Is United States' Economic Power in Decline? Can China Replace the U.S. as the World’s next Economic Superpower?

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Is United States’ Economic Power in Decline? Can China Replace the U.S. as the World’s next Economic Superpower?

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Chapter 1

Introduction

During George W. Bush’s first term many intellectuals in the International Relations (IR) field were talking about the greatness of American power. Many of them labeled the United States “the new Rome on the Potomac” or “A Modern-day Empire”. The United States accounted for twenty-five percent of the world’s economic output with its five percent of the world’s population (Nye, 2010: 2). The U.S. made up nearly half of global military expenditures; at the same time, it had the most extensive soft-power resources (Nye). However, starting with Bush’s second term in office, an increasing number of scholars have hotly debated the future of the U.S. power and its hegemony. They are insisting that something fundamentally changed in the U.S., and they interpret this fundamental change as the beginning of American power decline, which is very much reminiscent of the Athenians’ Sicilian Expedition. It is well-known case in the IR that the defeat of Athenians in Sicily was the turning point for Athenians. This changed the way their power was regarded by its enemies, and more importantly, by its allies. Before the shocked defeat, Athenians were seen as a powerful state that was able to hold wide and strong alliances against its enemies. However, after the defeat, due to the decline of Athenians power, many of its former allies made new alliances against Athenians. According to scholars, this is exactly what is happening to the U.S. They believe that starting from the second half of the first decade of 21st century the U.S. is losing its power in the international relations with fewer allies. Actually, this is not the first time that this debate has been raised. Since World War II, scholars, politicians and economists have resurrected the issue of the decline of U.S. power for each decade. Mao’s victory in China in the late 1940s, the Korean War, the Sputnik challenge of the Soviet Russia in the 1950s, the social unrest and Vietnam War in the 1960s, the
end of the Bretton Woods system and the oil shocks in the 1970s, Japan’s challenge and
gressions in the 1980s, the dotcom bust, September 11, the war in Afghanistan, and especially
in Iraq, were interpreted as the beginning of the American decline. The financial crises of 2008
and the rise of China as a world next superpower could be the latest cases of the same debate.
However, intellectuals who support the idea of U.S. power is in decline believe that this time is
different and the decline is real.

This overall situation raises questions that if it is really something different than previous
cases? Is decline of U.S. power for real this time? In most definitions, national or state power is
defined as a mix of military, social, political and economic strengths. However, since the
establishment of the modern state system, many intellectuals have considered economic
strength or power as one of the most important indicators for measuring national power.
According to them, without economic power there is no way to increase military and political
power capabilities. The links among a nation’s economic prosperity and its growth as a military,
political, and then super power became much stronger in last centuries. Economic power has
become the key to success in world politics following the end of the Cold War. From that
perspective, this research paper will focus on the economic side of the debate by scrutinizing
whether U.S. economic power is in decline and whether China is replacing the U.S. as the
world’s next economic superpower.

The questions above make measuring economic power correctly in the 21st century
crucially important. It is also important that the inefficient or inadequate methodology or
absence of good variables to calculate national economic power will make this research invalid,
unreliable and inaccurate. However, before we take into account all these concerns and focus
on our economic variables, we have to know what power is and what are the resources of economic power in different parts of history and especially in today’s world?

Power is one of the most important and most discussed terms in International Relations. In its most general sense power is the ability to do things and to control others. Robert Dahl defines power as “the ability to get others to do what they otherwise would not do” (Dahl, 1957: 205). Coercion plays important role on Dahl’s definition. Meanwhile, Morton Baratz and Peter Bachrach argue that it is possible to shape others’ preferences by controlling their expectations of what is legitimate or feasible (Bachrach and Baratz, 1963: 641-642). In this case, if others accept the legitimacy of the institutions and the social discourse, then these people may not feel coercion while they are taking their decisions. Finally, Joseph Nye argues that before measuring power in terms of the changed behavior of others, we have to know other people’s preferences. He thinks a person or an institution can shape basic or initial preferences. In other words, Nye says without overriding your initial preferences, a person or an institution can get you to want the same outcomes that this person or institution wants (Nye, 1990: 26).

It is commonly agreed by scholars that a state’s ability to shape other states’ behavior is associated with the possession of certain resources that this state has but other states do not or partially have (Waltz, 1978: 192; Morgenthau, 1967: 106-158; Kissinger, 2015: 9; German, 1960: 138-144). However, the same agreement can’t be reached on what these resources are. Despite a wealth of data, there is persistent disagreement for the questions of how to measure the economic power of states in a changing world and what sources provide the best basis for economic power.

Throughout the modern state system, different economic power resources played a crucial role in different periods for measuring economic power of the leading countries. For example, in
early modern Europe, most of wealth creation and economic rise of states is connected to military capabilities of these states. However, it was clear that without economic resources there was no way to increase military capabilities. Since most of the 16th century, warfare was fought by armies composed largely of mercenaries of various nationalities that were paid by monarchies. From that point, once a country increased its trade and its finance, then this country would find it easier to maintain large armies. Paul Kennedy indicates this correlation. In his study, he points out the link between productive and revenue raising capabilities and military strength (Kennedy, 1987: xvi). Therefore, finding additional economic resources to cover costs of the wars was the only way to protect the wealth and prosperity of states in this era. From that point, starting from the 16th century, some countries took a leading role for exploiting natural resources and building colonial trade in the New World.

The link between controlling oversees trade and an individual nation’s economic rise become much stronger in the 17th century. A.T Mahan, George Modelski and W.R. Thompson believe that the economic leadership role of a state is based on the particular nation’s use of naval strength to control the world’s oceans and merchant marines (Mahan, 1890: 1; Modelski and Thompson, 1988: 1-5).

Average cost of any war was increased by double in the 18th century (University of Nevada – Las Vegas). Countries in this century fought until they were militarily and financially exhausted. Joseph Nye, J. Peter Submilch and Stephen Krasner stress population by emphasizing its economic side. According to them, the welfare of a country was directly proportional to its population. In this period, the extent and effectiveness of a population size could be seen in the service of production and wealth creation (Nye, 1991: 7; Submilch, 2011: 74; Krasner, 1999: 19-20).
Many dramatic changes occurred in the 19th century that made it quite different from earlier eras. Due to that, economic power resources changed significantly. The mercantilist thought lost its popularity; meanwhile, the century witnessed the rise of free trade ideology. Improvements in transportation and communication played important roles on states’ strength in this century. Besides that, industrial and technological developments made drastic amendment in states’ economic power status.

Hans Morgenthau is one the most effective scholars who focuses on states’ industrial or economic capacity. He strongly believes that industrial or economic indicators lead to military power, and then national power (Morgenthau, 1967: 106-158). Many other intellectuals who analyze this century believe that countries’ share of world output was the main indicator of their economic strength. The production of coal and steel output was taken as a potential national strength and industrialization indicated a country’s overall economy and its technical capacity (Singer, Bremer and Stuckey, 1979: 165-166).

Scholars’ definitions of economic power in the 20th were not very different than that of 19th century. Like in the previous century these scholars pay specific attention to production, industrialization and share of world output. Davis Kinsgley uses national income as a proxy for states’ economic power. In his study he stresses that the idea of increasing real income per capita is connected to attaining greater national economic power (Kingsley, 1954: 206-242). Charles Hitch and Roland McKean use Gross National Products (GNP) in their analyses. They believe advancement in the military technology has dramatically changed the threat that nations face in the 20th century. Countries which effectively resist these new threats are the ones that have substantial economic power. According to Hitch and McKean, countries’ substantial economic power can be regarded as the nation’s capacity to produce goods, as
measured by gross national product (Hitch and McKean 1960: vi). Bruce Russett also believes that GNP is one of the best indicators for measuring national economic power in this century. However, he thinks due to the difficulties inherent in conversion to a common currency unit, total fuel and electric energy consumption for each nation might be even better summary measure of national economic power. He clarifies that by explaining the strong correlation between energy consumption and gross national product (Russett, 1968: 293). He also believes that using energy consumption as an indicator for national economic power makes cross-national comparison much easier and more reliable.

Government revenue is another indicator that is used for calculating national economic power in this era. Steven Rosen used central government revenue as a rough measure of national economic power and explains that by saying there was no GNP data available for the time before 1930. Today the data is available; however, Rosen believes that government revenues as an indicator for measuring national economic strength may be more sensitive than gross national product (Rosen, 1972: 171).

Scholars who focus on a single economic indicator believe that their measures are sufficient and appropriate. However, they are criticized by mathematically sophisticated scholars. These intellectuals bring several multivariable approaches with many additional variables to the field of measuring national economic power.

One of the earliest users of multivariable measurement was Klaus Knorr. According to Knorr, main bases of national economic power consist of states’ foreign trade transaction, volume of this transaction to size of GNP, international currency reserves and gold and its natural resources (Knorr, 1973: 84-93). A.F.K. Organski focuses on a variety of economic elements for measuring economic power of nations in the 20th century. According to him,
economic power is about industrial and technological power, which is based on machinery production or manufactured goods (Organski, 1968: 139). He asserts that great manufacturing countries have always been great economic powers such as Germany, Great Britain and the U.S. According to him, elements that are very much related to national economic power are the share of world output, production of iron and steel and industrialization (Organski).

New technologies from information & communication to manufacturing, from biotech & life sciences to energy fields have created huge changes in the traditional bases of economic power in the 21st century. Scholars Nye, Ferguson, Kirshner, Cumings, Gilboy and Cox focus on economic indicators such as the size and quality of GDP, trade, export-import balance, finance stability, productivity, the level of technology and science, natural and human resources, and political and legal institutions for markets in order to measure economic power of the nations.

As it mentioned above that different power resources played very different roles in different periods throughout history. Therefore, finding resources that provide the best basis to measure the states’ economic power is crucially important for analyzing this study’s research questions. It is important that this paper’s research questions have been studied at length by various scholars. However, as this paper covers them in the second chapter, most of these scholars’ studies suffer a multiplicity of weaknesses. Thus, there is a need for a more comprehensive research study that properly analyzes this topic. In that respect, this research study, which is different from earlier studies, not only gather and interpret the data. It also reveals the stories behind the data, and answers not only “what, when, and who” questions, but also “why and how” questions which prior research studies miss. This paper asserts that there is no way to draw a conclusion or persuade readers if the study does not provide a proper explanation behind the data. From that point, after taking everything into account, this research
study’s results contradict the results of previous studies. For example, contrary to most of the previous studies, which state that the financial crisis of 2007-09 created a situation that significantly undermined American economic power, this research study finds out that U.S. economic power is not in absolute, long-term, fundamental and irreversible decline. It is in a relative decline (a decrease in relative external economic power) that the U.S. has experienced several times in the past. From the same perspective, contrary to many previous studies, which argue that China will displace the U.S. as the world’s next economic superpower, this study reveals that it will be very hard for China to continue its high-paced economic growth in the future. That means rather than displacing the U.S. as the world’s next economic superpower, China’s future will be more about dealing with its own economic problems.

All these assertions are scrutinized in detail after the methodology chapter. In the next chapter this paper focuses on scholars and their analyses on whether the U.S. is a declining economic power and whether China is replacing the U.S. as the world next superpower. By reviewing literature, this research paper aims to find out new angles and ideas that further explore the topic.
Chapter 2

Literature Review

The literature in this review encapsulates numerous perspectives. Some scholars in IR argue that American economic power is declining. They believe that something has changed in the U.S. (such as Kennedy and Johnson administrations’ huge domestic and international expenditures, serious financial and economic problems in Nixon and Carter administrations, growing income inequalities in Regan administration) and/or in the world (such as OPEC’s oil embargo, Japanese and German industrialization and their rapid economic growth) and they interpret these changes as the beginning of American economic decline. From that point, they think U.S. economy very much resembles those of the past eras of Spain, the Netherlands, France, and the British Empire. On the other hand, some contemporary intellectuals interpret the financial crisis of 2007-09 as a watershed event that changed the economic balance of power in the world. They believe it was an economic catastrophe for the U.S.; therefore, it diminished U.S. economic power in the world. In addition, a big part of contemporary intellectuals’ arguments are based on China. According to them, China has proved its economic prowess in the world by growing at ten percent on average for more than 30 years which permits China to challenge American economic power all around the world. From that point, many scholars who think American economic power is in decline also believe that China will displace the U.S. as the world next economic superpower. In order to explore certain perspective from important scholars, the following section will look at individual scholars’ perspectives.

One of the most well-known intellectuals, Paul Kennedy, pays special attention to countries’ productive economic resources in his prominent study in the late 1980s. According to
Kennedy, the U.S. was the most economically powerful country in the world after WWII. The U.S. possessed two-thirds of the world’s total gold reserve, produced more than half of the total manufacturing production, and supplied one-third of the world’s exports (Kennedy, 1987: 385). However, not more than three decades later, he asserts the U.S. encountered serious economic problems, which cost the U.S. to lose the relative share of the world’s wealth, production, and trade. He links this decline to his theory of “imperial overstretch”, which refers to the overextension either economically or militarily eventually leads to the exhaustion of vital domestic resources, and decline (xv-xvi). Kennedy believes that all Great Powers—Spanish, Dutch, French and British—shared the same set of conditions that extensively allocate their resources for defense instead of investment and research and development. This eventually led them toward decline in their power and in losing their abilities to hold or carry out their economic and military roles in the world. Paul Kennedy believes that there are similarities between the U.S.’s position today and the declined Great Powers in the past. Like other great powers in the past, in order to secure its dominant status, the U.S. felt it necessary to assign more resources for defense while its economy was in decline. In the 1970s and 1980s U.S. share of global manufacturing and GNP was down, agriculture was in crisis, government was heavily in debt, and inflation was high (432-434). However, at the same time, the U.S. increased its military expenditures overseas and devoted a large share of its resources to the military forces. Kennedy believes this leads the U.S. decline in its economic power and then national power which is very much the same case for the Great Powers in previous centuries (434).

Clyde Prestowitz also believes that the U.S. economy is in trouble and supports Kennedy’s thoughts from different aspects. According to Prestowitz, America seriously over-stretched its economy (Prestowitz, 2010: 39). He asserts that due to six false doctrines, the U.S. is experiencing a relative and absolute decline in economy that makes the U.S. each year look a
little bit more like that of previous Great Powers of Rome, Spain and Great Britain. His list of doctrines includes; the prioritization of short-time geopolitical interests, the cultural shift toward consumerism, the belief of market fundamentalism, the theory of pure free trade, the globalization of U.S. corporations, and the addiction to cheap energy (72-247). Prestowitz stresses that most of these doctrines worked fine in the past; however, it becomes apparent as the global economy and the U.S. evolved that the U.S. needs to adopt new doctrines. Prestowitz believes that in today’s world, while the U.S. loses its economic supremacy, China is moving toward the top. Due to its production technology, its transportation and communication infrastructure, its tax and financial incentives, its highly disciplined and energetic labor force, and its currency that was managed to remain weak against the dollar, China is gaining more economic power each and every year, which turns the country a dominant power of the world economy. Prestowitz visualized China’s economic rise as a natural return to its historic position (2005: 58-75). However, he did the same kind of analysis three decades earlier. In the second half of the 1980s, he thought that U.S. economy was in decline and talked about the end of the American economic hegemony. According to him, a powerful state must sustain a leading role in a wide number of industries (1988: 503). In the 1970s, the U.S. was the world leader in technology, military, industry and finance. However, a decade later, the U.S. was the leader only in military power. In other areas the U.S. had traded places with Japan. According to Prestowitz, the dynamism of Japanese management, the cooperative and flexible attitude of labor and the supportive role of government were the reasons of Japan’s economic success (108). He asserted by that time that Japan became an undisputed economic superpower (3). Time shows that he was not right on his finding that Japan became the world undisputed dominant economic power. Since his analysis Japan has struggled with many crises that many times sent the country into serious long-lasting recessions and economic slowdowns. He admitted this two decades
later by saying Japan seems like a dying country. According to him, the reasons behind this include overvalued yen, changes in the tradition of government-business partnership, raising other new Asian competitors, its energy dependency and competitiveness (2015: 148-169).

Donald W. White is another scholar who also believes that U.S. economy has gone through cycle of rise and decline. He says after the end of the WWII, as the world’s leading economic power the U.S. had produced almost half of the world economy. In the early 1970s he indicates the figure had fallen to less than 30 percent (White, 1996: 383). White stresses that even though U.S. economy was in decline, many government officials by that time still believed that economically the U.S. were unchallenged in the world while they were celebrating the achievement of the world’s first trillion-dollar economy. A decade later, the American percentage of world production slid from almost 30 percent to nearly 20 percent (384). From that point, like Prestowitz, White believes that economic leadership of the U.S. was challenged by some countries, particularly Japan. However, White asserts that American economic decline was not the result of the revival of Japan. He thinks Japan had not grabbed some secret information that had been unknown to the Americans. According to him, Japanese were doing the same things that Americans had done in earlier periods, such as applying technology to production, working hard for the future reward, putting capital into production of high-quality goods at low cost, and providing most of their citizens a sense of well-being (402). From that point White thinks that Americans opened the way for Japanese to exceed them economically by choosing consumption on luxury and foreign goods instead of focusing on discipline of production.

About two decades after White’s analysis, Charles A. Kupchan makes a claim about future challenger of the American economic hegemony which is very different than other intellectuals’
findings. According to Kupchan’s research, with its superior technological base, its competitiveness and its huge market, Europe will soon emerge as America’s only major economic competitor. Kupchan believes that the intense focus on regional trade in the EU made European countries economically stronger and competitive. Besides that, following the sharp decline of the U.S. technology sector in the early 2000s, the venture capital began flowing primarily to Europe, which increased the possibility of productivity of Europe that the U.S. had enjoyed a decade ago (Kupchan, 2002: 137). Kupchan predicts that as Europe’s productivity, competitiveness and wealth increase, so will European’s appetite for greater international economic influence. And as the U.S. dominates the international economic order, the EU’s search for greater economic autonomy and status, which eventually take the form of resisting U.S. international economic influence (119-154). Since Kupchan’s analysis EU has experienced with many serious economic and political crises which brought the Union on the verge of disintegration. From that point, it is clear that like Prestowitz’s study over Japan, Kupchan’s analysis over EU was not justifiable. However, Kupchan sees the financial crisis of 2007-9 as a tragic event that created harsh economic realities for the U.S. According to Kupchan, new economic situation in the U.S. undermine its dominant status in the global economic order (2012: 62-67). Therefore, he thinks that in the twenty-first century the U.S. will not be the dominant power of the international economic order. However, Kupchan argues that nor China or anyone else will be the world economic superpower. He thinks there will be many economic power centers in the world such as China, India, Brazil, and Europe. From that point, he believes that for the first time in modern history, the world will not have an economic center of gravity (2012: 3).

Robert O. Keohane, in his influential 1984 book, agrees that the ability and willingness of the U.S. to allocate significant resources to maintain its international economic regime declined
few decades after the WWII. He thinks it seems unlikely that the U.S. will regain its global economic leadership in the world that it had during the 1950s and the 1960s. According to Keohane, the reason for this decline was the production and control of oil (Keohane, 1984: 176-178). He thinks the ability of the United States to carry out its economic leadership mostly depended on control and exploitation of oil supplies abroad and then the ability to remain as a leader in multilateral trade and monetary regimes (178). But due to the dramatic changes (end of the gold standard system, the oil crisis etc.) in the 1960s, and especially in the 1970s, the ability of the United States to control the oil market and use this control as a source of influence over Europe and Japan seriously declined. This decline eventually weakened U.S.’s trade and its monetary regimes. In all, it caused the U.S. to lose its global economic leadership (201, 244).

Like many other intellectuals Thomas J. McCormick believes that the U.S. emerged from the WWII as the only global economic power. According to him, the American economy at the end of the WWII was the workshop, the bakery, and the banker of the world. On the other hand, all other previous Great Powers; Great Britain, Germany, France, Soviet Union and Japan laid in ruin and their economies were completely devastated by war (McCormick, 1995: 47). However, few decades later in his analysis which is similar to Kennedy’s overstretch theory, he asserts that the U.S. global economic leadership is in decline due to transferring a huge amount of resources from civilian to military production, neglecting modernization and research and development needs of the domestic industrial plants, and overinvesting in foreign countries (7). McCormick indicates that these policies eroded American productivity and competitiveness. This situation eventually created serious economic crises, structural unemployment, economic slowdowns, income inequalities, heavy tax loads, and triple-dip recessions. He thinks that in the post-Cold War era the Soviet economy went over the cliff; however, the American economy hovered on the brink of the same cliff (239).
Stanley Hoffman compares U.S economy at the end of the 20th century with U.S. economy at the end of the WWII. He argues that most of the economic decline is normal and also has been planned by the U.S. He thinks since WWII the U.S. has done everything possible to help the economies in Japan, South Korea, Taiwan, and Western Europe even though its share of world GDP negatively affected from this policy. For the period after the Vietnam war Hoffman agrees with McCormick that overconsumption, underinvestment, insufficient industrial productivity, short-sightedness in industry, and lack of research and development were major factors that caused U.S. economy to decline (Hoffmann, 1998: 95-96). He believes in the current system U.S. global economic leadership status has been put in doubt, by Japan and also by the rise of United Europe mostly dominated by Germany (122).

Gideon Rachman characterizes the era after the end of Japanese threat to American economic hegemony as the age of American supremacy. However, about a decade later, he thinks this age come to an end with the arrival of new economic challenger, China. He asserts that China as an economic challenger is really different than previous ones (Rachman, 2011: 60). According to Rachman, China has proved its economic prowess on the global stage by growing at nine to ten percent on average for about three decades (60-61). This economic prowess is already allowing China to challenge American economic influence all over the world. On the other hand, he argues the predictions of the demise of the Chinese economic achievements were wrong in the past (such as the prediction of economic stagnation after the Tiananmen Square massacre in the late 1980s, or the prediction of economic meltdown due to fragile structure of Chinese financial-banking system), and these kinds of predictions will be wrong in the future (63). Roger Altman supports Rachman’s argument by revealing that China emerged from the financial crisis unscratched while countries all around the world were severely affected from it. According to Altman, the reason behind that is the nature of the Chinese political and
economic systems that are completely different than western world. First of all, the Chinese financial system plays a small role in its economy. China remains relatively closed economy in terms of foreign capital or portfolio investment. Besides that, China runs a budget surplus and carries little government debt. In addition, Chinese households save more than 40 percent of their incomes that increase Chinese investment and its foreign exchange reserves (Altman, 2009: 8). In sum, Altman indicates that due to these factors China is little affected by the financial crisis while much of the rest of the world has been hit seriously (9). On the other hand, Rachman argues with the statement that says because globalization spreads liberal economic values such as a free and open market, deregulation, privatization, and competition to, China will become an economically more liberal country in the future. According to Rachman, these assumptions will not work out, by using Beijing Consensus or Chinese Economic Model, China has managed to use policies that curb liberal economic values on the one hand and it continues its economic success on the other hand. Therefore, Rachman believes that China will be dominant economic power in the world and that every country will be obligated to adapt to this very new situation (Rachman, 2016: 2-5). From that perspective, John Ikenberry probably disagrees with Rachman. According to Ikenberry, it is true that economic power and influence is undeniably flowing away from the U.S. to China and the U.S. will be less able to shape the world economic order. However, he asserts that economic system that was created by the U.S. and its allies after the WWII is still alive and well (Ikenberry, 2011: 57-58). Ikenberry thinks over many decades liberal economic order has facilitated many regional and global transformation. For example, many countries in East Asia, Southern Europe, Eastern Europe, and Latin America transformed their economic structures and joined the international trading system with the help of American-led liberal international order. From that point, he believes that neither China nor any other emerging powers want to contest the rules and principles of the liberal international
order. China just wishes to gain more authority within the system. Besides that, Ikenberry thinks that alternative economic order “Beijing Model”, which is less open, more strict, rule-based model that includes heavy state involvement in the economy, would not advance the interest of other states on a global scale due to the fact that there are always a few states in this system which opportunistically exploit the other countries (61).

Jonathon Kirshner does not agree with the idea that says the American-led liberal international economic model is strong and stable and China is fine with its principles. Kirshner believes that China has a huge desire for reducing its dependency on the U.S. dollar and American-dominated global economic model. For that desire, Chinese leaders accelerate the pace of RMB internationalization, promote regional monetary cooperation, and propose reform of American-led global monetary management (Kirshner, 2014: 120). Kirshner explains the reason why China wants to change global economic model with the declining economic power and influence of the U.S. He believes that the financial crisis of 2007-09 undermined American economic power and influence in the world (2). According to Kirshner, the starting point of this decline was actually before the financial crisis of 2008. He says in the East Asian crisis, the America-led economic model which advocates the free-market economic principles and the reduction of state involvement was met with skepticism first in some Asian and Latin American countries, and then in much of the world with big resentment (80). After various financial crises at the end of the 1990s and the early 2000s he emphasizes that, countries that rigorously followed American-led economic model or Washington consensus principles usually ended up with serious economic crises. Later, the financial crisis of 2007-09 accelerated this process. Kirshner thinks the crisis brought up another important consequence other than relative erosion of the economic influence of the U.S. It was the reality of the increased economic influences of China. He indicates that China has experienced sustained and exceptional growth for over thirty
years. Due to this growth, the Chinese economy reached over 50 percent of the size of America’s from its seven percent at the end of the Cold War (157). Therefore, China wants to play a major economic role in the new world; however, Chinese leaders think American-led global economic order prevents them playing that role.

Niall Ferguson is another scholar who thinks the time for China has arrived. According to him, China is on the brink of surpassing the U.S. as world’s leading economic power and the financial crisis of 2007-09 just acted as an accelerator of that trend (Ferguson, 2011: 307-308). He believes that the decline of U.S. economic power is mostly about huge budget deficit and public debt in the U.S. He believes that it is very hard to achieve any economic growth under a heavy debt and deficit burden (2014: 147). From that point, even before the financial crisis he tries to take attention to U.S. soaring budget deficit and national debt. However, he said even though the seriousness of the problem, many Americans including well-informed scholars refused to believe bad financial conditions of the U.S. Ferguson believes this is because of East Asian capital that finance and stabilize U.S. unbalanced budget each and every year (2004: 262). After the financial crisis, he indicates that the fiscal position of the U.S. was worse than that of Greece. The debt-to-revenue ratio (which is the ratio of sovereign debt to all government revenue) of the U.S. was over 300 percent in 2009 (2011: 310). Other than debt-to-revenue ration, he believes that government solvency is also very much depended on interest rate that investors demand. From that perspective, he stresses that more than half of the U.S. debt is in the hands of foreign creditors and over a fifth is held by the monetary authorities of China (311). In sum, Ferguson believes that the U.S. is at the end of its economic predominance and China is very ready to be world next economic superpower.
Fareed Zakaria like most of previous intellectuals above believes that China has been experiencing rates of economic growth over the past few decades that were once unimaginable. On the other hand, the U.S. has been struggling with slow growth, high unemployment and overwhelming indebtedness (Zakaria, 2012: 2). The financial crisis of 2007-09 worsened the situation for the U.S. For many years saving and investment rates are low and trade, budget and account deficits are high in the U.S. By contrast, China has high saving and investment rates and trade and budget surpluses during the same period. In all, China has grown over 9 percent for three decades. Besides that, China’s income per capita has increased twentyfold and its foreign exchange reserve is the largest in the world (100-110). Zakaria describes the country as one of the most successful development stories in world history. From that perspective, he believes that the world is experiencing a great economic power shift. In the old world, American economic ideas had been the starting points for international economic action. However, after the financial crisis of 2007-09 the U.S. lost its economic power and its ability to create broad coalition in order to solve complex economic problems of states in the world (232). On the other hand, he states that China is taking up more space and more roles for the world economic problems.

There are some scholars on the other hand who think economically the U.S. is still the most powerful and most influential state in the world. They argue that there is no clear long-term absolute U.S. economic power decline. Some scholars believe the U.S. is in a relative economic power decline in terms of U.S. share of world gross products, share of global manufacturing activity, employment and GDP growth. At the same time, they admit that the U.S. has serious debt and deficit problems. However, they assert that this is not the same idea that the U.S. is in irreversible economic power decline. There are many factors, such as market size, competitiveness, productivity, national resources, human development, technological and
scientific achievements and the role of dollar in the world that make the U.S. the largest and richest economic power in the world. On the other hand, they criticize scholars who think China will be the world’s next economic superpower. They believe these scholars are exaggerating China’s economic achievement. They believe that China will face serious financial and economic problems in the future that put this country into the middle-income trap like other countries such as Mexico, Russia, Brazil and Turkey. From that point, they predict that China in the future will be all about meeting the needs of its own people rather than creating a global economic hegemony.

Samuel Huntington believed there are no facts or events that prove the U.S. economic power is in decline. According to Huntington, scholars who believe the U.S. is losing its economic hegemony in the world, tend to paint an impressionistic and fictitious picture of U.S. economy. He indicates that according to these scholars U.S. economy is in irresistible decline due to its mounting trade and fiscal deficit and its continuing and even accelerating decline of world production (Huntington, 1988: 76-81). However, Huntington argues that debt and deficit are overwhelmingly the result of the economic policies of U.S. government. These policies are used in order to stimulate investment, growth and revenues. According to Huntington, if these policies fail, they can be reversed by another set of policies that possibly not create any debt and deficit. On the other hand, he points out that the U.S. produced around 40 percent of world product in the 1950s. That share declined drastically to lower 20 percent of world product at the end of the 1960s (81). Since then it has remained the same. He argues that in the past two decades (1968-1988) the share of gross world product certainly has not declined. From that point he asserts that the arguments of scholars who believe the U.S. has suffered precipitous decline and center of economic production is shifting from the U.S. to other countries are obviously not supported by the facts (90-96).
Bruce Cumings agrees with Huntington’s analysis. Cummings believes the U.S. is still the only dominant economic power in the world at the end of the twentieth century. He indicates that the unemployment and inflation rates decreased at twenty-year low, the stock market went up and broke the records, the big federal budget deficit turned into a surplus, and economic growth reached almost five percent in the United States (Cumings, 1999: 271). After all of these factors, like Huntington’s thesis, he claims that no regional or major powers can challenge American global economic position. He thinks American international economic leadership is dependent on various strengths from mass consumption to scientific and technological prowess (275-295). Michael Cox agrees with Cumings and believes the U.S. has a great deal of economic power, much more than any other country in the world, now and for the foreseeable future. He approves Cumings’s list of factors that makes the U.S. a dominant economic power and adds more factors to the list such as natural resources (oil, gas, coal, and food that the U.S. possesses), economic competitiveness, innovation, corporate strengths, and American position in the world economic system (Cox, 2012: 371-376). On the other hand, he accepts that after the financial crisis there are some serious economic problems in the U.S., such as the declining trend of the U.S. share of the world GDP, growing public and external indebtedness and rising income inequalities. However, Cox believes that this is hardly the same idea that U.S. economy is in irreversible or absolute decline. Robert Kagan agrees with that statement. Kagan thinks during and after the financial crisis due to dismal economic situation the perception of American economic decline is certainly understandable. However, he believes the financial crisis cannot be interpreted as the beginning of the American economic decline. According to Kagan, it is true that there is a relative economic decline in the U.S.; however, this is mostly about the choice of Obama administration (Kagan, 2012). He states in order to decide whether American economy is in absolute decline one should do a more rigorous examination
by scrutinizing long-term data such as the size and the influence of the U.S. economy. Kagan argues in terms of long-term factors the U.S.’ economic position in the world has not seriously changed despite the financial crisis of 2007-09 (2012). Kagan interprets the financial crisis of 2007-09 is just another crisis like in the past. He indicates that the U.S. suffered deep and prolonged economic crises in the past; however, in each case, the U.S. rebounded and actually ended up in a stronger position relative to other powers than before the crisis (2012). From the same point, Matthias Matthijs argues that in order to decide whether U.S. economy is in decline, we have to look beyond short-term economic growth performance. We have to focus on long-term growth indicators such as human capital, technology, research and development, innovation as well as on aspects of economic legitimacy such as influence over international institutions, and ability to create and impose economic ideas (Matthijs, 2012:42). He says when we consider all these ingredients we see the U.S. economy is still far ahead of all other countries. In total, he believes the U.S. is more likely than any other states to stay at the top of the world economy in the coming decades (44, 51).

Michael Cox thinks China’s economic success is exaggerated by politicians, intellectuals and some parts of the public. He thinks China, like many other regional powers, has serious internal and external challenges that limit this country’s economic ability to move ahead (Cox, 2012: 379). George Gilboy focuses some of these challenges. Gilboy asserts that Chinese government frequently resists political and social reforms that are needed for a healthy economy. Due to the risks that inherent in China’s unreformed political and social system, Chinese managers focus on short-term profits, local autonomy and excessive diversification (Gilboy, 2004: 33-35). On the other hand, according to Gilboy, Chinese economic reforms are mostly inefficient (36). Gilboy claims that these reforms strongly favor state-owned enterprises that prevent the creation of private sectors. Besides that, China’s entry to the world economy
reinforces its dependence on foreign investment. In order to attract more foreign investment, the Chinese government creates an investment friendly environment for foreign investors. Due to this environment foreign firms accounted for 55 percent of China’s exports and also secure strong positions in the Chinese domestic market (38-40). China’s entry to the world economy also reinforces its dependence on foreign technology. Many Chinese firms need to import critical, high-tech components and manufacturing equipments from the US and other industrialized countries for their domestic operations (38). He believes Chinese markets are fragmented and the rules are constantly changing under manipulation by officials. So from that point, he predicts that without implementing structural economic reforms China cannot be a global economic competitor of the U.S. Matthias Matthijs agrees with these statements and also talks about the stability of Chinese financial market and Chinese economic model that is called “Beijing Consensus”. According to Matthijs the Beijing model and financial market have their own vulnerabilities and without serious reforms they cannot last long (Matthijs, 48-51).

Salvatore Babones’s analyses the issue from different perspective; however, his findings match with earlier scholars’ analyses. According to Babones, China’s massive economic growth over the past two decades was mostly about the two one-time boosts that led to massive increases in economic productivity in China (Babones, 2011: 82). One of these boosts he talks about the population’s declining fertility rate. Babones says declining fertility rate freed up women in China to join the formal labor market. Women, who used to work in the home, are now working in the money economy which increases China’s GDP. The second factor he talks about is urbanization. From the same point, he indicates hundreds of millions of people who used to stay in the village and work on the farm, now moved to cities. Urbanization in China increases GDP because urban populations are more financially productive than rural ones. Babones believes these are the one-time benefits and it already boosted Chinese economy (85-
Therefore, China will face all kinds of economic problems in upcoming future, which make China enter into the middle-income trap (88). From the same perspective, Michael Beckley believes it is true that over the last two decades, China’s GDP has risen more than 8 percent annually and its reported debt-to-GDP ratio reported is very low (Beckley, 2012: 58-59). However, Beckley thinks GDP cannot be taken as a proxy of national economic power. Besides that, Beckley thinks China’s true level of public debt is much higher than reported figures. According to Beckley, China’s real debt-to-GDP ratio is between 70 and 150 percent, which will negatively affect China’s GDP growth soon (60). Beckley also thinks that several factors (surplus of cheap labor and capital, expanding export market abroad, and sufficient natural supplies such as water and air) that promoted rapid Chinese growth in the past are now disappearing (60). From that point, he thinks China’s economic growth will slow in the future, which will create various economic challenges for China.

Charles Krauthammer thinks the China threat is vastly exaggerated. According to Krauthammer, American economic strength is in relative decline and this decline is a choice and it is in America hands (Krauthammer, 2009: 1-5). From that point, his analysis gets very close to that of Robert Kagan. Like Kagan, Krauthammer believes the Obama administration’s liberal ambitious economic policies move America from its traditional individualistic policies to more equitable European style social democratic policies. Krauthammer thinks social democratic policies come with some cost that include higher unemployment, higher debt and deficit amount, less innovation, less dynamism, less productivity, and less overall economic growth (1-5). Besides that, Krauthammer asserts that one of the major threats to the American economy comes from trade deficit, and two-third of this deficit comes from imported oil. However, he thinks this is not a fixed fact. It is a choice. He indicates, for example, if we remove the ban on new nuclear plants, and offshore and Arctic drilling, then we can eliminate our massive trade
deficit. In all, Krauthammer thinks all of these threats cannot still be interpreted as the U.S. is in absolute economic decline. He believes the U.S. has the most dynamic, innovative, productive, technologically advanced economy in the world (5). Krauthammer believes these are the factors that will continue to make the American economy the most powerful economy in the world.

One of the most influential foreign policy thinkers, Joseph Nye, also think that U.S. economy is not in absolute decline, and in relative terms, the U.S. economy will remain its top position in the world in the coming decades (Nye, 2010: 11-12). Nye agrees with Krauthammer’s forces list that makes American economy the most powerful economy in the 21st century. However, he adds more forces such as competitiveness, leading in critical new sectors, investment in R&D, energy and education. According to Nye, the U.S. is doing well for almost all of these forces. For example, U.S. productivity increased significantly after 1995 as well as its competitiveness, which is now ranked as one of the highest in the world (2002: 126-128). He indicates that the U.S. is the world leader for investment in R&D with its huge spending, which is higher than the next seven countries combined (2011: 192-193). The U.S. also leads in many critical new sectors such as information technology, nanotechnology and biotechnology. Besides that, according to Nye, after the shale revolution, the U.S. decreased its dependence on energy imports and actually starts exporting energy to other countries (2015: 79-80). Finally, he thinks American higher education is strong. Higher education spending as a percentage of U.S. GDP is doubled as compared to countries such as France, Germany, Britain and Japan (191-197). However, he claims that doesn’t mean there is no challenges and challenger. For challenges, Nye’s list includes saving, debt, income inequalities and lower level education. According to Nye, U.S. personal saving rate was down to near zero at the beginning of the 21st century from almost 10 percent in the 1970s (2002: 128). In addition, U.S. government debt level exceeds 90 percent (critical point for many economists) of GDP (2011: 195). Nye also argues that income inequality,
which poses serious problems to the economy, is high and it has risen steadily over the past decades. Finally, he asserts that American education is struggling at the lower level. According to Nye, American students at the lower levels are not really improving their knowledge and skills enough to keep pace with an advancing economy in the 21st century (196). On the other hand, he scrutinizes China as an economic challenger to U.S. economic supremacy. It is true that there is a rapid economic growth in China for the last few decades. It is important to know that China benefits greatly from imported technologies and cheap labor in the early stages of economic growth. However, Nye believes China’s growth rates will slow as its economy reaches higher level of development. In addition, Nye asserts that China will face serious economic problems from income inequality, corruption, inefficient state-owned enterprises (SOE), and unstable financial market. From that perspective, Nye believes that China still lags far behind the U.S economy. He thinks China is not likely to become a peer rival to the U.S. on a global basis; however, it could be a big economic challenger for the U.S. in Asia (186).
Chapter 3

Rationale of the Study

After scrutinizing previous researchers’ analyses on declining economic power of the U.S. and rising China’s economic power as the world’s next superpower, it has been found out that there are some gaps and weaknesses in these intellectuals’ analyses. First of all, some scholars have a flawed understanding of American economic role in the world. It is interesting that scholars such as Charles Krauthammer, Niall Ferguson, Clyde Prestowitz and Robert Kagan confused being an economic superpower in the world and enforcing and pressuring on other countries such as Japan, Germany, France, and China to get what it wants on every economic issue. In addition, there has been confusion about one of the critical terms, “decline”, in some of these intellectuals’ studies. The term is ambiguous and has many different meanings. For example, some scholars draw a distinction between relative and absolute economic decline in their analysis such as Joseph Nye, Bruce Cumings, Fareed Zakaria, Michael Cox and Paul Kennedy. On the other hand, some scholars, such as Donald White, Gideon Rachman, Jonathan Kirshner, and Thomas McCormick do not make a distinction and use these two terms interchangeably. However, it is important to know that relative economic decline is very different than absolute economic decline. In relative economic decline, other countries’ economic power increase much faster or greater than the first country’s economic power. For instance, in the 17th century and especially in the 18th century, the Netherlands’ economy was still in a good shape. However, they were in economic decline relative to other countries such as France and Britain, which were growing much faster and greater than the Netherlands. On the other hand, in absolute decline, a country loses some of its critical economic power resources or loses its ability to use economic power resources effectively that leads that country to a long-
term economic (GDP) decline. According to Nye, this type of economic power decline starts inside the country and then it contributes to loss of external power (2015: 20-21). Holy Rome and Ottoman Empires, that experienced a significant decline in economic activities (GDP) over an extended period of time, can be examples of absolute economic decline.

On the other hand, some intellectuals, such as Charles Kupchan, Clyde Prestowitz, Niall Ferguson, and Roger Altman measure current economic power of the countries with short-term data and then make predictions about the future economic conditions of these countries. However, it is crucial to know that there is no single future, there are many possible futures. If factors like humans and their complex interactions are involved in the process, then predicting the economic future of states become so much harder. For example, some intellectuals and politicians such as Horace Walpole and David Tume predicted that the United Kingdom (U.K.) would be an unimportant economic power when the U.K. lost its colonist in the New World (Walpole, 1842: 266; Stanlis, 1976: 192-193). However, they couldn’t foresee the effects of industrial and technological revolutions, which gave the U.K. another century of economic hegemony. In a more contemporary example, it was famously calculated and predicted by many respected intellectuals such as Prestowitz, Hoffman, and White in the U.S., taught that Japan would become “number one” economic power in the world; however, not even a decade later, the Japanese financial system almost collapsed and the country fell into a long-term recession which is known as the Lost Decade of Japan. Finally, in a more dramatic example, before the financial crisis of 2008 -after thousands of research and enormous of data analysis- the president of the Federal Reserve Bank told Americans that the U.S. market could never fail; however, it did only about two years later. All of these examples assure that confidence should be reserved when intellectuals and politicians explain what the world economy is going to look like in 50, 30 or even 10 years later.
From the same perspective, some scholars, such as Charles Kupchan, Gideon Rachman, and Roger Altman, use linear projection of economic growth trends in their studies. However, this could be misleading. It is essential to know that when countries grow, their growths will be more difficult to achieve and happen more slowly. When economies move up the value chain, they move their production from simple manufactured goods to more technological and complex products. In the early stages of production, countries such as China benefit from cheap labor and imported technologies; however, in the upper stages, they have to change their growth model in order to produce more sophisticated products. That process usually slows down their economic growth rate. For instance, it took 30 years for South Korea to raise its GDP per capita from one-thirtieth of U.S. GDP per capita to one-third of U.S. GDP per capita. However, it took about 20 years to reach from one-third of U.S. GDP per capita to one-half of U.S. GDP per capita (Babones, 80). More importantly, if the country fails to innovate or is unsuccessful in changing its economic growth model, then this country’s growth slows down. This is the situation that some countries, such as Mexico, Russia, and Turkey, have already experienced for more than two decades.

It is also important that some scholars failed to focus on key variables related to measuring economic power in the contemporary world in their studies. From that point, they take some economic variables as dogma and ignore the rest. For example, Gideon Rachman, Michael Cox, and Fareed Zakaria consider GDP as the single and most important variable and interpret the health of the country’s economy based on this indicator. GDP is one of the most important indicators; however, measuring overall health of the economy only by this variable makes any research study questionable. GDP is a measurement of a nation’s overall economic activities. From that point, GDP gives no information about composure or structure of an economy. Besides currency values, exchange rates play important roles for measuring GDP. When a
currency is under speculative attack, the market exchange rates of that country become inaccurate which cause a major shift in GDP. On the other hand, for elections or many other short-term benefits, law-makers can use policies such as easy credit and low interest rates in their country in order to increase employment and maximize GDP. However, in the long-run, these policies could have disastrous effects by raising inflation and budget deficit. It is important to know that if there is spending, GDP increases. However, high spending doesn’t always mean a flourishing economy. For example, many oil rich Arabic countries do irresponsible spending on projects that actually bring no benefits to the country in the future. Besides that, GDP does not give information about income inequalities, environmental quality, unemployment, and many other factors that affect people’s standard of living. Finally, in many countries, the value of currencies varies from market to market. For example, Iran uses three foreign exchange rates in its economy. Countries such as Iran, China, Turkey, and Russia constantly use this and other type of methods in order to manipulate their official GDP data. From that point, it is clear that using GDP as a proxy for economic or national power of a country is controversial. In order to support findings about GDP, many other variables should be taken into account such as inflation, demand and supply of currency, debt, saving, export-import balance, and monetary and fiscal policies. GDP is calculated by market exchange rate and market exchange rate is determined by various variables mentioned above. The GDP of a country will be inaccurate if that particular country manipulates any of these variables.

