par value changes greater than 10% should require Fund approval. Furthermore, the notion of fundamental disequilibrium (implying long term unsustainability) was highly ambiguous, and which limited Fund’s ability to disapprove in practice.

Hence, overwhelming US power did not enable the American government simply to ‘set the rules’ of the international monetary system.[11] Moreover, soon after the rules were laid out in the Bretton Woods agreement, they were found to be completely inappropriate to post-war international circumstances. Reconstruction and development were to be the tasks of the IMF’s sister institution, the International Bank for Reconstruction and Development (World Bank), but the Bank had even fewer resources than the Fund. By 1947, the Bretton Woods system had effectively collapsed, as the resources it provided for reconstruction in Western Europe were inadequate.

Despite this fatal inadequacy, the US government pursued Bretton Woods as a policy long after post-war circumstances had rendered it unviable. Understand that British acceptance of Bretton Woods rules was vital, the US granted Britain a balance of payments loan of $3.75 billion in December 1945, the equivalent of over 40% of total planned IMF resources. This was a doomed strategy. The US Treasury insisted as a condition of the loan that Britain reintroduce sterling convertibility within 18 months. When it reluctantly did so in July 1947, a run on sterling began which rapidly depleted British reserves. The British government revoked convertibility only seven weeks later.

The failure of Bretton Woods considerably weakened the influence of the Treasury in the US government's European strategy. In the meantime, political events in the form of the beginning of the Cold War conspired to provide the State Department with the means to set out a new and more viable strategy. This had already begun with the announcement of the Marshall Plan in June 1947, and now led to the wholesale abandonment of the Bretton Woods regime and associated policies. Security considerations produced a new kind of US hegemonic leadership that might not otherwise have been forthcoming. Economics had now become the servant of US grand strategy, rather than the reverse.

The geo-strategic argument was that the US had to prevent Western Europe from 'falling like a rotten apple' into Stalin's lap, by providing the finance for Europe's structural payments deficits that the Bretton Woods institutions could not. With Marshall aid, the US bypassed the IMF and World Bank, and promoted European integration and discrimination against the dollar and US exports. To hard-nosed critics within the US government such as the Federal Reserve and Treasury, the State Department argued that the Marshall plan represented at most the postponement and not the abandonment of Bretton Woods principles. Marshall planners in the

State Department and in the Economic Cooperation Administration, set up to administer Marshall aid, supported regional integration in Europe. They did so on the grounds that only through a single, integrated European economy and even political system could Europe hope to become ‘viable,’ and hence a strong and stable US partner.[12] While this argument was useful for convincing domestic sceptics of the need for a policy reversal, the clinching argument was that Marshall aid was in the US security interest. After all, if European ‘viability’ could only be achieved through full integration, why did US government not wish to promote regional integration elsewhere?

### *2.2. The international trading system negotiations*

The US and Britain, not to mention other countries, were further away from agreement on the basic principles of international trade than they were on monetary issues. During wartime negotiations, the US attempted to use Britain’s financial weakness to obtain a British commitment to the elimination of the system of trade preferences known as Imperial Preference. This was central to the US State Department goal of eliminating discriminatory trading blocs, seen as the main cause of depression and war. Yet within a few years, US policy had shifted entirely towards the promotion of discriminatory European trade integration, and had effectively dropped opposition to Imperial Preference. As on the monetary side, although the theories of hegemonic stability and embedded liberalism help to explain US leadership and the shape of the agreements reached on international trade, they do not adequately explain this shift in US policy. For this, security factors are again central.

Ever since the US Congress legislated the Reciprocal Trade Agreements Act (RTAA) of 1934, America had been negotiating tariff reductions with its major trading partners. The British feared (correctly) that US Secretary of State Cordell Hull’s main goal in the wartime negotiations was to eliminate Imperial Preference, established at Ottawa in 1932. American political and financial leverage gave Hull the chance to see his dream realised. Britain reluctantly agreed in principle to the dismantling of Imperial Preference in the Atlantic Charter of 1941, the Lend-Lease agreements during the war, and as a condition of the US balance of payments loan to Britain.

At the same time, Britain had a considerable interest in the reduction of trade barriers, if not in the elimination of preferences. As with its monetary proposals, the initial British proposal on trade in 1942 called for a supranational International Commercial Union to establish more harmonious trade relations, and for tariff reductions to be made on a multilateral across-the-board basis. This proposal was aimed at the still high level of US tariffs, and at the American government preference for a selective item-by-item approach to tariff reduction. The latter would allow the US government to continue protection for specific sectors. Britain refused to contemplate the elimination of preferences unless the US was willing to accept the principle of large cuts in its tariffs, but protectionist sentiment in the US Congress prevented any such deal.[13] The US government was unable to accept the more radical British approach to tariff-cutting (as it refused to accept Keynes' Clearing Union), and successfully linked a British commitment to the elimination of preferences to the December 1945 loan.[14] This particular piece of linkage is perhaps the best example of the exercise of hegemonic power in the early post-war period. The problem for the theory of hegemonic stability is that the linkage failed, just as linkage had failed on the monetary side. By late summer 1947, US policy had shifted towards a much more constructive stance.

Before then, the US government persisted in its attempts to eliminate preferences. In late 1946, UN negotiations began in London and continued in Geneva in 1947, aimed at obtaining the agreement of other countries to the Anglo-American agreement of mid-1945 to establish an International Trade Organization (ITO). As late as July 1947, American trade negotiators like Francis Wilcox still hoped to use Marshall aid as an additional source of leverage over Britain on the question of preferences. However, General Marshall himself signalled the reversal in US policy by telegraphing the US delegation in Geneva on 2 August 1947 to accept 'in the circumstances' the British desire to continue Imperial Preference.[15] As an interim measure before the establishment of the ITO, the 23 countries gathered at Geneva signed the General Agreement on Tariffs and Trade (GATT) on 30 October 1947. GATT was a statement of general trading principles that would underpin the ITO. Article I established the principle of unconditional Most Favoured Nation (MFN) treatment, but allowed for the continuation of Imperial Preference (though tariff negotiations would erode them over time).

The shift in US policy was hardly due to a meeting of minds on the specifics of embedded liberalism: the US government continued to see preferences as anathema. Rather, as on the monetary side, British cooperation was simply too important for the emerging US strategy of containment of the USSR. The extent of the shift in the US position is also clear from the agreement on Article XXIV of the GATT. This allowed the formation of customs unions and free trade areas, further compromising the principle of non-discrimination. Article XXIV, like the Marshall plan, was consistent the new goal of US foreign policy of promoting European integration in the interests of Atlantic security. For Britain and for other West European countries, the Cold War helped to shift American policy in a direction more consistent with European interests.[16]

Indeed, the Cold War led the Truman administration over 1947-8 towards an imaginative solution for the post-war European predicament, and to a more flexible interpretation of what the compromise of embedded liberalism would mean in practice. The Soviet threat not only led the US to extend the post-war transition period more or less indefinitely. It also became more tolerant of serious departures from the American model of capitalism in Western Europe. Of course, US domestic politics had always meant that global free trade was never a serious US policy goal, but the promotion of American exports had been. With the failure of the US Senate to ratify the ITO charter in 1950, the virtual irrelevance of the major international institutions envisaged by the wartime planners was complete. Although the GATT would serve as the platform for multilateral trade liberalisation in the 1950s and beyond, it was riddled with so many exceptions to its core principles that it was difficult at the time to be convinced of its potential effectiveness.

## 3. US-Western European monetary and trade relations up to 1973

Looking back, it is easy to view the 1950s and 1960s as a golden age of the post-war boom as well as of US-Western European economic relations. It is equally tempting to attribute this to the stabilizing influence of US hegemony, particularly given what was to come later once US relative decline became apparent. The breakdown of the system of fixed exchange rates by early 1973, the first oil crisis, the 1974-5 recession and subsequent macroeconomic and trade policy wrangling between the major countries suggested to many that the US was no longer sufficiently strong to impose order upon the world economy and Euro-American economic relations.[17] We have seen that a modified theory of hegemonic stability is useful if not entirely satisfactory as an explanation of the US role in the establishment of the post-war economic regimes. Arguably, however, the real test of the theory must lie in its ability to account for the change in the structure of US-West European economic relations from the late 1940s to the early 1970s. This section argues that the theory of hegemonic stability is least satisfactory as an explanation of these changes, particularly because of its failure adequately to take into account the way in which security factors impinged upon economic relations between the major industrial countries.

### *3.1. The rise and fall of the gold-dollar standard*

In 1949, the US government proposed the creation of a European Payments Union (EPU) to facilitate the reconstruction of European trade. While it was presented to US critics as a means to the eventual re-establishment of currency convertibility in Europe, in the medium term it meant the continuation of policies that would discriminate against US exports in favour of intra-European trade. This was consistent with the new policy favouring European integration and moving away from Bretton Woods, and with the view that Western security required asymmetric economic arrangements between the US and Europe. The EPU, in combination with the large devaluations of all major European currencies over 1948-9, resulted in a rapid improvement of the European payments position after 1950. By mid-1952, continental Western Europe was in balance on private sector trade with the US. Continuing large flows of US civil and military aid to Europe led to a steady increase in their dollar reserves. Over 1950-7, the OEEC countries' reserves increased by $6.5 billion, of which $5 billion accrued to West Germany alone. This increase in European reserves consisted in almost equal parts by increases in gold and foreign exchange, with new dollar reserves accounting for almost all of the latter. Accordingly, the 1950s saw the rise of the gold-dollar standard, which rested upon a presumption that the dollar would continue to be fully convertible into gold at $35 per ounce.[18]

From 1950, the US was effectively acting as banker to the Western alliance. Large US current account surpluses were financed by even larger capital outflows and official transfers, leading to the voluntary accumulation of dollar reserves by European countries. The contrast with the interwar period could not have been greater. Growing confidence in Europe due to rapid growth in incomes and trade eventually enabled the major countries to return to effective current account convertibility at the end of 1958.