This is not only the case for GDP. The same kinds of challenges are common for the variables such as debt, unemployment, productivity, savings, and interest rates. For example, Niall Ferguson, Paul Kennedy, and Robert Keohane pay specific attention to debt. According to them, it is very hard to achieve any economic growth under a debt and deficit burden. It is true that debt affects the economy and creates serious economic problems from higher inflation to
lower income and from lower investors’ confidence to higher unemployment. However, it is important to know that in some cases debt can be created in order to boost economic growth and finance the investment. For example, many times the U.S. government has increased debt and deficit spending in order to overcome economic slowdowns. This means the debt or deficit spending is not always a bad thing.

Another field which many scholars over-simplify is savings. Savings is one of the essential parts of economics. If there is low savings then there will be low investment and low growth. Many scholars such as Paul Kennedy, Stanley Hoffmann, Gideon Rachman, Fareed Zakaria, Joseph Nye, and Michael Backley emphasize the low savings rate in the U.S. and talk about its negative effects on overall economy. However, it is important to know that in many cases American savings rates are miscalculated. Many intellectuals usually focus on one side of the story by scrutinizing personal and/or government savings of the U.S. However, at the aggregate level the situation looks much better when they add corporate saving into the account. In other words, the low level personal and government savings are balanced out by corporate savings in the U.S. Nonetheless the situation could be at critical level if all three savings levels are low. But even in that case the U.S. has some exceptions. Because there are still many foreigners who want to invest in the U.S. or they want to hold their capital in the U.S. market, which gives the U.S. ability to cover the savings gap. However, that doesn’t make everything fine. If foreigners’ money that comes into the U.S. is used for investment, research and development projects, then this brings beneficial impacts for economic growth. However, if this money is used for budget deficits and excess U.S. consumption, then this creates huge buildups of debts and causes additional serious deleterious impacts on economic growth in the U.S.
Productivity is another variable that needs specific attention. It is one of the most important indicators in economics. A country’s sustained long-term economic growth and its ability to improve its standard of living come from increases in productivity (BCCampus, 2019). Nye, Prestowitz, Babones, Huntington, and Cox focus on productivity and analyze the relationship between productivity and economic growth of the U.S. in their studies. However, in their studies, these scholars rarely analyze the factors that affect productivity. For example, there are some forces that influence productivity over time, such as technological development, human capital, and public capital. However, it is important to know that each of these forces has different level of contribution to productivity. For example, increases in public capital cannot constantly contribute to productivity. It has one-time benefit that boosts the productivity and then its contribution margin decreases. It is important to know that the rate of productivity is very much dependent on the type of force. From that perspective, for example, the reason of Chinese productivity growth in the 1980s is very different than that of 2000s. Due to that, Chinese economy experienced different rates of growth in each of these decades.

It is also important to mention that psychology plays an important role in many researchers’ analyses. When it is compared to other nations, it can be seen that Americans are more likely to worry about their economic decline. Even after the financial crises in the late 1950s and early 1960s, there was pessimism about the future of the country’s economy. The current discussion of decline of U.S. economic power and the possibility of China to be the next economic superpower touch at the nerve of many American intellectuals. From that point, some scholars, such as Niall Ferguson, Jonathan Kirshner, Fareed Zakaria, John Ikenberry, Robert Kagan and Gideon Rachman, constantly talk about Chinese economic growth and its leading position in some fields such as manufacturing and its foreign reserves especially in the U.S. However, in most of the cases, they rarely address whether China can sustain such high
economic growth rates for the next twenty years or more in order to catch up to the U.S. or, they do not specifically focus on factors such as growing imbalance between high savings and low consumption, reliance on export market for growth, weak banking and financial system, and high level of corruption in China. Furthermore, they rarely touch upon political, environmental, social, and territorial difficulties that China is facing at present and which will likely grow more intense in the future. It is clear that all these challenges undermine the overall efficiency of Chinese potential economic growth in the future.

In all, there are many gaps and weaknesses in these scholars’ studies that seriously undermine the measurement of economic power in the 21st century properly. Due to these weaknesses and gaps, it has become clear that their judgment on whether U.S. economic power is in decline and whether the rise of China as the world’s next economic superpower is highly questionable. The overall situation above raises the importance of the following question; why we need to scrutinize this topic.

Creating economic prosperity, stabilizing markets, supporting employment, and protecting business development are the major economic objectives of almost all countries. In order to reach these objectives, countries use various economic policies. It is important that countries’ economic policies are very much relevant to their economic role and/or position in the world. A government can adopt different economic policies if this and other countries’ economic roles and positions in the world have significantly changed. From that point, it is highly possible that the U.S. changes its economic policies if the country is in economic decline or if China rises as a world’s next economic superpower. It mentioned above that scholars who believe the U.S. is in economic decline and China is replacing the U.S. as world’s next economic superpower substantially support protectionist and nationalist policies against China. For instance, if they
persuade the public and officials with their findings, although the situation shows the opposite, then their policies can be adopted as the U.S. official economic policies. These policies like Smoot-Hawley tariff in the early 1930s, can create disastrous consequences by increasing protectionist and nationalistic policies in the industrial sector first and then to all sectors of the economy and not between the U.S and China but all around the world. From many perspectives, this is actually very much what is happening to the U.S. now. However, there is a big chance that these actions or these policies can diminish American economic power even more without necessarily strengthening it. The same can be said for scholars who think the U.S. has the most powerful economy in the world and China cannot be world economic superpower. Underestimating Chinese economic power and ignoring problems such as debt, and low savings in the U.S. and taking no action for fixing them can also create catastrophic consequences for the U.S. economy. For example, it would be a serious mistake for the U.S. to assume that the Chinese economic challenges in the future will disappear. It will be wise for the U.S. to deal with these issues before they get unsolvable. In sum, it becomes clear that a study that fairly presents all perspectives is needed. This actually brings us to next section which is methodology.
Chapter 4

Methodology

Due to gaps and weaknesses in previous scholars’ analyses, there is a need for a more comprehensive study that accurately analyzes whether U.S. economic power is in decline and whether China is replacing the U.S. as a world’s next economic superpower. For analyzing and answering these research questions accurately, we have to measure economic power of the U.S. and China in a changing world correctly. In order to achieve that, this research study adopts the pragmatic research approach. In a pragmatic research approach, there are many different ways of interpreting the world and undertaking research. No single point of view can give the entire picture (Saunders, Thornhill and Lewis, 2012: 109). A pragmatic researcher does not see the world as an absolute unity. The truth is what works at a specific time. There is no law of nature; for example, a certain amount of economic power doesn’t always give any country a guarantee to implement its policies accordingly. It is important to know that there is no country in today’s world and there never was in the past that has/had capacity to get what it wants on every single economic issue. For example, Great Britain which was economically one of the most powerful countries in the world in the 1860s adopted a free-trade policy; however, many countries such as U.S. Austro-Hungarian Empire, the U.S. and Russia by that time opposed this policy by using protectionist policies. From that point, it is crucial that economic power measured in resources does not always equal to economic power measured in preferred outcomes.

For the method of this research study, this research study uses a mixed method research approach for collecting, analyzing, and reporting the database. The reason why this paper chooses this particular approach is because pragmatist approach creates an environment where researchers can use multiple methods, assumptions, and analysis in order to answer their
research problems much more accurately (Croswell, 2003: 204-205). The mixed method research approach basically integrates quantitative and qualitative research and data in a research study. That means for this study this paper collects and analyzes not only numerical data, which is the norm for quantitative research, but also narrative data, which is customary for qualitative research in order to address the research problems. Therefore, this approach provides qualitative and quantitative research strengths. With this approach this study is also able to employ deductive and inductive analysis.

In the first part, this research study qualitatively explores existing case-studies and analyzes perspectives of American economic power. These cases are international economic and financial events such as the collapse of the Bretton Woods financial system, OPEC oil embargo and trade and tariff disagreements in the GATT and WTO from World War II to today. From these cases, this research paper aims to find out whether the U.S. has enough economic power to get other countries to do what it wants them to do. In other words, this study explores whether the U.S. has ability to get other countries to do what they otherwise would not do. After a substantial amount of cases have been scrutinized, this research paper builds a pattern and then develops a theory that explains the data results. In this section, qualitative data is used with an inductive analysis. Cases are gathered from the resources such as documents, books, scholarly and newspaper articles, reports, and historic records such as archives.

A deductive analysis succeeds inductive analysis. Research questions of this section are “Is U.S. economic power really in decline?” and “Can China replace the U.S. as the world’s next economic superpower?” For these questions, this research starts with a hypothesis that says “U.S. economic power is not in decline and China cannot replace the U.S. as world next economic superpower”. These hypotheses are examined by analyzing quantitative data that
collected to explore different economic power variables. It was mentioned earlier that since the beginning of the modern state system, different economic variables have played important roles in different periods for assessing national economic power of states. From that point, it is important to find variables that provide a right mix for measuring economic power in the post-industrial world. For that aim this research study focuses on economic variables such as GDP, consumer price index (CPI) or inflation rate, productivity, saving, and finally budget deficit and debt. The following section provides an introduction to variables, and scrutinizes their interconnected relations by analyzing how a change in one variable very much affects the other variable/s. From that perspective, the next section also tries to explain the reasons why these particular variables are taken as right basis for measuring economic power.

A. Gross Domestic Product (GDP)

The economic power of nations is usually measured by gross domestic product. GDP is basically the total market value of all final goods and services produced within a country (Callen, 2018). Each county measures its GDP in its local currency therefore comparison can become a challenge. Due to that, countries convert their GDP which measured in local currency to GDP in U.S. dollars by using market exchange rate. Market exchange rate is the worth of a country’s currency in terms of another currency. Market exchange rates are usually free-floating and they are determined in the international financial market by the demand and supply of currencies. The demand and supply of any particular country’s currency is determined by several factors such as inflation, unemployment, trade, interest rates, and monetary and fiscal policies of this country. The process seems smooth; however, things are not working out as it is planned. It is always the case that when a currency is under speculative attack, the market exchange rates of countries become inaccurate and misleading which cause significant shifts in GDP measurement.
This is not the only challenge. There are many other cases. For example, for political and social reasons law-makers can make unwise decisions in order to maximize GDP and acquire short-term benefits. Government and the Central bank have a significant impact on the growth of the GDP of a country. For elections or many others short-term benefits government officials can use policies such as easy credits and low interest rates which increase the spending, employment rate and GDP. However, in the long-run these policies could have disastrous effect on overall health of the economy by raising inflation, and budget deficit. In addition, government officials can do irresponsible spending on projects that bring no benefits in the long-run. By definition, if there is a spending, the GDP increases. However, it is crucial that spending doesn’t always mean a flourishing economy. Thus, it is clear that GDP is only interested in the quantity in spending and ignore the more important part of quality in spending. From that perspective, GDP sees them the same way if a country spends $300 million for developing a new tank for the army that never use and a company in this country spends $300 million for producing high tech machineries. Furthermore, GDP does not give information about income inequalities, environmental quality, unemployment and many other factors that significantly affect people’s standard of living. However, all these factors play crucial role on stable and healthy economy in the long-run. GDP neglects the value of non-monetary activities. From that point, it excludes non-market transaction such as household production and unpaid services. However, in many developing countries, major business transactions occurred informally and big parts of transaction are not registered which result in inaccurate low GDP numbers for these countries. It is also important to know that GDP makes no distinction between productive and destructive activities. GDP increases when the numbers of transactions increases in an economy. From that point, it is not very important if the people are sick, if there is a huge natural disaster like a major flood or earthquake, or there is an accident as long as money is spent to treat the sick and
repair the damage. From the same point things such as unsustainable credit card debt, stock market bubbles or sub-prime lending all increase GDP. Besides that, crime, pollution, and resource depletion are also increase GDP if there is spending for preventing crime, mitigating the pollution and rescuing wetlands and forests. In total, it can be said that the GDP alone may not be an accurate indicator that gives information about health of the economy. However, its variation can at least give an idea that if the economy is growing or stagnant or in a recession. It is usually accepted that if there is a stable rising GDP then there is a healthy and growing economy. In this economy people get jobs, earn good wages, and increase their income. On the other hand, if the GDP decreases then the economy of this country shrinks. People lose their jobs, and income. Investors do not invest and production drops. Business revenue and customer spending decline. All these factors can cause a recession. The rule of thumb is that two consecutive quarters of shrinking GDP is the signal for a recession (Berge, 2014: 1). Finally, it can be said that GDP gives a rough view about how well a country’s economy is functioning. It is a good picture that gives an idea about a country’s economy, but it is not a complete picture. For scrutinizing GDP, this paper focus on indicators such as percentage change in the value of all goods and services produced in a country, reason of percentage change, causes of change, sources of long-term GDP growth, share of a country GDP as a percentage of global GDP, monetary and fiscal policies that increase or decrease GDP, and domestic and international events that spur or curb GDP growth.

There are times when the GDP increases as a result of rising prices. In that situation, the country still produces the same amount of goods and services. However, these goods and services are priced higher than a year before. Therefore, in order to compare changes in the production of a country between different periods more accurately, the effect of price changes or inflation must be isolated. For this reason, the term Real GDP is used in this study. Real GDP is
an inflation-adjusted measure that indicates the value in base-year prices of goods and services produced by a country in a given year (Callen). Real GDP provides a more accurate figure of GDP growth.

Conversely, this paper is highly concerned about the reliability of purchasing power parity (PPP), particularly for China’s PPP. PPP is an important economic concept that compares different countries’ currencies through a model called basket of goods and services. In this model, PPP assumes that prices of (basket) goods and services in one country should be equal to prices of similar (basket) goods and services in another country when they are expressed in a common currency (OECD, 2020). This assumption derives from the Law of One Price (LOOP) principle. It is crucial to note that this principle only works within strict circumstances. However, there are some forces, such as trade restriction, transportation cost, government intervention, tax differences, and limitations on competitions, contribute to persistent price differentials in some countries. In that respect, this paper asserts that China strongly uses these forces and manipulates the prices of goods and services. This paper will further discuss this topic within the third section that Chinese authorities use price control mechanisms in various critical areas that includes energy (oil, gas, electricity), food (pork, corn and wheat) and most of the real estate in order to keep the prices of these goods and services within socially reasonable ranges (below the market level). In addition to that, due to various reasons, the Chinese government keeps non-tradeable goods and services (wages, insurance, rent and utilities and public services) artificially low. This is another factor that leads to lower prices. Moreover, low transportation and logistics costs in China reduce the input cost and put downward pressure on prices. Trade restrictions, limitations on competition, and taxes are the other factors that Chinese authorities use for manipulating supply and demand curves in China. All in all, the prices of most of the goods and services are not determined under the free-market principles. Therefore, using PPP,
which works under the LOOP principles, is not an appropriate way to measure China’s economic power in the global economy.

Scholars, such as Jeffrey Frankel and Michael Pettis, address this concern and state that PPP is a good measurement if someone wants to compare people’s living standard or income per capita across countries (Frankel, 2014; 2020; Pettis, 2014). However, if someone wants to compare countries’ power in the global economy, it is better to use GDPs at market exchange rates (2014; 2020). According to Frankel, the size and/or power of a country’s economy is about how much goods and services this country’s currency can buy in the world market; it is not about how much local goods and services this county’s currency can buy in their domestic market (2014). Additionally, World Bank has some concerns regarding the reliability of its PPP statistics. World Bank states that PPP comparisons between countries with different economic structures are less accurate than PPP comparisons between countries with similar economic structures (World Bank, 2017). From the same perspective, World Bank announces that PPP measurement for services are less precise than PPP measurement for goods (2017). Finally, World Bank warns that the credibility of PPP measurement very much depends on the quality of the price data that participating countries contribute (2017). In that respect, it is important to know that China only partially joined World Bank’s International Comparison Program (ICP) in 1993 and, until 2005, China had never participated in a full ICP program (Deaton, 2009: 34). In 2005, China’s price collection took place in 11 cities that Chinese government decided (35). Since then, the Chinese government has increased its contribution to ICP. However, in 2020 Chinese authorities still have many concerns about the reliability of ICP’ results. They believe serious limitations exists in ICP’s results (National Bureau of Statistic of China, 2020). In that respect, they don’t endorse ICP’s results as official statistics (2020). From that point, Chinese officials recommend the use of exchange-based GDP statistic, which is recognized by
governments all over the world (National Bureau of Statistic of China, 2017). From the same perspective, OECD does not recommend using its PPP statistics in many situations that include calculating national growth rate and establishing precise rankings of countries (OECD, 2012: 37). There are also serious concerns about ICP's methodological shift in PPP calculation. It is important to note that ICP, one of the world’s largest and most complex statistical measurements, has been updating its technique and methodology, such as weighing the importance of different goods and services in different countries, in order to make a meaningful comparison of prices across countries since the end of 1960s (Deaton, 52). Nevertheless, after many years of updating ICP’s approach, it is still far from optimal. In sum, this paper asserts that using PPP is not an appropriate way to measure China’s economic capacity. In that respect, the figure (GDP based on PPP) that indicates China’s economy has already surpassed that of the U.S. to become the world’s largest economy is misleading. Therefore, this paper does not take this indicator into account.

B. Consumer Price Index (CPI)

Consumer Price Index (CPI) measures the average change in prices of household goods and services such as food, transportation, medical care, housing, education, appeal and recreation (U.S. Bureau of Labor Statistics, 2016). According to changes in prices the country experiences inflation, or deflation. For example, increasing in prices of goods and services (CPI) refers to inflation. There are many ways that lead to inflation; monetary policy is one of them. If a country uses monetary policies and increases its money supply more than its size of the economy then the purchasing power of currency in that country decreases while prices of everything rise. Besides that, expectations, demand and supply shocks also create inflation. In order to curb inflation, countries usually raise the interest rates. High interest rates lead to high
unemployment, low investment and low economic growth. Eventually all these factors contribute to an economic crisis. Therefore, raising prices are bad for the economy. However, on the other hand, falling prices also create a situation that hurts economy. For example, if prices are falling in a country, then consumers postpone their purchasing decisions in order to get goods and services cheaper in the future. However, this leads to less demand for goods and services in that country which results in less production, less investment and more unemployment. Overall, that situation also causes serious economic slowdown. Therefore, finding the right balance is very important task for governments and central banks. From that point, for example, while decreasing interest rates in order to boost the economy, officials have to be aware of the risks of driving up inflation. From the same perspective, while increasing interest rates for cooling down the economy, officials have to be mindful of the risks of recession that slows productivity, and reduce employment. For analyzing prices and its effect on economy this paper will focus on average price changes over time, causes of these price changes, effectiveness of fiscal and especially monetary policies in controlling price changes, consequences of these policies and its effect on GDP growth.

C. Budget Deficit and Debt

Budget deficit is the annual differences between government spending and government revenue (Peter G. Peterson Foundation, 2019). If the government spends more than it collects then there is a deficit. One the other hand, national debt is the total amount of money that government owes (U.S. Government of Accountability Office, 2019). Therefore, debt means the accumulation of past and present deficits. Budget deficit and national debt affect each other. For example, if there is a deficit then the government has to raise the money to cover the deficit. This type of financing creates public debt. On the other hand, debt decreases tax
revenue and increase budget deficit. Besides that, the interest on the debt is added to the deficit which also increases the deficit. Deficit and debt seriously affect the economy. In some cases, deficit spending can boost economic growth and finance the investment. However, deficit in most of the cases causes serious economic problems. First of all, it increases the national debt. Secondly, in order to cover budget deficit government borrows from the private sectors. Because of that transaction, the private sectors have fewer funds to spend and invest which at the end slowdown the economic growth. Countries with large and chronic deficit struggle to attract investors due to low confidence rate about the future of this economy. Finally, budget deficit causes inflation. For example, in order to cover budget deficit government issues bonds. However, if government-issued-bonds are not attractive then government has to print money to buy bonds on its own. However, during this process money supply increases higher than that of the actual size of the economy which eventually decreases purchasing power of currency. The scenario can be set up differently but each time deficit negatively affects the purchasing power of currency. From the same perspective, national debt also causes serious economic difficulties. First, due to the accumulation of past and present deficits, cost of interest increases. The more government spends on interest, the less is left for anything else. Thus, government raises taxes or cut spending on services for paying the increased debt services. Therefore, rising debt leads to lower incomes. High level of debt diminishes investors’ confidence and decreases foreign investment. From same points, investors doubt about government’s ability to repay debt which results in demanding even higher interest rates. Lower confidence and reduced investment slowdown productivity and wages first, and then overall economic growth later. Debt also decreases government’s ability to respond future economic, political and social crises. Finally, the inflation becomes a serious problem if the government prints money to pay for its debt. This (inflation) would reduce the value of domestic debt; however, it increases the burden of its foreign debt.
Besides that, inflation creates many crucial problems that it mentioned earlier. For scrutinizing deficit/debt section, questions such as how big is the debt/deficit (amount of debt/deficits, debt/deficit-to-GDP ratio, share of global debt as a percentage), what cause the debt/deficit, what percentage of the debt/deficit owned by domestic/foreign entities, and is the debt/deficit getting better or worse need to be answered.

D. Saving

Saving simply means the portion of income that left over after personal expenditures on goods and services is subtracted from the total income (Perozek and Reinsdorf, 2002: 14). Factors such as people’s preferences for the future over present consumption, economic uncertainties, changes in interest rates, government fiscal policies and population characteristics play important role on saving decision. Other than individuals, companies and governments also do saving. Companies’ savings are the part of their profits that do not pay out to shareholders in order to finance investment in the business. From the same perspective, government’ saving occurs when its revenues exceed its expenditures. This is the amount that left to spend for future investments. It is widely known that saving is important for economic prosperity of a country. Savings leads to increase income through investing in investment vehicles. However, if there is not enough saving then there will be less investment which causes lower economic growths, shortages and eventually crisis. Therefore, if the saving rate is low, then individuals, companies or governments have to look for available savings through domestic and international financial institutions. However, that way of finding investment resources bring cost with them. It is also crucial that individuals, companies, and governments cannot heavily depend on financial intermediaries for their investments. Because it is important to note that borrowing indefinitely from financial institutions causes higher inflation and higher interest
rates and then an economic downturn. For that reason, these entities have to cover their investments with their savings. For analyzing saving, this study focusses on indicators such as total amount of saving, gross national saving as a percentage of GNI and GDP, differences among the amount/rate of personal, business and government saving, changes in these amounts/rates over time, the reason of changes and its effect on overall economy.

E. Productivity

Productivity measures output for every unit of input. Increasing productivity indicates greater efficiency in production of goods and services. There are some factors that increase countries’ productivity. Technological development is one of them. Countries improve their productivity as new technologies are introduced and diffuse through the economy (National Academies of Science, Engineering and Medicine, 2017: 55-59). Countries also increase their productivity by investing in human capital. Workers who receive better education, better training, and higher level of knowledge become more productive over time. Another way of improving productivity is investing on public capital. Besides that, countries that provide better infrastructure such as roads, railways, harbors, bridges, airports and power plants make their companies more productive than their counterparts in other countries that suffer from inadequate infrastructure. It is crucial that productivity helps countries to increase their GDP. Other than GDP growth, higher productivity also leads to higher competitiveness, lower unit costs, higher wages, higher profits, better trade performance, and better living standards. Productive countries are more dynamic and very much connected to the world. They invest in technology and critical sectors. They attract highly skilled and creative people all around the world. In the long run it is fair to say that a country’s ability to improve its living standards very much depends on its ability to raise its productivity (Krugman, 1992: 9). On the other hand,
when productivity decreases in a country, it reduces workers’ wages and corporate profits in that country. Reduced wages and profits lead to lower investment rate and lower investment rate causes lower GDP growth rates. In order to examine productivity this paper emphasizes on output per hour of workers, ratio of aggregate output to aggregate inputs, resources that contribute to productivity, changes in these resources over time, and its effect on economic growth.
Chapter 5

Case Studies

Introduction

As it mentioned earlier that power is the ability to influence behavior of others in line with one’s own interest (Organski, 104). Therefore, powerful countries have capacity to force other countries to do things they otherwise would not do or have at least a serious impact on other countries’ decision-making (Nye, 1990: 154; Baldwin 1979: 161). From the same perspective, economic power is the ability to control and influence the behavior of other countries through use of economic assets (Whalley, 2009: 2-9). An economically powerful country has capacity to make decisions that benefit itself alone at the same time this country has ability to decrease the capacity of other countries that pose threats to its interest. In that respect, since the end of WWII, it has been believed that the U.S., as the world’s leading economic power, has played a dominant role for identifying and structuring world economic issues, taking measures to deal with these issues, organizing and implementing international efforts and enforcing norms, rules, and principles to address these issues. However, starting from the end of the 2000s some scholars began to argue that the financial crisis of 2007-09 undermined the legacy of this success. They think due to the financial crisis the world experienced enormous (power) changes, and these (power) changes diminished U.S.’s ability to set the rules and provide solutions for the world economic issues. In order words, these scholars claim that after the financial crisis of 2007-09 the U.S. lost its capacity to influence other countries in line with its own interest. From that point, this study scrutinizes four case studies in the following section and finds out whether the U.S. experienced an alleged power decline. Put it differently, whether the U.S. has enough power to get other countries to do what it wants them to do.
France and the Breakdown of the Bretton Woods International Monetary System

Introduction

It is important that after WWII, the U.S., as the world’s largest economic power, took a special role to provide norms, rules, and principles of the world economic system in order to maintain its dominant position in the system. In that respect, in 1944 the U.S. took a leading role in designing foundation of the world’s international monetary system, Bretton Woods system, which created the rules, norms and principles for commercial and financial relations among the countries.

However, on the other hand, France criticized the Bretton Woods international monetary system from different perspectives, challenged the U.S. leadership position in the system, undermined the confidence of the system and finally played a crucial role in the breakdown of the system.

From this point, this case study aims to scrutinize the relationship between these two powers by focusing on how a war-devastated ‘middle power’ country, France, successfully undermined the Bretton Woods international monetary system, which was mostly designed by the world’s dominant economic power, the U.S. In the first section, this paper gives a brief history of the US-France relations. It is important to examine historical background that could provide possible explanation of the French action of challenging the U.S.-designed international monetary system. The second section focuses on creation of the Bretton Woods international monetary system and tries to find out why the world in the first place needed another monetary system at the end of the WWII. The next section examines whether Bretton Woods succeeded
and whether it contributed to the world’s economic development. From that point, this paper explores who really benefited most from the system and more specifically if the U.S. benefited disproportionately from Bretton Woods agreement. In the last section the focus will be on the French criticism toward the Bretton Woods system and their actions that effectively weakened and helped to accelerate the collapse of the Bretton Woods international monetary system.

History of the U.S. & France Relationship

Even though there may have several areas of disagreements between France and the U.S., the relationship between these two countries has been strong, stable and mutually beneficial for both countries since the 18th century.

It is important that at the end of the Seven Years’ War in the second half of the 18th century France was heavily defeated and expelled from most of its North American lands from the British. Due to the bitterness of its humiliating defeat in this war, having lost most of its territories in North America and a way to get a retaliation from Britain without involving in another direct war with them induced the French to help American colonies for their Revolutionary war against Britain. As a result of that, France formed a critical and friendly relationship with American colonies by signing treaties of commerce and alliance in the middle of the American Revolutionary War. While the treaty of Commerce promoted trade and commercial ties between these two countries, the treaty of Alliance created a mutual defense between the U.S. and the France against Great Britain (The Library of Congress, 2020). It is important that, according to these treaties, neither France nor the U.S. could seek a separate peace agreement with Great Britain (The Library of Congress). It is also important that with these treaties Kingdom of France was the first country that formally recognized the U.S. as an independent nation (U.S. Department of State, 2019).
Starting from the end of the 18th century till the last quarter of the 19th century there were several events that put strain on the relationship between these two countries. The undeclared Quasi War at the end of the 18th century, the declaration of Napoleon as the Emperor of France, his conquest of Europe, depredation of American neutral shipping during the Napoleonic Wars, procrastination in payment of indemnities to the U.S. and then election of Andrew Jackson and his decision of reprisal of indemnities that were not paid by the French were several events in the first half of the 19th century that temporarily raised tensions between these two countries (U.S. Department of State, 2019; 2020; McLamore, 1932: 234-235; Thomas, 1976: 51).

During the U.S. Civil War, France helped the Confederate forces. The reason behind that was to weaken the U.S. power in order to protect its cotton trade in the U.S. and also its large investment in Mexico (U.S. Department of State, 2020). Beside that France took advantages of the U.S. Civil War and placed Austrian archduke of Habsburg on the throne in Mexico. However, the U.S. did not recognize the new government in Mexico and increased its pressure for France to withdraw its forces from there (Library of Congress, 1997).

After the fall of Napoleon III in the middle of the second half of the 19th century the relationship between France and the U.S. started to develop again. However, it was important that there was a significant change on countries’ power. The events after the U.S. Civil War, such as the expulsion of French from Mexico, the withdrawal of the Great Britain from Canada and the purchase of Alaska from Russia made the U.S. only dominant power in the continent. In addition to that, the U.S. went through a big economic transformation. The rapid technological innovation and large-scale agriculture production in the late 19th century accelerated economic growth in the U.S. In sum, from Civil war to the end of the 19th century U.S.’s relative share of world wealth boosted from 15 percent to over 35 percent (Singer and Small, 1993: 60-71).
Meanwhile, France was experiencing a serious stagnation. Its economic power was in decline compared to the U.S. and all other major power at the end of this century. France’s relative share of world wealth declined from 12 percent in 1860s to 8 percent at the end of the century (Singer and Small). There was an economic growth in France from the beginning of the new century to the WWI, however, it was too little too late. France became very dependent on American supplies and financial assistance when WWI started. During the war American support to France was incalculable. It was clear that without the U.S. support the victory would not have been possible for France (Lloyd, 2014). During this period, France acted like a privileged ally of the U.S. France would able to ask for anything and obtain everything from the U.S.

It was important that France was one of the victors of the WWI; however, at the end of the war, France was much needier and much poorer than Central Powers. During the war, France had suffered millions of causalities and borrowed heavily especially from the U.S. Large part of France were devastated and economic growth declined substantially. The huge cost of the war crucially weakened the financial structure of France. Therefore, French thought that the country should never experience anything like that in the future. From that point, France’s main goal was that Germany as the only cause of the war should not be able to rise again. Thus, France aggressively engaged in diminishing German military, economic powers, and its capabilities. On the other hand, the U.S.’s aim was to integrate Germany into the world economic and political community as an equal partner.

These two completely conflicting views created tension between the U.S. and France. Other than that, there were some other issues such as President Wilson’s 14-points proposal for the World peace and prosperity, the U.S. senate’s decision that refused to ratify the League of Nations treaty, the problem of France’s huge war debts and the U.S.’s demand on repayment of
its bonds in full, on the other hand, American financial assistance to Germany which allowed that country to pay for reparations, French insistence on building a strong Poland that annexed some German land in order to create hostility between these two countries and their desire for establishing an European army that watch and keep Germany down added more pressure to the U.S.-France relationship (National Archives, 2020; U.S. Senate, 2020; BBC, 2011; Reinhart and Trebesch, 2014: 23-24).

It is important that in the early interwar years the U.S. became the de facto economic and financial center of the world (Federal Reserve Bank of St Louis, 1989: 433). On the other hand, France and its economy were devastated due to loss of labor and infrastructure in WWI. France accounted for only 5 percent of world total wealth at the end of WWI (Singer and Small). It was crucial that as a victorious nation of the Great War, France, seemed unable to create solutions for the political and economic problems of the world. From that point, France, in these years, found itself playing a lower level role in the world politics. The Great Depression in the early 1930s brought many other serious economic and financial problems to this country. In addition to that, political crisis just worsened the overall situation. The country torn apart; governments fell one after another. French public were deeply divided. On the one hand, far right parties supported Mussolini, Franco and Hitler, on the other hand, communist party praised Stalin (Embassy of France in Washington D.C., 2015). Meanwhile nationalist became pacifist due to the fear of communism (Embassy of France in Washington D.C.). French Third Republic was in a serious crisis in the 1930s that made France changed its primary concern from a German invasion to a possibility of a civil war. During this time American influence in France which had started decades ago reached its peak. From that perspective, France desperately looked for help from U.S. when the WWII started.
Figure 1. Relative Share of the World Wealth (1830-1940)

Source: J. David Singer, and Melvin Small. (1993). National Material Capabilities Data, 1816-1985. Ann Arbor, MI: ICPSR. 1993. Note: Singer and Small take state’s mobilizable wealth (which refers to economic resources) and technological development as indicators of state power. They agree that GNP is probably the most commonly used indicator of state’s wealth. However, they think that GNP does not capture important differences in the mobilize wealth (economic resources) and technological sophistication of different states (62-63).

After WWII, Americans were welcome as a liberating force by France. The prestige of the U.S. was at its peak in France after the victory. During the early Cold War period the main goal of France was to secure itself from the German threat by keeping Germany down. Americans, on the other hand, decided to build up Germany, at least, the part of Germany they controlled. The U.S. also wanted to integrate Germany into the Western world. According to Americans, French policy of holding Germany down forever would eventually push this country to Soviet camp (Creswell and Trachtenger, 2003: 5-7). France had little choice in this manner. At the beginning very reluctantly and then increasingly inclined to accept the strategy that the U.S. promoted. French realized that with this strategy Germany integrate into the Western political system which would automatically limit Germany’s freedom of action. Besides that, if Germany stayed divided between east and west, and if Russian forces remained in the eastern part of the country, then western forces and especially American forces would stay in Western Germany.
which would provide France security not just against the Soviets, but also against Germany (Creswell and Trachtenger, 15).

However, it was important that the memories of the war were still in people’s mind in France and anti-German feelings were strong. In that respect, even though France officials embraced this strategy they wanted to proceed carefully, slowly, and cautiously.

Creation of German military unit was another important issue area in the early Cold War era. It was important that Americans were worried that entire Europe would eventually fall into Soviet camp if Western powers did not act on time for creating a defense bloc against Soviet Russia (Condit, 1996: 191-204). According to Americans, Western Germany would be an important part of their defense bloc (Condit). Therefore, the U.S. insisted on rearmament of the West Germany within the framework of an integrated European defense force. On the other hand, France tried to hold back that plan largely for their domestic political reasons, and instead of rejecting this plan they offered an alternative plan of their own which was a creation of highly integrated European Army. However, it is crucial that a few years after its proposal, the French government rejected its own plan and accepted American plan. From France’s standpoint they understood that the U.S.’s western defense force, NATO, plan made sense. According to them, integration of West Germany into the NATO with its limited power would pose no threat to France, and on the other hand, with this way West Germany could contribute to the defense of the West against the Soviet threats (Creswell and Trachtenger: 24-26).
It was highly crucial that during this era France seemed incapable of following a firm and consistent policy against the U.S. The declining power of this country was the main reason of that. France became much weaker than previous times that could only be classified as a middle power country. From that point, France was rarely likely to get its way for most of international issue. On the other hand, the U.S. rose as the dominant economic power and one of the two military superpowers of the world. Like in other cases for rearming the West Germany and creating the western defense force, NATO, the Americans was holding all the cards and eventually got what they wanted.

![Share of World GDP, 1950-1970](image)

*Figure 2. Share of World GDP (1950-1970)*

*Source: World Bank (2020), St Louis Federal Reserve Bank (2019). Note: Nominal GDP is used for measuring countries’ share of world GDP.*

However, it was quite important that starting from the end of the 1950s and throughout the 1960s France was able to pursue completely different policy which was much more stable and persistent than its previous policies. This policy was basically against the U.S. designed international monetary system which is also known as the Bretton Woods international monetary system.

**Bretton Woods International Monetary System**

In its peak of the WWII Allied power governments decided to establish an international economic structure for the post-war period in order to avoid the detected weaknesses of the
economic policies of countries in the interwar period. These weaknesses (beggar-thy-neighbor trade strategy, unstable exchange rate policies, protectionism, and incompatible national monetary principles) were considered as the main contributors of the Great Depression, and many other economic and financial downturns all around the world that led countries by that time to WWII. In the middle of the 1940s the new international monetary system (Bretton Woods) was established. It is important to know that contrary to its name, Bretton Woods international monetary system did not only include countries’ monetary policies. It also covered their economic and financial policies. Two institutions International Monetary Fund (IMF) and the International Bank of Reconstruction and Development (IBRD) later known as the World Bank also created under this system.

Bretton Woods international monetary system very much resembled the gold exchange standard system in the pre and interwar period. However, it was concentrated on dollar. In this system, the U.S. declared par value of its currency as $35 per ounce and all other countries declare par value of their currencies in terms of dollars (Bordo, 1993: 49). Declaring a par value was important. Because member countries had to exchange their own currencies for gold or convertible currency if other countries that held their currency requested it. In this exchange, countries used their declared par value. With this way, countries established a fixed relationship among their national currencies. It is crucial that in Bretton Woods system countries could change their declared par value only within a narrow margin which was plus or minus of no more than 1 percent of point (Simard, Bordo and White, 1994). However, in case of fundamental disequilibrium countries were able to adjust (revalue or devalue) their parities. But, even in this case before adjusting their currencies, countries had to have IMF’s permission.
It is important that in order to prevent external financial and economic difficulties, which created serious disequilibrium problems for its members, IMF could provide financial assistance from its funds. That means, member countries had not relied on specific mutual support agreements among central banks like in the previous monetary system of the interwar period (Truman, 2017: 5).

On the other hand, the Bretton Woods monetary system required its member countries to remove their restrictions on current account. Member countries had to permit inflow and outflow of goods and services (export-import). However, the system allowed them to maintain their controls on capital accounts such as foreign direct investment, portfolio investment, and loans from foreign governments (Helleiner, 1994: 47-48; Ghosh and Qureshi, 2016: 4-5). The reason behind that was the huge speculative movements of money which had undermined the currency stabilities of countries in the previous period (Helleiner, 25-33).

Besides that, member countries in this monetary system accepted some obligations that restricted their discretion. Bretton Woods institutions used surveillance over its member countries’ economic, financial, and monetary policies. A member country that in external financial problems could receive some financial support from the funds only if this country adopted adequate fiscal and monetary policies to correct its underlying economic problems, also if this country’s policies had very little adverse economic effects on other member countries (International Monetary Fund, IMF, 2020).

It is important that it took more than a decade for Bretton Woods international monetary system to fully operated. It was also important that even though all its planning and designing stages the system lasted a little more than a decade (1959-1971). However, it made some significant changes in the world economic and financial environments.
Benefit of the Bretton Woods System

The system was relatively successful and contributed a lot to development of the world free trade. During the era of the Bretton Woods system, the world economy experienced a rapid GDP growth from about $1 trillion in 1959 to $3.3 trillion in 1971 (World Bank, 2020). Besides that, world industrial production grew significantly, and real exchange rates were mostly stabilized. There was a high level of capital mobility, especially between the U.S. and Europe, that helped to increase investment and financial integration among countries (Morawetz, 1977:11-22). A high level of capital mobility and overall economic prosperity substantially increased trade. On the other hand, Bretton Woods institution’s IMF served as agency that set the rules for discouraging opportunistic behaviors of countries, coordinating transition to stability, and increasing confidence in the system. Likewise, another Bretton Woods institution, GATT, reduced tariff, and regulated international trade. Cooperation between governments and countries’ financial institutions increased during this period. Countries tried to find solutions for their problems even in the troubled times. On the other hand, dominance of the U.S. assured confidence in the system especially during the early years.

Who Benefit the most from Bretton Woods System

However, it is important that other than providing confidence to the Bretton Woods system, there were many factors that brought generous benefits to the U.S. First of all, the U.S. dollar was the reserve currency and the U.S. was the currency provider of the system. This is because of the U.S. was the only country at the end of the WWII that was prepared to exchange its currency into gold at the request of other countries. Due to that role, the Bretton Woods system provided a substantial seigniorage right to the U.S. at the expense of other countries. With that privilege, the U.S. was able to print money and send it abroad in huge amount without
the fear of inflation and devaluation. However, it is important that the seigniorage right works only if other countries are willing to accept and add to the dollars they already held in their reserves. The U.S. was able to finance its balance of payment deficit by its seigniorage right (Eichengreen, 2011: 3-4, 117-118). With this right, the U.S. made massive investment, built many military bases, and expanded its influence all around the world.

Moreover, due to its currency role in the world the U.S. had a huge flexibility for deciding its fiscal and monetary policies. The U.S. was able to determine its rate of monetary or fiscal growth with its substantial freedom; however, other countries, given their commitment to peg the value of their currency to the dollar, would have to adjust their monetary and fiscal growth in order to stabilize the exchange rate. Therefore, when the U.S. changed its monetary or fiscal policies, there would be serious spillover effects on financial stabilities in other countries. For example, if the U.S. used expansionary policies, that would create inflationary pressure in other countries. Thus, other countries had to decide what they would do with their surplus dollars, whether they hold it as reserve, or they request conversion of their dollars into gold.

France’s Actions and the Breakdown of the Bretton Woods System

The position of the U.S. in the Bretton Woods international monetary system helped this country to maintain its economic hegemony over the world until the late 1950s and other countries could not resist that. However, starting from the late 1950s and especially in the 1960s there was a country that took the leading role of opposing the position of the U.S. in the world monetary system. This country was France.

France criticized the extraordinary position of the U.S. (as a currency provider) in the Bretton Woods system. French officials thought that due to this extraordinary position American corporations made huge investment in the world especially in Western Europe, and American
government created numerous military bases and launched many military operations all around the world (Simard, Bordo and White, 1994). Moreover, French officials believed that this position allowed the U.S. to fund its balance of payments deficit without making any substantial adjustment. They thought financing account deficit by simply issuing money was the way of exporting inflation to the rest of the world (Bordo, 2017:15-17). French government strongly criticized these and launched a nationalistic policy that deliberately converting their dollars holdings into gold in order to undermine confidence in the dollar and challenge the Bretton Woods international monetary system. With that policy French officials aimed to reduce American political and economic dominance position in Europe and also in the world. From many points, French policy of threatening the Bretton Woods system was somehow successful. The system faced serious difficulties in the second half of the 1960s and finally it collapsed in 1971 when President Nixon cut the link between the dollar and gold.

However, it should be pointed out that the French influence was very weak during the establishment and the early years of the Bretton Woods international monetary system. For example, France officials and intellectuals did not offer any plan of their own in the Bretton Woods conference in New Hampshire. They simply supported the U.S.-U.K. plan as a final agreement. This was because the French economy was experiencing serious internal and external imbalances that restrained France from playing a major role for contributing and designing the world’s next monetary system in this period.

France created its own plan in the late 1950s that put the gold at the center of the world monetary system. From that point, French version of monetary system could be interpreted as an initial phase toward a return to an international gold standard. However, this proposal was mostly neglected by reserve countries. At the end of the 1950s, French government started to
convert its dollar reserves into gold in order to reduce American gold reserves and weaken confidence in the dollar. World Gold Council (WGC) and World Bank financial statistics stated that France increased its gold reserves from 516 metric tons in 1957 to 1458 metric tons in 1960. It is important that most of these golds were purchased from the U.S. Treasury (World Bank, WGC, 1999). Thus, in the same period the U.S. gold reserved declined from 20312 metric tons to 15822 tons (IMF and WGC). A year later in 1961 there was a disagreement between France and reserve countries about expanding IMF’s resources. French government thought that there is no shortage of IMF’s resources. They believed providing limitless source of reserves to nations in difficulties would weaken balancing budget principle of the Bretton Woods system (Dale, 1961).

<table>
<thead>
<tr>
<th>Balance of Payments (1960-68)</th>
<th>Billions of U.S. dollars</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>USA</td>
</tr>
<tr>
<td>1960</td>
<td>-3.4</td>
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<td>1961</td>
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<td>1962</td>
<td>-2.6</td>
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<tr>
<td>1963</td>
<td>-1.9</td>
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<tr>
<td>1964</td>
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<td>1965</td>
<td>-1.3</td>
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<td>1966</td>
<td>0.2</td>
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<tr>
<td>1967</td>
<td>-3.4</td>
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<tr>
<td>1968</td>
<td>1.8</td>
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</tbody>
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Table 1 U.S. and U.K Balance of Payments


From that point, France specifically focused on the size and persistence of the U.S. balance of payments deficit. French officials in the early 1960s warned reserve countries, the U.S. and the U.K., for their huge balance of payments deficit. They believed that due to huge budget deficit of the U.S., the world experiences a generalized inflation. From that point, France criticized the international monetary system from several points. First of all, French officials asserted that Bretton Woods monetary system had no effective institution to control balance of payments deficit. French officials also thought that there was an asymmetry between reserve countries which could easily finance their deficit by printing money and other countries that that had no such a right. From this point France made a proposal for a reform of Bretton Woods monetary system; however, this proposal was rejected by the U.S.
Meanwhile, French continued to convert its dollar holdings into gold. Gold made more than 73 percent of French reserves at the end of 1964 (Simard, Bordo and White). The next year when French reform proposal was rejected by the U.S. they retaliated that by increasing their gold reserved from 3314 metric tons to 4182 tons (WGC). With that rise, gold accounted for 86 percent of the French reserves (New York Times, 1966). Besides that, several high ranking French official include French President de Gaulle aggressively attacked the existing monetary system and discussed the probability of retuning to a gold standard system.