However, the gold-dollar standard was in trouble as soon as the transition period for Western Europe had effectively ended. Within a decade, it had collapsed. The trouble began in 1958-9, when the US Treasury lost $3.4 billion in gold reserves, compared to just $1.7 billion over the previous eight years (see table 1). The erosion of the real price of gold due to wartime and post-war inflation had led to a steady reduction in the flow of new gold onto the London gold market. This developing shortage led European central banks to present dollar balances for conversion into gold at the US Treasury's 'gold window'. In contrast to the previous decade, over 1958-67 increases in foreign exchange reserves (mostly dollars) accounted for 72% of the total increase in global reserves, with new gold reserves adding only 9% and new IMF and BIS (Bank for International Settlements) reserve positions contributing 19%. In other words, the drying up of gold production meant that European countries had only two options: to move towards an effective 'dollar standard' by allowing the gold composition of their reserves to fall steadily, or to try to maintain the gold-dollar standard by asking the US to convert some dollar reserves into gold.

**Table 1: Selected comparisons of major industrial countries, 1950-75**

| | **Country** | **1950** | **1955** | **1960** | **1965** | **1970** | **1975** |
|---|---|---|---|---|---|---|---|
| | US | 1.00 | | 1.00 | | | 1.00 |
| **1. Ratio to US GDP**[a] | Germany | 0.14 | | 0.22 | | | 0.23 |
| | Japan | 0.10 | | 0.16 | | | 0.33 |
| | UK | 0.22 | | 0.21 | | | 0.19 |
| | France | 0.14 | | 0.15 | | | 0.19 |
| | US | 17 | 18 | 17 | 16 | 15 | 13 |
| **2. Shares of world exports (%)** | Germany | 3 | 7 | 10 | 11 | 12 | 11 |
| | Japan | 1 | 2 | 3 | 5 | 7 | 7 |
| | UK | 11 | 10 | 9 | 9 | 7 | 5 |
| | France | 5 | 6 | 6 | 6 | 6 | 6 |
| | US | 68 | 62 | 47 | 34 | 30 | 27 |
| **3. Shares of world gold reserves (%)** | Germany | - | 3 | 8 | 11 | 11 | 12 |
| | Japan | - | - | 1 | 1 | 1 | 2 |
| | UK | 9 | 6 | 7 | 5 | 4 | 2 |
| | France | 2 | 3 | 4 | 11 | 10 | 10 |

[a] GDP is calculated in constant (1984) $US.
*Source:* Walter, *World Power*, 153.

Robert Triffin was the first to signal that this caught the US and the world on the horns of a dilemma.[19] If the world continued to rely upon dollar deficits to provide international liquidity, eventually the convertibility of the dollar into gold must be undermined; if the US took action to reduce or eliminate its deficits to maintain gold-dollar convertibility, the world would be plunged into a liquidity crisis with potentially disastrous consequences. For Triffin and many others, the gold-dollar standard was inherently unstable and should be replaced by a more rational system akin to that envisaged by Keynes during the war (this was to become the proposal to create ‘Special Drawing Rights’ within the IMF). Others disagreed, arguing that the gold-dollar standard could be saved by a substantial increase in the real gold price, increasing the supply of new gold and revaluing US reserves.[20]

An increase in the gold price was politically unacceptable to the US government during the 1960s. It would favour the French, who had openly called for such an increase, and the Russian and South African producers. The US attempted to persuade other countries to reduce their demand for gold, organizing the Gold Pool (made up of the central banks of the major industrial countries) in 1961 in response to growing pressure in the private gold market. However, continuing large US overall deficits ensured that by the end of 1967, US gold reserves had fallen to $12 billion while short term liabilities to foreigners amounted to $30 billion. The long-resisted devaluation of sterling in November 1967 unleashed a rush from dollars into gold. This forced the abandonment of the Gold Pool and the separation of the private and official gold markets in the Two-Tier Arrangement of March 1968. From this time, even the official gold convertibility of the dollar at $35 per ounce was tenuous. Everyone realised that any attempt at large scale conversion of dollars by central banks would force the complete closure of the US Treasury’s gold window. It was but a short step to Nixon’s decision formally to take the dollar off gold in August 1971.

Hence, the real question was not whether the gold-dollar standard could be saved by an increase in the gold price or by replacing it with a Keynes-style world central bank. It was whether Western Europe, and above all West Germany, would accept a *dollar standard*. After all, there was never any serious prospect that the US would significantly reduce the aid, military and investment outflows producing the overall deficits. These were the very basis of US hegemony within the West, and they continued unabated. Nor, despite their growing criticism of American monetary policy in the 1960s, could Western European (or East Asian) countries have seriously desired the economic and political consequences of any such reductions in the US role. There was a series of *ad hoc* measures designed to limit US capital outflows and to reduce the balance of payments costs of foreign troop deployment in the 1960s, but these had limited impact. The politics of the Western alliance were consistent with the dominant role of the dollar within the international monetary system.

The French government understood this linkage, but mistakenly believed that it might be broken. In a famous press conference in 1965, President de Gaulle called openly for the restoration of the Gold Standard. A barrage of French criticism of US policy followed, suggesting that through its inflationary payments deficits, the US was paying for the Vietnam war, Johnson's Great Society, and the acquisition of European assets 'on credit'. The claim that the US enjoyed an 'exorbitant privilege' within the alliance and the international monetary system touched a raw nerve in Washington, as did France's policy of demanding gold for French dollar reserves and its withdrawal from NATO's integrated military command. The quest for French monetary autonomy was directly linked to its desire for symbolic military autonomy, resting upon its ability to free ride upon America's willingness to defend West Germany.

As suggested above, however, this source of apparent French strength constituted the main source of American hegemony within the Western alliance. France could not overcome the effective leverage that the US enjoyed over Britain, Japan and West Germany due to their dependence upon US military protection. Although many European leaders apart from France agreed with de Gaulle's economic analysis, America's most important allies had a basic security interest in the creation of the dollar standard. West Germany was the linchpin of the American strategy. The German government agreed to offset the costs of US troop deployment and prevailed upon the Bundesbank to agree not to convert its dollar balances into gold. The Bundesbank gave a pledge to this effect in the celebrated Blessing letter of March 1967.[21] The US reached similar agreements with other major holders of dollars, all of whom were important and relatively loyal US allies. France's inability to persuade West Germany to accept French military protection in place of American underlined the basic weakness of de Gaulle's strategy.

Hence, between 1967-71, the US unilaterally changed the basic structure of the international monetary system. It could do so because of its position as leader of the Western alliance. A formal dollar standard was formally and relatively quietly instituted in the Smithsonian Agreement in December 1971, which revalued other major currencies against the dollar and left the latter inconvertible into gold. However, security leverage could not ensure the stability of the dollar standard. The increasing pre-eminence of domestic economic objectives in American policy thinking, as indicated by growing support within the Nixon administration for a floating exchange rate system, rendered the new system unstable.[22] Furthermore, increasing short-term capital mobility made greater policy coordination between the major countries necessary at the same time as basic policy objectives were diverging. In 1970-71, the US Federal Reserve was reducing interest rates to stimulate a sluggish domestic economy, while the Bundesbank was increasing interest rates to reduce what it saw as largely imported inflation. This led to a massive flow of funds into the Deutschemark (DM) which undermined German monetary policy. When this happened again in early 1973, the Bundesbank convinced the German government that enough was enough, and the DM floated off its dollar peg. The dollar standard lasted for an even shorter period than the Bretton Woods system.

The central problem with the theory of hegemonic stability as an explanation of the evolution of the international monetary system until 1973 is that it ignores the degree of choice available to the US hegemon. The US decision to oppose European calls for a revaluation of gold ensured that the gold-dollar standard was beyond saving. America's ability to foster the emergence of the unstable dollar standard rested upon its security leverage as alliance leader. To concentrate, as does the theory of hegemonic stability, upon the consequences of the economic decline of the hegemon risks missing the point. That said, the neo-realist version of the theory usefully links the economic decline of the hegemon with eroding interests in systemic openness. Certainly, there is little doubt that the shift in US policy that did occur reflected a general feeling in the Nixon administration that perceived US relative economic decline made the existing system additionally intolerable. However, the theory is unable to explain why the hegemon was successful in forging a new international monetary system that, although it was more consistent with perceived US interests, was not obviously a step away from systemic 'openness'.

Finally, similar problems afflict the theory of embedded liberalism. The change in regime was hardly the result of a new transnational consensus. Dissatisfaction with US monetary policy was running so high in West Germany and elsewhere from the late 1960s that without German security dependence upon America, it is doubtful that the dollar standard (at least in the form the US was offering it) would have been acceptable. Within only a few years, the combination of destabilizing US macroeconomic policy and the rise of détente led to a German decision to abandon the dollar standard altogether.

### *3.2. US-European trade relations until the Tokyo Round*

By the end of the 1960s, Atlantic trade relations had become only slightly less conflictual than monetary relations. This reflected very similar forces: the more rapid economic growth of US allies, the growing penetration of American markets in certain sectors, and the associated deterioration of the US current account position from the mid-1960s. As the neo-realist version of the theory of hegemonic stability suggests, relative US decline brought with it a declining interest in the existing system. To this extent, the theory is useful as a broad explanation. However, it is unable to account for the chronology of trade liberalization between the US and its major allies in Western Europe. The 1960s witnessed more substantial liberalization in the 1960s than in the 1950s, when US economic preponderance was much greater.