The clash between the French and American views was intensified in the middle of the 1960s. French decided to drop their support for composite reserve unit (CRU) and increased its gold reserves. It was clear for many countries in the middle of the 1960s that official dollar liabilities held by foreign countries exceeded that of the U.S. monetary gold stock (Triffin Dilemma) (Bordo 2020: 198-200). From that point the U.S. began to worry about the French action of constantly converting its dollars into gold could be followed by other countries that eventually reduce the U.S. gold stock to a point that lead to a run. It was important that there were many signs that, this was already happening. More and more countries started to convert their dollar holdings into gold and the gold component of the U.S. reserves had been constantly
falling since 1957. By that time the U.S. became fearful that a serious loss of gold reserves would carry the risk of undermining confidence and encouraging speculation not for the U.S. currency but also for the overall Bretton Woods international monetary system. From that point, the U.S. Treasury developed policies that include many controls and policies in order to decrease balance of payments deficits and discourage conversion of dollars into gold. The U.S. officials had put many of these controls and restrictions into effect even in the early 1960s. For example, U.S. government encouraged export by subsidizing loans from the Export-Import Bank in order to increase dollar inflow as early as 1960. Besides that, the U.S. government reduced its defense and non-defense government purchases abroad, asked banks and other financial institutions to curtail their overseas lending, increased taxes on foreign earnings of U.S. corporations, and reduced allowance for tourist purchases abroad. These early actions were able to decrease capital outflow and increase capital inflow; however, it provided just temporarily short-term solution. Problem would have returned when the control and restrictions eased or removed.

From that point, the U.S. Treasury introduced several measures in order to provide more concrete and stable solutions that encourage capital inflows and prevent foreign officials from converting their dollars into gold. The creation of the Gold Pool was one of these measures in the early 1960s. Eight countries in that organization pooled some of their gold reserves in order to prevent a rise in the free market price of gold which led to a run on the U.S. gold stock (Bordo, 1993: 56). Another action was the Reciprocal Credit Agreement which also called “swap” agreement that the U.S. signed with each major Western country. This agreement allowed Federal Reserve Bank of the U.S. to borrow other countries’ currency in time of need. With this agreement the U.S. increased its banks’ access to affordable financing and maintained liquidity without selling any of its gold reserves. Moreover, Roosa Bond allowed the U.S. to borrow other countries’ currency that could be used instead of gold when a country wanted to convert its
dollars into gold (Bordo). Besides that, lending facilities of IMF were expanded under General Agreement to Borrow (GAB). Member countries that were in economic crisis used these expanded resources instead of applying the U.S. to borrow money which increase the U.S. capital outflow. The U.S. issued an “interest equalization tax” that imposed a tax in foreign loans which also aimed to reduce capital outflow (Langer and Schwartz, 1965: 42). Meanwhile the U.S. monetary officials used a policy that called “operation twist” for strengthening dollar and stimulating capital inflows. In this policy Federal Reserve sold short-term treasury bills to raise short-term interest rates for encouraging capital inflows; at the same time, the U.S. Treasury bought long-term debt to lower long-term interest rates and attract investment (Federal Reserve Bank of San Francisco, 2011). Another long-term plan was to issue composite reserve unit (CRU). Under this plan the U.S. and other members placed some of its currency to a pool and received a related amount of CRU’s that could be used as equivalent to gold. An extension of the CRU was special drawing right (SDR) which also operated as an addition to the existing money reserves of member countries. This was because the gold was not sufficient to support growth in global trade and financial transactions in the second half of the 1960s. SDR was not a real currency; however, member countries used it as a real currency and traded their SDRs between each other.

Most of these policies, controls and restrictions relatively helped the U.S. to protects its gold reserves, at the same time they encouraged capital inflows and reduced balance of payment deficit until the middle of the 1960s. However, France on the other hand, opposed many of these policies. For example, they dropped their support for CRU, pulled themselves out of Gold Pool, opposed creating an international currency reserve unit, followed uncooperative policies that merely put France in an isolated position many times, and some other times convinced other common market countries to go along with them in order to put pressure on
U.S. for a reform in the system. Besides that, numerous French officials including finance minister and president used hard bargaining line by making contradictory statements for the international monetary system which created a confidence problem inside the system and contributed to serious speculative attack against dollar. France kept systematically converting their dollar reserve into gold. Late in the 1960s France seemed to not use this policy explicitly. It was crucial that by that time there was a high possibility that French government used other countries’ central bank to convert its dollars reserves into gold at the New York Federal Reserve. Countries in the Northern Africa, especially Algeria and Libya which were heavily dominated by France, had the highest demands for converting their dollars holdings into gold by that time. Algeria increased its gold reserves from $5.7 million in 1966 to $156 million in 1967 and $245 million in 1968 (World Bank, 2020). From the same point, (before Gaddafi) Libya boosted its gold reserves to $102 million in 1968 from $2 million in 1966 (World Bank). However, French authorities denied these claims.

![Algeria and Libya Gold Reserves 1965-1969](image)

Figure 4. Algeria and Libya Gold Reserves from 1965 to 1969

Source: World Bank and World Gold Council (2020)

It was important that world economy became more turbulent in the second half of the 1960s. Inflation rate increased steeply in the U.S. after Kennedy and Johnson administration monetary and fiscal policies. When these policies met with growing gold scarcity it created a situation that increased speculations in the financial market and undermined the dollar’s relationship with gold. On the other hand, after the election of Labor Party in 1964, the
U.K. experienced serious balance of payments deficit. In order to improve its economic situation, the British planned to join into the European Common Market. However, French prepared two conditions for British membership. The first condition, it said that the British had to drop sterling as an international reserve currency and second condition French insisted that British had to achieve equilibrium in their international balance of payments (Simard, Bordo and White). From that point, it was important that France persuaded other European Community (EC) countries for supporting its policies against Britain. Besides that, a combination of domestic and overseas events such as Arab-Israeli Six-Day War, closure of Suez Canal, rise in oil and other commodity prices, increased tension with China after British embassy attacked in Beijing, riots in Hong Kong, civil war in Nigeria, British withdrawal from Aden and weathered support of the U.S. for British economy created a situation that force the sterling parity be changed. Therefore, at the end of 1967 British currency was devalued from $2.80 to $2.40 (House of Common Library, 2017).

In the aftermath of the sterling devaluation French reinforced their pressure for a reform in the Bretton Woods system. This situation increased speculative attack to the system, at the same time it set off a huge wave of buying gold from the market. From that point, main reserve currency, dollar, started to weaken. There were various reasons that explain the depreciation of dollar. First of all, devaluation of the British pound sterling as the second reserve currency in the Bretton Woods system meant that the devaluation of dollar could be the next. Besides that, both countries (the U.S. and the U.K.) had been running balance of payments deficit. Kennedy and Johnson administrations in the U.S. and labor party in the U.K. had used expansionary monetary and fiscal policies and both countries had been reluctant to take severe measures for restraining inflationary pressure in their economies. From that point, in the eyes of foreign authorities two countries were the same. If one failed, other would follow. It is also important
that in order to provide support for the pound sterling, the U.S. had led international initiatives by that time which strengthened the sense of the dollar increasingly linked to the credibility of the pound sterling. Eventually, sterling crisis increased speculation on the gold-dollar parity. Due to that, the Gold Pool which established for stabilizing price of gold at $35 was collapse at the end of the 1960s. The end of Gold Pool provoked the creation of a two-tier gold market (Bordo, Monnet, Naef, 2017: 2). This new situation seriously threatened gold-dollar convertibility on the one hand, and on the other hand, it mounted speculative pressure for the overall system. After all these speculative pressures, the U.S. abandoned its commitment to peg the dollar to gold. In other words, the U.S. destroyed the foundation of the gold-dollar exchange system. With this end, the U.S. lost its privileged positions and lost its leadership position in the international monetary system.

It is very essential that France played a crucial role in the breakdown of the Bretton Woods international monetary system. Except few periods including the one in the early 20th century, the French economy was in constant decline compared to not only U.S. but also all other major countries. France became far more dependent on U.S. assistance during WWI. After the war, the French economy was on the verge of collapse. In the interwar years, the Great Depression and serious domestic political crises made the situation even worse for France. From that point, the country was unable to create any policy for the world’s economic and political problems. Thus, it is not surprising that France was in desperate need of U.S. assistance when WWII started. After the war, France became much weaker than previous times and ranked as a middle power country. During the early post-war period France seemed incapable of following solid and stable policies to get its way for most of international issues. However, it is quite important that starting in the second half of the 1950s and throughout the 1960s France, as a middle power country, followed completely different policies against U.S. designed international monetary
system that included aggressively, purposely and systematically converting its dollars holding into gold that aimed to deplete the stock of the U.S. gold reserves and reduce the capacity of the U.S. to support its currency in circulation in order to undermine U.S. economic leadership position in the world. It was important that after many years of steady and consistent effort France successfully challenged the U.S. leadership role in the international economic regime by playing a major role in the breakdown of the Bretton Woods system.

In total, this case raises the question that whether the U.S. power was in decline in this period. According to many power definitions, an economically powerful country has capacity to make decision that benefit itself, at the same time it has ability to decrease the capacity of other countries that intend to reduce its benefit and challenge its leadership position (Organski 1968; Nye 1990; Baldwin 1979; Whalley 2009). However, in this case that did not happen, even though France’s policies ultimately hurt U.S. interests, and upended the system that constructed by the U.S. which was the world’s dominant economic power. From that perspective, it can be said that in the post-industrial world there is no country in the world that has ability to get what it’s want on every issues. In order words, the U.S.’s inaction against France does not necessarily mean that the U.S. power was in decline by that time. Following cases would help us to understand more about this theme.

The Oil Crisis and the Role of Saudi Arabia

Despite major social, economic, political, and cultural differences between Saudi Arabia and the U.S., these two countries were able to overlook their differences and establish a mutually beneficial relationship in general. After three decades of struggling, King Abdul Aziz Al Saud was able to unify the Arabian Peninsula and proclaimed the independence of Saudi Arabia
in 1932 (Embassy of the Kingdom of the Saudi Arabia, 2020). However, the U.S. at that time had no interest and had no official representation in this country. On the other hand, King Abdul Aziz Al Saud (Ibn Saud) was very willing to establish full diplomatic relationship with the U.S. In order to build stronger relationship, Ibn Saud granted a concession to a U.S. oil company, Standard Oil of California, to explore for oil in the Saudi Arabian lands (Sorkhabi, 2018). Not even a decade later, when the rich oil resources were found for the first time in this country, the relationship between the Saudi Arabia and the U.S. strengthened.

Until WWII, the relationship between these two countries grew gradually. It is important that during WWII some of Saudi's oil facilities were bombed by Axis powers, which made Saudis look for closer relationship with the U.S. On the other hand, the U.S. by that time began to realize the importance of oil, more specifically the importance of Saudi oil. The U.S. petroleum companies by that time urged the president to accept more liability for security and political stability of Saudi Arabia (Metz, 1992). From that point, in 1945 Saudi’s King Abdul Aziz Al Saud and the U.S. President Franklin D. Roosevelt met for the first time in their countries' history. In this meeting King Abdul Aziz allowed the U.S. military to use Saudis’ air space and also build airfields in Saudi Arabia in order to protect oil facilities from possible attacks and also secure the region against Marxists and nationalist/revolutionist movements which posed a direct threat to the Saudi monarchy (Beauchamp, 2016). Meanwhile due to the threat of communism after the end of the WWII, the U.S. planned a strategy, containment, that prevent the spread of communism in many parts of the world included Arabic peninsula. From that point, because of its important geographic location and its world’s richest oil reserves, the security of Saudi Arabia became one of the top priorities for the U.S. President Truman formally assured King Ibn Saud about his country’s political stability and territorial integrity was a primary objective of the U.S. (U.S. Department of State, Office of Historian, 2020). A few years later, the U.S. expanded their
initial relationship with Saudis into a more stronger security alliance and signed a mutual
defense assistance agreement in 1951 with Saudi Arabia (U.S. Department of State, 1952: 1460-
1462).

In 1953, King Abdul Aziz died and his son Saud became the new King of Saudis. Meanwhile
President Eisenhower revised the U.S.’s anti-communist alliance strategy. This new anti-Soviet
strategy turned some of the Saudis’ regional rivals and enemies such as Iran and Iraq into
important players for the U.S. Saudis displayed their displeasure with this new strategy by
replacing U.S. forces with pro-Soviet Egyptian forces in the middle of the 1950s. However, a few
years later when the Suez crisis broke out Saudis changed their previous policy and began to
cooperate with the U.S. again. The U.S.’s opposition to the French-British-Israeli plan of seizing
the Suez Canal played important role on Saudis’ decision to improve relationship with the U.S.
King Saud of Saudi Arabia interpreted this policy as the U.S.’s opposition to Israelis plan and
giving the land back to Arabs. However, the U.S.’s real intention of opposing this plan was
because of the high possibility of increasing Soviet influence in this region if Britain-France and
Israel seized the Suez Canal (U.S. National Security Agencies, 1988: 8-12).

At the end of the 1950s Saudis once again approached to pro-Soviet alliance after the
Egypt and Syria united their power to form United Arab Republic in 1958. Nevertheless, few
years later when the Yemeni revolution started, Saudi used anti-revolution policies in order to
curb this movement. King Saud predicted that revolutionary feelings could reach Saudi Arabia if
it succeeded in Yemen (Ferris, 2016). On the other hand, Egypt strongly supported
revolutionists. In the early 1960s, Egyptian forces started to attack Saudi Arabia from its bases in
Yemen due to Saudis anti-revolutionary interventions (Rugh, 2015: 140-141). After these attacks
Saudi desperately sought the U.S. support. By that time, U.S. responded Saudis’ request urgently by sending several war planes to the region (Public Broadcasting Service, PBS, 2014).

When the conflict ended before the middle of the 1960s Prince Faisal forced his brother King Saud to abdicate in his favor to become the new king. King Faisal strongly rejected to have any relations with the Soviet Union. On the other hand, except the 1967 Arab oil embargo which was imposed on some Western countries including the U.S. during and after the third Arab-Israeli war, he established close relationship with the West especially with the U.S. Even though there were many accusations of his pro-American foreign policies, he continued to cooperate with the U.S. and remained a strong ally of the U.S. until 1973.

**Oil Embargo**

In October 1973, Arab oil producing countries led by Saudi Arabia cut their oil production and imposed an oil embargo against the U.S. and some other western countries in retaliation for their support to Israel during the Arab-Israeli War, also known as the October War or Yom Kippur War. Due to embargo and oil production cuts the average oil price of crude petroleum first doubled and then quadrupled (from $2.90 per barrel to $11.65) in a few months that created serious structural challenges to stability of the U.S. economy (Corbett, 2013).

![Figure 5 Price of Crude Oil from 1960 to 1976](Source: Federal Reserve Bank of St Louis, FRED. 2020)

This embargo and high oil prices came as a shock to
the U.S. Because the October War or Yom Kippur War was not the first war between Arabs and Israelis and from the same perspective the embargo of 1973 was not the first oil embargo that was imposed on the U.S. and Western world.

There were three Arab-Israeli wars (first in 1948 when Arab countries attacked Israel after Israel announced its independence in 1948, second in 1956 when Israel attacked Egypt after Egyptian president Gamal Abdel Nassar seized and nationalized the Suez Canal, and finally in 1967 when Israel launched an air strike to Egypt and its allies after years of diplomatic tension between Israel and Arabs) before the October war and there were four oil crises (first in 1948 during the first Arab-Israeli war, second in 1951-53 when Iranian prime minister Mohammed Mosaddegh nationalized Iranian oil industry, third in 1956 during the Suez Canal crisis, and fourth in 1967 during the third Arab-Israeli war) before the oil crisis of 1973. None of these initial cases contributed to significant economic setback in the U.S. also in the Western world like the one in 1973. From that point, it is important to know that this embargo and oil production cut coincided with many other factors in the U.S. such as declining domestic oil production, rising oil import, growing dependence on foreign oil, devaluation of the U.S. currency, rising consumer prices and national debt and declining employment in the U.S. in the first half of the 1970s and caused the U.S. to experience the worst economic recession in 1973-75 since the Great Depression.

The effects of the Saudi-led oil embargo of 1973-74 on the U.S. economy were disastrous. First of all, high oil prices weakened the consumer confidence in the U.S. and made them spend less on goods and services. On the other hand, due to high oil prices and lower consumer demand producers reduced their production significantly. In sum, oil embargo decreased U.S.’s economic growth by approximately 2.5 percent (Verrastro and Caruso, 2013). It is important
that under the embargo, the Nixon administration extended its wage-price control policy of 1971. An initial 3 months control policy turned into almost 3 years of policy. During this period companies were forced to keep wages high. Due to high wages companies could not reduce their production costs. Consequently, they could not lower their prices to stimulate overall demand. In order to survive companies laid off workers which increased the unemployment number over 7 percent by that time (Bryan, 2013). In addition to that, government price control, which planned to maintain oil affordability, created even higher oil shortages in the markets. When the price control was dismantled the results were devastating. The oil shortage and high oil prices had widespread effect on commodities throughout the economy which created a serious inflationary pressure. The consumer price index rose above 10 percent in 1974 (Bryan).

Meanwhile, the Federal Reserve tried to control inflation and stimulate economic growth or decrease unemployment at the same time by using stop-and-go monetary policies. Due to Fed stop-and-go policies companies in the U.S. lost their confidence for the future. In order to survive these companies simply reduced their cost by laying off employees which worsening the overall economy.

Besides that, embargo brought up new challenges to the U.S. designed world economic and political system. First of all, the embargo led to significant increase in prices of goods and services in the world. High inflation slowed down the world economic activities. The world economic growth declined to 4 percent annually after the embargo which was 5.1 percent before the crisis (The Washington Post, 1978). The rise in the world oil prices created big account surpluses for oil-exporting countries; however, these surpluses mostly deposited in Western banks for lending out to oil-importing developing countries in order to finance their energy imports. High oil prices increased these countries' budget deficit/debt which contributed to deteriorate their overall economic situation. Eventually these countries aggregated,
nonaligned movement, in the U.N. and passed a resolution that demanding the creation of a new international economic order in which included a series of economic reforms such as more equitable distribution of resources, a greater share of benefits derived from the exploitation of southern resources, preferred trade agreements with developed countries, a more comprehensive approach to third world countries’ debt relief and a more sustainable solution for economic development of the third world countries (Karunanayake, 1976: 111-118). From that perspective, there was a serious challenge to U.S. designed international economic order from the Third World Countries. On the other hand, economic downturn also had serious impacts on developed countries which were highly dependent on export revenues for their economic growth. Price rise of oil caused a serious inflation of other goods in the world which led to a low demand for imports by developing countries. Before the embargo and high oil prices, developed countries’ economic growth was around 6 percent annually; however, after the embargo it decreased to 4 percent (Giovanni, 2014: 15-16). In addition to that, many developed countries’ unemployment number severely increased due to high oil prices.

From that point, many countries tried to rise against the embargo and Arabs or more specifically Saudi’s monopoly over oil; however, by that time they were too reliant on the imported oil. They felt that high oil prices and oil shortage created a very high level of economic uncertainty which posed a serious threat to their economic security. The overall situation put pressure on these countries which later turned into a tension between the U.S. and its allies and eventually made these countries to reexamine their alliance with the U.S. Most of these countries believed that the high oil prices and oil shortage in the world was the result of U.S. pro-Israeli foreign policies (Hughes, 2008: 3-4, 32-34; Licklider, 1988: 216-218). Besides that, during the oil embargo Saudi-led Arab governments classified Western countries as they support or oppose to Arab position in the Arab-Israeli conflict and used their policies toward these
countries accordingly. From that point, in order to get different treatment from oil producing countries especially from Saudi Arabia some Western countries and Japan reconsidered their relationship with the U.S. Some of them shifted their policies remarkably and disassociated themselves from U.S. pro-Israeli foreign policies. For example, Britain refused to allow the U.S. to use British bases in U.K. and Cyprus for its airlift to resupply Israel (Licklider, 212). Other European countries also turned down many U.S. requests and distanced themselves from it. Even Canada after the embargo imposed on some countries, they quickly moved to pro-Arab position and shifted their voting practices in the U.N. even though their Middle Eastern oil dependence by that time was extremely low (213-14). It is important that some developed countries such as Japan moved ahead and almost broke off diplomatic relationship with Israel (Stork, 1974: 7).

In all, under the embargo many former U.S. allies started to use more independent policies in order to get friendlier treatment from the oil producing countries. From that point, it is important that Saudi’s led oil embargo of 1973-74 undermined the U.S. power in terms of influencing behavior of other countries in line with its own interest. The consequences of this embargo seriously challenged the U.S. position in the world by undermining the country’s confidence. It is important that there have been very few events in the U.S. history such as the Saudi led embargo of 1973-74 that produced deep, significant, and enduring economic, political, and social consequences both domestically and internationally.

Saudi Arabia’s Role in the Oil Crisis

It is crucial that as an only swing producer of oil (the ability to manipulate the price of oil in the world market by raising or lowering its own production) by that time Saudi Arabia, which was believed to be one of the closest U.S. allies in the region, was the leading proponent of the
1973-74 embargo. This was not the first attempt of the Saudis. After the Six-Day War between Arab countries and Israel in 1967, Saudi Arabia and some other oil producing Arab countries imposed an oil embargo to countries that aided Israel (the U.K. and the U.S.). However, due to the lack of unity among Arab countries, this embargo failed to achieve its objectives and resulted in the weakening of embargoing countries rather than those embargoed.

The Six-Day War caused severe losses of life and land for the Arab countries. The expansion of Israel provoked radicalization in many parts of Arab world. The Arab nationalist Baath party overtook Iraqi government in a military coup in 1968, a leftwing revolution overturned a conservative monarchy in Libya in the following year, and the situation in North and South Yemen continued to be problematic. Arab Nationalist government took the control of country in South Yemen few months after the Six-Day War which brought revolutionary movement to Saudi Arabia’s doorstep. It is important that all these revolutionary regimes aimed to destroy Saudi Arabia’s or King Faisal’s monarchic regime. On the other hand, King Faisal of Saudi Arabia connected revolutionary movements and states with communism that denies the existence of God which is the worst sin in the religion of Islam. From that point, right after the embargo King Faisal remained close to the U.S. for protecting himself and his monarchic regime from the threats in the region.

King Faisal expanded his defense budget tremendously with the U.S (Sher, 2017: 20). Due to increased military power King Faisal was able to secure his monarchy from the anti-imperial nationalist movements that were sweeping the Arab world after the Six-Day War. However, on the other hand, King Faisal was exasperated by U.S.’s willful ignorance of implementing UN Resolution 242, which was adopted unanimously by the U.N. Security Council in the aftermath of the Six-Day War and mandated the return of the Arab territories lost in this war (United
Nations Security Council, 1967). He believed unless the Arab-Israeli problem was solved, there would be more wars and more revolutionary movements that seriously threaten his regime in Saudi Arabia. From that point, he warned the U.S. and tried to get the U.S. to hear his political demand. Despite that, the U.S. dismissed Faisal’s demand. That ignorance convinced King Faisal that he had to change his initial policy to a more aggressive policy that include inducing other countries to wage a war against Israel, and using the “oil weapon” against the U.S. He therefore agreed to send weapon and hundreds of millions of dollars to Egypt for building a strong military that able to fight against Israel in the early 1970s. Faisal also thought that with this help he could draw Egypt’s Anwar Sadat away from Libya’s Qaddafi who also offered help to Egypt. Faisal believed that Qaddafi is a dangerous man who supports most of the radical revolutionary movements all around the Middle East. In addition to that, a few months before the Yom Kippur War, Saudi Arabia’s King Faisal had secretly met with Egyptian president Anwar Sadat and persuaded him to use an oil embargo for punishing Western countries if they supplied weapons and aided to Israel in the upcoming military conflict. With the assured backing of King Faisal, Anwar Sadat attacked Israel in October 1973. From that point, it is important that Saudi Arabia played a major role in events that leading up to the Yom Kippur War which triggered the Oil Embargo of 1973-74.

When the Arab-Israeli war broke out, U.S. supported Israel against the Arabs and deployed significant military aid to that country. Due to that Saudis decided to cut all exports to the U.S. In addition to that, right after the war a coalition of oil producing Arab countries headed by Saudi Arabia abruptly reduced their oil production as Saudi’s Faisal had promised Anwar Sadat to do so. Saudi Arabia (with Emirates accounted for 40 percent of the OPEC resources by that time) alone lowered its oil production by almost 30 percent in October which triggered widespread speculation in the oil market that led massive oil price rise in the world (Alhaji, 2005: 228). High
oil prices devastated oil consuming economies, planted distortion between the U.S. and its Western allies and transferred billions of dollars to Arab oil producing countries particularly Saudi Arabia.

Table 2 Saudi Arabia Oil Revenue (1969-1974)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue (million dollar)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>949</td>
</tr>
<tr>
<td>1970</td>
<td>1.149</td>
</tr>
<tr>
<td>1971</td>
<td>1.944</td>
</tr>
<tr>
<td>1972</td>
<td>2.779</td>
</tr>
<tr>
<td>1973</td>
<td>4.195</td>
</tr>
<tr>
<td>1974</td>
<td>22.375</td>
</tr>
</tbody>
</table>

Sources: Saudi Arabia Ministry of Petroleum and Mineral Resources, Statistical Survey 1977

It is important that when the U.S. Defense Secretary mentioned that he wanted to see the oil fields under the U.S. military control, the Saudi Arabia administration threatened to light fire to all Saudi oil installations and widening the embargo to the whole world (Alvarez, 2004; Frankel 2004). While many U.S. top officials denounced Saudi’s use of blackmail, Saudi Arabia on the other hand leveled complete opposition against the U.S. Months after the war, Saudi Arabia made several contradictory announcements about the embargo, claiming they agreed to lift it one moment and then postponing their decision the next; this led to a lot of speculation over oil prices (Sher, 36).

The situation brought important opportunities to Saudi Arabia that they were able to make money (their oil revenue jumped from $4 billion to over $ 22 billion within a year) and at the same time they pretended to be resilient defender of Muslim’s right in the region. From that point the crises and the embargo helped Saudi Arabia to expand its state capacity, modernize its economy and rise its power to a position that they could play a leadership role in the Middle East. On the other hand, the U.S. entered a recession not seen since the Great Depression. GDP plunged 6 percent between 1973 and 1975, unemployment doubled to 8 percent and inflation rose over 11 percent.
The embargo threatened not just the stability of the U.S. economy, but the economic and political sustainability of the entire Western bloc. In that respect, Saudi led oil embargo seriously weakened country’s confidence and challenged the U.S.’s position in the world which undermined the ability of the U.S. to influence behavior of other countries in line with its own interest.

It is important that Saudi Arabia which was thought to be one of the closest U.S. allies in the region played a pivotal role for the events that leading up the Yom Kippur War or October War in 1973. Once the war started Saudi Arabia again played a serious role that deliberately crashing oil prices and imposing embargo to the U.S. and some other Western countries in order to inflict damage on their economies. It is important that Saudi Arabia was one of the poorest countries in the world that craved for establishing relationship with the U.S. when it was founded in the 1930s. The situation was almost the same in the 1940s. Saudi’s economy was undeveloped and mostly depended on the revenue that generated from pilgrims who visited holy cities Mecca and Medina. After Axis Powers’ attacks on Saudi Arabia in the WWII, Saudis

![Figure 6 U.S. GDP, GDP growth Rate, CPI, Unemployment Rate from 1972 to 1976](image)

King decided to grant exceptional concessions to U.S. for exploring oil in his country in order to build stronger military and political relationships with the U.S. From the same point, when Egyptian and Yemeni forces attacked Saudi Arabia due to Saudi’s anti-revolutionary polices in the early 1960s, Saudi’s King desperately sought the U.S. support. In 1963 U.S. government sent war planes to Saudi Arabia in order to protect the Kingdom from Egyptian and Yemeni assaults. It is important that almost a decade later the same country played a leading role in the oil crisis that caused the U.S. to have the worst economic recession since the Great Depression. The U.S. faced similar challenges in the following decade. However, this time, countries that challenged U.S. leadership role in the world were its closest allies in Europe and Japan.

The General Agreement on Tariffs and Trade (GATT) and the U.S. - the European Communities (EC) – Japan Triangle

In 1947, twenty-three countries, led primarily by the U.S., created the General Agreement on Tariffs and Trade (GATT) (World Trade Organization, 1998). The reason for this agreement was to increase economic recoveries of the countries after WWII by reducing tariffs and removing non-tariff barriers such as quotas, standards, licenses, and administrative and technical barriers (WTO). The purpose behind that was to avoid a repeat of the mistakes (adopting protectionist policies) of the previous decades. It was critical that at the end of WWI, countries increased non-tariffs barriers and imposed higher tariffs on each other. This was completely different than the previous period’s trade structure. Before WWI, international trade relations centered on a network of bilateral trade agreements that also contained the most-favored-nation (MFN) clause. In this period countries were free to set their tariff rate so long as
it adhered to the MFN clause. This scheme was able to maintain very low trade barriers along with very little trade discrimination without any monitoring mechanism (Irvin, 1995: 323-324).

Nevertheless, WWI ruined this scheme. An outbreak of even greater protectionism started with the world economic downturn in the late 1920s and early 1930s. During this period, the U.S., despite having a large trade surplus, raised the average tariff on dutiable imports about 20 percent in order to save its domestic industry and protect its own workers (Irving, 2010). However, this action provoked retaliatory responses from many countries all around the world, and eventually the combined effect of all these anti-trade policies led to a collapse of international trade.

![Table 3 International Trade from 1929 to 1932](chart)

<table>
<thead>
<tr>
<th>Foreign Trade (1929-1932)</th>
<th>(millions of dollars)</th>
<th>1929</th>
<th>1932</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td></td>
<td>9.788</td>
<td>2.967</td>
<td>-69.7</td>
</tr>
<tr>
<td>U.K.</td>
<td></td>
<td>8.956</td>
<td>3.555</td>
<td>-60.3</td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td>6.415</td>
<td>2.471</td>
<td>-61.4</td>
</tr>
<tr>
<td>France</td>
<td></td>
<td>4.247</td>
<td>1.945</td>
<td>-54.2</td>
</tr>
</tbody>
</table>

This situation seriously worsened the economic problems of the countries and contributed to political conflicts between countries in the second half of the same decade which finally led to the outbreak of the WWII. After experiencing the heavy cost of protectionist policies for more than a decade, the U.S. government officials decided to create rule-based liberal trade policies that reduced trade barriers and increased international trade after the Second World War. The reason behind that policy was about a belief in the U.S. that said trade binds nation together and makes war unthinkable (World Trade Organization 2004).

As the prime designer of the GATT, the U.S. played a leadership role by pushing other countries to keep the GATT moving forward. From that point, first five rounds of GATT negotiations that covered from Geneva to Dillon (1947-61) were highly dominated by the U.S. In these rounds the U.S.’s focus was on reducing import barriers in countries where it wanted to
export. It is important to note that during this period the U.S. was able to convince many countries that international trade was not a zero-sum game. In that respect, other countries had no rationale to build national economic barriers that restrict international trade. Besides that, the U.S. used the trade-off of expanded market access abroad for its exporting industries against increased market access granted for its home markets to foreign industries (Grossman, 2016: 41). These negotiations mostly occurred between the U.S. and other developed countries. In other words, in these GATT rounds the U.S. asked other developed countries to reduce their tariffs. By that time developing countries’ world import and export shares were little. Therefore, little was asked of them in terms of their own trade liberalizations.

<table>
<thead>
<tr>
<th>Year</th>
<th>Place/name</th>
<th>Subjects covered</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>Geneva</td>
<td>Tariffs</td>
<td>23</td>
</tr>
<tr>
<td>1949</td>
<td>Annecy</td>
<td>Tariffs</td>
<td>13</td>
</tr>
<tr>
<td>1951</td>
<td>Torquay</td>
<td>Tariffs</td>
<td>38</td>
</tr>
<tr>
<td>1956</td>
<td>Geneva</td>
<td>Tariffs</td>
<td>26</td>
</tr>
<tr>
<td>1960-1961</td>
<td>Geneva Dillon Round</td>
<td>Tariffs</td>
<td>26</td>
</tr>
<tr>
<td>1964-1967</td>
<td>Geneva Kennedy Round</td>
<td>Tariffs and anti-dumping measures</td>
<td>62</td>
</tr>
<tr>
<td>1973-1979</td>
<td>Geneva</td>
<td>Tariffs, non-tariff measures, “framework”</td>
<td>102</td>
</tr>
<tr>
<td>1986-1994</td>
<td>Tokyo Uruguay Round</td>
<td>Agreements</td>
<td>123</td>
</tr>
<tr>
<td></td>
<td>Geneva</td>
<td>Tariffs, non-tariff measures, rules, services,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>intellectual property, dispute settlement,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>textiles, agriculture, creation of WTO.</td>
<td></td>
</tr>
</tbody>
</table>

*Table 4 GATT Trade Rounds*

*Source: WTO website, “The GATT Years: From Havana to Marrakesh”*

Starting with the Kennedy Round of negotiations in the middle of the 1960s through Tokyo Round in the 1970s and Uruguay Round in the 1980s, more and more countries joined to trade negotiations. In the Kennedy Round, for example, member countries more than doubled (62 countries). Most of these countries were developing countries that played only a minor role like
in previous trade negotiations. Primary concern of the Kennedy Round was further reducing tariffs in developed countries’ markets. Besides that, this round brought about anti-dumping measures. Overall the Kennedy Round went well, tariff reductions worth more than $40 billion (Norwood, 1969: 314). The U.S. was able to demonstrate Washington’s leadership role in Kennedy Round by organizing, leading and controlling most of trade issues. However, at the end of the round it became obvious that a more comprehensive perspective was needed for the next round in order to deal with the emerging challenges such as high economic growth of Japan and European Community (EC), formation of the European Economic Community (EEC), and EEC’s protectionist and inward looking policies in some sectors. The Tokyo round in the 1970s continued the GATT’s efforts to reduce tariffs to a very low level. In this round $33 billion worth of trade reductions made (Krasner, 1979: 514). However, it is important to note that Tokyo Round had mixed results for the problems that affecting agriculture and emergency import measures known as “safeguards.”

Before the Uruguay round, a series of economic recessions in the 1970s and the early 1980s caused high inflation and high unemployment rates in many countries which eventually made these countries use protectionist economic policies in the following decade. Besides that, high growth rates in Japan and countries in the European Community (EC) turned these players into major global traders over the last few decades. It is important that a few decades earlier these countries lay in ruins at the end of the WWII. Cities and towns in these countries were devastated by ground battles and aerial bombings. Homes, ports, bridges, railroads, factories and many other key infrastructures essential to economic commerce were completely destroyed. Economic cost of the war was also huge for these countries since WWII was the most expensive war in human history. WWII had taken a huge toll in people lives. It caused 40 million deaths in Europe alone. Total cost was around 60 million lives in the world (United Nations,
people who survived from this war in these countries suffered heavily from the shortage of food, water, fuel and all kinds of consumer products at the end of the war. These countries basically could not produce enough goods for their people. In total, they were desperately seeking help for their reconstruction at the end of the war.

From that point, the U.S. started to provide aid to these war-torn countries with various programs after WWII. From the end of the war to 1952 the U.S. invested $22 billion (over $180 billion after adjusted for inflation) for rebuilding post-war Europe (U.S. News, 2014). Besides that, the U.S. invested $2.2 billion ($18 billion after adjusted for inflation) in Japan for their reconstruction efforts (U.S. News). In addition to that, the U.S. opened its market to these countries for many decades after WWII. Finally, for their security concerns in post-war era the U.S. stationed hundreds of thousands U.S. troops in these war-torn countries.

After all this U.S. assistance, Europe and Japan reacted favorably to U.S. requests and its initiated programs in the early GATT negotiations. For example, Japanese government was submissive in terms of responding to trade actions against Japanese import surges, and agreed to voluntary export restraints. Rather than resisting the U.S.‘s trade restrictions against Japan in a confrontational manner, the Japanese government generally looked for ways to adjust these trade restrictions. From the same perspective, in the following decades after the WWII, the EC major concern was to achieve its post-war construction. After its establishment of EEC at the end of the 1950s, Europe focused mostly on its integration, pursued an inward-looking approach for their trade interest, and desired to have as little trade disagreements outside of Europe as possible. It was also clear that in the post-war period individual European countries were relatively small and had no power to significantly influence global trade negotiations.
Nevertheless, this changed dramatically in the late 1970s and early 1980s. First of all, the process of EC integration progressed further in Europe. In the 1970s, the U.K, Denmark and Ireland and in the 1980s Spain, Greece and Portugal joined the EC. It was important that countries in the EC significantly benefited from this integration. They stimulated their agricultural and industrial production, increased their trade with other countries, improved their balance of payments, and promoted their political and economic stability. In total, they experienced high growth rates in this period.

![EU and Japan GDP (1960-1986)](image)

Source: Derived from FRED, IMF and World Bank

Meanwhile, Japan also experienced a rapid economic growth through the 1960s, and 70s, and still high in the 1980s. It became clear in the 1980s that due to rising economic power and growing importance in the world economy, Japan and EC countries started to pursue more assertive trade policies in the GATT Uruguay trade negotiation that was very much different than the approach they had followed in previous periods.

Starting from the 1980s, Japan and the EC supported policies that were mainly focused on their economic interests in the GATT negotiations which include more aggressive export and more defensive import policies. Due to that, GATT Uruguay trade negotiations between the U.S. and Japan and the U.S. and the EC became more tension-ridden. For example, European
countries started to use strong and increasingly protectionist policies in the 1980s due to serious recessions in the 1970s and early 1980s. Rather than further liberalizing multilateral trade, these countries focused on their regional market and restricted their international trade by using non-tariff barriers such as unjustified packaging, labelling, and product standards, complex regulatory environment, unreasonable safety and health regulations and discriminatory rules of origin in order to preserve their jobs and protect their employees and their sectors from the U.S., Japan and the newly industrialized countries.

On the other hand, after the turmoil of the crises in the 1970s, the Reagan administration tried to re-establish the U.S. leadership role in the international economy under the rules of free trade and free market (Ronald Reagan Presidential Library Achieves, 1985). From that point, the EC’s protective measures and restrictive trade practices strained its relationship with the U.S. in the GATT Uruguay trade negotiations. In addition to that, the tensions also arose in the GATT negotiations between the U.S. and the EC over some specific sectors such as agriculture and steel. In these conflicts, the U.S. aimed to extend world trade principles to these sectors, on the other side, the EC strongly resisted to U.S.’s request and continued to use agricultural and industrial subsidies for these sectors.

From the same perspective, after experiencing decades of rapid economic growth, Japan became one of the major powers in the world in the 1980s. This played significant role on Japan to transform its submissive and passive trade policy to a more assertive policy against the U.S. From that point, following the 1970s trade relations between the U.S. and Japan became very problematic. Japan’s predatory business practices and its industrial policies triggered serious conflicts between Japan and the U.S. over semiconductor, steel, aerospace, automobile, service and agriculture sectors.
In all, it is clear that with their growing importance in the world economy both the EC and Japan insisted on setting their own economic priorities without considering U.S. designed liberal economic disciplines. This major policy change was obvious in the Uruguay Round trade negotiations in the 1980s and early 1990s. Contrary to previous trade negotiations, in the Uruguay Round both the EC and Japan became more assertive for their interest, more aggressive for their export and more defensive for their import against the U.S. even though these countries were the closest allies of the U.S. and shared a strong bond of friendship with the U.S. for decades after WWII. It is quite interesting that only few decades earlier, these counties were desperately seeking for U.S. assistance following the devastation of WWII. By that time, the U.S. provided billions of dollars to help finance rebuilding efforts in these countries. In addition to that, the U.S. was able to force these countries to reduce their tariff and non-tariff barriers. However, there was a significant change in the Uruguay Round negotiations that these countries significantly resisted U.S. led trade negotiations. From that perspective, this is another example that demonstrates the U.S., as the world’s largest economy, had no capacity to coerce, deter or punish countries that endanger its interest or behave in a way that violate norms, rules, and principles of U.S. designed world liberal trade principles. In addition to that, this action also weakened U.S. confidence and challenged its position in the world that undermined the ability of the U.S. to influence behavior of other countries in line with its own interest.

**World Trade Organization (WTO) and the Relationship between the U.S. and the Developing Countries**

It is important that around the end of the Uruguay Round in the mid-1990s, the EC started to provide a joint leadership for further trade negotiations. From that point, the U.S. and the EC
had combined their forces and established the World Trade Organization (WTO). The reason of the establishment of the WTO was because of the weaknesses of the GATT. Starting with the last decades of the 20th century, the GATT failed to achieve its goals. During this period, international economic system became more complex after it experienced rapid quantitative and qualitative changes due to dynamism of the world economy. As a result of that, there were many issues, fields, and sectors in the world trading system that were not covered by GATT rules. In addition to that, the GATT was believed to always be in favor of the developed countries (Page, 2002: 6-7).

It is crucial that 123 countries were participated the Uruguay round trade negotiations and almost a hundred of them were developing countries; however, developed countries specifically the U.S. dominated most of the trading process. Even though an increasing number of developing countries joined round negotiations, they were not powerful participants in the functioning or governance of the GATT system. For example, most of the developing countries had comparative advantages in textile, clothing, and agriculture sectors. Therefore, if these sectors were liberalized under the GATT system then these countries would reap benefits. However, many times these sectors were not even on the discussion table of GATT and the major industrial countries particularly the U.S. had no interest in liberalizing these sectors. U.S.’s focus was on the tariff reduction for the fast-growing industries. With the implementation of tariff cuts in these sectors, trade among the developed countries significantly increased. In all, due to the rising trade, developed countries particularly the U.S. experienced an exceptional rate of economic growth in this period. Meanwhile developing countries were struggling to protect their infant industries from developed countries’ industries. They criticized the non-discrimination concept of GATT and asserted that unequal countries can not be treated equally. They worked for a legal foundation that allow special treatment in their favor. Besides that, they
were also trying hard to make their voices heard for the issues such as fluctuating commodity prices, rules on GATT trade negotiations and protectionist policies of the developed countries (Shukla, 2000: 7). However, most of these efforts were largely ignored by the U.S. and some other developed countries due to developing countries’ lack of bargaining power. For example, developed counties pressured developing countries and introduced Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) in the Uruguay round trade negotiations (World Trade Organization, 2021). However, developing countries could not able to do the same for GATT’s Multi-Fiber Agreement which limited imports from the developing countries in order to protect developed countries’ domestic textile industries. In this case, developing countries only had little concessions that included gradually dismantling of textile quotas which was completed in the middle of the 2000s (World Trade Organization, 2020).

It is important that, this situation considerably changed at the end of the 20th century with the WTO Seattle Ministerial Conference in 1999 and the WTO Doha Development Round in 2001. In these negotiations developing countries became more assertive in demanding that their issues need to be addressed. Some revolutionist developing countries even insisted that they would not support another round of trade negotiation unless they noticed the negotiation program included their interests such as reduction of agriculture tariffs and subsides in developed countries, non-reciprocal market access for manufacturing sectors and finally protection for their service sectors from powerful counterparts in developed countries (Cimino-Isaac, Fefer and Ferguson, 2015: 1-2).

On the other hand, developed countries, particularly the U.S., aimed to increase access to developing countries’ industrial and service sectors while protecting their agriculture, textile and clothing sectors from developing countries that have comparative advantages. It is clear that
countries in the WTO divided between these two diametrically opposed thoughts. The strict philosophical divergence in the Doha Round was the main reason of deadlock.

After more than a decade from its first meeting, a report from the General Council of the WTO indicated that after many years of solid multilateral work, countries in the WTO still fail to narrow down their differences (The New York Times, 2016). That shows that in the contemporary world there is a shift in balance of trade power with the rise of many emerging economies. Developing countries now, like Japan and the EC in the 1980s and 1990s, pursued more assertive and reactionary policies. Unlike previous negotiation rounds from Geneva to Uruguay, developing countries played a much bigger role in the Doha Round. They set their own priorities and supported polices that were truly based on their economic interest which aimed to maintain a fair unemployment rate and protect their jobs and their sectors from the competition of developed countries. It is fair to say that all these policies limited the capacity of the U.S. and some other developed countries to shape the WTO and its rules in the 21st century. In other words, contrary to previous trade rounds, developing countries successfully challenged the U.S. and other developed countries’ hegemony in Doha Round and pushed these countries to seek bilateral trade agreements in order to expand their market access. In total, this is another case that weakened U.S. confidence and ability to control and influence the behavior of other countries.