As early as the mid-1950s, when the European boom was well under way, Congress became increasingly dissatisfied with the apparently slow pace of European trade liberalization vis-à-vis the US. However, in three GATT rounds from 1950, culminating in the Dillon Round of 1960-1, average US tariffs were cut by less than 10%. This was partly because the easier reductions had been made in the 1940s, but also because the item-by-item approach to tariff reduction had run out of steam. Democrats in Congress shifted towards a more protectionist stance over the 1950s. This constrained the Eisenhower administration's authority on tariff cuts (usually to the order of 5% per year), and imposed various 'peril-point' and escape clause conditions.[23]

The passage of the Kennedy administration's Trade Expansion Act of 1962 signalled the reversal of this protectionist trend within Congress. The result was the successful Kennedy Round of 1963-7, when average US industrial tariffs were cut by 35%. In the 1962 act, Congress handed the new President 50% tariff-reducing authority over five years, allowed the utilization of an across-the board method rather than item-by-item bargaining, limited peril-point and escape clause protection, and authorized negotiations on non-tariff barriers (NTBs). While the immediate reason for the greater success of the GATT in the 1960s lay in the shifting ground of domestic US politics, we must ask what caused this shift.

One explanation is that the Kennedy administration managed the domestic politics of trade policy much better than the outgoing Eisenhower administration. Kennedy undercut forces for protection within Congress by providing adjustment assistance for displaced workers and firms, and bought off politically important sectors like textiles with specific protection.[24] He took charge of the marketing of the proposed legislation, more effectively selling the benefits of freer trade to Congress than had Eisenhower.

However, the vigour of the Kennedy administration in pushing for trade liberalization was itself in part the product of two other factors: the perceived need for a renewal of the

Western alliance and the rise of the EEC as a trade power of considerable weight in the world economy. Both played a central and interconnected role in Kennedy's speech to Congress of 25 January 1962: 'The growth of the European Common Market -- an economy which may soon nearly equal our own...[has] laid the groundwork for a radical alteration of the economics of the Atlantic Alliance.'[25] The rise of the EEC and the potential trade- and investment-diversionary impact of the EEC's Common External Tariff (CET) and Common Agricultural Policy (CAP) upon the US was central, particularly given concern about the deterioration of the US payments position. American trade negotiators understood that the diversity of the EEC would make it impossible for them to negotiate on the old item-by-item basis, requiring the shift to an across-the-board approach.

The economic threat posed by the EEC to the US was most important in producing the shift in domestic politics. After all, there was nothing in the bipolar structure of security relations that had changed since the 1950s, when intra-Western trade negotiations were less successful. However, the politics of alliance trade had become inseparable from the politics of alliance security. Although one could trace the origins of the Atlantic 'burden-sharing' debate almost to the very beginnings of NATO,[26] the Kennedy administration was signalling publicly in its call for a 'two-pillared' alliance that a much stronger Europe needed to play a greater role within NATO. It is doubtful how serious the US was in wishing to accord Europe equal status within the alliance. Many European governments, and not only Paris, saw Kennedy's policy as an attempt to have them pay more without removing their subordinate status. The US request for a restructuring of the alliance was largely ignored by Western Europe until the Nixon administration's much blunter insistence on a full dialogue in 1971. In the meantime, individual countries such as West Germany quietly made concessions on US troop costs and on trade.

The neo-liberal version of the theory of hegemonic stability does help to explain the shift in US economic priorities towards demanding that other countries contribute more to the provision of ‘international public goods’. However, this shift constitutes a major difficulty for the neo-realist version of the theory. This version holds that the economic decline of the hegemon brings with it a declining interest in systemic openness. Yet the perception of relative US economic decline produced more active US leadership within the GATT and ultimately much greater trade liberalization than in the 1950s. Thus, the direction of causation appears to be the opposite than that predicted by the theory.

The Kennedy Round was in large part a US-European dialogue. Table 2 indicates the trade power of the EEC. What the EEC lacked in cohesion on trade policy it made up for in its sheer weight in the international trading system.[27] As the CET gradually replaced individual countries’ tariffs over 1959-68, the US government understood the implications of this growing weight and shifted its trade policy in response. The US also assumed that the EEC would eventually expand to take in the UK and other smaller Western European countries, although France’s 1963 veto of Britain’s first application was a major blow to this assumption. The willingness of the EEC (and particularly France) to use this bargaining power to resist US calls for the liberalization of the Community’s agricultural trade was indicative of the shift from hegemony towards bipolarity in international trade. The failure to liberalize agricultural trade was one of the major failures of the round. The liberalization of manufacturing trade, through US-EEC bilateral bargains, was its central success.

**Table 2: % Shares of World Exports (Excluding Intra-EC Exports), 1960-85[a]**

| | 1960 | 1970 | 1975 | 1985 |
|---|---|---|---|---|
| US | 17.2 | 15.9 | 15.1 | 13.8 |
| EC | 27.4 | 26.5 | 20.4 | 18.7 |
| US + EC | 44.6 | 42.4 | 35.5 | 32.5 |

**[a]** Calculated from UNCTAD, *Handbook of International Trade and Development Statistics* (New York, 1992), tables 1.1 and 1.12.