Conclusion for the First Part (Case Studies)

As mentioned at the beginning of this section, power is the capacity of a country to influence another country, or countries, in line with its own interest (Organski, 104). Therefore, an economically powerful country has the ability to make decisions that benefit itself; at the
same time reduce the capacity of other countries that aim to threaten its interest or decrease its freedom of movement. In that respect, scholars believe that the U.S., as the most powerful country in the world, took a dominant role in the world economy after WWII. With this dominant role, these scholars state that the U.S. punished countries that threatened its interests and its special position in the world economy, and, at the same time, rewarded others that built positive and cooperative relations with it. However, at the end of the first decade of the 21st century, some (declinist) scholars started to argue that the financial crisis of 2007-09 eroded the legacy of this success. They think due to the financial crisis there were many power changes that occurred in the world and these power changes significantly reduced the ability of the U.S. to set global economic rules, provide solutions for world economic problems and punish some countries that challenge and reward others that promote its interests. From that point, they think the U.S. will never experience its dominant position in the world economy that it enjoyed from WWII to the financial crisis of 2007-09 again.

Nevertheless, after analyzing cases above, this section of the paper finds that contrary to declinist intellectuals’ argument there is no major difference between U.S.’s economic power after the financial crisis of 2007-09 and its economic power in the 1960s, 1970s, 1980s, 1990s and 2000s. Like in the period after the financial crisis of 2007-09, the U.S. was not able to direct or influence the behavior of other countries in line with its own interest for every economic (including major) issues in the period before the financial crisis. Therefore, it is important to make a distinction between declinist intellectuals’ perception of indisputable and undeniable power like the deities in Greek mythology and actual, tangible exercise of that power, like we see in the U.S.’s economic influence over other countries in the post-financial crisis world. There is no country in today’s world and there never was in the past that has/had capacity to get what it wants on every single economic issue that included even major global economic issues. For
example; in the late 1950s and throughout the 1960s France played a major role in breakdown of the U.S.’s designed international monetary system, Bretton Woods. It is important that in this case France, one of the closest allies of the U.S., was in a constant decline. It was in desperate need of U.S. assistance for both world wars. Its economy was on the verge of collapse before, during and after WWII. From that point, France, as a middle power country, in this period had no capacity to follow solid and stable policies to get its way for most of international economic and political issues. On the other hand, the U.S. rose as a major economic power of the world around the same time. Nevertheless, it is quite important that not even a decade later, France pursued completely effective and efficient policy against the U.S.’s designed global monetary system. French policies (include pulling themselves from the Gold Pool, opposing for creation of an international currency reserve unit, following uncooperative policies and aggressively and purposely converting its dollars holding into gold that aimed to deplete U.S. gold reserve) intended to undermine U.S. economic leadership position in the world. It is crucial that after a decade of steady and consistent effort, France successfully challenged the U.S. leadership role in the world by playing a key role in the breakdown of the Bretton Woods international monetary system.

From the same perspective, one of the other closest allies of the U.S., Saudi Arabia, played a similar role for an event in the 1970s that seriously threatened the stability of U.S. economy and undermined the ability of the U.S. to influence behavior of other countries in line with its own interest. It is important that from its independence to the event of Oil Crisis in the 1970s, Saudi Arabia sought assistance from the U.S. in order to address its economic and security challenges. For example, Saudis desperately sought the U.S. support when Saudi’s oil facilities were bombed in WWII and when Egyptian forces attacked Saudi Arabia from Yemen. The U.S. responded to these and many other Saudis’ requests by sending U.S. troops to the region to
help maintain order. However, like France a decade ago, Saudi Arabia in the early 1970s started to play a key role for the events that ultimately hurt U.S. interest and threaten its leadership position in the world. Saudi Arabia followed policies that made major contributions to the causes of the Yom Kippur War. Once the war started Saudi Arabia played a pivotal role that deliberately crashing oil prices and imposing embargo to the U.S. that caused the U.S. to experience the worst economic recession since the Great Depression. In addition to that Saudi-led oil crisis created serious challenges to the U.S. designed world economic and political system. Many of U.S. allies reexamined their alliance with the U.S. during the oil crisis and started to pursue more independent policies afterwards. On the other hand, due to worsening economic conditions of the developing countries in this period there was a serious demand for the new international economic order. In sum, contrary to declinist intellectuals’ argument the U.S. in this period had not enough power to get what it wanted on this issue. In other worlds, the U.S. was not able to influence Saudi Arabia’s policies accordance with its own interest.

U.S. capacity to control policies of other countries was almost the same in the next decade. After experiencing rapid economic growth from the 1950s to the 1980s, Japan and the E.C. countries increased their importance in the world economy in the 1980s. It was important that after WWII, these counties lay in ruins. Cities and towns were all devastated. Homes, roads, bridges, factories and many key infrastructures were destroyed. They were like France and Saudi Arabia in the previous cases desperately seeking assistance from the U.S. Therefore, the U.S. started to rebuild these war-torn countries with various programs. In addition, the U.S. opened its market to these countries and stationed hundreds of thousand U.S. soldiers in these countries for their security reason in the post-war period. Meanwhile, these countries acted favorable to U.S. requests and its initiated programs in the early GATT trade rounds. However, with their increasing importance in the world economy, these countries started to set their own
economic priorities without considering U.S.’s requests and its initiated programs. From that point, contrary to earlier trade negotiations, Japan and the EC countries became more assertive for their interests, more aggressive for their export and more defensive for their import in the Uruguay Round. In addition to that, they strongly resisted the U.S.-led GATT trade principles. In all, this is like previous cases that the U.S., as the world’s most dominant economic power, in the 1980s and early 1990s was not able to punish Japan and EC countries that threaten its interests and violate rules and principles of U.S. designed world liberal trade principles. From that point, in opposition to declinists claim the U.S. was not capable of affecting behaviors of other countries in line with its own interest not only in the post-financial crisis period, but also in the 1980s and early 1990s.

Finally, U.S. power and its ability to influence other countries’ policies did not change that much in the 1990s and early 2000s. In this period developing countries, like Japan and EC countries in previous decades, pursued more aggressive policies that challenged U.S.’s interests. It is important that in the early trade negotiations these countries’ requests were not even in the GATT’s agenda. In that period, the U.S. had simply no interest in responding to developing countries’ claims. However, in the late 1990s this situation dramatically changed. Unlike previous trade negotiations, developing countries set their own priorities and supported policies that were truly based on their economic interests in the Doha Round trade negotiations. Developing countries’ assertive, aggressive and reactionary policies in Doha Round significantly reduce the capacity of developed countries, particularly the U.S., to shape the WTO and its rules in the 21st century. Ultimately, this case like previous cases that weakened U.S. confidence and its ability to control and change the behavior of other countries that aimed to threaten its interest and its freedom of movement.
After scrutinizing all these cases, it can be said that contrary to declinists’ arguments, the U.S. was not able to control and influence behavior of other countries in line with its own interest (even for the most significant world economic issues) not only in the period after the financial crisis of 2007-09, but also in the 1960s, 1970s, 1990s and 2000s. In that respect, it can be said that there is no change on U.S.’s status or power before and after the financial crisis.
Chapter 6

Economic Power of the United States

Introduction

As this study mentioned earlier, many intellectuals (both declinists and Americanist) believe that the U.S. was the most economically powerful country in the world after WWII. These scholars indicate that as the leading economic power of the world, the U.S. produced around half of the world’s industrial output, supplied almost a third of world total export and possessed over 70 percent of the world’s total gold reserves in the post-WWII era. However, starting a few decades after the 1950s some of these scholars (declinists) started to debate about declining economic power of the U.S. They argued that due to some significant changes in the U.S or in the world, the U.S. lost a relative share of the world industrial production, trade and wealth. From that point, they interpret these changes as sure signs of the decline of American economic power. It is important that the reason why U.S. economic power is in decline changes for each intellectual. According to some intellectuals, the U.S. power was in decline because of domestic and international economic policies that were used in the Kennedy and Johnson administrations. For some, it is because of the financial and economic crisis in the Nixon and Carter administrations. Some find massive debt and deficit that were created in the Reagan administration brought the U.S. to its knees. Finally, some contemporary scholars believe that financial crisis in the first decade of the 21st century is the main reason of U.S. economic power decline. They also argue that the latest decline is something different than previous economic power declines. They believe the decline is real this time. The overall discussion made the question of “is U.S. economic power in decline?” necessary to reexamine. In order to answer that question correctly, properly and efficiently this research study collects
and scrutinizes different economic power indicators (GDP, consumer price index, debt, saving and productivity) in the following section.

The Truth About U.S. Gross Domestic Product (GDP) Growth

At the end of the World War II, there was an expectation that due to sharp decline in defense expenditures the U.S. would go back the days of Great Depression. However, the U.S. economy experienced a steady economic growth till 1960. The Gross National Product (GNP) rose from $300 billion in 1950 to $500 billion dollars at the end of the 1950s (Federal Reserve Bank of St Louis, 2019). The GDP average growth rate was more than 4 percent in the 1950s even though there were negative economic growths in two years in 1954 and in 1958 (Yarrow, 2010: 7).

It is important to know that these figures represent the market value of all goods and services. Market value depends on output of all goods and services and their respective prices. From that point, reason of the U.S. GDP growth could be only about price increases in the 1950s. In order to fix that, real GDP is used. Real GDP is the total value of all goods and services in a county during a given year (Callen, 2018). In real GDP, prices have been adjusted for inflation and deflation. Therefore, in real GDP if there is an increase in GDP that definitely means this particular country produces more output from a year earlier. In order to calculate real GDP, there is a need for a base year and GDP deflator. The following tables show real GDP of the U.S. from 1950 to 2018 based on 2010 price index. In terms of real GDP, American economy overall grew from $2.289 billion in 1950 to $3.178 billion in 1959 which means U.S. GDP increased by more than 38 percent (Federal Reserve Bank of St Louis, 2019).
There were many factors that played significant role on the economic boom in this decade. First of all, most parts of the world, especially countries that used to be industrialized were destroyed in WWII. From that point, after the war, these countries struggled very hard to rebuild themselves. These countries such as Germany, France, Great Britain, Soviet Union and Japan used to be the potential competitors of the U.S. On the other hand, the U.S. benefited a lot from wartime production. Wartime production not only pulled U.S.'s economy out of depression, but also helped individuals in the U.S. to accumulated significant amount of resources during the war. When the war ended, the consumer goods became available to people who were already very willing to spend for these goods. It is important to mention that some factors significantly increased customer demands in that period. For example, there was a new way of spending mentality “buy now and pay later” that created first time in the 1950s (Constantine, 2017: 14-16). People began to use credit and club cards to buy goods and services. On the other hand, industries answered these huge consumer’s demands accordingly. With the advances in science and technology many new products were created in this decade such as television, dishwashers, washing machine, dryers, vacuum cleaners and air conditioner. Besides that, construction and automobile industries significantly benefited from huge consumer demands of the 1950s (U.S. Department of Labor, 2006: 21-26). Many people in the U.S. had never owned the products mentioned above. President Eisenhower and his administration on the other hand believed that government has a duty to stimulate economic growth (Public Broadcasting Service, PBS, 2018). From that perspective U.S. government directly or indirectly supported stimulus programs such as providing affordable mortgages for members of the military, constructing interstate highway system, or enacting the new way payment system such as club and credit cards. Other than providing access to low-interest mortgages, extended G.I. Bill also gave military veterans affordable access to education and work force which played
important role on the economic boom in the 1950s. In addition, cheap domestic energy resources such as oil help industries to produce their products efficiently. Meanwhile, due to the communism threats in many parts of the world, the U.S. continued to spend billions of dollars for war supplies which created a huge military-industrial complex in the U.S. Finally, recreation of international monetary system opened the world markets to U.S. exports. The privileged status of the U.S in this system helped the U.S. economy to grow faster in this decade.

![Figure 8 and 9 U.S. – World Nominal GDP and U.S.-World Real GDP (2010 prices)](image)

**Figure 8 and 9 U.S. – World Nominal GDP and U.S.-World Real GDP (2010 prices)**


The average GDP grew by 3.3 percent each year in this decade. Finally, in nominal term the U.S. accounted for 38.1 percent of the world GDP and with 2010 prices the U.S. made up 30 percent of the world GDP in this decade.

In nominal term GDP in 1960 was little bit over $500 billion. At the end of the decade it became over $1 trillion (Federal Reserve Bank of St Louis, 2019; World Bank, 2018). And in real terms the GDP increased from $3.2 trillion in 1960 to $4.8 trillion in 1969 based on 2010 price...
index (World Bank, 2019). That means U.S. economy grew by little bit more than 50 percent in this decade. It is crucial that the economy was in recession when the President Kennedy took the office in 1961. Due to the recession, the GDP growth rate were around 2 percent in the beginning of the 1960s (Davies et al. 2011). In order to end the recession and stimulate economic growth Kennedy administration implemented an economic growth and recovery plan that consisted of increasing government spending with social programs and cutting taxes for business. These programs seemed to work out; the economy grew by 5 percent over the next two years (Emmons, 2012). However, president Kennedy believed that the economy needed additional stimulation packages in order to grow faster. After his assassination government role in the economy continued to grow. President Johnson used expansive economic programs that aimed to spread benefit of economy to all society. Federal government spending increased drastically with his “Great Society” programs. In this period government pumped billions of dollars into the economy with new programs such as Medicare, Food Stamps, several education programs, infrastructure and research and development programs. Military spending also increased dramatically in this period due to funding the Vietnam War and other proxy wars against communism all around the world. Federal revenues by that time were high enough to pay all these expenditures. All of these caused GDP growth to rise above 6 percent for few years. However, at the end of the decade things turned around and economy suffered heavily from all these large-scale government spending. Meanwhile, government was not able to raise taxes to pay for the war in Vietnam, the war on poverty and other social programs. From that point, at the end of the 1960s the economic growth that had flourished in the previous decade began to wane. The constraints in the international monetary system worsened the overall situation. In this decade consumer expenditures and government spending had major effects on overall GDP growth. They made up almost 80 percent of GDP growth (Patton, 2014). The GDP
growth rate was dropped by almost 3 percent at the end of this decade. However, throughout the 1960s real GDP growth rate in the U.S. averaged 4.2 percent. The U.S made up 38.5 percent of the world nominal GDP and in 2010 prices U.S.’s share of the world GDP was 27.1 percent in this decade.

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Table 5 U.S. – World Nominal and Real GDP (2010 Prices)1960-1969

In the early 1970s GDP growth rate slowed down to 2 percent from its previous rate. In the middle of the decade U.S. economy had negative growth. Country by that time entered a period of stagflation. Second half of the decade economic growth rate was little bit better than the first half. The average GDP growth rate in this decade was around 3 percent. Nominal GDP increased from $1 trillion at the beginning of the decade to $2.6 trillion in 1979 (U.S. Department of Commerce, Bureau of Economic Analysis, 2012: 183). It seemed that there is a fair growth in GDP; however, that growth included the price hikes of this decade. In real term there was a moderate U.S. economic growth. U.S. GDP rose from almost $4.7 trillion in 1970 to $6.5 trillion at the end of the decade with 2010 prices (World Bank, 2018; Federal Reserve Bank of St Louis, 2018). The overall economy grew by 36 percent in the 1970s. In other words, the economy slowed down 15 percentage point from the previous decade. There were many reasons that could explain that. First of all, the U.S. faced serious economic problems in the 1970s. Some of
these economic problems were the results of policies that followed by Kennedy and Johnson administrations. For example, funding the war in Vietnam and social welfare programs created a situation in the 1970s that increased the inflation and government deficit. Vietnam War continued till 1975 that increased military spending in the first half of this decade. In addition, President Nixon maintained and even increased social programs that were created in previous decade. The war between Israel and Arab countries worsened the overall picture. After the war the OPEC imposed an embargo to the Western countries which had helped Israel during the war. Due to the embargo the U.S. faced oil shortages that rapidly raised oil prices first and increased the prices of everything else later which pushed inflation to record high. In order to decrease the inflation Nixon administration mandated wage and price controls (Yergin and Stanislaw, 2008: 60-63). However, wage and price control lowered overall demand in the markets that slowed down economic growth even further in the U.S. For stimulating growth Nixon administration aimed to protect domestic industries by imposing tariff on imports. However, a few months after the imposition of tariff, the Smithsonian agreement was signed which lifted the import surcharge (Irwin, 2012: 40). Besides that, U.S. companies couldn’t lower wages due to the power of the Unions; at the same time, they couldn’t raise prices either to be profitable. One thing was clear that rising import prices slowed economic growth even more. In all, as it mentioned that the GDP growth rate fell to negative numbers in the middle of the 1970s. Meanwhile Federal Reserve aimed to implement two contradictory objectives in this decade. At first, Federal Reserve raised its rates to decrease inflation and then lowered their rates to increase economic growth and employment. But these “stop-go” policies confused
businesses and mostly worsened the economic growth.

Figure 10 and 11 World Nominal and Real (2010 Prices) GDP 1970-1979


In sum, U.S. real GDP growth rate averaged 3.2 percent in the 1970s. Like previous decade consumer and government expenditures were responsible for 80 percent of GDP growth (Patton, 2014). This was the first time that net export had a negative impact on economic growth. Finally, the U.S. GDP as a percentage of world GDP declined from 36.2 percent in 1970 to 26.3 percent in 1979. However, in real terms (2010 prices) the decline is just 1 percentage point. Throughout decade the U.S. represented 23.7 percent of the world GDP.

Crises in the previous decade passed into the 1980s. Especially in the 1960s and 1970s there were high levels of government spending for the Vietnam War and social programs. On the other hand, OPEC’s oil embargo and second oil price shock in the second half of the 1970s pushed oil prices record-high that caused U.S. economy to slow down (Kilian and Vigfusson, 2014: 6). Meanwhile, in this and previous decade European countries and Japan finished
reconstructing their economies from World War II. They strongly entered into the world market and gained a big share of world trade.

Due to fierce competition and changes in the world economic system, the U.S. lost some of its advantages that it had enjoyed in post-WWII. All of these resulted in decreasing economic growth more down and increasing prices of goods and services more up. The Federal Reserve used restrictive monetary policies in order to fight with inflation. The GDP growth rate turned negative and the U.S. entered into a recession at the beginning of this decade. Due to economic slowdown the Fed backed off its restrictive monetary policies for a while and then it tried its second attempt to lower the inflation and expectation of inflation with its more restrictive policies (Volcker and Gyohten, 1992: 172-184). These policies made U.S. economy enter another recession which was more serious than earlier one. U.S. economy was decreased by 2 percent in 1982 (Federal Reserve History, 2013). However, this attempt was more successful than the first attempt. Conditions began to improve at the end of 1983. The U.S.’s economy rebounded and then grew significantly till 1987 with an average of 4.6 percent. Reasons that explained this economic turnaround were various. President Reagan’s economic policies “Reagonomics” played important role on this economic comeback. First of all, he supported the supply-side economic theory for economic growth. In that theory it is believed that large tax cuts for

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Table 6 Export of Goods and Services from 1970 to 1985

Source: World Bank selected countries export of goods and services, IMF, OECD trade in goods and services (2020).
individuals and businesses result in more savings, investment and production which at the end stimulate overall economic growth (Volcker and Gyohten, 1992: 248-249).

From that point, President Reagan reduced the taxes at first. On the other hand, he thought the federal government has been too large and too interfering. Failed Keynesian economic policies in the 1970s played important role on that decision. He cut government spending on some domestic programs: however, military spending in this period increased significantly. In addition to that, he reduced regulations that affecting consumers and businesses.

Other than Reagan administration policies, there were some factors that played important role on this economic growth. One of them was the falling oil prices. Annual average oil price dropped from $36-37 at the beginning of the decade to $16-17 dollars in the second half of this decade (U.S. Energy Information Administration, 2018). The sharp decline in oil prices push the cost of production down and stimulate the economic activities not only in the U.S. but all around the world. After many years of discussion between Japan and the U.S., Japan agreed to impose voluntary quota on its products to the U.S.by that time. Besides that, stock market was one of the key indicators that stimulated the economic growth in that period. The stock market tripled itself from 1983 to 1987 (White, 2006: 193-195). During this period rising returns of the stock market created unique opportunities for investors in the U.S. However, stock market later in this decade suffered heavily when it lost 22 percent of its value in a single day (Carlson, 2017). As a matter of fact, economic growth continued till the end of the decade. Average annual growth of real GDP was 3.1 percent in this decade. In nominal term the GDP increased from 2.8 trillion dollar in 1980 to 5.6 trillion dollars in 1989 and in real term GDP rose from $6.5 trillion to $8.8 trillion during the same period. Overall the U.S. economy grew by 35.9 percent in this decade.
Consumer expenditure was responsible for almost two-thirds of GDP growth. Investment and government spending made up the rest. Like previous decades net export had negative impact on economic growth (Bureau of Economic Analysis, 2001).

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Table 7 U.S. and World Nominal and Real GDP (2010 Prices) 1980-1989


In total, the GDP value of the U.S. represented 28.8 percent of the world GDP in this decade. And in 2010 prices the U.S. made up 23.7 percent of the world GDP which was the same with previous decade average.

Like the beginning of previous decades, the economy of the U.S. had a relatively poor performance in the early 1990s. The economy fell into a recession in 1990. The growth rate was over 1 percent in 1990 but the next year it fell into negative number (Bureau of Economic Analysis, 2018). However, starting from 1992 to the end of the decade there was a completely different scenario. There was a constant economic growth that counted as one of the longest economic expansion in the U.S. The economy grew by an average of 4 percent per year from 1992 to 1999. Overall U.S. economy grew by 34.6% in this decade. Globalization and technology played important role on this economic expansion. Globalization by that time dramatically increased trade between countries. Technological developments, on the other hand, worked as an engine of 1990s growth. Expansions in the production of important technologies such as
personal computer, cell phones, software and telecommunication components were the main drivers of this economic boom. Economic policies also played crucial roles in this growth. Most of times in this period, legislative and executive branches worked together for adopting the right economic policies. For instance, government eliminated many regulations in order to give flexibility for the private firms to function. Discretionary programs such as military spending, were decreased and resources transferred to other programs such as infrastructure and research & development that created more jobs encouraged economic growth. (Congressional Budget Office, 2019: 20-25). The Federal Reserve also played a crucial role for the growth. It raised interest rates when inflation threatened the economic expansion. On the other side, it lowered rates in order to stimulate economic activities and growth when there was a risk of recession. Free-trade zone –NAFTA- was another factor that accelerated trade and economic activities in the North America by that time (Dixon and Rimmer, 2014: 34). Oil prices fell sharply in this decade that helped to increase economic activities in the U.S. and in the world. Stock prices on the other side increased dramatically in the 1990s. It was also one of the key factors that stimulate the economic expansion by providing funds for investors. Besides that, relatively peaceful international environment made people more confident for the future of the economy. The fall of the Soviet Union and Eastern European communism in the late 1980s expanded trade and economic opportunities between East and West in the 1990s. Due to all these causes U.S economy in real term increased from 9 trillion dollars in 1990 to 12.1 trillion dollars in 1999 (World Bank, 2019; Federal Reserve Bank of St Louis, 2018). GDP grew by an average of 3.2 percent per year in this decade. Consumer expenditures made up over 67 percent of GDP growth. Investment and government spending share were over 15 percent in this decade. Like previous decade net export had negative impact on GDP growth in the 1990s (Bureau of Economic Analysis, 2001). Finally, the GDP value of the U.S. in the 1990s represented 26.6
percent of the world total GDP in nominal terms, and in real terms (2010 prices) U.S. GDP as a percentage of world GDP averaged 24.3 percent.

Figure 12 U.S. – World Nominal and Real GDP (2010 Prices) 1990-1999

Source: Compiled by World Bank and IMF (various years), world current and 2010 GDP database; U.S. current and real GDP derived from Federal Reserve Bank of St Louis Michael Roscoe, US Federal Reserve / BIS/ Economist / World Bank and BEA database

The public in the U.S. was in full of economic confidence at the beginning of the decade. The U.S GDP for the first time passed 10 trillion dollars in 2000 and GDP growth rate was over 4 percent (Federal Reserve Bank of St Louis). However, in 2001, the first recession of the decade started. Due to the recession many software firms went to bankrupt. Meanwhile the Federal Reserve ignored the market and kept the interest rate high which made the cost of borrowing high. The September 11 attack worsened economic downturn. The stock market closed for almost a week after the attack. When the market reopened again the shares of the stocks dramatically fell down. GDP growth dropped from 4.1 percent in 2000 to 1 percent in 2001 (U.S. Bureau of Economic Analysis, 2004). In order to end the recession and boost the economic growth Bush administration used expansionary fiscal policies. From that point, Bush administration cut the taxes and increased the spending. These policies increased consumer
demand little bit. In addition, Federal Reserve used monetary policies for expanding economic growth more. The Fed decreased interest rates which made homes, buildings, auto purchases available. Due to these policies the recession was ended at the end of 2001. However, Bush administration and Federal Reserve maintained low interest rates till middle of this decade which contributed one of the most important causes of Great Recession in 2007-09.

There were other events that adversely influence economic growth in this decade. Hurricane Katrina was one of them. Estimation for the cost of this hurricane was around 180 billion to 250 billion dollars which had serious negative impacts on economic growth (Blanchard, 2008: 1-2). Beside that due to Hurricane Katrina, many oil facilities in the Gulf of Mexico damaged which caused oil prices to increase. The average annual price of one barrel of crude oil was $19 dollars in 1999 and a year later it rose up to $30 dollars. The oil prices constantly increased till the new decade. At the end of the 2000s the average price of oil reached $90 a barrel (U.S. Energy Information Administration, 2018). The sharp increases in oil prices had a negative impact on the economic growth. On the other hand, the wars in Afghanistan and Iraq consumed vast financial resources (over 800 billion spent for two wars) in this decade. From the same point, Bush administration increased federal spending in areas of health care and homeland security. All these dramatically raised the federal budget deficit which created pressure for economic downturn.

In order to encourage consumer spending and economic growth, Bush administration used more federal spending and enacted larger tax cuts. At the same time Federal Reserve cut interest rates to historic low. However, due to these policies average home prices in the U.S. raised continuously. Meanwhile the financial institutions were supplying high-risk and high-interest mortgage loans to consumers who had no ability to make required payments.
Everything was fine; however, when the housing prices started to decline in 2006 then the situation turned upside down. People started to default on their loans. Corporations, hedge funds, mutual funds and many other investors that invested in this field found themselves in danger. Banks stopped lending to each other. Some big prestigious financial institutions such as Lehman Brothers, Bear Stearns, Fannie Mae and Freddie Mac filed for bankruptcy. However, President Bush, congress, treasury secretary and federal reserve chairman agreed to use $700 billion federal funds to bail out troubled financial institutions in order to prevent banking and financial system from collapsing. Nevertheless, the bailout couldn’t prevent a recession in the U.S. economy. Stock market fell sharply. The Down Jones Industrial Average lost more than half of its values (Blumenthal, 2013). On the other hand, financial institutions were unable to lend money which made businesses unable to pay suppliers and employees. Due to growing economic uncertainties people stopped spending. The production and trade slowed. Millions of people lost their job. In sum, GDP fell more than 2 percent at the end of this decade. This crisis has been the worst and longest financial crisis in the United States since the Great Depression. The energy, confidence and optimism about economic expansion at the beginning of the decade completely vanished at the end of decade. The U.S. experienced serious of economic shocks from beginning to the end of this decade that made this decade maybe the most tumultuous decade for the U.S.

In total, nominal GDP increased from $10.2 trillion at the beginning of the decade to $14.4 trillion in 2009 (World Bank, 2019; Federal Reserve Bank of St Louis, 2018). Real GDP rose from $12.6 trillion in 2000 to $14.6 trillion at the end of the decade (World Bank). In this decade consumer expenditure was responsible for 70 percent of GDP growth. Net export’s negative impact on GDP growth increased almost 5 percent. Government expenditure and investment contributed 15 and 19 percent to GDP growth. Real GDP grew by 15.8 percent in this decade
which is the slowest economic growth of the U.S. since WWII. The average GDP growth rate was 1.9 percent in this decade. U.S. GDP represented 27.7 percent of the world GDP in this decade. And in 2010 constant prices the U.S. made up 24.2 percent of the world GDP which was almost the same with previous decade average.

![Figure 13 U.S. – World Nominal and Real GDP (2010 Prices) 2000-2009](image)

*Figure 13 U.S. – World Nominal and Real GDP (2010 Prices) 2000-2009*

*Source: Compiled by World Bank, world current and 2010 GDP database, from 2000 to 2009; U.S. current and real GDP derived from Federal Reserve Bank of St Louis, Michael Roscoe, US Federal Reserve / BIS / Economist / World Bank and BEA database*

Due to crises in the previous decade the U.S.’s economy bottomed out. The GDP was around $15-16 trillion in the first half of the 2010s (Federal Reserve Bank of St Louis, 2019). GDP growth averaged 2 percent during the same period. That means the U.S. economic growth stayed weak during the Obama administration. There were some reasons behind this sluggish recovery. First of all, the Great Recession was not an ordinary recession and it hasn’t looked like any of recession that occurred earlier since Great Depression of 1929. The effect of this recession was huge. Many households and businesses were not confident about the future of the economy even years after the shock, so they deferred their spending or investment
decisions. There were also many uncertainties over financial regulations and taxes that also
curtailed business activities in the U.S. From many perspectives, the fiscal policies were poor.
Government budget cuts stymied economic growth. On the other hand, monetary programs
were also too slow to provide necessary monetary stimulus. Uncertainties in both financial
market and the real economy forced Federal Reserve to used “wait and see” policies many times
which caused a slow recovery. Factors outside of the U.S.’s government and Federal Reserve’s
control such as global and financial crises in Europe and elsewhere lowered the demand for U.S.
products by that time which had negative impact over economic growth in the U.S. Another
factor that had negative impact on economic expansion in the U.S. was high oil prices. Average
crude oil prices in the first half of 2010s remained around $90 dollars (U.S. Energy Information
Administration, 2018). However, consumer confidence and economic optimism gradually
increased after the first half of this decade. The Trump administration aimed to increase
economic expansion through tax and spending programs (Timiraos, 2017). For fast and strong
economic growth, the administration tried to increase consumer demand and economic
capacity by stimulating investment and supporting labor force participation (Baily, 2018). On the
other hand, Europe and many parts of the world began revive from the financial crises at the
beginning of the 2010s which have positive impacts for the U.S. economic growth. From the
same perspective, the sharp drop in oil prices since 2015 expanded business activity. Overall,
the GDP growth rate in the second half of the 2010s increased by almost 1 percentage point. In
2018 GDP growth rate almost reached 3 percent and in nominal terms the U.S. economy was
over $20 trillion which was about $5 trillion more than the 2010’s GDP of $15 trillion. In real
terms the U.S. had $17.9 trillion economy in 2018. GDP growth rate averaged 2.2 percent from 2010 to 2019.

In this decade consumer expenditure like previous decade is responsible for around 70 percent of GDP growth. Net export’s negative impact on GDP growth passed over 5 percent. Government expenditure and investment, both contributed between 17 and 18 percent to GDP growth. In all, in nominal terms U.S. GDP represents 22.9 percent of the world GDP until at the end of 2018 and in real terms it is 22 percent of the world GDP.

![U.S. - World Real GDP (2010 Prices) 2010-2018](image)

*Figure 14 U.S. – World Nominal and Real (2010 Prices) GDP 2010-2018*

*Source: Collected by World Bank and IMF (various years) for world current and 2010 GDP database; U.S. current and real GDP derived from Federal Reserve Bank of St Louis, Michael Roscoe, US Federal Reserve / BIS/ Economist / World Bank and BEA database*
The Evolution of U.S. Inflation - Consumer Price Index (CPI)

The table below shows annual Consumer Price Index (CPI) from 1950 to 2019. The base years for this index are 1982-1984. In other words, price of (market basket) consumer goods and
services is 100 dollars in 1982-1984. From the table, it is clear that except a year at the beginning of the decade, there was relative price stability in the 1950s even though the U.S. experienced two recessions. First recession was mostly about the effect of Korean War. After the Korean War, annual prices of goods and services increased to almost 8 percent which generated pessimism toward the economy (Achinstein, 1958: 3). Federal Reserve stepped in and tightened money supply in order to curb the inflation. Inflation slowed down and stayed 0-1 percent for the next four years (Federal Reserve Bank of St Louis, 2019); however, Fed’s contradictory monetary policy caused U.S. to enter into another recession in the second half of the decade which was more intensive than the first one. Besides that, there was a downward pressure on production which reduced overall economic activities in the U.S. By that time, the world also suffered from a heavy recession; a strong dollar and a dollar shortage in the international markets by that time limited not only U.S.’s but also the world’s trade. At the end of the decade, government increased spending for social programs, military expenditures, and major infrastructure projects such as Interstate Highway System in order to supply dollars to markets. However, these policies pulled prices little bit higher. Overall, throughout this decade the U.S. experienced relatively modest increases in inflation. This was definitely different than previous decade that the U.S. exposed to sharp inflation and drastic deflation (Federal Reserve Bank of Minneapolis, 2019). Due to drastic price changes in previous decade, inflation-deflation still caused a lot of fear in the minds of policymakers in the 1950s. The total averaged price change for the market basket of consumer goods and services was $5 in this decade (U.S. Bureau of Labor Statistics and Federal Reserve Bank of St Louis, 2019). There was 20.7% increase for the prices of market basket goods and services. In other word, the U.S. had average 1.9 percent inflation in this decade.
Recovery from the recession in 1958 was very slow. Besides that, the Federal Reserve started to tighten monetary policy in 1959 even though the prices of goods and services were not that high (Bordo and Humpage, 2014: 12). The major reason of this policy was about the psychology of the Fed’s members. The Fed’s members had experienced high inflation after the World War II which made them very fearful of any kind of inflationary rise (Reed, 2014). In the late 1950s and early 1960s they believed that the prices were running high which would create inflation in the future (Reed). Therefore, they acted to control it by tightening money supply. On the other hand, in the previous decade there was a dollar shortage in the international markets; however, starting from the early 1960s this turned into dollar glut that seriously threatened the Bretton Woods monetary system. In order to protect the dollar-gold exchange system, the U.S. used restrictive monetary policies. These policies lowered the inflation about 1-2 percent (Federal Reserve Bank of Minneapolis). However, it caused a recession at the beginning of the decade. Recession ended after President Kennedy economic growth and recovery package that
consisted of twelve measures. The prices were modest, rising at a very slow rate till the middle of the 1960s. The average annual increase of inflation was 1.3 percent from 1960 to 1965. During this period, government officials and economic planners implemented policies that increase economic expansion at the same time limit inflation. From that point, for example, in order to curb inflation, President Kennedy put pressure on industries and unions to keep wages and prices down (Raskin, 1986). However, things started to change in the middle of this decade. From 1965 to end of this decade the prices rose at an increasing rate. Prices of all components of market basket surged by more than 20 percent. The annual inflation was 4.25 percent during this period (Federal Reserve Bank of St Louis). Many factors played role on this surge. First of all, President Kennedy and then Johnson aimed to accelerate economic expansion by using expansionary monetary and fiscal policies which helped the economy grew faster than previous periods; however, on the other hand these polices created inflationary pressure in the second half of this decade. President Kennedy performed his twelve measures package include funding for poor, farmers and disadvantages people. He also created programs that gave medical help for elderly and aid for inner cities. His successor President Johnson expanded these programs and added new ones. His “Great Society” programs that included medicare, food stamps, elementary, secondary and higher education and public work and development programs dramatically increased federal government spending (Brown-Collier, 1998: 26). Meanwhile military spending grew drastically due to the Vietnam War. Most of these programs and spending were funded by deficit spending without raising taxes. Therefore, rising cost of these programs resulted in domestic inflation. On the other hand, wage and price control started to break down in the second half of the 1960s which also increased inflationary pressure in the economy (Bryan 2013). Finally, the constraint of the international monetary system was another factor that exacerbated economic situation in the U.S. Overall the U.S. experienced high
inflation in the late 1960s, that means the demand exceeding the supply which mostly the case in heavily stimulated booming economies. The total amount of price change for the market basket of consumer goods and services was $7.1 in this decade (U.S. Bureau of Labor Statistics and Federal Reserve Bank of St Louis, 2019). That means prices of goods and services increased 23.9 percent in the 1960s. U.S. average annual inflation rate was 2.1 percent in this decade.

At the end of the 1960s the federal budget deficit grew rapidly due to social and economic programs. Military spending also increased sharply because of the Vietnam War and some proxy wars against the Soviet Union. Government aimed to close the budget deficit. Federal Reserve tightened monetary policies by raising interest rate in order to slow down the economy. On the other hand, Bretton Woods international monetary system by that time was in trouble. In order to defend the gold standard, the Fed raised rates again. These policies in the early 1970s created a recession which lasted about a year. However, it was important that even though high interest rates and recession, prices continued to rise (stagflation) by that time which cannot be explained by Keynesian economic principles. High inflation, high unemployment rate and high budget deficit played important role on rising prices in this period. Beside that escalation of the Vietnam War and taking the U.S. off the gold standard worsened the overall situation. For turning the trend around, President Nixon imposed wage and price control (Ghizoni, 2013). However, that didn’t work well. It slowed the rise in prices temporarily. On the other hand, it caused food and energy shortages that created serious inflationary pressure. In 1973 the first oil shock arrived. Sharp increase in energy prices pushes prices of goods and services record high. President Ford’s “Whip Inflation Now (WIN)” program which encouraged thrift also failed (Bryan 2013). The second shock came in the late 1970s. This shock was even bigger than the first. All components of the CPI soared dramatically. It is crucial that no matter what the recovery programs were, the prices continued to rise in this period. From that perspective, in terms of
price stability the 1970s was different than earlier decades. Other than the contributors that mentioned above, there were also some serious other reasons that played significantly role on price hike in this decade. First of all, the wage and price control program started to break down at the end of previous decade. Unions in this period started to have power and with that power they were able to increase wages. Due to wage increase, the unit cost of output raised which pushed companies to increase their prices. This is like a spiral that once it’s started, wages and prices chase each other up and up. In addition to that, expectation about future of the economy played important role on the creation of wage and price spiral (Yellen, 2006). During the 1970s workers and investors had expectation for higher prices for the future. This situation created another spiral in this decade that higher expectation led to higher prices and higher prices required ever higher expectations. From that point, the impact of tightened monetary policies in this decade was felt on employment and output instead of prices. Complicated polices that were used by Federal Reserve confused workers and investors by this period. During this decade the Fed repeatedly raised its rates to decrease inflation and then lowered their rates to increase economic growth and decrease unemployment rate. However, these policies (which is called stop-go policy) created an unpredictable environment in the economy that caused the prices rise. Besides that, Federal Reserve by that time was very skeptical to use restrictive monetary policies to control inflation. It was crucial that till the end of this decade curbing inflation was not a high priority of many politicians and Federal Reserve (Nelson, 2004: 8-9). At the end of the decade the average price for the market basket of consumer goods and services was $33.8 higher than the price of the same goods and services at the beginning of this decade (U.S. Bureau of Labor Statistics and Federal Reserve Bank of St Louis, 2019). The total increase for the prices of market basket goods and services was 87% in the 1970s. U.S. average annual inflation rate increased to 6.5 percent in this decade.
The early 1980s was the continuation of the 1970s. Prices remained relatively high in the early 1980s. However, one thing seriously changed which was the policy shift in Federal Reserve. In this new period Federal Reserve quickly signaled that inflation reduction became the highest priority of Fed (Medley, 2013). From that point Federal Reserve tightened the monetary policies. High interest rates caused a recession. Inflation fell down little bit during the recession, but it was still relatively high (around 10 percent) (Federal Reserve Bank of Minneapolis, 2019). From that point, Federal Reserve started to use expansionary policies that reminded investors its stop and go policies that had used in previous decade. However, Federal Reserve pushed its tightening policies second time. The Fed started to raise its rates again this time above 15 percent (Sablik, 2013). They kept interest rates high till 1982. The economy entered into another recession which was more severe and more extended than previous recession. As the recession worsened government pushed Federal Reserve to loosen monetary policies. However, Federal Reserve continued to use high interest rates and tight money supply to bring down inflation and inflation expectations that had created in previous decade. Finally, this persistence paid off and inflation rate got down to 6 percent in 1982 and 4 percent in 1983 (Federal Reserve Bank of St Louis, 2019). Other than Federal Reserve’s tight monetary policies, declining oil prices by that time also caused inflation rate to fall. Oil price which was the main contributors to inflation in the 1970s fell sharply from $37 dollars in 1980 to $15 in 1986 (U.S. Energy Information Administration, 2018). This severe drop in oil prices pushed overall inflation down. Therefore, the inflation was under 2 percent in 1986 (Federal Reserve Bank of Minneapolis). However, a year later energy prices recovered and inflation rate returned to around 4 percent till the rest of the decade. Throughout the decade the prices of CPI increased from $82.4 to $124 which means the prices increased by 50.4 percent and first few years of this decade made big part of this increase (U.S. Bureau of Labor Statistics and Federal Reserve Bank of St Louis, 2019). It is
important to know that during this decade inflation dropped from 13.5 percent in 1980 to 4.8 percent in 1989. Finally, the average annual inflation rate was 4.1 percent in the 1980s.

Like previous three decades, there was a recession at the beginning of the decade. Reasons of this recession were various. First of all, President Reagan’s economic programs resulted in both an economic expansion and huge budget deficit. Investors at the beginning of the 1990s started to believe that large U.S. budget deficit might cause a serious inflation in the future. Beside that a large number of savings and loan institutions in the second half of the 1980s went bankrupt due to the deregulation of this industry in the 1980s (Robinson, 2013). The collapse of savings and loan institutions negatively impacted the economy. Government spent billions of dollars in this period to save some of these institutions which placed further strain on the government budget. On the other hand, the Gulf War increased the price of oil. Due to the Gulf War energy prices was raised by 20 percent (Lieber, 1992: 163). Inflation rate at the beginning of the decade stayed around 5 percent which was relatively higher than the rest of the decade. The Federal Reserve like previous decade focused strongly on its role in promoting price stability. From that point, the Fed used restrictive monetary policies. When the inflation rate dropped to 3 percent, this time the Fed used low interest rates in order to protect the U.S. economy from serious international financial crisis; such as the Mexican Crisis in 1995, the Asian Financial Crisis in 1997, and the Russian Crisis in 1998 without causing price increases in this period. Second half of this decade the average annual inflation rate was 2.36 percent (Federal Reserve Bank of St Louis 2019). During this period employment rose, national deficit decreased, wages increased and inflation fell at the same time. In terms of inflation and prices the decade of 1990s was an exceptional quiet and stable decade. Except 1990 and 1991, throughout the decade all-items CPI increased between 1.6 to 3.0 percent per year. Total price of CPI goods and services increased from $130.7 in 1990 to $166.6 in 1999 (U.S. Bureau of Labor Statistics and
Federal Reserve Bank of St Louis, 2019). That means the prices grew by 27.4 percent in this decade. Annual average percentage change in prices was 2.4 percent.