As suggested above, the neo-liberal version of the theory of hegemonic stability does help to explain why eroding US trade hegemony could be consistent with greater trade liberalization. However, the neo-liberal version is misleading in its focus on the GATT as an international public good. It ignores the fact that the US-EEC dialogue in the Kennedy Round was a bilateral relationship nested within a military alliance. GATT trade liberalization in the 1960s was overwhelmingly in products of interest to the major industrial countries, who were members of a US-centred alliance. The GATT system was less a world free trade system than a trade system established by an alliance leader. The 'success' of the Kennedy Round must qualified accordingly. It was considerably less important for the developing countries, let alone the Soviet bloc countries who remained outside the GATT. Mutual security interdependence provided the US and Western Europe with incentives to liberalize trade amongst themselves. This was partly due to the habit of cooperation and partly because their mutual enrichment would enhance rather than diminish their common security vis-à-vis the USSR. However, this was more true of the US-German or US-British relationship than that between the US and France. As in money, France remained the great antagonist for the US within the GATT. However, West Germany's inclination to side with the US rather than France on issues of trade liberalization pushed the Community's trade policy in a more liberal direction.

### *3.3. Comparing trade and monetary evolution*

In the post-war economic system, GATT survived, but Bretton Woods collapsed. This poses a particular problem for the neo-liberal version of the theory of hegemonic stability, which has placed emphasis upon the ability of regimes to outlive hegemonic decline. If both were international public goods, why should one survive and not the other?

The neo-realist version of the theory of hegemonic stability is more plausible in the monetary sphere, since it could be argued that US power remained sufficient to engineer a 'breakdown' of Bretton Woods to foster a more liberal international financial system.

However, *some* decline was presumably necessary to produce a shift in US interests within the international monetary system, but how much is unclear. The great imprecision of the independent variable of hegemony makes arguments over whether the US has declined 'enough' a bottomless pit. All we are able to say is that from the late 1940s to the early 1970s there was a clear shift in the balance of economic power away from the US towards other countries in the system, including Western Europe. This places the neo-realist version of the theory in considerable difficulty, since it predicts systemic closure as a result of hegemonic decline, yet the GATT was more successful in the 1960s than the 1950s.

Thus, both versions of the theory of hegemonic stability can only be at most half right. The US had lost interest in the Bretton Woods system by the time of the Nixon administration, and was able to engineer its destruction. The new international monetary system that rose up in its place was more a product of a combination of Anglo-American cooperation and competition in the deregulation of finance than of hegemonic regime creation.[28] However, the GATT, despite some difficulties, continued to be in the interests of the US and all the other major industrial countries, and this largely explains its resilience. This provides a little respite for the neo-liberal version and for embedded liberalism.

Many feared in the early 1970s that the international trading system would go the way of the Bretton Woods system, particularly given the 'new protectionist' response in the West to exports from Japan and newly industrializing countries. However, much of the so-called new protectionism was quite old, a manifestation of the embedded liberal compromise rather than its breakdown. It was thrust into the light of day by the very success of intra-alliance tariff-cutting in the Kennedy Round. When it was new, it usually represented a common response to a new set of problems that affected both the US and Western Europe simultaneously. From the late 1960s, rising import penetration in certain manufacturing sectors of the US and European economies produced a protectionist response. In 1968, in response to pressure from the steel industry, the US administration negotiated voluntary export restraints (VERs) on Japanese and European steel exports to the US. In their wake, VERs on products such as footwear, automobiles and consumer electronics followed. The basic cause was not simply the overvaluation of the dollar, but a long term shift of comparative advantage in labour-intensive industries towards Japan and the low wage newly industrializing economies (NIEs) of East Asia.

The competitiveness of Japan and the East Asian NICs in these sectors was difficult to deal with because it broke the trend of 'intra-industry' trade that had characterised Atlantic trade in the 1950s and 1960s. Intra-industry trade growth and the embedded liberal compromise had been mutually self-reinforcing, since all countries could liberalize trade but maintain similar industrial structures. New protectionism resulted from the gradual opening up of an international trading system that hitherto was restricted to the North Atlantic area (see table 2). In the Tokyo Round of the GATT from 1973-9, the US and Western Europe attempted to deal with NTB issues in less buoyant economic conditions. However, they increasingly protected important sectors from growing extra-Atlantic area imports.

Yet even if trade policy-making had become much more difficult, there was certainly no wholesale collapse of the transatlantic trading system, as some had predicted in the early 1970s. The structure of the GATT did not prevent the US (or Europe) from seeking new solutions in trade policy, as had the Bretton Woods system on the monetary side. It has enabled both to pursue NTB protection to sectors suffering from international competition. It also permitted Europe and later the US to pursue regional arrangements with preferred partners, and to use bilateral mechanisms to place additional pressure on countries like Japan to liberalize. Bretton Woods, by contrast, simply ceased to be in the interests of the major countries, above all the US and West Germany.

## 4. Conclusions: Security, society and hegemony

Despite its shortcomings, the theory of hegemonic stability will remain central to the study of post-war international relations. As most of its critics accept, the theory usefully points to a direct relationship between the dramatic success of post-1945 international economic regimes compared to the interwar experience and the assertion of leadership by the US after 1945. It helps to explain why a large state such as the US should have perceived an *economic* interest in such leadership. More generally, the theory is suggestive as a starting point for understanding the relationship between the structure of the international political system and the stability and openness of the world economy. For all of these reasons, the theory of hegemonic stability has been highly influential both in academic literature and in more popular accounts of world economic order.

To say that students must study the theory of hegemonic stability, however, is not to argue that it provides an adequate account of post-war international economic relations. As we have seen, two other competing theories, alliance leadership and ideational consensus, suggest that two other important sources of stability existed in post-war economic relations between the US and Western Europe. Deciding which among these three factors is pre-eminent is probably impossible. This will not satisfy those who prefer parsimonious theories, but some kind of theoretical amalgam seems unavoidable.

We have seen that the two most popular kinds of theory, the two versions of the theory of hegemonic stability and the theory of embedded liberalism, cannot stand by themselves as satisfactory explanations of the construction and evolution of the post-war world economic order. Theorists have ignored the way in which the security structure impinged upon them and modified them in crucial ways. The security structure initially helped to push US hegemonic leadership in a more constructive direction in European terms, away from implementing Bretton Woods-style rules, towards promoting regional integration.

By the 1960s, however, the stabilizing impact of the security structure for US-European economic relations had become more ambiguous. In trade, growing US fear of the economic threat posed by the emergence of the EEC led to the success of the Kennedy Round. On the monetary side, however, the security leverage enjoyed by the US over West Germany and others enabled the US to marginalize support for alternatives to the unstable dollar standard. Unfortunately, this outcome contributed considerably to the partial erosion of the trade regime in the 1970s.

Michael Webb and Stephen Krasner have argued that there are two possible reformulations of the theory of hegemonic stability in response to the argument that it is often inconsistent with the evidence.[29] The first alternative is that the US might have declined but still possesses sufficient hegemonic power and interest in maintaining openness in the world economy. The second is to argue that the US has declined 'enough', but that there is some form of lag between hegemonic decline and the closure of the world economy. The first is unconvincing, not simply because of the problem of adequately defining when hegemony does and does not exist, but also because we have seen that it provides a misleading account of the construction and evolution of the major post-war economic regimes. The second not only suffers from this difficulty, but implies that the theory requires major modification, as Webb and Krasner themselves suggest.

This chapter has argued that alliance politics was crucial to understanding the post-war international economic system. In the late 1940s, US hegemonic leadership of a constructive kind stemmed from security rather than economic motives, and the theory of hegemonic stability diverts our attention from this fact. In addition, the North Atlantic alliance helped to solidify the embedded liberal compromise within and between the US and Europe. The Soviet threat weakened the influence of forces within US society which might have picked apart embedded liberalism after the New Deal had waned. It also strengthened the hand of those (mainly within the foreign policy elite) who took a more tolerant view of allied economic policy. It also nudged important European countries such as the UK and West Germany towards the more market-oriented end of the embedded liberalism spectrum.

However, the stabilizing impact of the alliance upon domestic political economy in the major industrial countries had its cost. This was particularly so in the case of the US-Japan relationship, where a consistent US policy of turning a blind eye to Japanese protectionism contributed to the sudden and destabilizing outbreak of popular resentment in America in the 1980s. The point can be made more generally. Growing US trade deficits and the difficulties of high-profile US industries in international competition from the 1970s resulted in an increasingly widespread American perception that its provision of ‘international collective goods’ has imposed net costs upon the US economy. There is little doubt that this perception is an exaggeration, to say the least. The long term economic and political benefits to the US of prosperity and stability in Western Europe and Japan, and of a resoundingly successful NATO alliance, have been very large if inherently incalculable. However, the popular demand to shift US foreign economic policy firmly in the direction of national economic interest and away from the goal of alliance solidarity is understandable. The problem is that it goes against the grain of the growing integration of the US into the world economy.

Thus, although the Western alliance is central to an understanding of both US hegemony and post-war US-European economic relations, a theory of international economic openness or stability that relies entirely upon security structures is also unsatisfactory. Alliances alone are unlikely to be sufficient to produce cooperative behaviour, particularly (as with the US at present) if there is a strong feeling of exploitation by alliance partners. The relative stability of the post-war regimes was precisely to do with the fact most of the parties involved perceived them to be legitimate. While there were major senses of grievance, particularly on the part of the French, de Gaulle was unable to convince his European partners that these grievances justified the wholesale rejection of American-led regimes. Although this was partly because of Germany's greater security dependence upon the US, it was also because the German, British and other governments often felt French criticisms to be illegitimate. US hegemony worked best when it worked within the transnational norms of the Western countries and while the important countries did not dispute the distribution of alliance burdens. Important work remains to be done on the impact of the shifting security structure upon international economic relations since the early 1970s.