Price stability in the 2000s was very much a continuation of previous decade’s price change even though the U.S. faced many tumultuous events in this decade such as dot.com crisis, September 11 terrorist attacks, wars in Afghanistan and Iraq and finally Great Recession. It is important to know that Federal Reserve and its focus on price stability played a major role on that. Consumers and investors’ confidence for the future of the economy boosted at the beginning of the decade. However, this created a situation that encouraged excesses, then these excesses caused bubbles and finally bubbles turned into crisis. That’s known as business or economic cycle and that’s what started to happen in 2001. Sharp increase in computer and software industries in the 1990s increased the stock price of many software companies. Investors bought a lot of shares of these companies without knowing whether they are doing well. When the computer and software business slowed down “dot.com boom” turned into a bust which sent the U.S. economy into a recession. Sharp increases in oil prices from $19 in 1999 to over $30 dollar in 2000 (U.S. Energy Information Administration, 2018) and September 11 attack just worsened the recession. Meanwhile, the Fed just ignored the market and raised its funds rate. This act showed that the Fed was willing to bear recession in order to reduce inflation in the future. However, after 2002 for the purpose of increasing economic growth, Bush administration used expansionary fiscal policies and on the other hand, Federal Reserve lowered the rates and increased money supply. From many points, these policies were the main factors that contributed to another recession in the second half of the same decade. Due to easy money policies, house prices rose continuously. Meanwhile, because of the structural changes in the financial sector in the 1990s and the early 2000s financial institutions were able to make high-risk and high-interest mortgage loans to consumers who had no ability to make
required payments (Federal Reserve Board of Governors, 2010). Everything seemed under control; however, things turned around when house prices started to decline. Wars in Afghanistan and Iraq, low consumer confidence and high budget deficit worsened the economic downturn. Eventually the U.S. entered into the worst economic recession since the Great Depression. Market basket consumer goods and services remained around 2-3 percent (Federal Reserve Bank of Minneapolis, 2019). Meanwhile, oil prices rose dramatically. The average annual price of one barrel of crude oil was $72 dollars in 2007 and the next year it increased to $99 dollars a barrel (U.S. Energy Information Administration, 2018). This pulled the CPI rates little bit up to almost 4 percent. However, in 2009 the price of oil dropped almost by 40 percent to $61 a barrel (U.S. Energy Information Administration). Low confidence for the future of economy, low demand and low investment dropped the CPI rates even in negative numbers at the end of the 2000s. Easy money and easy credit policies could not stimulate overall demand in this decade. People lost their willing to buy goods and services. Investors lost their enthusiasm to invest for new projects. This situation created fears in this period that the U.S. might experience the same thing that Japan had recently suffered in their lost decade (1990s). Overall all-items CPI grew 24.6 percent throughout the decade. In other words, at the end of the decade the average price for the market basket of consumer goods and services was $42.3 higher than the price of the same goods and services at the beginning of this decade (U.S. Bureau of Labor Statistics and Federal Reserve Bank of St Louis, 2019). U.S. average annual inflation rate was 2.17 percent in this decade.
During the recession the Fed and government took many actions such as lowering interest rates, making regulatory reforms and giving out hundreds of billions of dollars through stimulus packages. This generated fears in the economy that these policies would lead to a serious inflation. Despite that fear, after years from the recession the predicted inflation has not emerged. Economic growth has been slow and inflation has stayed around 2 percent (Federal Reserve Bank of Minneapolis, 2019). There were some reasons behind that. First of all, catastrophic consequences of recession in the U.S. and also in the world prevented consumers and businesses from spending and investing. Less spending and less investing pulled down the overall demand and supply of the economy. Investors’ expectation for the future of the economy is another reason. In the past, it was usual that investors demanded an interest-rate premium for the risk of inflation. However, since the financial recession investors have been confident that the Fed will keep the inflation low. Therefore, investors don’t need that premium. This is the situation exactly opposite from the one in the 1970s. In the 1970s, expectation about higher inflation led to higher prices and higher prices caused even higher expectation. However, in the 2010s both consumers and investors don’t have expectation for higher inflation. Due to the Fed’s success at eradication expectation of inflation, prices remained stable around 2 percent in this decade. Besides that, due to the Fed and government expansionary monetary and fiscal policies, corporate debts increased significantly (Board of Governors of the Federal Reserve System, 2019: 9-15). In addition to that, these policies boosted
prices of stock and real estates in many cities (Board of Governors of the Federal Reserve System). It is important that as prices raise their returns decline. That creates a situation in this decade that there is no incentive to lend or invest for these assets. In other words, expansionary policies of the Fed and government could not stimulate spending in this period. Finally, the economy in the U.S. has changed in ways that diminish its capacity in reaction to price changes. Evolution from more manufacturing economy (more price sensitive) to more financial and services economy (less price sensitive) create an environment that can only allow a sluggish growth with price stability. In all, price of the market basket of consumer goods and services increased from $218 in 2010 to $251.1 in 2018 (U.S. Bureau of Labor Statistics and Federal Reserve Bank of St Louis, 2019). That means prices of goods and services increased 15.2 percent in the in this decade. All components of CPI increase 1.6 percent annually from 2010 to at the end of 2018 which means prices of goods and services remained stable.

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Table 8 U.S. Consumer Price Index - 1982-1984 Base Year, Figure 20 U.S. CPI Decade Average


The Long Story of U.S. Debt

The U.S. involved with the Korean War in the early 1950s. However, unlike previous wars in the history the Korean War didn’t significantly increase the deficit. There was an increase in
military spending for this period but the debt only grew a small amount. $257 billion dollars
government debt rose to $274 billion debts in the middle of the decade (U.S. Council of
Economic Advisers, 2019). During the same period federal debt as a percentage of GDP fell from
86 percent to 55 percent. In the second half of the 1950s President Eisenhower aimed to
balance the federal budget. From that point, there were surpluses in 1956 and 1957. However,
till the new decade in order to end the recession in the second half of the 1950s and to
stimulate economy growth, President Eisenhower allowed deficit to grow though government
spending. Interest rates were lowered during this period. Meanwhile, people in the U.S. started
to use credit and clubs’ cards which also induced Americans to spend more for the new products
such as televisions, washing machines and air conditioners. In total, the household debt in this
decade rose significantly from $51 billion in 1951 to $141 billion in 1959 (U.S. Board of
Governors of the Federal Reserve System, 2019). That means household debt as a percentage of
GDP rose from 16.6 percent to 27 percent of GDP. It is essential to know that providing access to
low interest mortgages through GI Bill was one of the main players of this households’
borrowing hike. Besides that, during this time the international monetary system was in serious
trouble. The world at the end of the 1950s was experiencing dollar shortage. Countries in the
Europe and Japan wanted to increase their imports for recovering from war damage; however,
by that time the dollar was the only internationally accepted money. That means these
countries had to have foreign reserves denominated in the U.S. dollar for importing goods and
services (Ilzetzki, Reinhart and Rogoff, 2017: 49). From that point, the U.S. increased its deficit in
order to provide liquidity to allow these countries’ economies to recover. Throughout the 1950s
federal budget debt grew from $257 billion in 1950 to $288 billion in 1959 (U.S. Council of
Economic Advisers, 2019). It is important to know that strong GDP growth in this decade
compensated the effect of increase in government spending. Therefore, federal budget debt as
a percentage of GDP decreased from 85.7 percent in 1950s to 55.1 percent in 1959. Average
annual government debt grew by 1.1 percent in this decade. Corporate debt on the other hand,
rose from $70 billion in 1950 to $133 billion in 1959 (U.S. Boards of Governors of the Federal
Reserve System, 2019) which means an average of 6.6 percent increase for each year in this
decade. However, in this decade the ratio of corporate debt-to-GDP decreased from 26.6
percent in 1951 to 25.5 percent in 1959. Overall, the total debt increased from $378 billion in
1950 to $562 billion in 1959. Even though total debt rose by 170 billion in this decade, it
decided in ratio-to-GDP. During the 1950s GDP annual growth rate (4.6 percent) was higher
than total debt annual growth rate (4.0 percent). From that point, the ratio of total debt-to-GDP
decided from 126 percent in 1950 to 107 percent in 1959. Finally, at the end of the decade the
U.S. made up over 40 percent of world total debt (Mbaye, Badia, Chae, 2018: 14-20; World
Bank, 2019)

![U.S. Debt 1950-1959](image)

*Figure 21 U.S. Debt 1950-1959*

*Source: Derived from U.S. Council of Economic Advisers for federal debt and household debt; Boards of Governors of the Federal Reserve System for corporate debt and nominal GDP from Federal Reserve Bank of St Louis. For calculating 1950s household debt, nonprofit organization and household and motor vehicle loans data derived from Federal Reserve Bank of St Louis.*
At the beginning of the 1960s the economy was in recession due to mostly Fed’s monetary policies. During this period Fed believed that CPI was high that would create serious inflation in the future. The experiences after WWII played an important role in that belief. However, President Kennedy aimed to growth the economy by increasing government spending and cutting taxes. From that point, he launched many ambitious programs to help poor and elderly people and improve education and transportation. On the other hand, the relationship between the U.S. and Soviet Russia became very dangerous by that time. Serious confrontations brought two countries close to war. In response to that, U.S.’s military spending reached 9 percent of the GDP (Stockholm International Peace Research Institute, SIPRI, 2019). In addition, in the middle of the 1960s the U.S. engaged in a proxy war in Vietnam which made military spending remain around 9 percent of GDP (SIPRI). Overall discretionary spending was 12 percent of GDP in this period (U.S. Office of Management and Budget, 2009). Meanwhile, President Johnson continued and expanded Kennedy’s social programs. He also created new programs such as Medicare and Food Stamps in order to spread the benefits of the U.S. economy to more people. Besides that, he designed social programs to fight crime and end racial and gender discriminations. Thus, in the second half of the 1960s mandatory expenditure increased by 1 percent to over 5 percent of GDP (U.S. Office of Management and Budget). However, these programs had a positive effect on household debt. In previous decade 10.5 percent of annual household growth rate dropped to 7 percent in the 1960s. Throughout the decade household debt rose from $155 billion to $308 billion (U.S. Board of Governors of the Federal Reserve System, 2019) and its share of GDP increased from 28 percent in 1960 to 30 percent in 1969. It is important to know that during this period for establishing a presence in the international political and economic environments, the U.S. maintained a high level of overseas spending. Most of the programs and spending were funded by deficit spending. After all of these expenditures that included mandatory and
discretionary expenditures, federal budget debt increased from $290 billion in 1960 to $366 billion in 1969 (U.S. Council of Economic Advisers, 2019). However, like in precious decade strong GDP growth in this decade led to decline in debt as a percentage of GDP. Government budget debt as a percentage of GDP declined from 53.6 percent in 1960 to 35.9 percent in 1969. Annual federal debt increased by 2.3 percent each year in the 1960s. Kennedy and Johnson administrations fiscal and the Fed monetary policies induced corporations in this decade to increase their borrowing. During this decade like previous decade they heavily invested in foreign countries. Their debt grew by 7.8 percent each year in the 1960s reached to $307 billion in 1969 from $142 billion in 1960 (U.S. Boards of Governors of the Federal Reserve System, 2019). Therefore, their debt as a percentage of GDP increased from 26.3 percent at the beginning of the decade to 30.2 percent at the end of the decade. The total debt rose from over a half trillion ($588 billion) in 1960 to almost a trillion ($981 billion) in 1969. U.S.’s debt accounted for 36.2 percent of global debt (World Bank, 2019: Mbaye, Badia, Chae, 2018: 14-20). However, total debt decreased in ratio to GDP. Total debt in this decade fell more than 10 percent from 108.5 percent in 1960 to 96.4 percent in 1969.

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Table 9 U.S. Debt 1960-1969

Source: Derived from U.S. Council of Economic Advisers for federal debt and household debt; Boards of Governors of the Federal Reserve System for corporate debt and nominal GDP from Federal Reserve Bank of St Louis. For calculating 1960s household debt, nonprofit organization and household and motor vehicle loans data derived from Federal Reserve Bank of St Louis.
There were some attempts to lower federal budget deficit at the end of the 1960s. From that point, Fed raised its interest rates; however, that caused a recession. The budget debt continued to grow in the 1970s. Kennedy and Johnson administration welfare programs in previous decade played the major role for government budget deficit. When these programs were created they consumed less than 1 percent of GDP. However, at the end of the 1960s more and more people began to benefit from these programs. Their share of GDP rose to 5 percent quickly before the new decade (U.S. Office of Management and Budget 2019). These programs in the 1970s also created government obligations that caused deficit to grow. On the other hand, the war in Vietnam continued in this decade which generated higher level of military spending in the first half of this decade. Government budget deficit was $15 billion in 1973, but it dramatically increased to $53 billion in 1975 and $74 billion in 1976 (U.S. Office of Management and Budget, 2009). The sharp rise in oil prices due to the OPEC embargo was another main player of this debt. By 1979, federal debt reached almost $830 billion. It was little bit over $380 billion at the beginning of this decade which means government debt more than doubled in this decade (U.S. Council of Economic Advisers, 2019). However, like previous decades debt as a percentage of GDP decreased from 35.5 percent to 31.6 percent. Moderate GDP growth (36.8% percent throughout the decade) in the 1970s was the reason of this fall. Averaged annual federal deficit was over $35 billion dollar and annual government debt increased by 8.1 percent each year in the 1960s. On the other hand, due to sharp rise on home mortgage and auto loan in this decade, household debt increased higher and faster than government debt. In this decade household debt was almost tripled. It rose from $317 billion in 1970 to $890 billion in 1979 which means there was 10.9 percent increase each year in the 1970s (U.S. Board of Governors of the Federal Reserve System, 2019). Household debt as a percentage of GDP increased from 29.5 of GDP in 1970 to 33.9 percent at the end of the decade.
There were many economic, political and social challenges and uncertainties in the 1970s that undermined the confidence of corporations. On the other hand, the U.S. government expanded business regulations in this decade in order to defend employee’s and consumers’ right and protect the environment. In total, businesses held or cancelled their investment projects and lay off hundreds of thousands of workers. From that point, the ratio of corporate debt to GDP dropped 1.5 percentage points from 32.8 percent to 31.3 during the 1970s. However, the amount of corporation debt increased from $352 billion to $820 billion (U.S. Board of Governors of the Federal Reserve System). The amount of total debt in this decade rose from $1.050 trillion in 1970 to $2.541 trillion in 1979 and its share as a percentage of GDP decreased just 1 percent from 97.8 to 96.7 in the same period. U.S. total debt made up a quarter of the world total debt (Mbaye, Badia, Chae, 2018: 14-20).

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<th>Year</th>
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<th>GDP</th>
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<td>2451</td>
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Table 8 U.S. Debt 1970-1979

Source: Collected from U.S. Council of Economic Advisers for federal debt and household debt, Boards of Governors of the Federal Reserve System for corporate debt and nominal GDP from Federal Reserve Bank of St Louis. For calculating 1970s household debt, nonprofit organization and household and motor vehicle loans data derived from Federal Reserve Bank of St Louis.

President Reagan had criticized debt and deficit spending before his presidency. However, federal budget deficit grew even faster under his administration. In response to serious recessions in the early 1980s, President Reagan reduced the taxes and increased government spending to stimulate the economy in an attempt to create growth and incite a recovery.
Meanwhile, spiraling cost of programs that were created in previous decades such as Medicare, Medicaid, Food Stamp and Social Security continued in the 1980s. Therefore, mandatory expenditure increased to over 9 percent of GDP (U.S. Office of Management and Budget, 2019). In addition to these programs, there was a massive military buildup in this period. From 1982 to the end of the decade annual defense expenditures remained about 6 percent of GDP (SIPRI, 2019). From that point, the total of discretionary expenditure stayed around almost 10 percent of GDP (U.S. Office of Management and Budget, 2009). In order to finance all of these spending the U.S. faced with higher interest costs. From beginning to the end of this decade the interest payment rose from 1.9 percent of GDP to 3.0 percent of GDP (U.S. Office of Management and Budget). President Reagan used several deficit reduction measures; however, to eliminate the deficit in this decade was unsuccessful. The average federal budget deficit in the 1980s was more than $150 billion each year (U.S. Office of Management and Budget, 2009). Government budget debt increased from $909 billion in 1980 to $2.868 billion in 1989 (U.S. Department of the Treasury, 2013). In other words, throughout the decade government debt tripled. After three decades of decline, debt as a percentage of GDP rose due to increases in spending such as military and social programs and decreases in tax revenues in Reagan administration. The rise was significant that the debt as a percentage of GDP increased by almost 20 percent from 32% in 1980 to 51% in 1989. Total federal debt grew by 12.2 percent each year in 1980s. Due to president Reagan’s expansionary monetary and fiscal policies Americans felt comfortable to borrow in this decade. Therefore, household debt rose from $1.003 billion in 1980 to $2.465 billion dollars in 1989 (U.S. Board of Governors of the Federal Reserve System, 2019). There was 9.4 percent growth in household debt each year in the 1980s. Household debt as a percentage of GDP increased from 35.1 percent in 1980 to 43.7 percent in 1989. The situation was the same for corporate debt. President Reagan believed supply-side economics. Under this approach
government cuts taxes, lowers interest rates and uses other easy money policies to encourage businesses for more investment and production. That was exactly what happened in the 1980s. Due to these policies business debt increased dramatically. The average annual corporate debt growth rate was 10.4 percent each year. Corporate debt rose from $891 billion in 1980 to $2.390 trillion in 1989 (U.S. Board of Governors of the Federal Reserve System). That means corporate debt as a percentage of GDP rose from 31.2 percent in 1980 to 42.3 percent in the 1989.

![U.S. Debt 1980-1989](image)

**Figure 22 U.S. Debt 1980-1989**

*Source: Collected from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts. Nominal GDP from Federal Reserve Bank of St Louis. For calculating 1980s household debt, nonprofit organization and household and motor vehicle loans data derived from Federal Reserve Bank of St Louis*

In sum, the total debt rose significantly. It was $2.8 trillion in 1980 and it rose to $7.7 trillion in ten years. U.S. total debt as a percentage of global debt decreased from 29.5 percent to 25 percent in this decade (Mbaye, Badia, Chae, 2018: 14-20; World Bank, 2019). Annual total debt growth rate was more than 10 percent (10.6%). Due to this massive debt hike total debt as a percentage of GDP increased from 98.1 percent in 1980 to 136.9 percent in 1989.
There were two different scenarios in the 1990s. Taxes were raised and extended by the Bush administration in the first half of this decade. Despite tax's hike in this period the federal budget deficit rose. The annual federal deficit was 200-250 billion dollars from 1990 to 1995 (U.S. Office of Management and Budget, 2009). Government dept as a percentage of GDP rose from 54% in 1990 to 64% in 1995. The reasons of this hike were various that included spending billions of dollars for military and social programs especially in Reagan administration, bailing out a large number of saving and loan institutions due to financial and deregulations problems at the end of the 1980s, rising oil prices caused by the Gulf War in Iraq and Kuwait, and using expansionary polices in order to protect the economy from serious international financial crises. However, in the second half of this decade there was a strong economy and significant budget surpluses. Federal government in this period decreased the spending growth for discretionary programs. For example, military budget during this period fell from 5.2 percent to 3 percent of GDP (SIPRI, 2019). Overall, discretionary expenditures declined from 9 percent to 7 percent of GDP (U.S. Office of Management and Budget, 2009). Besides that, steady GDP growth and low unemployment rate in this period increased government’s revenues. More people had jobs and income in this decade that generated more tax revenues for government. On the other hand, reliance in certain mandatory programs fell due to rising income of people. That further decreased government spending. Due to budget surpluses the level of borrowing decreased in the second half of the 1990s which caused interest spending to fell. Net interest spending decreased from 3 percent of GDP to 2 percent of GDP in the 1990s (U.S. Office of Management and Budget, 2019). High spending cuts, strong GDP growth, high revenue increases and low unemployment rates especially in the second half of the 1990s contributed to the reduction in the national debt. Government debt as a percentage of GDP fell from 64% in 1995 to 58% ($5.6 trillion) in 1999 (U.S. Department of the Treasury, 2013). Economic policies and prosperity
especially in the second half of the decade increased wages and wealth of Americans. Due to their rising income, people were able to slow down the speed of their household debt. During this decade household debt as a percentage of GDP did not increase. It remained the same (45% of GDP). However, its amount rose from $2.705 billion dollars in 1990 to $4.793 billion dollars in 1999 (U.S. Board of Governors of the Federal Reserve System, 2019). That means throughout the decade annual growth rate of household debt was 5.9 percent each year. Corporations on the other hand, in this decade heavily invested in technology, particularly in IT. This huge investment led a dramatic improvement in IT producing sectors. Meanwhile, government supported corporations with its economic and regulatory policies. Corporations increased their earnings which made them invest in technology with their resources later in the decade. At the end of the decade, corporation debt as a percentage of GDP had increased by just 0.6 percent to 43.3 percent. The total corporation debt increased from $2.548 in 1990 to $4.173 trillion in 1999 (U.S. Board of Governors of the Federal Reserve System).

Figure 23 U.S. Debt 1990-1999

Source: Collected from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts. Nominal GDP from Federal Reserve Bank of St Louis of St Louis. For
calculating 1990s household debt, nonprofit organization and household and motor vehicle loans data derived from Federal Reserve Bank of St Louis.

Total debt rose from $8.459 trillion in 1990 to $14.573 trillion in 1999. During the same period the ratio of total debt-to-GDP increased from 141.8 percent to 151.4 percent. Finally, the ratio of U.S. total debt-to-world total debt was 24.5 percent at the end of the 1990s (Mbaye, Badia, Chae, 2018: 14-20).

The period of budget surpluses ended in 2001 and a completely different era started. In order to end the recession at the beginning of the decade President Bush used expansionary fiscal policies that included cutting the taxes and increasing the spending. These policies caused the debt to grow again. Especially household debt increased significantly during this period. September 11, 2001 terrorist attack worsened the situation. Due to the attack the economy stalled which cost government to receive less revenue. On the other hand, this attack dramatically increased the spending for homeland security. After the attack, the U.S. started the War on Terror which included wars in Afghanistan and Iraq. All of these significantly pushed spending to higher levels. During this period the federal debt grew at a rate of $400- $500 billion per year (U.S. Office of Management and Budget, 2009). Hurricane Katrina was another tragic incident that cost about $180 to $250 billion to U.S. economy in the middle of the 2000s (Blanchard, 2008). Hurricane Katrina and international political and economic crises pushed the oil prices almost $100 a barrel in the second half of this decade which increased government spending substantially (U.S. Energy Information Administration, 2018). Government’s mandatory spending programs in this period also grew noticeably. Spending on Social Security, Medicare and Medicaid was little bit over 7 percent at the beginning of this decade. However, less than a decade spending rose over 9 percent of GDP. Total mandatory spending was 14.5 percent of the GDP (U.S. Office of Management and Budget, 2009). From the same point, discretionary expenditures significantly increased and reached almost 9 percent of GDP in this
Toward the end of 2007, the U.S. has entered into the worst recession since Great Depression. Due to this recession GDP fell dramatically, many businesses went bankrupt and millions of people lost their job. All these factors sharply decreased government revenue. On the other hand, federal government used more than $700 billion federal funds to bail out some of businesses. During the recession in order to encourage economic growth, the government created many stimulus packages. Government agencies such as Federal Reserve also provided additional programs. On the other hand, spending in existing programs like unemployment insurance also increased. The cost of all these programs caused national debt to grow at an unprecedented rate. The growth of federal debt was more than $1 trillion per year at the end of the 2000s which roughly equaled to 10 percent of GDP (U.S. Council of Economic Advisers, 2019). Throughout the decade the government debt increased from $5.6 trillion in 2000 to almost $12 trillion in 2009 (U.S. Council of Economic Advisers). In other words, it more than doubled itself in this decade. From that point, federal debt as a percentage of GDP rose dramatically by 27 percentage points from 55% in 2000 to 82% in 2009. Annual growth on federal debt was 7.7 percent in the 2000s. On the other hand, household debt grew significantly, following the same path that federal debt did. Easy money policies such as lowering interest rate and supplying more money to the system made borrowing costs very cheap that induced Americans to pick up their borrowing to a record level in this decade. $5.2 trillion U.S. household debt in 2000 grew by 9 percent each year till the end of decade. Household debt rose to $12.3 trillion in 2009 (U.S. Board of Governors of the Federal Reserve System, 2019). During the same period the ratio of household debt-to-GDP increased more than 30 points from 50.9% to 85.5%. Corporations in this decade hold their investment due to deteriorating economic conditions in the U.S. and also in the world even though government used expansionary fiscal and monetary policies. In the middle of the decade the ratio of
corporate-debt-to-GDP declined from 44.5 percent in 2000 to 39.5 percent. During and after the financial crisis government aggressively expanded its incentives. Tax breaks, loans and subsidies were effectively used in order to encourage economic activities. Corporate debt increased till the end of the decade. It rose to $6.377 trillion at the end of the decade (U.S. Board of Governors of the Federal Reserve System). That means business debt grew 1.8 trillion (3.4 percent each year) in the 2000s. In 2009 corporate debt as a percentage of GDP reached 44 percent. In total, like in the 1980s there was a massive debt accumulation in this decade. The total amount of debt increased from $16.190 trillion in 2000 to $31.607 trillion in 2009. That means total debt as a percentage of GDP grew by more than 60 percentage point from 157.9 percent in 2000 to 218.7 percent in 2009. Finally, the U.S. total debt made up 19 percent of the world total debt (Mbaye, Badia, Chae, 2018: 14-20; Adler and O’Sullivan, 2019: 12).

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Government continued to cut taxes and increase its spending in order to stimulate the economy in the early 2010s. These policies kept the federal deficit above $1 trillion till 2013 (U.S. Office of Management and Budget, 2019). Federal debt as a percentage of GDP increased to 99 percent by this time. After 2012, the deficit gradually brought down to $440 billion dollars until 2015. Meanwhile, the economy slowly recovered and unemployment declined. The deficit
started to rise again in the second half of this decade due to president Trump’s tax breaks. Trump administration, like Reagan administration more than three decades ago, believes that the tax cuts would pay for themselves through stronger growth and stronger growth would lead the budget deficit to decline. However, until the end of 2018 there was no sign of strong economic growth. Besides that, federal debt increased to over 100 percent of GDP. It is important that, in the second half of the 2010s President Trump keeps military budget almost the same. Therefore, discretionary spending averaged over 7 percent. On the other hand, spending for domestic programs such as Social Security, Medicaid, and Medicare increased. Overall, the mandatory expenditures rose to almost 13 percent of GDP (U.S. Office of Management and Budget). It is crucial that all these spending caused interest on the national debt to rise which increased the cost of financing the debt. In sum, federal debt increased from $13.5 trillion in 2010 to over $21 trillion in 2018 (U.S. Council of Economic Advisers, 2019). In other words, the federal debt as a percentage of GDP grew by 15 points from 90 percent in 2010 to 105 percent in 2019. Average annual debt growth rate was 5.3 percent in the 2010s. On the other hand, household in this decade still taking advantages of low-interest rate environment; however, total amount of household debt rises slower than in the previous decade. It is clear that highly indebted households in previous decade do not spend the way they used to even though all interest rates remain historically low. From that point household debt as a percentage of GDP decreases 15 points from 82 percent in 2010 to 67 percent in 2018. Total amount of household debt in this decade grew by 1.2 percent each year. It rose from $12.3 trillion in 2010 to $13.7 trillion in 2018 (U.S. Board of Governors of the Federal Reserve System, 2019). Meanwhile, some economic uncertainties in the previous decade were reduced a few years after the financial crises which had a positive effect on business confidence in the 2010s. Due to rising business confidence and future expectations, corporations started to invest again
in this decade. Ultra-low interest rates, easy borrowing terms and broadly improving economic conditions play important role on corporations’ investment decisions. From that point, corporations boosted their debt at 5% annual pace in this decade. Total corporation debt increased from $6.117 trillion in 2010 to $9.484 trillion in 2018 (U.S. Board of Governors of the Federal Reserve System). The ratio of corporation debt-to-GDP rose from 40.8 percent in 2010 to 46.3 percent in 2018. The total debt increased from $31.923 trillion in 2010 to $44.638 trillion in 2018. The ratio of total debt-to-GDP rose from 212.9 percent in 2010 to 217.8 percent in 2018. In all, U.S. total debt accounted for 18 percent of the world total debt (Adler and O’Sullivan, 2019:12).

Figure 24 U.S. Debt 2000-2018

Source: Derived from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts. Nominal GDP from Federal Reserve Bank of St Louis. For calculating 2010s household debt; nonprofit organization, household and motor vehicle loans data derived from Federal Reserve Bank of St Louis. Starting from 2001 consumer loans added to household debt, and starting from 2006 student loans also added to household debt. Both data are collected from Board of Governors of the Federal Reserve System.
Figure 25 U.S. Federal, Household and Corporate Debt as a Percentage of GDP

Source: Data derived from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts; Nominal GDP from Federal Reserve Bank of St Louis of St Louis. For calculating household debt from 1950 to 2001, nonprofit organization, household and motor vehicle loans data are used which are derived from Federal Reserve Bank of St Louis. Starting from 2001 consumer loans such as credit card debt added to household debt. Starting from 2006 student loans added to household debt. Both data are collected from Board of Governors of the Federal Reserve System and Federal Reserve Bank of St Louis.

### Table 12 U.S. Debt Growth Rate. Figure 26 U.S. Debt as Percentage of World Debt

Source: Table 12, the data is collected from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts. Figure 26, data derived from Michael Roscoe, US Federal Reserve / BIS/ Economist / World Bank and IMF (2018): Mbaye, Badia, Chae, 2018.
Figure 27 U.S. Total Debt as Percentage of GDP from 1950 to 2018

Source: Data collected from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts; Nominal GDP from Federal Reserve Bank of St Louis.

Saving Trends of the United States

Two decades from 1950 to 1970, the U.S. was in a period of stability in terms of saving rate. The U.S. gross saving rate as a percentage of gross national income (GNI) averaged 22.1 percent in 1950s and 22.9 percent in 1960s (Bureau of Economic Analysis, 2015). The personal or household saving made almost 40 percent of the total saving in this period (8.4 percent in 1950s and 8.6 percent in 1960s) (Bureau of Economic Analysis, 2019). Households’ accumulation of resources during and after the WWII played significant role on high personal or household saving rate. Besides that, experiences of serious economic shocks since Great Depression made people in the U.S. more likely to save for the future days in the post-WWII period. It is also important that, starting from the second half of the 1960s there was a housing boom as baby-boomers started to build their own household (Munnell and Cook, 1991: 17-18). This is another
reason that explained high household saving rates in this period. Finally, rising household income in the 1950s and especially in the 1960s substantially increased household saving rates. On the other hand, corporations’ saving was also high in this period. Average corporate saving rate was 10.3 percent in 1950s and 11.2 percent in the 1960s (Bureau of Economic Analysis, 2015). U.S. corporations in this period were very profitable due to lack of competition from corporations in foreign countries. Many potential international competitors of U.S. corporations by that time were struggling hard to recover themselves from WWII. Government saving rate was 3.5 percent in the 1950 and 3.6 percent in the 1960s (Kliesen, 2005: 6). Government’s expansionary economic policies, its military expenses and its spiraling cost of social programs from education to health care were the main reasons of this low level of saving. Non-resident saving in the 1950s was -0.1 percent and in the 1960s it was -0.6 percent (Bureau of Economic Analysis, 2015). In all, total saving before the non-resident’s contribution was 22.2 percent of GNI in 1950s and 23.4 percent of GNI in the 1960s. After non-resident’s contribution total saving was 22.1 percent of GNI in the 1950s and 22.8 percent of GNI in the 1960s. In terms of GDP, gross saving in the 1950s was 20.8 percent of GDP and in the 1960s it was 21.6 percent of GDP (Bureau of Economic Analysis, 2015).

Government saving rates declined in the 1970s. The Vietnam War, social welfare programs, oil shocks and recession in this decade significantly reduced government saving. It is also important that, in the early post-WWII period government branches tended to run budget surpluses; however, in the 1970s government’ s tendency toward budget surpluses changed. In this period, there was a mood in the government that was okay with having low level of budget surpluses or even budget deficit. Therefore, in the 1970s government saving significantly declined and averaged 0.5 percent of GNI (Kliesen, 2005: 6). Corporate saving rates which had slightly increased past two decades continued to rise moderately in this decade. Corporate
saving contributed 11.6 percent per year to total national saving (Bureau of Economic Analysis, 2015). On the other hand, household saving as a percentage of disposable income increased by 1 percent to 9.6 percent of GNI per year in the 1970s (Bureau of Economic Analysis). Economic conditions and prediction about the future of the economy played important role on household saving rates in this period. In addition to that, Kennedy and Johnson administrations’ social policies were continued and even increased by Nixon administration that also played positive role on household savings in this period. Finally, baby-boomers’ housing boom continued in this decade which was another reason of the rise in household saving in the 1970s. In sum, U.S. gross saving rate averaged 21.7 percent of GNI in this decade. After non-resident’s contribution total saving in the 1970s was 21.6 percent of GNI. Finally, total saving averaged 22.5 percent of GDP (World Bank, 2019).

Due to government spending policies in the 1980s, the effect of oil shocks and recessions in the first half of the decade government saving rates continued to decline. Government saving rate turned to negative numbers as deficit rose. On the other hand, after Reagan administration’s business friendly policies, corporate saving rates slightly increased and averaged 12.4 percent in the 1980s (Bureau of Economic Analysis, 2015). It is essential that starting from this decade business saving became the main component of gross saving. On the other hand, household saving rate increased slightly in the first half of the 1980s and then decreased steadily to below 8 percent in the second half of this decade. It is important that housing boom in previous decades significantly increased real-estate prices in the U.S. Due to rising house prices, many households in the 1980s significantly increased their capital gain from their houses. However, later in the decade this situation caused household to reduce their saving (Munnell and Cook). People in this decade also reduced their pension saving due to some regulatory issues. Overall, household saving averaged 8.4 percent of GNI per year in the 1980s
Government saving rate in the first half of the 1990s continued to decline. However, in the second half government saving rate turned into positive numbers and climbed up almost 3% at the end of the decade. On the other hand, household saving rate continued to fell sharply. It is important that like government’s experience in two decades earlier, the household felt ok with having low level of saving in this period. The average 7.4 percent of household saving in the first half of the 1990s declined to 5.9 percent in the second half of this decade (Bureau of Economic Analysis, 2015). The drop in household saving increased the importance of corporate saving rates. During this period there was a sharp increase in investment for computer, telecommunication and software technologies. Due to these investments, companies significantly raised their productivity and then their profitability. In addition to that, globalization in this period increased the trade between the U.S. and rest of the world. In sum, corporations were able to keep their saving rate around 11-12 percent of GNI (Bureau of Economic Analysis, 2019). After non-residents (1.4 percent) contribution, gross saving rate in the 1990s averaged 20.4 percent of GNI and 20.3 percent of GDP (Bureau of Economic Analysis; World Bank, 2019).

Government saving averaged 2% in the early 2000s; however, government monetary and fiscal policies and its persistent budget deficit due to Hurricane Katrina and wars in Iraq and Afghanistan especially in the second half the decade drastically reduce government saving to negative 7.7 percent of GNI in 2009. Overall government saving rate was -1.1 percent of GNI in the 2000s (Bureau of Economic Analysis 2019). On the other hand, dramatic decline in
household saving rates continued in this decade. Gross household saving declined to 5.5 percent in the first half of this decade, and rose to 6 percent of GNI in the second half of the decade (Bureau of Economic Analysis). It is important that corporate saving was above 12 percent of GNI throughout the decade. From that point, corporate saving played a role in this decade that offset the reduction in household and government saving. In order words, relatively high level of corporate saving somewhat compensated the effect of decrease in government and household savings in this period. Overall, after (4.4 percent) non-resident’s contribution total saving was 21.5 percent of GNI in the 2000s (Bureau of Economic Analysis). In GDP terms total saving was 17.6 percent in the 2000s (World Bank, 2019).

Governments’ generous tax cuts and its various economic recovery packages in the 2010s substantially decreased government saving. In addition to that, government’s mandatory and discretionary expenditures (over 20 percent of GDP) also played important role on low level of government saving in this period. In total, government saving rate averaged -3.6 percent of GNI from 2010 to 2018 (Bureau of Economic Analysis, 2019). Household saving climbed up to almost 8 percent of GNI in the first half of the decade and then it declined. It is averaged 5.9 percent of GNI (Bureau of Economic Analysis). Like previous decades low level of government and household saving rates increased the importance of corporate saving. Business or corporate saving rate was strong in this decade. It averaged over 15 percent of GNI which is almost 3 percentage point higher than previous decade’s average (Bureau of Economic Analysis). From that point, like previous decade corporate saving in this period significantly helped to balance the downward trends of household and government savings. It is important that, this is not the case for only the U.S. Many countries, especially developed countries, all around the world have shifted their composition of national saving away from household and government savings toward corporation saving for more than two decades. For example, most of the industrial
counties’ corporate saving rates were around 10 percent of GNI and most of these countries’ investment was funded by their household and government savings in the 1980s; however, in the 2010s these countries’ corporate saving rates increase over 15 percent and two-thirds of their gross investment is funded by their corporate saving (Chen, Karabarbounis and Neiman: 2017: 1-3). After non-residents (2.5 percent) contribution, gross saving rate in the 2010s averaged 20.1 percent of GNI and 17.1 percent of GDP (Bureau of Economic Analysis; World Bank, 2019).

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Table 13 Household, Government, Corporate and Nonresident Saving Rate in the U.S.

Source: Household, Government and Corporate savings data collected from various sources of Bureau of Economic Analysis, Department of Commerce, Federal Reserve Bank of St Louis, Minneapolis, Dallas, San Francisco, Richmond and Boston. Gross National Saving data are derived from World Bank and Central Intelligence Agency (CIA), White House archives and Federal Reserve Banks publications.

Figure 28 U.S. Saving as a Percentage of GDP and GNI

Source: Gross National Saving as % of GDP data are collected from World Bank and Central Intelligence Agency (CIA), White House archives and Federal Reserve Banks publications. Gross National Saving as a % of GNI data derived from Federal Reserve Bank publications.
Fluctuation in U.S. Productivity

After the World War II U.S. productivity in the private nonfarm business sector rose steadily. Several factors played important role on this expansion. First of all, advances in productive knowledge, cost-reducing technological innovation and commercialization of these technological innovations increased productivity in the 1950s. It was important that all these technological progresses came from organized research and development (R&D) programs. Due to these programs many new industries were created such as jet engine, plastic and electronics industries. Besides that, there were many newly created consumers appliance products such as air conditioning, television, washing machine and dishwasher. All of these created strong efficiency gains in the U.S. throughout the decade. Other than efficiency gains, there were also capital-deepening. Businesses in this decade invested in more machinery and equipment which made employees produce more products in each hour they work. On the other hand, there were many changes in quality of labor. Increase in the average education and training of the employees raised productivity significantly in this period. Finally investing in public capital also improved productivity. During this decade substantial amount of investment in telecommunication, electricity and transportation networks such as highways and ports increased productivity of the corporations. In sum, total factor productivity grew at 1.4 percent (with 2011 constant national prices) per year while labor productivity grew at a 2.8 percent (University of Groningen and University of California, Davis, 2019; Sprague, 2014).

Productivity growth in the 1960s was the continuation of the previous decade. The growth rate fell by almost half percent for total factor productivity in the 1960s (2011 constant national prices). Like previous decade a great deal of productivity growth continued to come from technological knowledge. Technological knowledge and diffusion of this knowledge to new
industries improved productivity remarkably until the mid-1960s. On the other hand, during this period corporations reached new local, national and international markets with the investment in transportation and telecommunication networks. All of these helped corporations to achieve economies of scale. Corporations significantly lowered their cost of production with the advantages of economies of scale in the 1960s. It is also important that during his inaugural address President Kennedy spoke his famous words, "ask not what your country can do for you, ask what you can do for your country" (JFK Presidential Library and Museum, 2020). After this speech, President Kennedy was able to put pressure on industries and unions to keep wages down. This was another important factor that allowed corporation to lower their cost of production. Besides that, corporations in this decade entered into a period of consolidation. Many corporations merged and created stronger institutions such as ITT Corporation, Litton Industries, Textron, and LTV (Ling Temco-Vough) (Dean, 1970: 17). These institutions increased their capital investment which resulted in a growth of the capital-labor ratios. The surge in the rate of growth of the capital-labor ratio increased the productivity growth. From 1960 to 1966 the average annual labor productivity growth rate was 3.1 percent. However, productivity slowdown started at the end of 1966 (U.S. Bureau of Labor Statistics, 2019). Annual productivity growth dropped to 1.87 percent per year from 1967 to 1970 (U.S. Bureau of Labor Statistics). Overall labor productivity grew by 2.7 percent and total factor productivity 1.0 percent (with 2011 prices) per year in the 1960s (University of Groningen and University of California, Davis, 2019; Sprague, 2014).

The productivity slowdown started in the second half of the 1960s and in the 1970s it continued to decline. The rate of labor productivity averaged 2.0 percent and total factor productivity 0.1 per cent (2011 prices) per year in this decade (University of Groningen and University of California, Davis, 2019; U.S. Bureau of Labor Statistics, 2014). There were several
factors that were responsible for productivity slowdown in this period. First of all, the capital-labor ratios decreased due to companies’ low rates of investments (Giandrea and Sprague, 2017). The reduction in the capital-labor ratio reduced the growth of productivity. Second of all, in this period government increased its rules and regulations over businesses. New types of environmental and safety regulations were created. In order to meet these rules and regulations, companies used more of their resources which resulted in a reduction in productivity. The energy crises significantly lowered productivity growth. The price of oil quadrupled in this decade. Due to high oil prices, companies delayed their investment and slowed down their business’ activities. Research and development (R&D) expenditures decreased from 3 percent to almost 2 percent in the middle of this decade (Congressional Budget Office, 2005: 3-5). Decrease in R&D spending negatively affected productivity in this period. On the other hand, in the 1960s and the 1970s European countries and Japan finished reconstructing their economies from World War II. They strongly entered into the world market and gained a big share of world trade due to their scientific and technological changes. Meanwhile, the U.S. was experiencing an exhaustion of the post-World War II technological boom. From that perspective, there was a depletion of investment opportunities in this decade in the U.S. Finally, changes in labor demographics also played a significant role on declining productivity growth in this era. In the 1970s inexperienced young baby boomers and women entered into the labor force, while more productive and highly experienced older generation exiting the workforce (Dohm, 2000: 17). All of these factors caused a significant slowdown of total factor and labor productivity in the 1970s.

Labor productivity growth in the 1980s was not very different from the previous decade. It rose by an average of 1.5 percent per year which was just 0.4 percent below the annual average of previous decade (Giandrea and Sprague, 2017). Total factor productivity on the other hand,
grew by 0.5 percent from previous decade’s rate to 0.6 in the 1980s (2011 prices) (University of Groningen and University of California, Davis, 2019; U.S. Bureau of Labor Statistics, 2014). The first and second oil shocks of previous decade and the recession of 1980-82 were the major contributors to low productivity in this decade. Besides that, depletion of investment opportunities still had negativity effect on productivity growth. Some industries such as telecommunication, electric-utility, automobile and computer, unsuccessfully tried to extend the ongoing exploitation of economies of scale (Shackleton, 2013: 11). However, they were not successful. Their failed attempts actually led to reduced productivity. In order to increase productivity in this decade companies got involved in the process of corporate restructuring, downsizing and reengineering. However, predicted outcomes could not be gained in this decade. It is also essential to know that depletion of earnings from the expansion of transportation and communication networks also played important role on productivity slowdown in this decade. Finally, a significant decline in non-military research and development programs in the 1980s was another factor that contributed to productivity slowdown (Eiseman, Koizumi and Fossum, 2002: 4).

There were two completely different periods in the 1990s. The first half of this decade was the continuation of previous decade. The labor productivity in the private nonfarm business sector grew at a 1.7 percent per year in this period which was not much above the last two decades rates (U.S. Bureau of Labor Statistics, 2010). However, in the second half productivity grew rapidly, averaging 2.4 percent per year (U.S. Bureau of Labor Statistics). Factors such as capital deepening, efficiency gains and increase in skill drove a dramatic improvement in productivity growth that started in 1996. First of all, there was a massive increase in the quality and quantity of capital stock that contributed a lot to productivity growth. This surge was not only about an increase in the number of machines that used for production, it was also about
large quality improvements. It is important to know that many of these improvements were because of the revolution in information technology (IT). In this period there was a rapid investment in information technology (IT). The investment for IT increased from 3 percent of GDP in 1991 to 5 percent of GDP at the end of the 1990s (Gorman, 2001). This huge investment led to rapid improvement in the information-technology-producing sectors. Overall the growth of IT improved the efficiency of businesses in production that helped to increase productivity. Meanwhile, the prices of IT products fell rapidly. Due to declining prices, producers and sellers of IT products had a positive supply shock. This also had positive impact on productivity growth in the second half of this decade. On the other hand, companies by that time obtained a lot help from their’- reengineering (adopting new techniques such as just-in-time deliveries, and cross-training of employees), downsizing (laying off unproductive employees), and restructuring (improving corporations’ financial, legal and operational structures) attempts that had started in the previous decade. With this help in the second half of the 1990s companies used their resources better. During this period, it is also important to know that employees who took classes and learnt how to use computer and IT systems increased their skills which result in boosting their productivity. In addition to that, increased rates of college attendance in this decade was one of the other sources that raised productivity. Low oil prices on the other hand permitted companies to invest heavily in IT which was another factor that accelerate productivity in the 1990s. In sum, total factor productivity grew at 0.8 percent while labor productivity grew at a 2.1 percent per year in the 1990s (University of Groningen and University of California, Davis, 2019; Sprague, 2014; U.S. Bureau of Labor Statistics, 2019).

IT fueled productivity growth lasted through the middle of the 2000. In the first half of the 2000s annual average labor productivity was 3.4 percent and total factor productivity was 1.2 percent (U.S. Bureau of Labor Statistics, 2019; University of Groningen and University of
California, Davis, 2019). After 2004-05 the contribution of information technology to productivity growth became much less important. The productivity growth dropped below 2 percent in the middle of the decade (U.S. Bureau of Labor Statistics, 2019). The financial crisis of 2007-09 and high oil prices in the second half of the decade discouraged business owners to do investment. During this period gross domestic investment as a share of GDP fell its lowest level (13.4 percent) since World War II (U.S. Bureau of Labor Statistics, 2020). The lack of investment first decreased the demand and then productive capacity of the U.S. in the 2000s. Both factors in this period were major contributors to low level of productivity. In total, annual productivity growth dropped to 1.9 percent per year in the second half of the 2000s. Overall labor productivity grew by 2.7 percent annually and total factor productivity 0.7 percent per year in this decade. (University of Groningen and University of California, Davis, 2019; Sprague, 2014; U.S. Bureau of Labor Statistics, 2019).

The sluggish economic growth after the recession lowered the productivity growth in 2010s. The growth rate mostly remained under 1 percent in this decade. Forces that caused weak GDP growth (2-3 percent) and low level of investment (16-17 percent) (U.S. Bureau of Labor Statistics, 2020) were the key factors on low productivity growth in this period. On the other hand, recent technological advances could not drive strong productivity growth in the 2010s. In this era, it is very difficult to improve labors’ skill by increasing their educational attainment when most of the workers already have at least a high school or college degrees. From the same point, it is also very difficult to boost productivity by expanding transportation and communication networks as in the past decades that cannot be repeated. These are mostly one-time sources that already boosted productivity in the past decades. Finally, it is important that trade and investment increase competition and productivity growth. However, since financial crises in 2007-09 the U.S. in many cases shut down its borders and in the Trump
administration the U.S. launched trade wars with many countries. This was another factor that slowed down the productivity in this decade. In sum, from 2010 to 2018 the average annual labor productivity rate dropped to 1.1 percent from 2.7 in previous decade. During the same period total factor productivity rate also dropped to 0.5 percent per year (University of Groningen and University of California, Davis, 2019; U.S. Bureau of Labor Statistics).

![U.S. Labor and Total Factor Productivity (Percent)](chart1.png)

**Figure 29 U.S. Labor Productivity Nonfarm Business and Total Factor Productivity from 1950 to 2018**

*Source: Labor Productivity Data is collected (various years) from U.S. Bureau of Economic Analysis, Total Factor Productivity is derived from (various years) from University of Groningen and University of California, Davis, Federal Reserve Bank of St Louis and various years from Bureau of Labor Statistics.*

![U.S. Real GDP, Labor and Total Factor Productivity](chart2.png)
Conclusion for the Second Part (Economic Power of the U.S.)

Before analyzing the findings of this section there are some key points that need to be considered. As it was mentioned earlier that U.S. economic power has been hotly debated by many intellectuals for decades. In these debates some of intellectuals strongly argue that U.S economic power is in decline. However, the reason for the decline of U.S. economic power changes for each of these scholars. Massive expenditures in the Kennedy and Johnson administration, economic crises in the Nixon and Carter administration, huge debt and deficit in the Reagan administration and weak neoliberal economic policies and financial crisis in the Bush administration are just some of these reasons that have been used by these scholars interchangeably. It is crucial that even though intellectuals use different reasoning in their studies, they all conclude their analysis with the statement that says it seems impossible for the U.S. to regain its global economic leadership in the world that it had enjoyed in the early post-war period. However, how accurate can a research study be if any intellectual takes early post-war period as a base era? In other words, is comparing U.S. economy in the post-war period with U.S. economy any time after that the right way of analyzing the question of “is U.S. economic power in decline”?

It is a well-known fact that WWII was one of the most important events not only in the 20th century but also in entire human history. WWII was the greatest and deadliest war in the history. Around 60 million people were killed through six years of ground battles and aerial bombardments. Many cities and towns laid in ruin at the end of the war. Industrial, agricultural
and transportation infrastructure (roads, bridges, tunnels, ports, airports, and railways) had been destroyed. Millions of people were forced to abandon their houses and to move on to new lands. Poverty and hunger became common problems even in Western European countries which had once controlled most of the world’s economic resources. European countries (potential competitors to U.S.) had spent enormous amount of their money for this war. From that point, their gold reserves were quickly depleted. In addition to that, they borrowed heavily mainly from the U.S. in order to finance the war. Therefore, at the end of the war they were deep in debt. For example, before the war Great Britain was the world’s largest creditor; however, at the end of the war it became largest debtor in the world (Burton, 2020). Besides that, Britain lost most of its industrial production and more than a quarter of its wealth in this period (Broadberry, 2020: 30-31). In all, in the post-war era Britain was in a big economic ruin. From the same perspective, the Soviet Union also suffered heavy losses in the war. Over 25 million people were killed which means that the Soviet Union lost more than 15 percent of its population at the end of the WWII (Brainerd, 2007: 1-2). In addition to that, its economy had been devastated. The Soviet Union lost almost half of its industrial base and a big share of its agricultural output (Kotkin, 2000: 188). Economies in France and Italy were also in ruin after the war. In Germany industrial production decreased by about 50 percent (Wunderlich, 2010: 3-29). Besides that, Germany like Soviet Union lost about 10-15 percent of its population in the war (University of Houston, 2016). Cities and towns, including some of the leading industrial centers, all around Germany had been destroyed. Moreover, Germany was divided into many zones after the war and forced to pay massive sums of money to many countries particularly in Europe. On the other side of the world, China was already in difficult economic condition due to the Sino-Japanese war before the WWII. During the war Chinese economy was in tatters. After the WWII, China started its costly full-scale civil war with Communist forces. Most parts of the country by
that time were stalked by famine. At the end of the civil war, China came close to bankruptcy. Finally, Japan, like Germany, was mostly devastated. It lost its colonial territories, and one-third of industrial production (Okazaki, 2017: 57). Its GNP declined by over 50 percent of its prewar level (Okazaki). Besides that, Japan faced with a severe inflation and balance of payment deficit crises. Most of its population was near starvation in the early post WWII era.

In a nutshell, all previous Great Powers (and potential competitor of the U.S.) were in ruin and their economies were seriously devastated by WWII in the post WWII era. However, there was a country that came out from the war unscathed even though most of the countries were destroyed both physically and financially. It was the United States. The U.S. suffered very little physical destruction when it is compared to the destruction that other countries faced. And in financial terms the U.S. essentially benefitted the most from the war. This was an extraordinary condition in the world history and under this extraordinary condition a strong and steady U.S. economic expansion was anticipated in the decades following WWII. However, at the end of that exceptional period U.S. economic power was expected to gradually decline as previous great powers in Europe and Japan finished reconstructing their economies from the devastation of WWII. This is exactly what happened in the post-WWII era. While other countries such as Great Britain, France, Soviet Union, Japan and France were struggling to rebuild their economies, the U.S., on the other hand, increased its production significantly and raised its GDP from $300 billion in 1950 to over $1 trillion at the end of the 1960s. It is important to know that under this particular period of time the U.S. benefited a lot from wartime and non-wartime production, privileged status in the international monetary system, many direct and indirect stimulus and economic recovery programs, infrastructure and social safety programs and the advances in science and technology. Overall, the U.S. accounted for 37-38 percent of world nominal GDP and 28-30 percent of world real GDP from the early 1950s to the late 1960s.
However, this started to change when previous big powers finished rebuilding their economies from the WWII and caught up with American economy. At the end of the 1960s these countries strongly entered into the world market and gained a big share of the world market from the U.S. Meanwhile, due to the fierce competition from Europe and Asia and also drastic changes in the international economic system, the U.S. lost many of its advantages that it had enjoyed since WWII. Therefore, at the end of the 1960s economic growth of the U.S. began to wane for the first time since WWII. The pace of decline accelerated in the next decade. Factors such as social welfare spending, the war in Vietnam, the OPEC oil embargo, government’s monetary and fiscal policies and a series of international economic and political turmoil in the world created severe economic problems for the U.S. in the 1970s. Due to these problems, U.S. economic growth slowed down significantly. At the end of the decade U.S. GDP as a percentage of world GDP declined from 36-37 percent to 26 percent. However, in the following two decades the U.S. economy rebounded and grew considerably till the new century. The major factors that stimulated the economic expansion of the U.S. in this period were supply-side economic policies, low oil prices, stock market boom, scientific and technological development, globalization and rising trade between countries, appropriate monetary and fiscal policies and relatively peaceful international environment especially after the fall of the Soviet Union. From that point, U.S. economy increased from $2.8 trillion at the beginning of the 1980s to almost $10 trillion at the end of the century. During the same period U.S. GDP as a percentage of world GDP raised from 25 percent to almost 30 percent. Nevertheless, in the first decade of the new century the U.S. economy was in decline once again. It is important that the decline of U.S. economy during the 2000s was more severe than the one that U.S. had suffered few decades earlier. The first recession of the decade started in 2001 when many software firms went to bankrupt. In the same year terrorist attacks of September 11 worsened economic downturn.
Afghanistan and Iraq wars, Hurricane Katrina, high oil prices, inappropriate and ineffective monetary and fiscal policies and finally the financial crisis of 2007-09 were the other factors that adversely influenced economic growth in this decade. In short, the U.S. faced many serious economic and political problems from beginning to the end of this decade which made it one of the most tumultuous decades in the U.S. history. In all, throughout the decade the U.S economy grew only 15.8 percent. The U.S. GDP as a share of world GDP decreased from about 30 percent to 23-24 percent in the 2000s. The financial crisis in the second half of the decade had especially serious long-term effects on U.S. economy. From that point, early in the 2010s U.S.’s households and businesses were not confident for the future of the country. Therefore, they cut their spending and investment plans. Besides that, inappropriate monetary and fiscal policies caused the U.S. to have a slow recovery in the first half of the 2010s. On the other hand, high oil prices and the crises in Europe and elsewhere lowered the demand for U.S. products remarkable. However, consumer/business confidence and economic optimism expanded in the second half of the decade. The new administration launched various new tax and stimulus programs in order to increase consumer demand and economic capacity. Meanwhile, there was a sharp drop in oil prices which had positive impact on increasing economic activities in the U.S. On the other hand, Europe and many other parts of the world started to recovery from the financial crises. This also had positive impact on the U.S. economic expansion. The GDP growth rate slowly and gradually increased. At the end of the 2018 it reached almost 3 percent and the U.S. economy passed $20 trillion in nominal terms. The U.S. share of world GDP dropped 21 percent in the first half of the decade and then gradually increased to almost 24 percent. In terms of real GDP, the U.S. share of world GDP held stable at about 21-22 percent of world total.

Ultimately, it is crucial that if one looks beyond any particular short-term period and see overall picture by looking at the long-term period, he or she will find out that there is no
permanent and disastrous decline trend that has appeared in the U.S. It is certain that the power of the U.S. that measured by economic expansion (GDP growth) and the U.S. share of the world output has relatively decreased. However, this decline is not long-term and irreversible. American share of world output has only decreased from 29-30 percent to around a quarter of the world output. From the same perspective, there is no permanent and fundamental decline seen in the U.S. growth rate. It is clear that the U.S. has experienced a slower economic growth (2-3 percent GDP growth) since the financial crisis of 2007-09. However, this drop, like the U.S. share of the world output, is not significant and permanent. It is important to know that the average long-term economic growth in the U.S. was 3.4 percent from 1950 to 1999, and 3.1 percent from 1979 to 1999. From that point, 2-3 percent of growth since GFC is hardly a sign of economic stagnation of any kind. Besides that, 2-3 percent of GDP growth would not be high enough for a developing country; however, it is a fair growth rate for a country that has massive, mature and developed economy like the U.S. In addition to that, even 2-3 percent GDP growth rate of the U.S. is higher than that of other developed countries such as in Europe and Japan whose growth rates have been hovering around 1-2 percent for decades. Therefore, it is crucial that if scholars used a more appropriate and representative base year (the late 1960s or the early 1970), they would find out that the American share of world output and its GDP growth rate were about the same then as it is now. There is no any kind of long-term, significant, disastrous and absolute decline.

The same can be said for the CPI. Many intellectuals worry about inflation, deflation, hyperinflation, or stagnation in U.S. economy by focusing on particular short-term period. For example, policymakers and Fed’s officials had experienced serious price changes in the 1930s and 1940s, which made them very fearful to any kind of inflationary rise in the post-war period. Due to this idea they used restricted monetary and fiscal policies that caused several recessions
in the 1950s. However, in the next decade, Keynesian economics dominated economic theories and policies in the U.S. This theory argues that during chronic economic uncertainties, countries face inadequate private investment and spending. Due to a lack of private investment and spending, supply and demand balanced each other out at a point that does not support full employment and high growth in countries. For the solution to this problem, the Keynesian economics support the idea of government involvement. That means in order to substitute the missing private investment and spending; governments step in, borrow money and spend on goods and services that increase employment and expand economic growth. This is what happened in the 1960s. Kennedy’s Twelve Measurement Package, Johnson’s Great Society Programs, and all other federal expansionary fiscal (intensively) and monetary policies boosted the economy and employment on one hand and created a huge deficit and inflationary pressure on the other. During this period, contrary to previous decades’ ideology, restraining inflation was not a high priority. Domestic and foreign policy objectives were more important than curbing debt and inflationary pressures by that time. Other than that, Keynesian economics’ solution for the high inflation was seemingly simple. In order to curb inflation, governments needed to cut the spending and raised taxes and interest rates. It was widely believed that these actions would bring down the prices. From that point, in the next decade social and economic programs of previous decades were extended. This increased the budget debt and also inflationary pressure even higher. It was crucial that Nixon administration had expected lower prices when they increased interest rates and cut some of the federal spending. However, that didn’t happen. This was something that cannot be explained by Keynesian economic principles. There was high inflation, high interest rate, low employment and low growth rate. The overall situation worsened with many domestic and foreign events. Prices continued to increase in the second half of this decade. At the beginning of the 1980s, policymakers and the Federal Reserve
officials drastically shifted their policies for inflation. They took inflation as government’s top priority and used severe restricted monetary policies for a long time to curb inflation and inflation expectation. This persistency paid off and the inflation rate got down dramatically. Around the same time, the Reagan administration displaced some Keynesian mixed economic principles and leaned toward free-market principles that include free trade, deregulation, and smaller government. For economic growth, President Reagan supported the supply-side economic theory. Under this theory large tax cuts and expansionary monetary policies were used for stimulating economic growth. However, this theory has repeatedly caused economic cycle since 1980s. In this cycle, expansionary economic policies that government officials have used, raised expectations, raised expectations encouraged excesses, these excesses caused bubbles and at the end bubbles turned into crisis such as in the late 1980s stock market crisis, in the early 2000s dot-com crisis and finally in the late 2000s housing crisis. Business or economic cycles that have continually happening from 1980s to late 2000s is not a high priority for government officials. It is clear that when government officials shift their policies and take this issue as a top priority, they will take necessary actions to avoid the next economic cycles. However, it is important that despite the fear of another possible economic cycle or inflationary pressure due to the economic policies used during and after the GFC, the predicted inflation or the chance of another economic cycle has not emerged. There are some reasons behind that include investors’ expectation for the future of the economy and the lack of incentive for investment and spending, diminishing marginal returns in businesses, shifting from manufacturing economy to more financial and service economy and demographic reasons such as ageing population. From that point, it seems that the inflation and inflation expectation will not be the policymakers and Fed's top priority, even though there is more spending on economic stimulus programs.
Like the decline in U.S. share of world production, rising U.S. debt is a serious concern for many intellectuals. Starting from the 1980s and especially in the new century, many scholars repeatedly discuss fears of the growing U.S. debt and its possible effects on the future economy. It is a valid concern that raising debt indicates serious challenges for U.S. economy over the long term. However, in order to correctly analyze the questions of how serious the U.S. debt is and how it affects U.S. economy; a researcher has to look beyond any particular indicator and short-term data, focus on aggregate data and see the big picture of the story. From that point, it is important to know that the U.S. debt is not something new or something recent. For many decades since WWII, the U.S. has been holding a large debt (which is measured with nominal terms) that included the 1950s when the U.S. made up over 40 percent of world debt and the 1960s when U.S. debt was 36 percent of world debt. It is crucial that most of the scholars pay specific attention to U.S. share of world GDP when they compare the health of the economy now and then or two different periods of time; however, they do not do the same analysis for U.S. share of world debt. From that point, if they take U.S. share of world debt into consideration, (contrary to their argument) they will see that U.S. share of global debt is steady and gradually declining from over 40 percent in 1950s to below 30 percent in the 1980s to 18 percent in the late 2010s.

Besides that, it is also crucial that most of the same scholars take federal or government debt as the most important indicator and interpret U.S. debt concerns based on this indicator. Thus, very few intellectuals worried about U.S. debt when the rise in government debt was low in the 1950s (12 percent) and 1960s (24 percent). Started from 1980s intellectuals placed specific emphasis on debt due to a huge hike in government debt. However, total debt consists of three components; government, household and corporation debt. Household and corporation debts are as important as government debt. For example, household and
Corporation debts played a major role in creating the financial crisis of 2007-09. It is crucial that when many households and corporations declared bankruptcy in 2007-09, government stepped in and used billions of dollars to bail out households and corporations. By that time household and corporation debts were largely added to government debt and government debt increased fundamentally (over 100 percent of GDP) in this period. From that point, if scholars pay attention to household and corporation debt they will see that the U.S. had a serious debt issue even in the 1950s and 1960s since its household and corporation debts by that time increased by over 100 percent.

Another important point is about GDP growth rate and its linear negative impact on total debt-to-GDP ratio. In other words, a strong rise in GDP rate plays important role on decline in total debt-to-GDP ratio, or vice versa. From that point, strong GDP growth rate in the decades after the early post-WWII period (as this study mentioned earlier that this robust growth was because of the extraordinary conditions of that period) was associated with a significant decrease in the total debt-to-GDP ratio. From the same perspective, relatively slow GDP growth rate in last two decades plays crucial role on the rise in the total debt-to-GDP ratio. For example, in both decades (1950s and 2010s) the total debt increased around the same level (44-48 percent); however, in 1950s total debt as a percentage of GDP decreased from 126 percent to 107 percent and in 2010s it increased from 213 to 218 percent. For another example, in the 1960s total debt rose by almost 70 percent and in the 2000s it rose by over 90 percent. However, total debt-to-GDP ratio in the 1960s diminished by more than 10 percent (from 107 percent to 96 percent), although in the 2000s it increased by over 60 percent (from 158 to 218 percent).
In sum, contrary to many intellectuals’ popular belief, the U.S. has run a big total debt not only in last few decades, but also in every decade since WWII. Another point, which is contrary to theory (that says high debt level causes interest rates and inflation to increase), there is no need to fret about high U.S. debt in the recent period since historic low interest rate in the last few decades allow the U.S. to shoulder high debt burden. It is noticeable that interest rates and inflation are declining steadily even though the U.S. continues to hold a high level of debt.

As in the debt issue, many researchers and intellectuals have been deeply concerned about the low savings rate of the U.S. for decades. However, it is crucial to note that most of these scholars focus on one side of the story by analyzing household and government savings, and overlooking corporate savings which is one of the major components of gross savings. In that respect, in the early post-WWII era, U.S. savings rate was relatively high. Extraordinary conditions in this period played an important role on household savings. Factors such as massive housing booms, strong economic growth, rising household income, growing social and economic programs and prediction about the future of the economy encourages household during this period to raise their saving. It is also important that experiences of serious economic shocks since the Great Depressions made household in this period much more prone to save for the future days. In addition to that, by this time there was a perception in the government that admire budget surpluses and high savings. However, the U.S. government’s tendency toward savings and budget surpluses dramatically shifted after the second half of the 1960s. Their new perception argued that it was fine with having low level of savings and budget deficit. A decade later, the same perception moved to households. Since then, there has been a steady and gradual decline in household savings. However, it is important that the decline in government savings first and household savings later increased the importance of corporate savings. Meanwhile, corporations significantly boosted their productivity and their profitability with
President Reagan’s business friendly policies. Due to this, corporations increased their savings considerably. Starting from the 1980s, corporate savings became the major component of gross savings. Corporations’ high savings play an important role for compensating the effect of decreases in government and household savings. The importance of corporate savings increased over the last few decades not only in the U.S. but also most of the other developed countries. It is important to know that most of the investment were funded with government and household savings before the 1980s and the share of corporate savings were around 10 percent of GNI in developed countries. However, after the GFC corporate saving rate increased to 15 percent of GNI and two-thirds of gross investment started to fund by corporate savings.

Scholars have also raised many concerns about U.S. productivity slowdown when they compare U.S. productivity growth in two different periods of time. In their argument they usually focus on the declining U.S. productivity without addressing the root causes. It is important to know that there were many factors that boosted productivity in the previous decades; however, their contribution to productivity growth eventually slowed down and faded away as time passed. For example, in the early post-WWII era (which was an exceptional period for the U.S.) technological innovations and commercialization of this new technology played a significant role on productivity growth. In addition, during this time there were rooms for increasing productivity by expanding capital deepening (i.e. investing in more machinery and equipment), improving labor quality (i.e. increasing education and training of the employees) and raising public capital (i.e. spending on telecommunication, electricity and transportation networks). The same factors continued to promote productivity in the 1960s. There was especially dramatic improvement in (public capital) transportation and telecommunication networks allowed corporations to reach many new local, national, and international markets. Moving forward, corporations during this period significantly boosted their production and
lowered their production cost. All these factors helped corporations to achieve economy of scale. It is also important to note that, in this decade corporations entered into a consolidation period. Many companies joined together and created even stronger institutions which helped them to raise their capital investment substantially. However, it is crucial that after they finished reconstructing their economies from WWII, previous big powers in Europe and Japan strongly entered into the world market and quickly grabbed a big share of world trade at the expense of the U.S. in the late 1960s and 1970s (which was the end of the exceptional period). Meanwhile, the U.S. was experiencing the exhaustion of post WWII technological boom and depletion of investment opportunities. There were many historic events in the 1960s that significantly changed U.S. politics, economics, and social environments in the following decades. These changes also had a big impact on productivity. For example, rules and regulations over corporations increased. New type of environmental, safety, and gender requirements were imposed on corporations. Corporations used more of their limited resources for meeting with these requirements, which resulted in significant reduction in corporate productivity. Besides that, due to gender equality requirements many inexperienced and less productive women entered into the labor market while highly productive and experienced labors was exiting the workforce. Depletion of investment opportunities continued in the 1980s. Contrary to previous decades, investing in public capital or the expansion of transportation and communication networks did not bring the expected outcomes. In addition to that, the process of extending the exploitation of economy of scale was not successful like in previous decades. However, in the 1990s the revolution in IT improve the efficiency and profitability of corporations. As in the early post WWII era there was an increase in the quantity and quality of capital stock which played a major role on increasing productivity. In addition to that employees increased their education (by attending high schools and colleges) and learnt how to use IT system. In sum, capital
deepening, efficiency gains and increase in skill improved U.S. productivity remarkably in the 1990s. The contribution of IT to productivity lasted through the middle of the 2000s. Since then its effect gradually slowed down. It is important that competitive environment in this period positively affected productivity. However, GFC and its long-lasting effect dissuaded business owners to do investment in the 2010s. Factors that increased productivity in the previous decades became much less important in the 2010s. For example, there is no rooms for increasing productivity by expanding (public capital) transportation and communication networks which already boosted productivity in the early post WWII era. From the same point, it is hard to increase labor productivity by increasing workers’ education attainment when most of the workers already have at least a high school degree. These are mostly one-time sources that already boosted U.S. productivity in the past. In the 2010s, their contribution margins to productivity were low. It is also important that starting from the GFC and especially after second half of the 2010s the U.S. closed its borders and launched trade wars with many countries that lessen competition substantially. This could be another factor that negatively affect productivity. Finally, the lower productivity growth rate in service industry (which accounted for two-thirds of GDP and over 70 percent of jobs in the U.S.) also played important role on decreasing U.S. productivity in this period.

In all, it is important that the U.S. underwent an important productivity growth in the decades following WWII. However, this growth was because of the extraordinary conditions the U.S. was experiencing by that time. From that point, factors that boosted the productivity in the early WWII era could not bring the same productivity growth in recent decades. Therefore, the low level of productivity growth (like low level of GDP growth) is the new normal until the U.S. raise its productivity again with another IT kind of revolution. Finally, it is important to note that low level of productivity is not a concern only for the U.S., but for almost all other developed
countries. For decades developed countries in Europe and Japan have been experiencing low level of productivity. From that point, the U.S.’s productivity level is much higher than that of most of the other developed countries.

In conclusion, the overall findings in this section of the paper conflict with the argument of scholars that support the view that U.S. power is in absolute and irreversible decline. This paper asserts that under the extraordinary conditions in the decades following WWII, the U.S. experienced a steady and strong economic expansion. This exceptional period of time came to an end after previous great powers finished reconstructing their economies from the ruinous consequences of WWII. Since then, the abnormal increase in the U.S. economic power has returned to normal. Therefore, if scholars, who scrutinize this topic, take a more appropriate and representative base year for their research, they will see that U.S. economic power is not in a continuous, long-term and disastrous decline. For example, the decline of American economic power in the 1970s rebounded in the next decade, and the U.S. experienced a steady economic growth until the new century. From the same perspective, after the sharp economic decline in the 2000s, which made many scholars believe that the U.S. economic power was in permanent and absolute decline, U.S. economy has slowly but gradually been growing again. It is important to note that the growth is lower than the potential; however, it is inaccurate to describe this as a sign of overall and fundamental decline.
Chapter 7

Economic Power of China

Introduction

As this paper mentioned earlier, since the early 2000s, many scholars have passionately debated about the rise of China as the world’s next economic superpower. This debate gained a lot of attention after the GFC. On one side of the debate, some scholars think that China has proved its economic power in the world by growing around 10 percent for over three decades and emerging from the GFC undamaged while other countries were seriously affected. These scholars believe that China is different that previous U.S. economic challengers, and will become the next economic superpower in the near future. On the other side of the debate, there are scholars who think the first group of scholars are exaggerating China’s economic achievement. They agree that China experienced an extraordinary economic growth over the last few decades. However, they argue China will face serious financial and economic problems that limit the country’s ability to maintain its high growth rate in the future. In that respect, these scholars believe that China is not likely to become a rival to the U.S. on the global basis; however, it could be a big economic rival to the U.S. on regional basis. This overall discussion made it necessary to re-examine the question of “will China become the world’s next economic superpower?” In order to answer that question correctly, and efficiently, this research study collects and scrutinizes China’s economic power indicators (GDP, CPI, debt, saving and productivity) in the following section.
The Myth and Reality of Chinese GDP

At the end of the 1970s, China was still in the chaos due to its tragic Cultural Revolution that had begun in the 1960s. China’s GDP was below 200 billion dollars and its income per capita was not even $200 in a year (National Bureau of Statistics of China, 2018). China was one of the poorest countries in the world with its almost a billion populations. However, after the death of Chairman Mao in 1976 Chinese government decided to change its Soviet style centrally controlled economic policies with more market-driven western style economic policies that included opening up trade and investment with some western countries that had no relationship before (Morrison, 2019: 4). The aim of this policy change was to increase economic growth and raise its people’s living standard. The economic transformation began in the late 1970s and continued in the early 1980s with various reforms. During this period government authorities used expansionary monetary policies in order to support reforms financially. Government launched its economic reforms in agricultural sector. First of all, government increased prices of agricultural goods. In addition to that government gave relative autonomy to farmers over the land use and crop selection decisions (Lohmar, Gale, Tuan, et. al., 2009: 3-5). The new system created incentive among the farmers to increase their productivity. Increased agricultural productivity reduced China’s food constraints which freeing millions of agricultural workers to pursue employment in more productive sectors such as township and village enterprises (TVEs) (Harvie, 1999: 4). It is crucial that the success of the agricultural reforms motivated Chinese government to launch the same kind of reforms in the nonagricultural sector. From that point, Chinese government started its reform on state-owned enterprises (SOEs) by allowing these institutions to buy and sell output at market prices after they succeed in producing assigned quotas of production that transacted at official prices (Wang, 2018: 171-
173). In addition, moderate autonomy was given to these enterprises in decision regarding of production, investment, supply, and marketing (Putterman and Dong, 2000: 413-414). On the other hand, economic control of these entities assigned to regional governments. These governments were permitted to operate SOEs on free market principles, rather than under the direction of central state planning. After all of these reforms, SOEs production increased significantly which result in a boost in gross production in the country. It is important that like in the SOEs case, central government gave provincial and local governments a greater autonomy in order to engage in foreign trade. After gaining autonomy, these governments created their own trade agencies in order to engage in direct trading of their products. The number of trade agencies in these provinces increased from 12 at the end of the 1970s to over 5 thousand at the end of the 1980s and the amount of trade rose from $30 billion to over $80 billion in the same period (Lardy, 1992:694; National Bureau of Statistics of China, 2018). Another important policy that Chinese government took at the beginning of China’s economic reform period was to creation of special economic zones (SEZs) in four coastal cities where central government offered tax and trade incentives in order to attract foreign investment. In these zones non-state-owned enterprises including foreign firms were allowed to enter in industries which had forbidden in earlier periods. In total, these reforms had positive effect on China’s economic growth in the first half of the 1980s. From 1979 to 1985 China’s annual GDP averaged 9 percent (World Bank, 2019). In 1985, China’s GDP grew from 178 billion dollars in 1979 to 300 billion dollars (National Bureau of Statistics of China, 2018). In terms of real GDP (2010 U.S. constant prices), Chinese economy in this period increased from $341 billion in 1980 to $565 billion in 1985 (World Bank, 2019; Federal Reserve Bank of St Louis, 2019). The massive reform movement continued in the second half of this decade. It is important to know that China implemented these reforms gradually. During the 1980s government officials tried to figure out
which reform policies created positive outcomes and which policies did not. If there was a positive economic outcome of a policy then government could extend and use this policy in other regions of the country. From that perspective, Chinese government increased the number of SEZs from 4 to 14 coastal cities at first and then opened the entire coastal area as SEZs in the second half of the 1980s (Chen, 2018: 597). Deng Xiaoping’s decision of “Open-door” policy in the middle of decade played important role on extending SEZs. With this policy China drew more foreign direct investment (FDI) due to liberalization of the country’s economic system. Especially in the second half of the decade, Chinese government was very eager to attract more FDI; however, by that time foreign investors were still cautious about investing in China. Therefore, throughout the decade the annual average FDI was around $1.8 billion (Chen, 2018; People Republic of China Ministry of Commerce (MOFCOM), 2019; Amirahmadi and Wu, 1994: 171-174). On the other hand, in order to increase trade, China enhanced its diplomatic and economic relationships with the U.S., Japan, and some industrialized European countries like France in the 1980s. Meanwhile, TVEs flourished in many parts of the country. There was also a significant growth in non-state sector. All these factors raised people’s income that increased Chinese households’ capacity to save more. High households’ savings and rising foreign capital inflows through FDI were used for investment. Investment mainly boosted economic growth till 1989. It is important to know that during all these reforms periods Chinese authorities used expansionary monetary and fiscal policies except for some short periods between 1980-83, 1985-86, and 1989-91 (China Financial Yearbook Magazine, 2017; Laurenceson and Chai, 1998: 396-399). In these excluding periods authorities used restrictive monetary and fiscal policies in order to slow down the growth and inflation. In total, China’s GDP rose from $260 billion in the middle of the decade to almost $350 billion dollars in 1989 (National Bureau of Statistics of China, 2018; World Bank, 2019). That means China’s GDP grew at an average annual rate of 11
percent from 1984 to 1989. During the same period real GDP rose from $565 billion to almost $800 billion dollars ($797) (World Bank, 2019; Federal Reserve Bank of St Louis 2019). However, it is important to know that despite overall economic progress, some people wealth in China did not rise accordingly in this decade. That made a lot of people unhappy with overall situation. For example, agricultural reforms in the second half of the 1980s could not increase the productivity as in the first half of this decade. Farmers’ income drastically decreased. Besides that, Deng Xiaoping’s economic reforms in non-agricultural sector caused many corruption cases at the end of this decade. In addition, newly created Central bank in this decade took many poor decisions due to its lack of experience. For example, central bank in the 1980s validated so many loans that included bad loans in order to keep all banks in business (Bank for International Settlement, 1999: 18-32). However, this situation created a balance of payment deficit and a serious inflation issues later in the decade that eventually result in an important crisis that plagued China in the late 1980s. Growing economic difficulties and widespread corruption motivated many people such as students, intellectuals, and many urban dwellers to start their protest movements. Their protests ended with Tiananmen Square massacre. Aftermath of the Tiananmen Square case, economic reforms were slowed down. Some western countries issued economic embargoes against China. Meanwhile, for decreasing inflation and soothing the economy, Chinese authorities used restrictive monetary and fiscal policies (China Financial Yearbook Magazine; Laurenceson and Chai, 397). In addition, Chinese government launched a serious austerity measurement that controlled FDI and restricted monetary flows. Therefore, the growth rate dropped from 11 percent in 1988 to 4 percent in 1989 (World Bank, 2019). It was tragic that the growth rate was even below 4 percent in 1990. Overall, in this decade Chinese economy grew from $191 billion in 1980 to $349 billion in 1989 (National Bureau of Statistics of China, 2018). In other word, China’s GDP increased by 82.2 percent.
real GDP, China’s GDP rose from $341 billion in 1980 to $797 billion in 1989 (World Bank, 2019; Federal Reserve Bank of St Louis) which means Chinese GDP increased 134 percent throughout this decade. The average growth rate was 8.9 percent each year in the 1980s. In nominal terms Chinese economy in this decade remained 6-7 percent of U.S. economy. However, in real term, Chinese GDP rose from 5.2 percent of U.S. GDP in 1980 to 9 percent of the U.S. GDP in 1989. Finally, China’s share of world GDP increased by 1 percentage point, from 1.2 percent in 1980 to 2.2 percent in 1989 (World Bank, 2019).

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After Tiananmen massacre, some conservatives tried to obstruct market-oriented reforms and recentralized the authority. These efforts generated dissatisfaction among public and government officials. Meanwhile, Deng Xiaoping retired from public view. As the final political act in his career, he made his famous southern tour in 1992 and delivered a warning speech about the continuation of reforms. A year later, Jiang Zemin who earned his popularity during the Tiananmen Square events for taking a hard-line stance against protesters, became the next
president of China. Despite western countries trade embargoes, under his administration, economic growth was accelerated with his macro-economic reforms. These reforms led to a significant growth in Chinese household and corporate income. These large levels of income made it possible for China to support high level of investment. At the end, high level of investment boosted China’s economic growth like in the previous decade. It is crucial to know that most of the investment had been made on state sector in the previous decade. In the 1990s, the resources to support SOEs gradually increased. However, even though there was a relative improvement on SOEs’ performance from the previous decade, they were still lagged behind other enterprises, particularly private enterprises. From that point, financial institutions raised its loans for SOEs to cover their expenses. Nevertheless, it became clear that most of these loans were non-performing loans which eventually created serious deficit and chronic high inflation around the middle of this decade. In 1994 the inflation rate even reached 25 percent (National Bureau of Statistics of China, 2019). President Zemin realized that this could no longer be sustained before the middle of the 1990s. From that point, Chinese government reduced its commitment to SOEs. Government authorities closed down many unprofitable SOEs or let them to go bankrupt in order to make rest of these enterprises more competitive and productive. Besides that, some SOEs were sold to their workers at privileged low rates and some other SOEs were privatized. On the other hand, private investment sharply increased in this decade. Its share in the economy rose from 3-4 percent in 1990 to over 14 percent at the end of the 1990s (Lardy, 2014: 83). From the same point, the share of the private enterprises in industry sector rose from 30 percent in the middle of the decade to around 70 percent at the end of the decade (Hofman, 2018: 55, 63). Like in the previous decade, structural shift in resources such as moving employment from agricultural sector to non-agricultural sectors continued in this decade that also had positive effect on economic growth. In addition to that, China’s economy benefited a
lot by integrating with the world economy in this decade. Chinese authorities in the 1990s changed its model of growth to an export-oriented philosophy. From that perspective, Chinese government adopted market-oriented macroeconomic policies. At the end of the first half of this decade Chinese government severely devalued the currency (the dollar to yuan exchange rate drastically increased from 5.8 in 1993 to 8.6 in 1994), and used extremely favorable monetary policies in order to boost export (World Bank, 2018). China became the workshop of the world with these and other aggressive growth-oriented policies. Chinese exports growth rapidly accelerated which made China to acquire a special place in the global production chain.

The value of export of goods and services increased from almost $50 billion in 1990 to almost $200 billion in 1999 (World Bank, 2019; National Bureau of Statistics of China, 2019). From that point, export as percentage of GDP rose from 13.6 percent in 1990 to 18.2 percent in 1999 (World Bank). In addition, trade-investment reforms, cheap workforce and stable and repressive labor laws created a huge surge in FDIs inflow in this decade. It is important that, in previous decade Chinese government already experienced some FDI inflows that significantly contributed to China’s economy growth in terms of employment creation, export accumulation and technology transfer. From that perspective, Chinese government decided to launch new policies and regulations that liberalized its FDI regime in order to attract more FDI in the 1990s. In addition to that, in this decade Chinese policymakers opened more SEZs in cities particularly in inland and border areas. In sum, throughout the decade the FDI increased significantly from $4 billion in 1990 to over $40 billion in 1999 even though there was serious financial crisis in the region at the end of the decade (Zebregs, and Tseng, 2002: 3). Due to this surge, China’s productivity and overall economy grew substantially. It is important that during the 1990s Chinese government launched a program that aimed to sell off collective housings to their occupiers. That program also had positive effect on GDP growth. Finally, after Central Bank’s
inexperienced policies many banks were technically insolvent in previous decade. In the 1990s Central Bank of China used growth-oriented monetary policies that significantly accelerated GDP growth. However, it was an exception that from 1993 to 1996 there was a high level of price instability in China. In this period average annual prices grew more than 18 percent (National Bureau of Statistics of China, 2019). However, after few years of restrictive monetary and fiscal policies, the inflation rate dropped to 2 percent (National Bureau of Statistics of China). The economy started to grow over 10 percent in this decade. This time the growth was stronger than the one in the previous decade. From 1991 to 1997 China’s grew at an average annual rate of 11.5 percent. The GDP increased from 383 billion dollars to almost 1 trillion dollars (961 billion dollars) (National Bureau of Statistics of China, 2018). In order words, this growth enabled China to more than double the size of its economy in 7 years. However, China’s economic growth rate slowed down to 7 percent in 1998 and 1999 due to the impact of Asian financial crisis. The Asian financial crisis affected China through decline in the growth rate of export volume, and decline in FDI. However, factors such as holding significant amount of foreign reserves, having a currency that was not freely convertible, boosting public spending, using proactive monetary policies and receiving capital inflows for long time investment protected China from the worst effects of the crisis. At the end of the decade, two foreign colonies returned to China, Hong Kong from Britain in 1997 and Macau from Portugal in 1999, which also
created a positive effect for the economy.

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In total, at the end of the 1990s China’s nominal GDP rose from $361 billion in 1990 to over 1 trillion dollars ($1.093 trillion) (National Bureau of Statistics of China; World Bank, 2019). In terms of real GDP, Chinese economy overall increased from $828 billion in 1990 to $2.057 trillion in 1999 which means China’s GDP rose by 148.4 percent in this decade (World Bank, 2019; Federal Reserve Bank of St Louis, 2019). The average growth rate was 10 percent each year in the 1990s. China’s GDP increased from 6.05 percent of U.S. in 1990 to 11.4 percent of U.S. GDP in 1999. In real terms, China’s GDP rose from 9.2 percent of U.S. GDP to 17 percent of U.S. GDP during the same period. Finally, China’s share of world GDP increased from 1.6 percent in 1990 to 3.4 percent in 1999 (World Bank, 2019).

After a decade of Jiang Zemin presidency, Hu Jintao became general secretary of the Communist Party and then the president of China in 2002. Under his administration China experienced a rapid and robust economic growth. However, most of the causes of this economic
growth were because of his predecessor Jiang Zemin’s implementation of reforms in the 1990s. Like in the previous decade, factors such as large-scale capital investment, urbanization and productivity growth were the main drivers of economic development in this decade. Integration with the world economy continued in the 2000s. The process started with four SEZs in the early 1980s, expanded to 14 zones first and whole coastal economic zones later. Riparian and inland regions were followed that. Finally, this trend reached its peak in 2001 by joining the World Trade Organization (WTO). Besides that, China signed economic treaties with many Asian, European, African and American countries such as Shanghai Cooperation Organization (SCO), China-ASEAN, China-Chile, Chine-Iceland, China-Switzerland, and China-Korea Free Trade Agreements. All of these turned out to boost Chinese export during this period. China’s average annual export growth was almost 30 percent from 2001 to 2008 (Yao, 2018: 76). The value of export rose from $250 billion in 2000 to $1.262 billion in 2009 (World Bank, 2018; National Bureau of National Statistics of China Statistical Yearbook, 2018). Export as a percentage of GDP during the same period grew significantly. It was 20.9 percent of GDP in 2000, 36 percent of GDP in 2006 (World Bank, 2018). Due to global financial crisis at the end of the 2000s it dropped to 24.7 percent of GDP in 2009 (World Bank). However, even though serious financial crisis in the world China became the largest exporter in the world at the end of this decade. It is important that in previous decade Jiang Zemin reduced legal barriers for acquiring private enterprises. On the other hand, Zemin shut down many unproductive state enterprises which created space for productive private enterprises in the 2000s. After experiencing high productivity and high GDP growth because of these policies, Hu Jintao in this decade accelerated privatization of SOEs and TVEs in order to boost the economy further. These newly privatized enterprises pursued more productive activities than SOEs and TVEs. On the other hand, some of SOEs and TVEs gained back. In 2003 Chinese government established the State-owned Assets Supervision and
Administration Commission (SASAC) for overseeing some of SOEs’ (large size SOEs) investment, profits and growth projects (Song, 2018: 356). In addition to that, central government specified some critical (strategic and pillar) industries and used SOEs to retain the control of these industries (Lardy, 2018: 335). Meanwhile, central government also launched many financial and industrial policies that in favor of SOEs. As a result of these policies, at the end of the decade many SOEs become among the largest corporations in the world (Mourdoukoutas, 2019). Their assets and output increased while their number and the share of contribution to the economy continued to fall. In this decade China’s economy benefited from additions to labor force. Tens of millions of people from rural regions moved to coastal provinces to find job in manufacturing and service sectors (Gregory and Meng, 2018: 398-399). This created a situation that kept wages and also cost of production low. In the second half of the 1990s, due to China’s trade and investment reforms foreign investment in China rose. In the 2000s the extension of economic reforms and the membership of the WTO accelerated foreign direct investment (FDI). It was essential to know that due to lack of free market principles in the 1980s and in the early 1990s FDI inflows increased moderately in China. By that time, total flow of FDI was lower than $10 billion (Davies, 2013: 10-11). However, the amount rose over 40 billion in the second half of the 1990s, $50 billion in the early 2000s, $70 billion in the middle of 2000s (10 percent of world FDI) and finally over $100 billion dollar (20 percent of the world FDI) at the end of the 2000s (Davies, 10-13). Rising FDI inflows in China increased demand for labor, capital formation, technology transfer and human capital accumulation which significantly contributed to economic development of the country in the 2000s. GDP average growth rate in China was 10.5 percent from 2000 to 2007. China’s GDP rose from $1.211 trillion in 2000 to $3.550 trillion in 2007 (National Bureau of Statistics of China, 2019). However, the Great Recession of 2007-09 slowed down China’s economic growth. Chinese export dropped down more than 10 percent of GDP to
around 24 percent of GDP (World Bank, 2019). GDP fell from over 14 percent annual growth in 2007 to around 9 percent in 2008 (National Bureau of National Statistics of China, China Statistical Yearbook, 2019). Nevertheless, Chinese government quickly reacted to this downfall by injecting $600 billion, over 12 percent of GDP, in various sectors of the economy (Bradsher, 2009). Regional and local governments launched to build roads, bridges, dams, rails and all other infrastructure works in order to keep the economy afloat. Financial institutions gave out millions of renminbi (RMB) mainly to SOEs and private companies for financing their investments. It is important to know that even during the Great Recession Chinese government did not aim to increase domestic consumption that much because this would have caused a wage hike. A wage hike would have increased the cost of productions and a higher cost of productions would have slowed down Chinese exports that China’s economy was not ready to face. That policy worked out well. After a few years from the crisis Chinese investment and production increased as fast on average as in the early years of decade. Growth rate returned to over 10 percent in 2010. Overall, from 2000 to 2009, China’s GDP rose from $1.211 trillion in 2000 to $5.102 trillion in 2009 (National Bureau of Statistics of China; World Bank, 2019). During the same period real GDP increased from $2.232 trillion to $5.502 trillion (World Bank, 2019; Federal Reserve Bank of St Louis 2019). Real GDP grew by 146.5 percent in this decade. The average GDP growth rate was 10.3 percent each year in the 2000s. China’s GDP increased from 11.8 percent of U.S. GDP in 2000 to 35.3 percent of U.S. GDP in 2009. In real terms, China’s GDP rose from 17.7 percent of U.S. GDP to 37.6 percent of U.S. GDP during the same period. Finally, China’s share of world GDP increased from 3.6 percent in 2000 to 8.4 percent in 2009 (World Bank, 2019).
Few years after the global economic slowdown, the rate of GDP growth in China started to decline again. It is crucial that, this economic slowdown is not a cyclical downturn that China had experienced several times at the end of each decade. This time it is deep, constant and steady.
which seems very different than previous economic downturns. In 2018 the GDP growth rate of China gradually dropped from 10.6 percent at the beginning of the decade to 6.6 percent. Causes of this downturn are various. First of all, productivity which was one of the main drivers of economic growth in earlier periods has started to decline in the 2010s. Factors such as increasing quality and quantity of the labor force, transition to market driven prices, allocating resources more efficiently, foreign direct investment and their technology transfer continue to contribute productivity growth; however, in the 2010s their contribution to productivity is not the same pace of the past. It is much smaller. For example, the value of FDI grew by 100 percent (from $50 billion to $100 billion) in previous decade. However, in 2010s the growth of FDI was much slower.