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[1] Charles P. Kindleberger, *The World in Depression, 1929-39* (Berkeley, 1973), 292.

[2] See Charles P. Kindleberger, 'International Public Goods without International Government,' *American Economic Review*, 76 (1986), 1-13; Robert O. Keohane, *After Hegemony* (Princeton, 1984); Duncan Snidal, 'The limits of hegemonic stability theory,' *International Organization*, 39 (1985), 579-614, and Joanne Gowa, 'Rational Hegemons, Excludable Goods, and Small Groups: An Epitaph for Hegemonic Stability Theory?', *World Politics*, 41 (1989), 307-24.

[3] The regime school paid little attention to Kindleberger's argument that rules would be insufficient in a crisis, when hegemonic power resources would be required for stabilization.

[4] Stephen Krasner, 'State Power and the Structure of International Trade,' *World Politics*, 28 (1976), 317-43; David A. Lake, *Power, Protection, and International Trade : The International Sources of American Commercial Strategy, 1887-1939* (Ithaca, 1988).

[5] Robert Gilpin, *US Power and the Multinational Corporation* (New York, 1975), 104-6.

[6] Keohane, *After Hegemony*, 137.

[7] Robert O. Keohane and Joseph S. Nye, *Power and Interdependence: World Politics in Transition* (Boston, 1977), 30-1. See also Krasner, 'State Power,' 322-3.

[8] See Joanne Gowa, 'Bipolarity, Multipolarity, and Free Trade,' *American Political Science Review*, 83 (1989), 1245-56, and Joseph M. Grieco, 'Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism,' *International Organization*, 42 (1988), 485-507.

[9] John Gerard Ruggie, 'International Regimes, Transactions and Change: Embedded Liberalism in the Post-war Economic Order,' in Stephen D. Krasner (ed.), *International Regimes* (Ithaca, 1983), 195-231.

[10] See G. John Ikenberry, 'A World Economy Restored: Expert Consensus and the Anglo-American Post-war Settlement,' *International Organization*, 46(1992), 289-321. The combination of 'hard' and 'soft' hegemonic power has received increased attention in recent years, particularly from the 'Gramscian' school. See Stephen Gill, ed., *Gramsci, Historical Materialism, and International Relations* (Cambridge, 1993).

[11] E.g. Joseph S. Nye, *Bound to Lead* (New York, 1990), 39-40. In an otherwise sceptical account of the hegemony thesis as applied to the 19th and 20th centuries, Nye is curiously willing to accept with little argument its applicability to trade and money after 1945. For a more persuasive account, see Henry R. Nau, *The Myth of America's Decline* (New York, 1990), part II.

[12] Andrew Walter, *World Power and World Money* (Hemel Hempstead/New York, 1993), 159-61.

[13] Note that the depth of protectionist sentiment in the post-war Congress well into the 1950s is difficult to reconcile with the neo-realist view that the hegemon should be more free trade oriented than medium-size countries.

[14] Interestingly, however, in the 1962 Trade Expansion Act, Congress gave the Kennedy administration the across-the-board tariff-cutting authority that the British had asked for during the war.

[15] See Alan Bullock, *Ernest Bevin: Foreign Secretary* (Oxford, 1985), 451-2.

[16] Of course, it created a new conflict between British and American policy over the question of Britain's participation in the project of European integration, a conflict on which America also eventually gave way.

[17] E.g. Wolfram Hanreider, *Germany, America, Europe* (New Haven, 1989), 323-4.

[18] See Walter, *World Power*, 163-4.

[19] Robert Triffin, *Gold and the Dollar Crisis* (Yale, 1960).

[20] Milton Gilbert, *Quest for World Monetary Order* (Wiley, 1980).

[21] See Gregory F. Treverton, *The "Dollar Drain" and American Forces in Germany* (Athens, Ohio, 1978).

[22] Joanne Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods* (Ithaca, 1983).

[23] Baldwin, *Trade Policy*, 52-56.

[24] The Long Term Agreement on Trade in Cotton Textiles of 1962 provided for an international system of bilateral quota arrangements, later extended into the Multi-Fibre Agreement in 1974.

[25] Reprinted in Ernest H. Preeg, *Traders and Diplomats* (Washington, 1970), 282-90 (at 282).

[26] During the 1950s, one of the difficult issues of alliance burden-sharing was the US attempt to get Europe to bear more of the burden of integrating Japan into the world economy. European countries initially refused to provide Japan with full MFN treatment, even after it joined the GATT in 1955. See Gardner Patterson, *Discrimination in International Trade* (Princeton, 1966), ch.6.

[27] World import shares would be a better measure of US and EEC bargaining power within the GATT, but figures on intra-EEC imports were unavailable.

[28] On this, see Eric Helleiner, 'States and the future of global finance', *Review of International Studies*, 18 (1992), 31-49.

[29] Michael C. Webb and Stephen D. Krasner, 'Hegemonic stability theory: an empirical assessment', *Review of International Studies*, 15 (1989), 183-98 (at 195).