![China's Foreign Direct Investment (FDI) Inflows](image)

**Figure 33 China Foreign Direct Investment**

*Source: Data compiled from IMF 2018, China Statistical Yearbook and Ministry of Commerce, People’s Republic of China (MOFCOM) various years.*

The value of FDI in this decade increased from $110 billion in 2010 to around $135 billion in 2017 which means FDI increased by 22.7 percent (People’s Republic of China, Ministry of Commerce (MOFCOM) 2019; Chen, 596; Kroeber, 2016: 53). From the same perspective, the pace of China’s export of goods and services also slowed down in the 2010s due to serious economic crises and financial uncertainties in the world. The export growth rate was over 400 percent in previous decade (from $250 billion in 2000 to $1.262 trillion in 2009) (World Bank,
2018; National Bureau of National Statistics of China Statistical Yearbook, 2018); however, in 2010s the rate dropped to 60.5 percent. China’s export increased from $1.654 trillion in 2010 to $2.655 trillion in 2018 (World Bank; National Bureau of National Statistics of China Statistical Yearbook). Therefore, it became clear that it would be hard for China to continue its economic growth with Deng Xiaoping’s era economic model which featured labor-intensive, low-wage manufacturing for export, and high level of government investment. Therefore, when Xi Jinping was elected as President of China, he decided to adopt a new economic model that included principles such as strong domestic consumption, high value-added production, low level of SOEs and high level of private sector roles (Garnaut, Song and Fang, 2018: 18-21). However, there are many challenges on the way to shifting the model of economic growth. For example, Chinese government started an unprecedented anti-corruption campaign in order to fight income inequalities and increase the legitimacy of Chinese Communist Party (CCP) (Wang, 183; Naughton, 2018: 383). Besides that, in the middle of the 2010s China had its financial crisis. During the crisis, officials fought hard to control price bubble which had been generated by excessive liquidity of financial resources. In 2016, Xi Jinping started to restrain financial industry in order to reduce the risk of...
price bubble. From that point, government limited unofficial lending institutions which are called shadow banking institutions (Financial Times, 2014; Kroeber, 140). However, private sector very much depended on these financial institutions. Thus, government’s deleveraging campaign had serious negative effect on private sector. In addition, after the closure of many shadow-banking sectors, regular financial institutions became more reluctant to lend to smaller private companies (Elliott, Kroeber and Qiao, 2015: 12-13). Millions of Chinese citizens and investors lost their savings during this period which created an atmosphere among the people for curbing additional market reforms. Meanwhile SOEs had easy access to credit, and they were protected from the impact of deleveraging campaigns. At the end of the decade, uncertainties of trade wars between the U.S. and China create additional negative effect on China’s GDP growth. In sum, China’s GDP growth rate slowed down considerably in the second half of the 2010s. However, that does not mean the Chinese economy is shrinking. It just means the growth rate is not the same pace of the previous periods. China’s GDP rose from $6.087 trillion in 2010 to $13.608 trillion in 2018 which means China more than doubled the size of its economy in this period (National Bureau of Statistics of China, 2018; World Bank, 2019). In terms of real GDP, China’s GDP increased from $7.147 trillion in 2010 to $12.766 trillion in 2018 which means China’s real GDP grew by 78.6 percent (World Bank, 2019; Federal Reserve Bank of St Louis 2019). The average GDP growth rate was 7.8 percent each year in this decade. In nominal term Chinese economy in this decade rose from 40.6 percent of U.S. GDP in 2010 to 66.1 percent of U.S. GDP in 2018. In real term, China’s GDP grew from 40.6 percent of U.S. GDP in 2010 to 60.9 percent of the U.S. GDP in 2018. Finally, China’s share of world GDP rose from 9.2 percent to 15.8 percent during the same period (World Bank).
Figure 35 and Table 16 China, U.S. and World Nominal and Real GDP (2010) from 2000-2009

Figure 36 and 37 China Economic Growth by Decade and Average GDP Growth Rate

Source: China’s nominal GDP collected from National Bureau of Statistics of China, China Statistical Yearbook and real GDP derived from World Bank, IMF, Federal Reserve Bank of St Louis and National Bureau of Statistics of China

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China’s Inflation (CPI) Dilemma

It is important that consumer price index (CPI) or inflation affects all parts of the economy from investment, unemployment and interest rates to government fiscal and monetary policies. In that respect, officials usually try hard to keep inflation under control. Nevertheless, it is usually the case that when a country transitions from central planning economy to a free-market economy, severe imbalances between supply and demand occur. China was not an exception. During the period of early reforms in the late 1970s, Chinese authorities aimed to decrease price controls on goods and services. From that perspective, Chinese government allowed farmers to sell some of their products in the market with market prices. Due to that, prices of agricultural goods fluctuated more freely than before as part of the process of enabling free-market forces to play a bigger role in Chinese economy. On the other hand, government raised its procurement prices of farms products by up to 50 percent in order to boost farmers’
income (Naughton, 1991: 207-209). However, shortly afterwards deficit in the government budget increased due to the surge in procurement prices. In order to finance this deficit government increased monetary supply at the beginning of the 1980s. Economic situation started to deteriorate. Inflation reached 6 percent in 1980 (National Bureau of Statistics of China, China Statistical Yearbook, 2006). Factors such as farmers’ rising income, government subsidies and then its deficit, and price liberalization were the main players of this first inflation hike. In the following year Chinese government used restrictive monetary policies by increasing interest rates, tightening credit controls and cutting its expenditures in order to restrain the expansion of aggregate demand. This caused inflation to fell 2 percent in 1981. Conservative fiscal-monetary policy was followed few years which kept the inflation around 2 percent (National Bureau of Statistics of China, China Statistical Yearbook). However, this policy slowed down the economic growth. After its agricultural reforms, Chinese government started to give its main focus on urban reforms. From that point, Chinese government used the initial (agricultural) reforms for SOEs and allowed them to sell some of their products in the market at market prices. Authorities also allowed SOEs to make some of their expenditures and investments decisions on their own such as setting up their wage levels, financing their investment, recruiting and staffing (Song, 349). Besides that, much of the supervisory and regulatory power over SOEs was transferred to provincial and local governments. SOEs gave generous wage increases and bonuses to its employees. At the same time, they invested as much as they could for grabbing maximum share from the market. Provincial and local governments which were the supervisory and regulatory branches of SOEs supported these enterprises for their investment decisions in order to promote industrial development in their provinces or regions. They pressured state-owned financial institutions to give or extend credit to SOEs. Therefore, SOEs borrowed heavily from state-owned banks to finance investment and
higher wage increases without the fear of bankruptcy. From that point, government’s fiscal and monetary liabilities to industrial SOEs gradually increased from 1.4 percent of gross national product (GNP) in 1980 to almost 10 percent of GNP at the end of the decade (Huang, 1999: 113). On the other hand, in the middle of the decade the economy was overheated. GDP growth rate was around 13-15 percent in that period. There was a strong increase in aggregate demand. Due to that, import increased significantly from $20 billion in 1983 to $40 billion in 1985 (World Bank, 2017). In total, this and all other factors such as raised wages, increased bank credits, investment and import had a serious effect on consumer prices that pushed inflation rate to over 9 percent in the middle of the decade (National Bureau of Statistics of China, China Statistical Yearbook). Central government responded inflation by decreasing government expenditures, raising interest rates and enforcing credit controls on provincial and local branches of banks. These policies worked out well and inflation dropped 6.5 percent in 1986 (IMF, Oppers, 2017: 25). However, unlike in the first half of the decade Chinese government this time quickly loosened its restrictive policies again. Government adopted loose monetary and fiscal policies in order to finance investment, accelerate economic growth, and subsidize provincial and local governments and SOEs. Eventually, inflation quickly started to increase again with these policies in the second half of the 1980s. In addition, in the midst of this rising inflation period, government implemented some price adjustment and further price adjustment were announced for the following years. This made public believe that government would set all price higher in 1989 which led to speculative buying and hoarding that additionally increased aggregate demands (Naughton, 2009). The inflation increased over 18 percent in 1988 and 1989 (World Bank, 2019). Rising inflation was one of the main reasons of domestic unrests at the end of the 1980s which ended with Tiananmen Square massacre. Chinese government’s response to rising inflation was similar to that in the previous cycle such as raising interest rates, cutting
investment growth, tightening credit control, reducing provinces’ control over administrated prices and re-imposing price controls. However, the intensity of policies that used for this macroeconomic instability was much stronger than the previous cases. Economic growth and inflation significantly dropped. Inflation rate dropped from 18 percent in 1989 to 3 percent in 1990 (World Bank). GDP growth decreased from 11 percent in 1988 to 3-4 percent in 1989 (National Bureau of Statistics of China, 2018). Throughout the 1980s average CPI rate was at 7.5 percent.

After two years of low economic growth and relative stability of the overall price level, government decided to adopt policies that accelerate the growth. Deng Xiaoping’s southern tour and his strong message for the growth and reform played important role on that decision. With its growth-oriented policies Chinese economy drastically increased in this period (GDP growth rate was over 13 percent). However, these policies reinvigorated inflation again in 1993. Most of the forces that increased prices from 1993 to 1996 were essentially similar to that in the previous decade. In addition to that, government significantly reduced the price controls in 1992 (IMF, 1993: 27-28). That caused administered prices to rise to market level prices. Besides that, prices and wages in this period were also on rise. It is important that in the second half of the previous decade, Chinese government gave greater autonomy to provincial and local governments and SOEs to set their wages and allocated their resources. From that point, most of these institutions connected their employees’ wages to the price levels of country (Zhang, 2016: 9). That means rising prices of goods and services drove wages high. Therefore, it is easy to predict that high wages in turn caused even higher prices of goods and services. This mechanism by itself contributed to high inflation in this period which forced Chinese government to implement wage reform in the middle of the 1990s for breaking the link between wage rate and inflation. It is important that, while prices and wages kept on rising in
1992, government loosened its control on credits. In addition to that, government in this period licensed many financial institutions (Okazaki, 2007: 10). With these new institutions, government aimed to accelerate credit growth in order to boost investment and economic growth. From that point, central government heavily financed thousands of SEZs that founded in the first half of this decade. Moreover, in this period government continued to provide funds to SOEs for their expenditures despite its previous decision of restructuring these institutions. Thus, GDP growth rate in this period reached over 13 percent; however, factors that boosted GDP rate also pushed inflation rate record high. Average annual prices grew more than 18 percent from 1993 to 1996 and in 1994 the inflation reached nearly 25 percent (National Bureau of Statistics of China, China Statistical Yearbook, 2006; World Bank, 2019). Chinese government decided to implement some structural changes after the dramatic price hikes in 1993-1996. First of all, government cut the link between price level and wage rate. In other words, wages will not increase automatically when prices of goods and services rise. Wages only increased if workers’ skill and productivity increased (Chow, 2018: 98). In addition, government started to restructure SOEs which had been the cause of many credit-fueled spending in the previous period. Besides that, government implemented many actions that aimed to slow down the economy such as raising interest rates, tightening credit control, decreasing investment growth and moderating GDP growth. From 1995 to end of 1996 inflation came down significantly. Inflation dropped to 2 percent in 1997, meanwhile GDP growth rate declined to 7 percent (World Bank, 2019). During and after the Asian Financial Crises in 1997, China changed its macroeconomic policy from tight financial and monetary policy to expansionary fiscal and monetary policy. With this policy China maintained a high level of production. However, it is important that at the end of the 1990s, China overfilled foreign and domestic markets with its goods. Oversupplying goods in this period was one of the main factors in China that put downward pressure on consumer prices. On the
other hand, consumer demand remained relatively low in this period. People in China like in the past preferred to save their income rather than spend. Combination of constantly rising supply and weakly growing demand drove prices of goods and services down after the Asian financial crisis. From that point, China experienced deflation or insufficient demand problems in 1998, 1999 and 2002. In order to stimulate domestic demand Chinese government issued billions of RMB. In addition, interest rates lowered and expansionary financial policies enforced (National Bureau of National Statistics of China, China Statistical Yearbook, 2005). After these policies the domestic demand increased and China’s economy came out from deflation. Average inflation rate remained around 7 percent (7.7%) in the 1990s.

Like in previous decade, oversupplying and overproducing of Chinese goods were the major factors that keep consumer prices relatively low in the 2000s. Due to massive production of goods, China once again fell into deflation at the beginning of the 2000s. Government by that time used expansionist monetary policies for invigorating domestic demand. However, domestic demand remained low for a variety of reasons. It is important that, this situation didn’t create a serious problem for China till the global financial crisis. China during this period was able to export its products to the world. However, China’s export fell substantially when the recession hit the U.S. and then the world at the end of the 2000s. Global financial crisis and economic downturns in many countries significantly reduced foreign demand for Chinese goods. In addition to that, Chinese consumption declined along with the demand of Chinese goods in the world which made China to fell into deflation for the second time in the 2000s and third times in last ten years. This situation encouraged Chinese authorities to adopt more aggressive expansionist fiscal and monetary policies in order to increase domestic consumption and economic growth. Expansionary policies increased investment and GDP till the end of the decade (above 10%); however, domestic consumption still remained low. Meanwhile, Chinese
authorities took stabilizing the price level as one of the top priorities of government policy (China Daily, 2012). Since then the annual inflation rate in China has barely transcended 5 percent even though government uses massive amount of liquidity in the market as part of government stimulus efforts. In 2000s the average annual inflation rate was 1.8 percent and in 2010s it was 2.3 percent. It is essential that there was a strong correlation between oil prices and consumer prices especially for a country such as China that very much depends on foreign oil. However, Chinese government uses price controls in order to keep oil and also some other commodities’ (coal, pork, corn and wheat) prices within socially reasonable ranges. The reason is that central government thinks that rising prices especially some important commodity prices can cause serious social unrests in China which it was experienced in Tiananmen Square at the end of the 1980s (Bradsher, 2011). From that perspective, rising or decreasing these commodities’ prices have no strong effect on consumer prices goods and services. Nevertheless, it is important to know that price control of oil and other commodities hide the true costs of many economic processes in China and just transferring these costs to the government budget in some ways that affects the overall economy at the end.

Figure 39 China’s CPI, GDP and GDP Growth Rate from 1980 to 2018
China’s Debt Bomb

High national (total) debt causes a number of serious economic difficulties in an economy such as reducing investment and income, increasing interest rates, and decreasing governments’ ability to respond future economic crisis. In that respect, for a long time after its establishment, People’s Republic of China had adopted a balanced budget fiscal policy. However, when government launched its economic reforms programs at the end of the 1970s, it began to run budget deficit and issue limited debt. Most of these deficits in the first half of the 1980s arose because of the rising procurement prices of farms products. Procurement price was an established price to farmers for their products. Government in this period aimed to increase farmers’ income by raising procurement prices (Huang and Rozelle, 2018: 488). In order to finance that government borrowed from the central bank and also issued several government bonds. The total debt was just over 50 percent of the GDP which was around $100 billion in the
first half of the 1980s (World Bank, 1997: 131-133). In the middle of the decade Chinese
government started to implement its urban reforms. From that point, government gave some
autonomy to SOEs for managing their affairs, pricing their products and funding their
investments. It is important to know that even though these early decentralization reforms,
SOEs were still very much financially dependent to the central government. During this period
other than direct financing, central government used subsidies, tax exemptions and soft credits
to help these firms overcome their budget constraints. Under the reforms programs in order to
boost the productivity, central government allowed SOEs to give generous bonuses, wages and
all kind of amenities to their employees (Fang, Garnaut and Song, 2018: 11-12). Besides that,
SOEs also invested heavily for gaining a bigger share in the markets and creating more jobs in
provinces and cities where they located. All of these had positive effect on growth and
productivity; however, that created a massive debt for central government. It is crucial that
during this period total of all monetary and fiscal subsidies, incentives and expenditures of SOEs
to GDP grew substantially from 1.4 percent in 1980 to over 10 percent in 1989 (Zengxian, 1997:
1254). In sum, the national debt increased over 80 percent of GDP ($280 billion) at the end of
the 1980s (IMF, 2019). Government debt accounted for 6-7 percent of the total debt (National
up almost 90 percent of China’s total debt at the end of the 1980s (over 75 percent of the GDP)
(IMF). SOEs debt made the major share of it with 45 percent. Private business debt was around
30 percent of GDP (IMF). Finally, China’s debt as a percentage of U.S.’ debt averaged 3.8 percent
in this decade and in terms of world’s debt, China’s debt made up 1.1 percent of the world debt
(Mbaye, Badia, Chae: 14-20; World Bank, 2019; Council of Economic Advisers, Boards of
The inflation and corruption scandals created a serious domestic unrest in the late 1980s. After the Tiananmen Square crackdown Chinese government suppressed reforms and used restrictive fiscal and monetary policies. Debt and deficit decreased. Nevertheless, the mounting losses of SOEs continued in the first half of this decade. In order to finance SOEs debt, central government launched a banking reform. Chinese government also enacted a law in 1993 that forcing the Ministry Finance to fund its total budget deficit by issuing bonds (Lin, 2002: 78). With these laws total debt started to increase moderately until the Asian Financial Crisis. However, during and after the Asian Financial Crisis government drastically changed its macroeconomic policies from tight to expansionary fiscal and monetary policies. As a result of these policies total debt increased significantly. In this decade China’s debt as a percentage of GDP passed 100 percent which means total debt moved beyond $1 trillion (World Bank, IMF, 2019). Government debt increased to 22 percent of GDP at the end of the decade ($236 billion) (World Bank, IMF; National Bureau of National Statistics of China, 2000). Like previous decade SOEs and private firms (corporate) debt made the major share of the total debt. During the 1990s corporate debt increased from 75 percent of GDP to 100 percent of GDP (Over $1 trillion). Finally, household debt first time in this decade appeared on the debt list. Government authorities’ expansionary fiscal and monetary policies especially during the Asian financial crisis played important role on creating household debt at the end of the 1990s. In all, the total debt reached almost 130 percent of GDP (over $1.4 trillion) (World Bank, IMF). In this decade the ratio of China’s total debt-to-U.S. total debt was 6.6 percent. From the same point, China’s overall debt accounted for 1.6 percent of the world total debt (IMF; Mbaye, Badia, Chae; World Bank, 2019; Boards of Governors of the Federal Reserve System, Federal Reserve Bank of St Louis, 2019).

There was a global economic prosperity from early 2000s to the Global Financial Crisis. Thus, Chinese government continued to use expansionary monetary policies for accelerating its
export. During this period, China heavily invested in some sectors such as steel, cement and aluminum (European Union Chamber of Commerce in China, 2016: 1). Total debt as a percentage of GDP rose almost 150 percent before the middle of the decade. In other words, China’s total debt was more than $3 trillion around the middle of the 2000s (IMF, World Bank, 2019). The tragic event which was the origin of China’s debt problem was the U.S. and then Global Financial Crises. Before the financial crisis, China’s total debt was around $4-4.5 trillion and about 150 percent of GDP. During this time government debt was 25 percent of GDP, household debt 15 percent and corporate debt was almost 110 percent of the GDP (National Bureau of National Statistics of China, 2011; World Bank, IMF, 2019). Just a decade after the Financial Crisis, the total debt of China skyrocketed to $34 trillion which was equal to 255 percent of GDP in 2018 (IMF; World Bank). In other words, China built up a massive debt (around $30 trillion) in a decade. It is important to know that China’s rising debt issue was the result of a deliberate self-chosen decision that was taken by Chinese government during and after the financial crisis. The reasons of why Chinese government took decision that increase China’s debt burden suddenly and extremely were various. First of all, Global Financial Crisis dropped global demand for goods. Due to that, Chinese exports plummeted sharply from 35 percent of GDP in 2007 to 25 percent of GDP in 2009 (World Bank, 2019). During the same period account surplus fell more than 5 percent of GDP (Kroeber, 217; National Bureau of Statistics of China, 2019). As a result of these, hundreds of factories shut down and millions of workers lost their jobs in China. For keeping the economy functioning and creating hundreds of thousands of jobs in an effort to reduce unemployment, Chinese government announced its huge stimulus package in the middle of crisis. The first package was almost $600 billion and Chinese government gave authority to local governments and some investors for carrying out much of the implementation of this package (Batson, 2008). It is important that in order to get
highest return local government and investors invested heavily in real estate sector which resulted in big property bubbles in many cities (Anderlini, 2014). This process kept the GDP growth steady on the one hand, but on the other hand, it created a record amount of debt.

With its huge stimulus package Chinese government also aimed to make a transition from an export and investment driven growth model to a model that relies more on domestic consumption and service industry. However, it is important that government stimulus package could not accelerate domestic consumption immediately in the real economy. Most of the stimulus went to real estate and some infrastructure projects that generated low investment returns. Low investment returns increased country’s total debt gradually. Meanwhile, China failed to implement structural reforms (such as strengthening economic and legal infrastructure, increasing competition, encouraging innovation, improving public sector governance and liberalizing labor, capital and product market) that make enterprises particularly SOEs more productive. With the stimulus support SOEs maintained even increased their employment and production even though the world trade slowed down drastically in this period (Morrison, 25-27). This worsened overcapacity and overproduction problems of SOEs that had already seriously damaged the efficiency of these enterprises. In addition to that, when Xi Jinping elected as president of China in 2013 he has promoted the role of SOEs at the expense of private domestic and foreign firms. SOEs relatively increased their productivity and profits in some fields; however, most of the other fields SOEs were still quite inefficient and they continued to operate with huge loses (Song, 356-361). Contrary to the previous decade, central government rarely allowed these enterprises to go bankrupt or let very few of them taken over through merger and acquisition. From that point, the only way these enterprises survive was to increase borrowing from state-owned banks to cover a substantial portion of their financial losses. They borrowed heavily and after a decade from the GFC, their debt reached over $13 trillion (Molnar
and Lu, 2019: 16). This was an increase almost four folds compared to their debt amount in the GFC period. It is crucial that during the same period SOEs revenue rose only 1.5 times and their profit grew by 60 percent (Molnar and Lu). In addition to that, during this period government’s expansionary monetary and fiscal policies drove not only SOEs but also some private enterprises to produce more goods than market demanded. Due to overcapacity, overproduction and structural problems, these enterprises’ efficiency declined seriously which created many difficulties for them to repay their debts. In order to repay their debts, they borrowed more that eventually created even greater problems for these enterprises.

Under the new growth model central government launched some programs that aimed to improve social services and expand public safety net especially in the rural regions of China. The size of these programs was massive that covered hundreds of millions of people. For example, providing free rural education covered around 150 million students, producing health care services covered more than 800 million people and supplying basic pension coverage covered 400 million people (Kroeber, 33; Bloomberg News, 2019; Yu, 2015: 1148). After these and all other programs, the spending on education increased from 3 to 4 percent of GDP, on health care from 4 to 5 percent of GDP, on welfare from 6 to 9 percent of GDP, on pension from 0.5 to 1.5 percent of GDP and on social security from 2 to 3 percent of GDP in a decade (The State Council, PRC, 2019; World Bank, 2019; OECD, 2019; World Bank Trading Economics, 2019; Zhang, L., et al, 12, 20). It is important that the majority of these programs were implemented by regional and local governments. These programs added enormous costs to the budgets of these governments. In order to finance these social service programs and all other programs including especially infrastructure programs regional and local governments started to rely overwhelmingly on extra-budgetary resources- mainly off budget borrowing. It is crucial that regional and local governments operated their off-budget borrowing practices beyond the
central government fiscal surveillance. From that point, these governments’ debt increased drastically. Due to that many regional and local governments were in unsustainable level of debt.

On the other hand, central government highly concerned that, expansionary monetary and fiscal policies could cause a price hike in the economy that eventually could lead to a social unrest like the one in the late 1980s. From that point, Chinese government used price control by setting prices below market prices in some critical areas such as real estate, food and energy. For example, in order to hold energy prices (oil, natural gas, coal and electricity) within socially acceptable ranges, central government heavily subsidized SOEs to sell its goods and services at low prices. However, such funding disguised the true cost of many economic activities in China. On the other hand, it created a massive debt burden for the country in this decade. From the same perspective, for easing the pressure of rising real-estate prices over families, central government launched many projects such as building enormous number of residential houses in hundreds of cities across the country in order to pull property prices down. Finally, central government also used its policies for controlling the food prices (pork, wheat, corn) in reasonable level. In sum, Chinese government reduced the risks of price inflation and the potential of social unrest by using various policies that hold the prices of critical sectors’ goods and services in socially acceptable ranges. However, on the other hand, these policies caused massive economic disruption and led to a surge in government debt.

Currency appreciation was another factor that significantly increased budget debt in this period. It is important that Chinese currency gradually appreciated from 8 yuan per U.S. dollar in 2005 to 6 yuan per U.S. dollar in 2014 (World Bank, 2018). Many investors in China expected that the RMB would appreciate even more due to other countries’ (particularly the U.S.)
pressure on China for manipulating and lowering the value of its currency against other currencies in order to increase export to grow the economy by over 10 percent each year. This expectation made Chinese investors borrow dollars from foreign banks and exchanged them to RMB in order to get a high return. Chinese investors borrowed $20 billion from foreign financial institutions in 2008; however, this number soared to $1 trillion in 2014 (United Nations Conference on Trade and Development (UNCTAD), 2017: 80). China’s financial liberalization efforts in this period played important role in creating this debt. However, it is important that when Chinese currency started to depreciate, Chinese investors rushed to repay their debt after 2015.

Another factor that increased the debt burden of China was the fast expansion of shadow banking. Shadow banking is a non-bank financial intermediary activity. It is less transparent service that produces high-risk loans with higher returns than traditional financial institutions. During and after the global financial crisis under the government massive economic stimulus packages many small and mid-size private firms still could not find enough credits from traditional financial institutions. Therefore, these firms borrowed heavily from shadow banking institutions that provide wider and easier access to affordable credit. Shadow banking’s loans became popular gradually and in 2015 the size of these loans reached nearly two-thirds of China’s GDP (over $7 trillion) (IMF Monetary and Capital Markets Department, 2016: 36). However, it is important that most of institutions repackaged these loans and showed them as investment in their balance sheet. From that point, shadow banking institutions create big bad credit bubble that pose a serious risk to Chinese financial system. Therefore, Chinese authorities enacted a law that crack down shadow banking channels after 2016 (Financial Times, 2016).
Energy prices were other major factors that significantly increased the debt of China in this decade. Due to its robust economic growth in the 2000s, China’s demand for oil increased significantly. Although its growth has slowed down since 2010, the country’s demand for oil is continuously rising. China’s consumption of oil increased from 7800 thousand barrels per day in 2007 to over 10000 thousand barrels per day in 2012 and finally to over 13500 thousand barrels per day in 2018 (British Petroleum Company, 2019: 20). It is important that the country has relatively poor oil reserves. Therefore, China relies on import of oil around 75 percent of its total usage (Clemente, 2019). From that point, it is predictable that China has been affected severely by rising or declining global oil prices. Low prices of oil are expected to boost economic growth of China and also increase China’s current account surpluses. On the other hand, high oil prices are anticipated to decrease net export and total output. High oil prices also have negative effect on consumer prices and overall economic expansion. From that point it is crucial that prices of oil dramatically increased after 2000. Prices of a barrel oil rose from $23 in 2001 to $50 in 2005 and then $107 in 2011. It stayed average $79 per barrel till 2018 (Organization for Economic Co-operation and Development, (OECD), 2019). However, it is very important that China uses state control over its oil industry by adjusting the prices of oil and its products and directing all sales through state agencies in order to keep the prices of goods and services in socially reasonable ranges. This way maybe helps to keep the prices in order and prevents a social unrest; however, it has a devastating effect on government budget.

After all of these spending programs Chinese government was able to create enough jobs to reduce unemployment rate and maintained a relatively high economic growth even during and after the Global Financial Crisis. However, the cost of implementing that was huge. China’s debt to GDP ratio increased dramatically from about 150 percent of GDP in 2008 to over 255 percent of GDP in 2018 (IMF, 2019; World Bank, 2019). It is important to know that most of the
debt is corporate debt. China’s corporate debt rose sharply from 98 percent of GDP ($4.5 trillion) in 2008 to 156 percent in 2018 (IMF; World Bank; Bank of International Settlement (BIS), 2019). This is one of the highest corporate debt-to-GDP ratios in the world. The value of total amount of corporate debt is $20 trillion. It is also important to know that over two-thirds of Chinese corporate debt is owned by SOEs (about $13.2 trillion) (Deutsche Bank Wealth Management; NikkeiAsia, 2019). Local government accounted for half of SOEs debt and one-third of total corporate debt ($6.6 trillion) (NikkeiAsia; Deutsche Bank Wealth Management). Besides that, China’s household indebtedness is moderate even though it jumped by over 30 percentage points over a decade. In 2018 household debt increased from 18.4 percent of GDP ($846 billion) in 2008 to 51.2 percent of GDP ($6.97 trillion) (IMF, 2019; World Bank, 2019). Government indebtedness is relatively low when it is compared to other governments’ debt. In 2018 it is 50.6 percent of the GDP ($6.87 trillion) (IMF, 2019; World Bank, 2019; National Bureau of National Statistics of China, China Statistical Yearbook, 2019). However, like the household and corporate debt, the rise of government indebtedness from 2008 to 2018 was significant. Government debt was 27 percent of GDP in 2008 ($1.2 trillion) (IMF; World Bank; National Bureau of National Statistics of China, China Statistical Yearbook). It is crucial to know that regardless of the ownership of the total debt, dealing with considerably high level of debt creates serious challenges for Chinese economy. In total, China’s debt as a percentage of U.S. debt drastically increased from 17.1 percent in the 2000s to almost 60 percent in the 2010s. In terms of world total debt, the ratio of China’s total-debt-to world total debt surged from 3.2 percent in the 2000s to 10.7 percent in the 2010s (IMF, Mbaye, Badia, Chae; World Bank; Federal Reserve Bank of St Louis (various years)).
Figure 42 China’s Debt to GDP Ratio (Corporate, Household and Government Debts) 1980-2019

Source: Data collected from National Bureau of National Statistics of China, China Statistical Yearbook (various years); World Bank (various years); Federal Reserve Bank of St Louis (various years); IMF (various years).

Figure 43 China Total Debt as Percentage of GDP from 1980 to 2018

Source: Derived from (various years) National Bureau of National Statistics of China, China Statistical Yearbook, IMF, World Bank and OECD
### China - U.S. Debt to GDP Ratio 2007-2018

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Table 18 China - U.S. Debt to GDP Ratio (Corporate, Household and Government Debts) 2007-2018

Source: China’s debt data derived from National Bureau of National Statistics of China, China Statistical Yearbook, World Bank, Federal Reserve Bank of St Louis; IMF (various years). U.S.’s debt data collected from Council of Economic Advisers for federal debt; Boards of Governors of the Federal Reserve System for corporate and household debts; For calculating household debt from 1950 to 2001, nonprofit organization, household and motor vehicle loans data are used which are derived from Federal Reserve Bank of St Louis. Starting from 2001 consumer loans such as credit card debt added to household debt. Starting from 2006 student loans added to household debt. Both databases are collected from Board of Governors of the Federal Reserve System and Federal Reserve Bank of St Louis.

### China’s Debt as % of U.S. and World Total Debt by Decade

Puzzle of China’s High Saving Rate

It is very crucial that saving, which leads to increase people’s income through investing in investment vehicles, plays an important role for economic growth of a country. In that respect, Deng’s Xiaoping economic reforms that started in the late 1970s made drastic changes on China’s saving rate. At the beginning of the reforms in the late 1970s, household saving was around 6-7 percent of the GDP, government saving accounted for 15-18 percent and corporate saving was between 8-9 percent of the GDP (Kraay, 2000: 551-554; Qian, 1988: 592-594). Total saving in that period was around 30 percent of the GDP.

In the 1980s China’s household saving started to increase and that trend continued through the early 1990s. There were various reasons behind China’s high household saving rate. First of all, traditional ideas and historical factors played an important role on it. Not only in this period, but also in earlier periods people in China tended to save more than people in different countries. Past experiences, poverty and inequalities tragically affected people in China and made them reluctant to spend their earnings. From that point, they increased their precautionary saving even though their incomes started to rise. Besides that, reforms on agriculture in rural areas and then reforms on SOEs in urban areas significantly increased the income of Chinese households which made them able to save more for the future. In addition, the transition from a planned economy to a market economy in this period encouraged people in China to save more for future opportunities such as purchasing state assets or investing private companies’ bond. It is also important that in the early stages of reforms period people had less control over their earnings. It was usual that Chinese government forced people to save their income or purchase company bonds. Later in the 1980s, government’s control over people’s earning decline; however, household saving continue to rise. It is also crucial that
demographic changes played an important role on the rise of household saving. The fertility rate declined drastically in the 1980s due to the one-child policy that was enforced by Chinese authorities in the previous decade. This policy created a situation that increased household saving first by spending less for fewer children and then saving more for the future (precautionary saving) as fewer children would take care of them when they get old (Zhang, L., et al, 2018: 7). Finally, rural and urban reforms created a volatile environment in China in this period that people felt less certain about their future income. This was another factor that forced people in China to save more for the future. In sum, household saving increased from around 6-7 percent of GDP at the beginning of the 1980s to 20 percent around the middle of decade (National Bureau of National Statistics of China, China Statistical Yearbook, 1999; Modigliani and Cao, 2004: 146-147; Kraay: 567-570). Due to social unrests and political instabilities in the late 1980s, household saving decreased 11-12 percent of GDP and then rose again to almost 15 percent at the end of the 1980s (National Bureau of National Statistics of China; Modigliani and Cao; Kraay).

On the other hand, there was a sharp decrease in government saving. Before the reforms, government was the largest saver in China (15-18 percent of GDP) (Qian, 594). At the end of the decade government saving rate dropped more than 10 percent to 5 percent of GDP (Yang, Zhang and Zhou, 2011: 13-14). This means government in this period spent a lot; however, it collected little. During the 1980s government authorities mostly used expansionary monetary and fiscal policies in order to support reforms financially. From that perspective for example, government authorities raised procurement prices of agricultural products, gave generous bonuses to SOEs employees, raised their wages and pressure financial institutions to extend credits for SOEs. Government also spent a lot for establishing SEZs. Besides that, authorities by that time gave tax breaks and all kind of incentives to foreign firms for moving them inside the
newly established SEZs. In addition to that government spending for social services such as housing, education, pension and medical services were high in this early reform period.

Finally, corporate saving increased few percentage points in this decade to 11-12 percent of GDP (Kraay, 566). It is important that during the 1980s some SOEs boosted their income due to lack of competition and their monopolistic power. On the other hand, government heavily subsidized these institutions in order to promote growth. From that perspective, corporations’ cost of production dropped steadily. They had easy access to energy, land and capital. Besides that, labor market reform in this decade relaxed workers mobility restrictions which allowed millions of rural workers to move to cities (Gregory and Meng, 395-399; Meng, 2012: 76-82). Due to a large flow of rural labor to cities, corporations in this decade were able to increase their profit by keeping the wages down. Corporate restructuring on the other hand, in the 1980s raised productivity and boosted corporate profit (Chow, 100). In total, China’s gross saving in the 1980s was around 32-33 percent of the GDP.

Like in previous decade household sector was the largest saver in the 1990s. Household saving was around 17-18 percent of GDP (Kuijs, 2005: 17). Some of the reasons of high household saving rate in the 1980s were also the same reasons of high household saving in the 1990s. For example, cultural, historical experiences, rising people income and demographic factors such as declining fertility rate also encouraged people to save more in this decade. Other than that, household in the 1990s saved more of their income due to China’s shrinking social safety net. The transition from central planned economy to more market-based economy led to the shrinking of social safety net in this decade (Zhang, L., et al., 8-9). For example, government responsibilities of pension, health care, welfare and unemployment insurance shifted to employers or employees themselves. As a result of this, people in China started to increase their
precautionary savings. It is also very important that housing ownership increased drastically in this decade. Government housing reforms at the end of the 1980s fostered the effort of privatization of housing on the one hand, and banned company-supplied dorm style housing on the other hand (Perkins, 2018: 150; Fang, H., Gu, Q., Xiong, W. and Zhou, L.-A., 2016: 110). After these reforms there was a massive surge for house ownership in China that prompted household saving in the 1990s. From the same perspective, government in this decade decided to take an aggressive action to privatize small and medium size of SOEs by selling these institutions to its employees which also stimulated the household saving. It is important that weak financial market and banking system in the 1990s created a lot of serious liquidity constraints in China. It was very hard to get a home loan or any other forms of credit in this period (Shimek and Wen, 2008). In order to obtain a loan, borrowers had to make a large down payment. That means increased savings were needed for obtaining the loan. This was another factor that increased household saving in the 1990s.

Government saving rate decreased by 2 percent during the 1990s and hovered around 3-4 percent of GDP throughout the decade (Yang, Zhang and Zhou, 44). However, at the end of the decade it dropped to 2 percent of GDP (Yang, Zhang and Zhou). Except few years after the Tiananmen Square crackdown, government mostly used economic policies that accelerate the growth. During and after the Asian financial crisis government authorities increased public spending and used more proactive monetary and fiscal policies to protect China from the worst effect of the crisis. In addition to that, government like in previous decade covered SOEs huge budget deficits even though government enlarged its privatization of these institutions.

Corporate saving like previous decade rose moderately and reached 14-15 percent of GDP in the 1990s (Ma and Yi, 2010: 15-16; Kraay, 566). Previous decade’s reforms expanded and
intensified in this decade. It is important that China launched a serious large-scale market-based reforms included privatization and restructuring of SOEs in this decade. Due to that, corporations’ productivity and profitability increased drastically. Another important factor that boosted corporations’ profitability and productivity was China’s export expansion. China’s export growth accelerated when Chinese government devalued its currency and increased the amount of subsidies for its companies. After the Asian financial crises Chinese authorities expanded export-promoting policies and gave more subsidies to its corporations that included refunds, low-interest loans, cheap land and preferential tax rates. Other than export expansion and government subsidies which directly contributed to corporations’ profitability; keeping production costs down in this decade also increased the revenues of Chinese corporations. From that point, it is important to know that during this period Chinese authorities gradually loosened rural-urban migration restrictions in order to keep the wages and production cost down for corporations (Gregory and Meng, 395-396). In sum, corporate saving in this decade increased 3-4 percentage points from the previous decade’s average. Finally, China’s gross saving in the 1990s was around 35-36 percent of the GDP.

Household saving rate steadily increased after China’s World Trade Organization (WTO) entry. It is very important that China’s accession to the WTO resulted in a magnificent growth of export. This positively affected the wages. Household income grew at more than three times in the 2000s. It rose from about $800 in 2000 to over $2.7 thousand in 2009 (National Bureau of National Statistics of China, 2019). Due to rising income, households were able to save more. Other than rising income there were other factors that positively affect household saving. For example, One Child Policy that was introduced in the late 1970s resulted in more household saving in 2000s like previous decades. On the other hand, decline in social safety net continued in this decade which also increased household precautionary saving. The rise of private home
ownership that had started in the previous decade also continued until global financial crisis. Private home ownership rate in this period reached over 90 percent (Shepard, 2016). The impact of household ownership on saving was positive throughout the 2000s. Besides that, like in previous decades, historical and cultural experiences and demographic factors also encouraged people in this decade to save more. In sum, household saving rate reached 22-23 percent of GDP in this decade.

Government saving rate in 2000s was totally different from previous decade’s government saving rate. During the 2000s government saving was on a steady upward trend and peaked over 10 percent in global financial crisis times (Ma and Yi, 10; Yang, Zhang and Zhou, 44). After the crisis government saving moderated and stabilized at around 5 percent (Zhang, L., et al, 18-19). First of all, export boom in this decade significantly increased government revenues. Rising government revenue had positive impact on government saving. Besides that, with its structural reforms that was started in the late 1970s Chinese authorities gradually diminished its social spending especially on health, pension and social assistance. Lower social spending in the early 2000s allowed Chinese government to increase its saving in this decade. However, starting from the second half of this decade social safety spending started to increase under the harmonious society program (Hofman, 63). FDI also had positive impact on government saving. During this decade FDI rose substantially. At the end of the 2000s the value of FDI was over $100 billion (Ministry of Commerce, PRC, 2019). However, during and after the global financial crisis government authorities used aggressive expansionist monetary and fiscal policies which decreased government saving at the end of the decade from 10 percent of GDP to 6 percent of GDP.
Corporate saving rate increased significantly after China’s accession to the WTO. This surge continued until global financial crisis. During and after the crisis corporate saving rate moderated as the economy slowed down. It is essential that the exchange rate played important role on corporation saving in this decade. Chinese currency was undervalued until the late 2000s which had a significant impact on the export boom in this decade. It is also important that during this period government heavily subsidized Chinese corporations in order to increase export and economic growth. A result of these, trade surpluses drastically increased and due to trade surpluses Chinese corporations were able increase their savings. In addition to that factors that had contributed to corporate saving in previous decade also positively affected corporate saving in the 2000s. For example, like in previous decades Chinese authorities reduced workers mobility restrictions and encouraged rural-urban migration in order to respond corporations’ demand for unskilled labor in urban areas in the 2000s. It is important that the demand for unskilled workers significantly increased when China attracted more and more FDI especially in the late 1990s and early 2000s. The demand for labor reached the heights point after China joined the WTO. From that point, 100 million migrants joined to urban workforce in less than ten years (from the end of the 1990s to global financial crisis) (Gregory and Meng, 396). It is crucial that a large flow of workforce from rural areas to urban areas in that period helped corporations to keep their wages and production costs down even though these corporations substantially increased their profits. In total, corporate saving increased from around 15 percent of GDP in the 1990s to almost 20 percent of GDP in the 2000s (Ma and Yi, 2010: 15; Kraay, 566). Finally, China’s overall saving in the 2000s was over 45 percent of the GDP.

It is important that after the global financial crisis household saving remained around 22-23 percent and then gradually decline to 20 percent (Zhang, L., et al, 6). One of the major reasons of this decline is China’s economic slowdown in the 2010s after export-driven growth
lost its power. Structural and institutional problems, the US-led trade war, aging population and a slowing global economy negatively affect household saving rate in this period. Besides that, factors that used to contribute significantly to household saving in previous decades have no or less impact on household saving in this decade. For example, after serious financial and interest rate liberalization programs in this period, financial constraints play no major role on boosting household saving in the 2010s. It is important that in previous periods due to China’s underdeveloped financial and banking system it was very difficult to borrow for housing, health care, durable goods such as car and appliances and other big expenditures. Hence, households increased their saving for their future expenses. However, since 2012 Chinese authorities have gradually liberalized banking and financial sectors that included the relaxation of financial constraints over Chinese household. This new situation results in a decline in household saving rate in this decade. Besides that, housing ownership rose drastically in previous decade (reached 90 percent in the previous decade); however, in 2010 the growth stopped and then started to slow down (87 percent) (Huang, He and Gan, 2020). Decline in homeownership ratio decreases the household saving in this decade. In addition to that, Chinese authorities gradually decreased social safety net until the harmonious society program in the second half of the previous decade. Since then, Chinese government has started to rebuild the social safety net with various programs such as new rural health care system and pension schemes. It is also important that after his election as president, Xi Jinping pledged to improve all social and public programs. All of these factors play substantial role on decreasing household saving in this decade.

Government saving similar to household saving increased until global financial crisis (over 10 percent). Then it slowed down and stabilized around 5-6 percent in 2010s (IMF, 2017). An important decrease from 10 percent in the second half of previous decade to 5-6 percent in the 2010s was about rising social spending of the Chinese government. However, Chinese
government still has lower social spending compared to other countries, even though there was a significant spending increase on health (from 4 percent of GDP to 5 percent of GDP) (World Bank, 2019), education (from 3 percent of GDP to over 4 percent of GDP) (The State Council, PRC, 2019), pension (from 0.5 percent of GDP to 1.5 percent of GDP) (World Bank, Trading Economics, 2019), and social assistance to household (from 6 percent of GDP to 9 percent of GDP) (OECD, 2019) in this decade. Besides that, it is important that social security used to be one of the main drivers of government saving in the previous decades. However, due to aging population the system started to give deficit in the middle of 2010s. In other words, payments exceeded contributions in China’s social security system (almost 3 percent of GDP in the second half of the decade) (Zhang, L., et al, 12, 20). In sum, as a result of declining global demand for Chinese products during and after the global financial crisis it has become clear for China that it would be very hard to continue its economic growth with its labor intensive and low-wage manufacturing export. Since then Chinese government has spent hundreds of billion dollars in order to transit to an economic model that features strong domestic consumption, high value-added production and strong private sector role. However, all of these factors have negative impact on government saving in the 2010s and brought down government saving from 10 percent of GDP to 5 percent of GDP.

Like all other component of saving, corporate saving rate was stagnant during the global financial crisis period and then slowly decreased to 17-18 percent of GDP in the 2010s (Zhang, L., et al, 6). It is important that during and after the initial reforms periods economic and institutional changes resulted in the rise in corporate profitability. However, in 2010s most of these changes had no big impact on corporate profitability. On the other hand, expansion of export in previous decade significantly increased corporate saving. However, in the 2010s global demand of Chinese products gradually decreased. China-U.S. trade war on the other hand just
worsened this situation in the second half of this decade. Besides that, wages and other factors cost of production increased during this decade which also negatively affect corporation saving. It is crucial that in previous decade when Chinese authorities loosened rural-urban migration restrictions, over a hundred million rural workers responded that by migrating to the cities. However, in the 2010s only 20 million people migrate urban areas and more importantly from 2014 to 2017 there was almost no rural worker migrated to cities (Gregory and Meng, 396) even though government officials substantially reduce rural workers mobility restrictions and encourage them to migrate urban areas. In sum, China’s gross saving in the 2010s was around 42-44 percent of the GDP.

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<th>Saving Rates in China</th>
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<td>Household Government Corporation Total</td>
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<td>1980s</td>
<td>15-16 5-6 11-12 31-34</td>
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<td>1990s</td>
<td>17-18 3-4 14-15 34-37</td>
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<td>2000s</td>
<td>22-23 5-6 19-20 46-49</td>
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<td>2010s</td>
<td>20-21 5-6 17-18 42-45</td>
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Table 19-20 Saving Rates in China and in the U.S.

Source: China’s household, government and corporate savings data derived from various resources included; National Bureau of National Statistics of China, China Statistical Yearbook (various years); Modigliani and Cao, 2004; Kraay, 2000; Qian, 1988; Yang, Zhang and Zhou, 2011; Kuijs, 2005; IMF, World Bank and OECD (various years); Ma and Yi, 2010 and Zhang, L., et al., 2018. U.S. household, government and corporate savings data collected from various (years) sources of Bureau of Economic Analysis, Department of Commerce, Federal Reserve Bank of St Louis, Minneapolis, Dallas, San Francisco, Richmond and Boston Gross National Saving data are derived from World Bank and Central Intelligence Agency (CIA), White House archives and Federal Reserve Banks publications.

The Rise and Decline of China’s Productivity

Productivity is one of the key sources of economic growth. It is important that in the long-term countries capacities’ to improve their living standards depends on their abilities to increase their productivity. In that respect, from the early 1950s to the late 1970s China maintained its Soviet-style slow, inefficient and unproductive centrally planned economy. With that economy
Chinese government controlled a large share of country’s economic output by regulating production, prices and resources. However, this did not bring prosperity to China. At the end of the 1970s China was still weak, stagnant, inefficient and isolated from most of the world economies. In order to increase economic growth, raise the income level and living standards of its citizens, Chinese leader Deng Xiaoping decided to launch several economic reforms at the end of the 1970s. China at that time was primarily an agrarian country. Therefore, reforms were started in agricultural sectors. First of all, government shifted collective farming system to household responsibility system (HRS). Under the HRS, government allowed farmers to produce more agricultural output in order to sell them in the market at market prices after they finished selling their assigned fixed quota of products to the government with official prices (Chow, 94). Government’s decision of giving farmers freedom over production and allowing them to make profits from more efficient use of factors of production (particularly land and labor) created strong incentive among farmers to be more productive in the early 1980s. With their improved productivity farmers increased their agricultural output by almost 50 percent in the first half of the 1980s (Lin, 1992: 45; Huang and Rozelle, 492). It is very important that the increase in productivity and agricultural output reduced China’s food constraints in that period. Due to that, millions of people who had employed in the agricultural sector was able to change their jobs and work in more productive rural industrial enterprises which are also known “township and village enterprises” (TVEs). This was a structural shift in productivity that transferred labor from low productivity sector (agriculture) to high productivity sector (industry and service).

The success of the agricultural reforms in the early 1980s motivated Chinese government to launch same kind of reforms in the nonagricultural sector. From that point, the government which was responsible for 75 percent of nonagricultural output and 80 percent of the total urban employment at the end of the 1970s (Zhu, 2012: 114), introduced dual-tracking system.
This was very much like the HRS in the agricultural sector that state-owned enterprises (SOE) were authorized to purchase input and sell output at market prices beyond their quotas that was given to them by central government for their production input and output with the fixed official price (China Labor Bulletin, 2007). Like in the agricultural sector dual-tracking system increased the productivity in nonagricultural sectors. In addition to that, central government gave more autonomy to provincial, city and county-level of governments and SOEs managers for setting SOEs’ wages, hiring and firing SOEs’ workers, purchasing and selling SEOs’ goods and services, and pricing SOEs products (Chow, 97-98). It is important that lower-level governments and SOEs managers were thought to have greater knowledge on local SOEs’ needs. From that point, they mostly took decisions that make SOEs more productive in this period. Besides that, central government connected managers and workers’ wages to financial outcome of SOEs in order to increase workers and employers’ productivity (Hoi Yei, 2006: 157). Meanwhile, due to the central government’s generous financial and legal incentives the number of TVEs rapidly increased from 1.52 million at the end of the 1970s to almost 19 million at the end of the 1980s (National Bureau of National Statistics of China, China Statistical Yearbook, 2003). In the same period the number of workers employed in TVEs increased from 28.3 million to almost 94 million (National Bureau of National Statistics of China). In addition to that, special economic zones (SEZ) played important role on increasing productivity in this period. Chinese government established SEZs in four coastal cities in 1979 and offered tax, trade and financial incentives to attract foreign investment. By establishing SEZs, central government also planned to build trading ties with other countries in the 1980s. In the final analysis, Deng Xiaoping’s reforms opened the economy to internal and external markets in this decade. Expanding markets allowed Chinese corporations to reach a higher degree of specialization and more efficient use of resources. In addition to that reforms (HRS, managerial responsibility system) that
encouraged workers and employers to use resources efficiently. There were also improvements in the quality of inputs. Labor and capital qualities gradually increased in the 1980s. Finally, technological change also played some roles on productivity in this decade. Starting from the early reforms Chinese government adopted policies that promote technological change in order to boost productivity. In total, annual average growth in labor productivity was 6.4 percent in the 1980s (Reserve Bank of Australia, 2019; Federal Reserve Bank of St Louis, 2019; National Bureau of Statistic of China, 2019; CEIC, 2019). Total factor productivity grew by 2.7 percent annually (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; Zhu, 111).

The productivity growth in agricultural sector started to slow down in the second half of the 1980s. Government in the 1990s gradually liberalized market for agricultural inputs and outputs. Farmers starting in the early 1990s were able to make their own decisions with less intervention and fewer restrictions. On the other hand, central government reduced its financial incentives for the farmers. Agricultural market liberalization encouraged farmers to invest more on new technologies. Due to technological investment, productivity in this sector increased. Like in the previous decade when productivity increased in the agricultural sector, a smaller number of farmers met China’s food demand without causing any difficulties. Due to that a great number of workers were reallocated to the nonagricultural sectors (Fang, 2018: 243-244). By that time average labor productivity in nonagricultural sectors was at least six times higher than the productivity in agricultural sector (Zhu, 114). Therefore, reforms and productivity growth in agricultural sector was one of the major sources of the productivity increase in other sectors. It was important that throughout previous decade SOEs’ productivity remained low. One of the main reasons behind that central government had commitment to support employment in the SOEs. Due to this commitment, SOEs had no budget constraints and market disciplines.
However, in the 1990s after their deteriorating economic performance, the economic condition of SOEs worsened significantly (Kobayashi, Baobo, and Sano, 1999: 12-15). From that point, financial aid that needed to sustain SOEs increased steadily in the late 1980s and early 1990s. In the middle of the 1990s it became clear that this could no longer be sustainable. Therefore, central government declined its commitment to SOEs and adopted a reform program known as “grasping the big and letting go of the small and medium size of these enterprises” (Hsieh and Song, 2015: 299-301). According to this program, government focused on large SOEs in strategic industries, and released small and medium size SOEs. From that point, government started to shut down many unproductive small-medium size SOEs. The vast majority of them were privatized and some of them were sold to their employees. In the middle of half of the 1990s Chinese government enacted “Company Law” that basically legalized the development of private firms (Lardy, 330). In addition to that, central government facilitated to reregister over a million collective firms as private companies (Lardy). After these decisions the number of private enterprises grew drastically. Labor and capital moved from state to private sector. State financial institutions gradually recognized private enterprises and directed a larger share of their lending to these institutions (Cheng and Wu, 2016: 2). Combination of shutting down of unproductive small and medium size SOEs, legalizing the development of private enterprises, and increasing the access of private enterprises to funds had strong effect on productivity growth in China in this decade. Meanwhile, central government gradually reduced and eventually eliminated the dual-tracking price system for the existing SOEs. In the middle of this decade most of the products were sold at market prices. Reforming price system created some incentives for SOEs to increase their productivity little bit. It is important that after the Asian financial crisis in the second half of the 1990s China experienced a massive downturn in export. In order to remove negative effect of financial crisis, Chinese authorities cut interest rates,
increased money supplies and used other expansionary fiscal and monetary policies. That response was successful. In a few years Chinese GDP started to increase again. However, it is crucial that monetary and fiscal stimulus projects were directed by public institutions such as SOEs, central, provincial or regional governments. This process cut the earlier efforts of expansion the relative role of private enterprises in Chinese economy. Overall, due to rising government and SOEs activities in the economy, productivity growth slowed down at the end of the 1990s. Nevertheless, except this, there were some factors that drove productivity upwards in this decade. For example, the quality of labor and capital increased much faster than previous decade. The quality of high school-college education and vocational training improved significantly (Tsang, 2000: 611). Besides that, spending on research and development rose gradually (World Bank, 2019). These factors helped China to develop industrial technologies in the 1990s. It is also important that starting from second half of the decade there was a sharp increase in FDI. FDI had a significant spillover effects that brought new production technologies and techniques and modern management practices to the country. From that point, FDI significantly contributed productivity growth in this decade. In sum, it is important that annual labor productivity increased by 2 percentage points from previous decade’s average and reached to 8.4 percent in the 1990s (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; CEIC). Annual total factor productivity was increased by less than 1 percentage point from precious decade’s average. In the 1990s annual average total factor productivity was 3.5 percent (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; Zhu).

The productivity growth in the 2000s was very much a continuation of previous decade’s productivity growth. Like in the previous decade, factors that drove the productivity upwards such as capital investment, resource allocation, technological change and improvement in the
quality of input continued even more intensively in this decade. Unproductive state enterprises (SOEs, TVEs) lost their edge. The number of SOEs that closed down increased. At the end of the 1990s there were over 50 thousand SOEs in China; after a decade that number dropped to 9 thousand (Song, 370). Many of these enterprises were privatized. Some of them restructured and reorganized. Reallocations of factors of production (labor, entrepreneurship and capital) from state to non-state sectors accelerated in this decade. Due to that, productivity has significantly improved. Chinese government’s decision to enter into World Trade Organization (WTO) opened a new era for China to launch further reforms. It is important that in order to join the WTO Chinese government cut tariffs, reduced restrictive barriers, broadened trade rights and allowed non-state enterprises enter the domestic trade sectors. After its entry into the WTO, Chinese firms improved their access to foreign markets. Improved access to foreign market created two major consequences. One was an expansion of trade which expanded the capital accumulation and the other was a further realization of its comparative advantages that helped China to use its production factors more efficiently (Chow, 2003: 109). Both consequences have positive effect on productivity growth in China. It is also important that with their increasing access to world markets after joining the WTO, Chinese firms were able to import more technology intensive goods as both investment and intermediate input which also promote productivity in that period. From the same point, liberalization of country’s economic system played critical role on accelerated FDI in China in the 2000s. At the end of the decade China attracted 20 percent of the world FDI (World Bank, Ministry of Commerce, PRC). Like in the second half of the previous decade, FDI brought new production technologies and new management practices that led to increase productivity. Besides that, it is also important that the improvement in human capital continued in this decade. The number of people who received college degrees increased. In addition to that, the quality of education at China’s
colleges significantly improved. Finally spending on R&D significantly rose in the 2000s (almost 2 percent of GDP at the end of the decade) (World Bank; OECD, 2019). These developments also played important role on improving the productivity in China. It is critical to know that combination of trade liberalization, privatization, and access to foreign markets in this decade increased competition in manufacturing sector which led to a rapid productivity growth. However, the same thing can’t be said for the sectors that were dominated by SOEs. Especially in the service sector government, still made up over 70 percent of employment, had strict barriers to entry (Lardy, 334). From that point, due to overregulation, barriers to entry and low level of competition productivity growth in government dominated sectors lagged behind of other sectors. It is important that central government continued its previous decade’s policy of grasping the big and letting go of the small and medium size of SOEs. On the other hand, government identified some important industries (strategic and pillar) and used a variety of industrial and financial measures for allocating resources to these SOEs favorably (Song, 357-361). As a result, revenue and the size of SOEs increased substantially; however, their productivity deteriorated especially at the end of the decade due to GFC and the polices that central government adopted after the GFC. GFC was an important factor that negatively affected productivity (slightly) at the end of this decade, but extensively in the next decade. In all, labor productivity grew by 9.4 percent annually which was 1 percentage point higher than previous decade’s average (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; CEIC). On the other hand, total factor productivity grew by 3.9 percent annually in the 2000s (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; Zhu).

It is essential that China experienced a very different productivity growth in the 2010s. Starting from the GFC in the late 2000s, China’s productivity growth declined steadily. There
were many factors that contribute to decline in productivity growth. First of all, during and after 
the GFC the demand for Chinese export decline significantly. Chinese government responded 
this decline by adopting a massive stimulus package. The aim of this stimulus was to maintain 
the employment and sustain the production. Therefore, during and after the GFC Chinese 
enterprises increased its production even though the world trade slowed down significantly. 
Eventually this created serious overproduction and overcapacity problems that damaged foreign 
trade relations and economic sustainability of China. It is important that most of this package’s 
projects were in infrastructure and construction sectors that increased the economic growth 
substantially; however, added almost nothing to productivity. In addition, similar to that of the 
stimulus package in response to the Asian financial crisis a decade ago, central government 
authorized public institutions such as SOEs, regional and local governments to administer the 
monetary and fiscal stimulus project. From that point, a large amount of money from the 
stimulus package was directed to unproductive SOEs that mostly generated a weak return on 
assets (Song, 355). Overstaffing, overinvestment/overproduction and weak corporate 
governance after the GFC prevented SOEs to be more productive (359-361). Besides that, when 
Xi Jinping became president in 2013 he increased the role of the state in the economy. He 
launched many reforms that boosted the importance of SOEs. SOEs increased their production 
and profits in areas where private enterprises once led. On the other hand, business 
environment worsened for the productive private enterprises after Xi Jinping’s reforms. 

It is noteworthy that in this decade many foreign companies started to reduce their 
investment in China as a result of trade disputes (particularly between China and the U.S.), 
political and economic pressure of Chinese government on foreign firms, foreign firms’ 
reluctance to share technology and management techniques with their Chinese partners, and 
finally continuously increasing production cost of corporations in China. From that point, the
pace of FDI flows into China decreased to 2 percent per year in this decade which is 8 percent lower than previous decade’s average of 10 percent (UNCTAD, 2019: 42). It is crucial that in previous decade China was able to attract 20 percent of the world gross FDI; however, less than a decade China lost half of that share (in 2018 China accounted for 10 percent of the world FDI) (UNCTAD). Declined growth of FDI in the 2010s slowed down the transfer of foreign technology into China which further deteriorated productivity in this country. Consequently, in order to raise productivity Chinese government aimed to create homegrown technology with the project called “Made in China 2025”. Chinese authorities identified ten key sectors (from information technology to aerospace equipment and from ocean engineering equipment to bio-medicine and high-end medical equipment) and several technologies (from 3D printing to mobile internet to cloud computing) in this project and aimed to improve its ability to innovate and then capture these sectors and technologies (The State Council, PRC, 2019). However, until 2019 Chinese enterprises failed to change their organizational structure which favors top-down and autocratic approaches to management that inconsistent with the culture of innovation. As a result of that, Chinese enterprises found it difficult to increase productivity through homegrown technology creation.

It is also crucial that China’s working-age population started to decline from the middle of this decade. This played an important role on productivity decline in China. When the working-age population falls, domestic consumption decreases so do companies’ revenues. Lower revenue means less investment on factors that boost the productivity such as R&D. China’s one-child policy is one the major reasons of working-age population decline. One-child policy also plays important role on reaching Lewis turning point (LTP) which is a situation that (surplus rural labor is fully employed in manufacturing and service sectors in urban areas) causes urban wages to surge. In the previous decades the migration from rural areas (agricultural sector) to
industrialized urban areas (manufacturing and/or service sectors) invigorated productivity in China since average labor productivity in nonagricultural sector is higher than the productivity in agricultural sector. It is noteworthy that in this reallocation case, migrant workers who drawn from the agricultural sectors forced to accept low wage-jobs. They accepted low-wages because they preferred to work in the city with low-wages over living in the farm. However, in the 2010s there is a situation that employers in the cities (nonagricultural sectors) could not find enough labor or attract workers from the rural areas (agricultural sector) to employ in their companies. Due to that companies started to raise their wages in order to attract more employees. This had important consequences. First of all, in the previous decades millions of people who had worked in the rural areas each year went to work in the cities. This structural shift increase productivity significantly, however; in 2010s the amount of people who head to work in the city gradually diminished (Balding, 2019) which means the productivity growth decreased in this decade. Another consequence was about the rising wages. Due to rising wages, companies’ profits and savings declined. And due to declined profits and saving, companies could not finance the capital formation for investment and expansion which also leads to decrease productivity. It is also important that there was a structural shift from industrial sectors to service sectors in China in 2010s which is quite different than the shift in the previous decade (from agricultural sector to industrial sector). It is the rule of thumb that productivity in industrial sector is higher than the service sector (Sorbe, Gal and Millot, 2018: 3). From that point, as the Chinese economy shifts closer to service sector, productivity growth will slow further down. In addition to that, service sector is mostly dominated by (unproductive) SOEs in China. Therefore, service sector is strongly protected with trade and non-trade barriers from international competition. Due to the lack of competition service sector in China has weak productivity growth.
In sum, in order to increase productivity Chinese government proposed some reforms in the middle of this decade that included financial and fiscal reforms such as liberalizing the financial system and increasing the efficiency of fiscal policies (Huang and Wang, 2018: 295); structural reforms such as reforming the Hukou system (The State Council, PRC, 2014) and external sector reforms such as further opening up markets. However, after Xi Jinping took office in 2013 the chance of implementing these reforms successfully gradually diminished. Nevertheless, the productivity rate of China is still higher than most of the countries in the world in this decade. It is important that factors such as; R&D, improvement in human capital and some managerial capabilities, opening up some sectors to competition, resource (capital, labor) allocation, technological changes and technology diffusion, privatization, liberalization, institutional changes and policy reforms continued to contribute productivity growth; however, in this decade these factors’ contribution to productivity is smaller than the previous decades’ contribution. In sum, annual average growth in labor productivity was 7.4 percent which was 2 percentage points lower than previous decade’s average (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; CEIC). Total factor productivity also declined more than 2 percentage points. It grew by 1.8 percent annually in the 2010s (Reserve Bank of Australia; Federal Reserve Bank of St Louis; National Bureau of Statistic of China; Zhu).
Conclusion for the Third Part (Economic Power of China)

As it mentioned above that before its rapid economic growth, China was one of the poorest countries in the world. In 1978, China’s GDP was below $200 billion and its GDP per
capita was around $150. However, after the death of Chairman Mao, the Chinese government gradually shifted its Soviet style centrally controlled and highly inefficient economy to a Western style market-driven economy. Since then, China has experienced an unprecedented economic growth with its GDP growth rate averaged over 10 percent for decades. With this high growth rate China’s GDP increased from $190 billion dollars at the beginning of the 1980s to $13.6 trillion at the end of the 2010s. Nevertheless, the overall situation raised several questions about China’s economic growth. How did China grow so fast? What were the external and internal factors that affected China’s economy growth? Is China’s economic growth sustainable? What are the challenges for the future of China’s economic growth? What will be the future of China’s economic growth? It is important to note that rather than properly answering these questions, some scholars jumped to conclusions by assuming that China will continue to maintain relatively high economic growth rates in the future which would eventually make China the world next economic superpower.

However, this study goes into further detail to elucidates the reasons behind China’s GDP growth and determine the likelihood of whether China can maintain its high GDP growth in the future. In that respect, this study detects various factors that increased China’s GDP growth significantly through the decades. For example, in the 1980s, China’s economy greatly benefited from the reforms in the agricultural and non-agricultural sectors. Besides that, starting from the middle of the same decade, the Chinese government launched various economic relationships with many countries in the western world that had no prior connection. Building economic relationships stimulated trade and trade increased China’s GDP in this period. In addition to that, China created SEZs and offered tax and trade incentives in order to attract foreign investment. This worked out as planned; trade and investment rose remarkably in this period. As a result, people’s income gradually increased. During this period, the Chinese government
was able to use people’s raised income for further investments. In the following decade, economic growth accelerated through the continuation of reforms. There was a structural shift in resources in the 1990s, which included millions of workers moving from agricultural sectors to nonagricultural sectors. Besides that, China’s government closed down many unprofitable SOEs in order to make rest of these remaining enterprises more competitive and productive. Some of the SOEs were sold to their employees while others were privatized. Private investment increased substantially through further integration with the world economy. At the end of the 1990s, Chinese authorities changed its economic growth model to an export-oriented philosophy. From that point, China devalued its currency significantly (the dollar to yuan exchange rate increased from 5.8 to 8.6) and used extremely favorable monetary policies for expanding its exports. After its accession to WTO over the next decade, China drastically increased its exports and became the largest exporter in the world. Meanwhile, as in previous decades, China’s economy benefitted a lot from large scale capital investment, urbanization, and privatization. Moreover, the Chinese government expanded SEZs to the whole coastal region first and then expanded to the riparian and inland regions. Economic reforms, creation of new SEZs, decentralization policies, and the membership of WTO significantly accelerated FDI. Raising FDI inflows increased capital formation, technology transfer, and human capital accumulation that all contributed to China’s economic growth during the 2000s. In addition to that, all these processes also boosted demand for labor. It is important to note that during this decade tens of millions of people moved from rural inland regions to coastal provinces to find job in manufacturing and service industries. This created a situation in the 2000s that kept wages and production cost down which made Chinese companies highly competitive in the international markets.
However, a few years after the GFC, China’s GDP growth started to decline. It is important to note that this decline has been slower, but steadier and more severe than earlier cases. There are various reasons behind this.

Primarily, factors that drove high-paced economic growth in the previous decades such as improving quality and quantity of labor force, allocating resources more effectively, investing public capital, and increasing FDI and export continued to contribute economic growth; however, in the 2010s their contribution to growth is not the same pace as in the past. It is much weaker than previous decades. For example, after the GFC, household income stagnated in many parts of the world. Due to income stagnation, households reduced their consumption significantly which had a major negative impact on Chinese exports since China is the largest supplier of consumption goods. Furthermore, as a result of serious economic crises and financial uncertainties in this era, the pace of the FDI inflows to China significantly decreased which created additional negative effect on GDP growth. In the previous decades, reforms in agricultural and nonagricultural sectors played significant role on economic growth; however, their effect on growth gradually diminished. From the same perspective, China exploited late-comer advantages in the previous decades by acquiring and imitating technologies from developed countries and achieved higher level of technological innovation with low cost and fewer risk. However, this advantage dwindled in the recent period. It is noteworthy that China benefitted significantly from its growing working age population in the previous decades. However, due to the one-child policy and low fertility rate, China’s working age population has started to decline since early 2010s. This situation created a serious burden on the Chinese economy after the first half of the 2010s. With China’s declining working age population, it has become harder for China to adequately support its economic growth in the new period. China also enjoyed its mass migration of workers from rural to urban areas in the previous decades.
This large-scale migration created a situation in preceding periods that kept the wages and the cost of production remarkably low. As a result, Chinese corporations were able to raise their profits, savings, and investment. Therefore, mass rural-urban migration significantly contributed to China’s economic growth. However, this situation started to change in the early 2010s. There are many signs in eastern coastal provinces that availability of surplus labor at low wages is disappearing. In other words, China has passed the Lewis Turning Point. From the Asian financial crisis to GFC over a hundred million migrants moved to eastern coastal cities to find a job in the manufacturing and service industries. Yet, the number of workers who moved to coastal big cities declined to 20 million from GFC to 2016. And it is crucial that there was almost no increase in migrant workers from 2014 to 2017. One of the most important factors behind that is a trend toward closing the wage gap between rural and urban workers. Another factor is the hukou system that makes it difficult for workers to switch their registration from rural to urban workers. Hukou system also restricts migrant workers’ access to urban public services. All these factors discourage rural workers to move big coastal cities in recent period. From that point, in order to attract rural workforce, Chinese corporations start to offer higher wages. However, it is crucial that higher wages increase China’s production cost and also reduce its corporations’ competitiveness in the new period. It is also important that in the previous decade Chinese economic growth model which was characterized by labor-intensive manufacturing for export coincided with an era of increasing globalization. In that respect, China benefitted a lot from engaging in global production and trade in this period. However, this period came to an end after the GFC. Today’s international environment has entered a period of uncertainties. Rule-based multilateral economic system and liberal economic principles are under assault by many institutions and countries. Therefore, in this new international economic environment it is very hard for China to seize the same opportunities that it enjoyed in the previous period. From that
point, after his election as President of China, Xi Jinping decided to change China’s economic growth model (Wong, 2019). The new model that included principles such as strong domestic consumption, high-value added production and high level of private sector role in the economy could not bring the same economic growth rate that China had in the previous decades. Xi Jinping and his government’s faltering performance on these new economic principles play an important role in that. In sum, forces discussed above that promoted rapid Chinese growth in last four decades have been withering each and every year since the early 2010s. From that point, China’s economic growth will decelerate even more in the new period, which is bound to create various economic challenges for China in the near future.

Many scholars take price inflation as a serious problem for China. It is important that like many other transition countries, China experienced extreme price volatility in the early decades of reform. For example, China used ambitious expansionary monetary and fiscal policies in order to finance investment and accelerate economic growth three times in the 1980s. In each of these periods, China’s economy grew significantly. However, each of these periods ended up with an overheated economy that led to rising prices of goods and services. Central government responded to these price rises by raising interest rates, cutting government spending and enforcing credit control on financial institutions. In the middle of the 1990s, China experienced its last severe price increase after another wishful growth-oriented policy that Chinese government had launched in 1992. At the end of this dramatic price hike, which increased the inflation almost 25 percent, Chinese authorities decided to implement some structural changes in the economy. From that point, China liberalized its trade and adopted an export-led economic development model. Since then China has increased its production significantly and overfilled not only domestic but also international markets with its goods. Nevertheless, overproducing and oversupplying goods put a strong and stable downward pressure on prices. In addition to
that people in China like in the previous decades preferred to save their income rather than spend. In all, China began to experience sustained periods of price decline (deflation). It is crucial that China fell into deflation three times in a decade. Before the GFC China was able to export its products to the world. Therefore, falling prices were not a serious issue for China. However, after the GFC global demand for Chinese goods fell sharply which increased the downward pressure on domestic prices. Meanwhile, Chinese authorities adopted a new growth model that aimed to increase domestic consumption. From that point, government used aggressive expansionary monetary and fiscal policies. Notwithstanding, after years of using these policies, domestic consumption still remains low which creates additional downturn pressure over prices. In all, combination of continuously rising supply and weakly growing demand has severely raised the fear of chronic deflation in China in the new period.

It is important that declinist scholars greatly underestimate China’s debt. First of all, they focus particularly on China’s government debt which is relatively low when it is compared to other governments’ debt. Besides that, the same scholars fail to emphasize China’s massive debt burden that was built up in the past decade. It is true that China used balance budget policy and carried little debt for about three decades after its establishment in 1949. However, when Chinese government launched its economic reforms first time at the end of the 1970s, China began to run budget deficit and issue some limited debt. China’s total debt increased moderately from 1980 to 2006-07 (from $100 billion to $4-4.5 trillion). During this period procurement prices of farms products, SOEs, local and regional governments expenditures, monetary and fiscal subsides, incentives and hundreds of thousands of infrastructure projects were the main drivers of total debt. Before the financial crisis, which was the origin of China’s debt problem, total debt was $4-4.5 trillion and around 150 percent of GDP (In 2006, GDP of China amounted to around 2.7 trillion U.S. dollars). However, only a decade from the GFC
China’s total debt increased tremendously, which deeply undermine the future of its economy in the new period. The reasons why China’s debt level in both dollars and as a percentage of GDP increased enormously within a relatively short time were various. First of all, instability and uncertainty in the world economy after the GFC significantly dropped global demand for Chinese goods. This led to a sharp decline in China’s export that caused thousands of factories to shut down and millions of workers to lose their jobs. In order to reinvigorate the economy and recreate hundreds of thousands of jobs, Chinese government started to use its massive stimulus packages. This project was one of the key reasons that boosted the debt burden. It is important that most of the funds from the stimulus packages went to real estate and infrastructure projects that generated low investment returns. From the same perspective, SOEs acquired a lot of stimulus support. With that support SOEs continued to maintain its employment and production level which worsened China’s overcapacity and overproduction problems. It is important to note that most of SOEs were inefficient and they maintained their operation with huge loses. However, contrary to earlier periods, central government did not allow these enterprises to go bankrupt or taken over though merger and acquisition. In fact, with the election of Xi Jinping more resources channeled to SOEs. In the new period, Xi Jinping promotes the role of SOEs at the expense of private corporation since he wants to continue state ownership in critical and strategic industries that includes defense, telecommunication, energy, civil aviation, IT, electric production and distribution, shipping, steel, coal and construction materials. In addition to that, he sees SOEs as the backbone of the socialist economy. In other words, he aims to implement his objectives such as maintaining economic and social stability through SOEs. In sum, some SOEs slightly increased their profit; however, most of SOEs financial performance declined substantially. From that point, these enterprises borrowed heavily from state-owned financial institutions to cover their losses. After a decade from the GFC their (SOEs)
debt level reached over $13 trillion which was equal to almost 100 percent of GDP in 2018. In addition to that in the new period due to overproduction and overcapacity problems many private enterprises’ efficiency declined which created serious challenges for these enterprises to repay their debts. After GFC, China also aimed to improve social services and the expand public safety net. Thus, Chinese authorities launched thousands of projects in central and western part of China. These projects significantly increased the budget debt. It is important that local and provincial governments took an important part in these projects. These governments rapidly raised their spending in this period as well. However, for obtaining the additional resources that needed for financing these and many other projects that includes infrastructure projects, local and provincial governments created informal and backdoor financing practices which are called local government financial vehicles (LGFV). It is critical that local and provincial governments operated these type of financing practices beyond the central government surveillance. Therefore, central government has little knowledge of how fast that debt is rising. Nevertheless, it is expected that local and provincial governments are in unsustainable level of debt at the end of the 2010s. On the other hand, small and mid-size private enterprises used similar types of financing practices in this period. After borrowing heavily from shadow banking institutions, these enterprises repackaged their loans as investment in their balance sheet. In that respect, these enterprises like local and provincial governments are also in unsustainable level of debt at the end of the decade. Another factor that significantly increased the debt of China is the government price control mechanism for some critical areas such as energy (oil, gas, coal and electricity), food (pork, wheat and corn) and real estate. Chinese government believes that a price hike in these critical areas could lead to a social unrest, much like China experienced previously in the late 1980s. From that point, government in China used policies that set the prices of goods and services in these critical areas below the market level; however, these
polices caused serious distortions in the economy and also led to a surge in government debt. In all, at the end of 2018 China’s total debt increased to over $34 trillion which was equal to 255 percent of GDP in 2018 (Curran, 2018). That means China built up a massive debt burden ($30 trillion) in a decade after the GFC. Through these tremendous spending programs, China was able to open tens of thousands of factories, create million jobs and maintain a relatively high economic growth even in the 2010s which were mostly remembered as a decade of uncertainty and instability. Nevertheless, it is important that at the end of the 2010s China’s debt reached an unsustainable level that could trigger an economic crisis in China in the near future. From that point, China’s future growth will very much depend on how well China deals with its massive debt.

China’s savings rate is another topic that attracts a lot of attention. Many scholars emphasize high savings rate in China, which is still about 10-15 percentage point higher than global average, without addressing the factors that increased the level of savings in previous decades and factors that started to reduce the level of savings in the new period. It is important that China significantly increased its already high savings rate in the early 1980s. Factors such as culture, past experiences, demographic changes, government’s strict control over people income, weak financial and banking system, increasing people income, shrinking social safety net and raising house ownership encouraged people to save more until the late 2000s. Corporations during the same period substantially boosted their profits and their savings as well. It is crucial that government subsidies such as easy access to energy, land and capital and corporations’ monopolistic power played important role on the rise of corporation savings. Besides that, labor market reforms during this period relaxed workers mobility restrictions that significantly pull corporations’ production cost down and their earnings and savings up. Finally, China’s accession to the WTO resulted in a massive growth of export which increased
household, governments and corporation’s savings significantly. At the end of the 2000s China’s total saving reached almost 50 percent of GDP. However, it is crucial that China’s total savings started to decline steadily few years after the GFC. For example, seven out of eight years in the 2010s China’s total savings rate was in decline. There are various reasons behind that decline. One of the key reasons is about China’s economic slowdown in the 2010s after its export-driven growth model lost its power. Besides that, structural and institutional problems, the U.S.-led trade war, and a slowing world economy negatively affect China’s saving rate in the 2010s. It is important to note that factors such as weak financial system, rigorous state control over people’s income and poor social safety net played important role on China’s saving in previous decades. However, these factors had little impact on savings in the new period since China has gradually developed its financial market, improved its social safety net and relaxed its control over people’s income. From the same perspective, home-ownership positively affected savings in previous decades. Starting from the early 2010s home-ownership growth ratio started to slow down. Declining home-ownership ratio is another factor adversely affect savings in this decade. Social security was one of the main drivers of savings before the 2010s. Yet, as a result of the aging population in China the system has started to give its first deficit in the middle of the 2010s. Corporate savings was also in decline. Previous reforms and expansion of export had a big impact on corporate profitability. Nevertheless, their effect gradually diminished after the GFC. Besides that, wages (Lewis Turning Point) and other cost of productions such as raw materials increased in the 2010s which negatively affect corporate savings. It is important that in order to pull wages down, Chinese authorities loosened rural-urban restrictions; however, there are still very few rural workers migrate to cities in the new period. In sum, China’s saving rate steadily and constantly declined from about 50 percent at the beginning of the decade to
43 percent at the end of the decade. After scrutinizing factors that is mentioned above, this paper predicts that China’s savings rate will fall further in the future.

As in the savings issue a lot of scholars pay specific attention to China’s productivity growth. In their research, most of these scholars emphasize China’s rapid productivity growth and its effect on the growth of Chinese economy. It is true that productivity improvement played an essential role on China’s economic growth in the previous decade. However, since GFC, Chinese productivity growth has declined steadily. This is mostly because the factors that significantly contributed to productivity in the previous decades have little or no effect on productivity in the new period. For example, in the early 1980s reforms in agricultural sector (household responsibility system) improved farmers productivity remarkably. Raising productivity in the agricultural sector freed millions of rural workers to move cities and work in more productive manufacturing and service industries. From the same point, reforms in nonagricultural sectors (dual-tracking system) improved the productivity of SOEs. The spillover of technology and knowledge from FDI was another factor that boosted China’s overall productivity in this period. There were also substantial improvements in labor and capital. For example, high school and college education improved significantly. Spending on research and development rose remarkably. The government started its further reforms on SOEs in the middle of 1990s. Chinese authorities took an important decision and closed down many unproductive SOEs. Thousands of other SOEs were privatized. Labor and capital moved to more productive private sector. It is important that, after China’s accession to the WTO, Chinese enterprises improved their access to global market. In addition to that, these enterprises started to import more technology intensive goods (inputs) that they used in their production function in order to promote their productivity further. Competition also increased noticeably particularly in manufacturing sector which led to a drastic productivity growth in this period.
However, few years after the GFC China started to experience a steady and continuous productivity slowdown. There were many factors that contributed to a decline in productivity growth in this period. First of all, after the GFC, Chinese authorities used massive stimulus projects in order to reinvigorate the growth. It is important that these projects caused serious overproduction, overinvestment and overstaffing problems that led to a decrease in China’s overall productivity. It is also important that most of the stimulus projects went to infrastructure and real estate sectors that rapidly increased GDP; however, they added almost nothing to productivity. Furthermore, for administrating these projects central government authorized unproductive SOEs and other local and provincial institutions that generated lower return from assets. From the same perspective, after his election as President of China, Xi Jinping substantially increased SOEs’ role in the economy. During this period, highly unproductive SOEs started to control most of service and some manufacturing sectors which private enterprises once led. Foreign corporations in this decade started to reduce their direct and portfolio investments to China as a result of China’s aggressive policies over foreign corporations, trade disputes, particularly between China and the U.S., foreign corporations’ unwillingness to share technology and know-how with their Chinese partners, and finally constantly increasing production cost of corporations in China. Decline in direct and portfolio investments in China further deteriorated productivity. It is crucial that starting from the middle of the 2010s China’s working population started to decline. When the working age population falls, domestic consumption decreases. Decline in domestic consumption causes corporations to have less revenue and less investment that needed for boosting the productivity. Around the same time, China reached the LTP. Due to LTP, corporations’ production cost started to increase, and that lead to corporations to have less revenue and investment which is critical for increasing productivity. In addition to that, China’s service sector is growing at the expense of the
manufacturing sector in the new period. It is important that productivity in service sector is much lower than the productivity manufacturing sector. This shift is quite different than the shift in the previous decades. In the previous decades, China experienced a transition from agricultural economy to manufacturing economy that played positive role on productivity growth since productivity in manufacturing sector is higher than productivity in agricultural sector. Finally, it is crucial that China’s service sector is protected with many barriers and mostly dominated by unproductive SOEs (in financial, banking, insurance, transportation, and utilities (water, gas, and electricity) sectors). This is another factor that causes further deterioration in productivity in the new period. In sum, it is important to know that factors that drove China’s productivity upwards in the previous decades are no longer contributing the productivity in the same way. In addition to that, some (new) factors that are mentioned above lead to a decrease in productivity. From that point, it is predicted that the almost decade-long drop in China’s productivity growth will continue further in the future.

In conclusion, it is important to note that overall findings in this section contradict the findings of scholars that state that China will continue to maintain relatively high economic growth rates and will displace the U.S. as the world’s next economic superpower. This paper asserts that forces that drove high-paced economic growth in China in previous decades have been withering each year since the early 2010s. As a result of that, China has been facing a number of major challenges that include excessive debt and persistent decline in prices, productivity and savings. Consequently, China’s economic growth has been steadily slowing down. It is very important that this economic slowdown is not a periodic downturn that China had experienced several times at the end of each decade since 1980s (the Tiananmen Square massacres at the end of the 1980s, the Asian Financial crisis at the end of the 1990s and finally the GFC at the end of the 2000s). This time the decline is continuous, more intensive, more
stable and more severe than previous cases. Thus, it will be very hard for China to maintain its high economic growth that it enjoyed in the last three decades. From that point, China’s future will be more about dealing with its own problems (mentioned above) rather than displacing the U.S. as the world’s next economic superpower.
Chapter 7

Conclusion

As this study mentioned earlier, the decline of American economic power has been vigorously debated for decades. Starting from the Kennedy administration, there were many cases that scholars interpreted as the beginning of American economic power decline. The financial crisis of 2007-09 is the latest case of the same debate. However, unlike the previous cases, scholars who support the idea of U.S. economic power is in decline after the financial crisis, strongly believe that this time the decline is different. This time the decline is real. In addition, the same scholars also argue that China, as an economic challenger which is different from previous ones, will replace the U.S. as the world’s next economic superpower. All these concerns made this topic necessary to examine again. From that point, this research study set its research questions as “is U.S. economic power in decline?” And “is China replacing the U.S. as the world’s next economic superpower.”

In order to answer the first research question, this study qualitatively explores four case studies, France and the breakdown of the Bretton Woods International Monetary System, the Oil Crisis and the role of Saudi Arabia, the General Agreement on Tariffs and Trade (GATT), and the U.S. - the EC – Japan Triangle, and finally the World Trade Organization (WTO) and relationships between the U.S. and developing countries, and analyzes perspectives of American economic power. In these case studies, this paper assumes that an economically powerful country (the U.S.) should have capacity to make decision that benefit itself alone, while at the same time it should have the ability to decrease the capacity of other countries that intend to challenge its (American’s) core interests and leadership position in the world economic system. However, after analyzing the cases, this paper reveals how the U.S. could not control and
influence the behavior of other countries in line with its own interest, not only during the period after the financial crisis of 2007-09, as many scholars predicted, but also in many decades before the financial crisis. In that respect, this paper asserts that there is no significant change in U.S. economic power now and then. In other words, contrary to most scholars’ arguments, U.S. economic power is not in decline.

In the second part of this study, the same question (is U.S. economic power in decline?) is tested by analyzing quantitative data that includes GDP, CPI, debt, savings, and productivity. After analyzing the data, this paper claims that under the extraordinary conditions (or period) in the decades following WWII, the U.S. experienced a sharp economic growth. Nevertheless, this exceptional period of time came to an end at the end of the 1960s. Since then, the abnormal increase in U.S. economic growth has returned to normal. From this point of view, the decline of American economic power in the 1970s rebounded in the 1980s and 1990s. Similarly, after the rapid economic decline in the 2000s, which made many scholars believe that U.S. economic power was in permanent and fundamental decline, the U.S. economy has slowly but steadily been growing again. Thus, as in the first part of this paper, overall findings of the second part of this study conflict with the arguments of scholars that state that U.S. economic power is in an irreversible decline.

In the last part, this paper tries to determine whether China can overtake the U.S. as the world’s next superpower. After analyzing GDP, CPI, savings, debt and production, this paper argues that forces that contributed to rapid economic growth in China in previous decades have been fading away each and every year since the beginning of the 2010s. Therefore, China’s economic growth has been slowly and gradually slowing down. It is important that this slowdown is not a cyclic downturn that China had faced several times in previous decade. It is
continuous, more stable and more intensive than previous slowdown cases that will pose many challenges to China’s future growth. In that respect, paper concludes that China’s future will be more about dealing with its own challenges, rather than overtaking the U.S. as the world’s next economic superpower.

Lastly, it is crucial to note that there are two major limitations in this research study that could help shape future work. First, for analyzing qualitative data, four cases are scrutinized. These cases exemplify the most important international economic and financial events in the period before the financial crisis of 2007-09. Through these cases, this research study builds a pattern and develops a theory that aims to answer the first research question. However, it would be helpful if future studies consider more cases to account for in order to support its pattern and its theory more strongly. From the same perspective, this research study analyzes five economic indicators, GDP, CPI, debt, savings and productivity, and tries to answer the research questions in the second and third part. Nevertheless, a more complete picture about whether U.S. economic power is in decline and whether China is overtaking the U.S. as the world’s next economic superpower can be obtained by adding additional indicators such as competitiveness, GDP per capita, unemployment, technology and innovation, and income inequality to future research studies. It is crucial that the decline of American power and China’s rise as the world’s next superpower will remain contested issues with strongly held positions for and against it at least in the near future. In that respect, additional indicators that mentioned above help to answer research questions effectively in the future studies.
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