

# *Internationalization and Domestic Politics*

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**CAMBRIDGE**  
**UNIVERSITY PRESS**

W1D-LC

HF

1359

.I 5877

1996

Published by the Press Syndicate of the University of Cambridge  
The Pitt Building, Trumpington Street, Cambridge CB2 1RP  
40 West 20th Street, New York, NY 10011-4211, USA  
10 Stamford Road, Oakleigh, Melbourne 3166, Australia

© Cambridge University Press 1996

First published 1996

Printed in the United States of America

Library of Congress Cataloging-in-Publication Data  
Internationalization and domestic politics / edited by Robert O.  
Keohane, Helen V. Milner.

p. cm. – (Cambridge studies in comparative politics)

ISBN 0-521-56264-3 (hc). – ISBN 0-521-56587-1 (pb)

1. International economic relations. 2. World politics – 1989–  
3. Comparative government. I. Keohane, Robert O. (Robert  
Owen).

1941– . II. Milner, Helen V., 1958– . III. Series.

HF1359.I5877 1996

337 – dc20

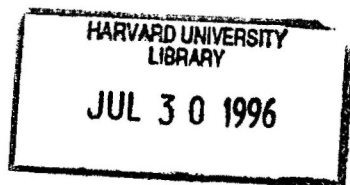
95-41396

CIP

A catalog record for this book is available from the British Library

ISBN 0-521-56264-3 hardback

0-521-56587-1 paperback



08923

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## Economic Integration and the Politics of Monetary Policy in the United States

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JEFFRY A. FRIEDEN

International economic integration has profound effects on monetary policy. In this chapter, I argue that it has equally important effects on the *politics* of monetary policy. It makes monetary policy more prominent politically, by heightening its impact on relative prices. Because high levels of capital mobility mean that national monetary policy implicates the exchange rate, it gives rise to clear-cut distributional effects that in turn lead to political divisions. At the same time, high levels of world trade make the exchange rate a critical price for much of the population. When the general effects of economic openness are compounded by international price shocks, there are strong incentives for affected groups to seek redress in the monetary arena. Economic internationalization leads to an increased politicization of monetary policy and a change in the sorts of socioeconomic and political divisions it implies.

The United States has in fact experienced the impact of economic integration on monetary politics. Both the country's integration into the world economy, and its monetary politics, have varied substantially over time. Indeed, monetary policy was once at the center of American politics. From the 1860s until the 1930s, "The Money Question" was, along with the tariff, the great constant of political debates in the United States. It brought forth messianic populist fervor, terrified defenses, two of the more successful third parties in the nation's history, and impassioned speechifying from the floor of Congress to the wheat fields of Kansas. However, after the mid-1930s, monetary policy seemed to drop off the political agenda, although it has resurfaced to some extent in recent years.

This chapter contends that changes in the level of American interna-

The author acknowledges support from the Center for International Business Education and Research and the Center for American Politics and Public Policy at UCLA; and useful comments and suggestions from Barry Eichengreen, Peter Kenen, Robert Keohane, David A. Lake, Nathaniel Leff, Lisa Martin, Kathleen McNamara, Helen Milner, Ronald Rogowski, Howard Rosenthal, Kenneth Shepsle, and Peter Temin.

tional economic integration help explain why monetary policy was high politics for over a half a century, then nearly disappeared from the political agenda. It asserts that a major cause of the political prominence of monetary policy before 1930 was the extensive ties of the United States with the rest of the world economy. Between about 1930 and 1970, the United States economy was quite closed, and monetary policy faded into popular oblivion and scholarly tedium. Since 1970, international financial and commercial integration have increased dramatically. This has made monetary policy more politically important and contentious, and is likely to change the political divisions and institutional settings in which monetary policy is made.

This analysis of the changing pattern of American monetary politics tends to support the proposition that international economic conditions have powerful effects on domestic politics. Changes both in the overall degree of integration of the United States into the world economy, and in specific relative prices, led to the mobilization of interest groups in ways that were both affected by and had an impact on the institutional structure of American monetary policy-making. International economic trends altered the environment within which monetary policy was made; they also had a differential distributional impact on socioeconomic groups, which led to substantial political conflict.

It is far beyond the scope of the present study to carry out a rounded evaluation of the sources of American monetary policy from the 1860s through the 1980s. Its purpose is to present a perspective on monetary politics that builds on the approach developed in this volume, and to apply it in a preliminary way to a vast swath of American monetary history. While systematic empirical evaluations of the approach are certainly possible, I believe that the historical evidence presented here helps at least establish the plausibility of my argument.<sup>1</sup>

This chapter, then, evaluates the impact of internationalization on the politics of American monetary policy over a 120-year period. In Section I, I summarize the expected effects of international financial and commercial integration on the politics of monetary policy. Section II surveys the American experience with monetary policy in an open economy between the Civil War and 1930, and in a relatively closed economy from the 1930s until the 1960s. In Section III, I look at how growing economic internationalization has affected American monetary politics since 1970. Section IV discusses implications of the study, and is followed by a conclusion.

## I. MONETARY POLITICS IN CLOSED AND OPEN ECONOMIES

International goods and capital market integration have important effects on the economics and politics of monetary policy. These effects operate by

way of two channels, on the effectiveness of particular policy instruments, and on the preferences and preference intensities of economic agents. The clearest way to see this is to look at two polar cases, of very low and very high levels of economic integration.<sup>2</sup>

In a closed economy, monetary policy has its primary impact by way of the nominal price level. A monetary stimulus raises prices, thus reducing real interest rates and encouraging spending.<sup>3</sup> By this channel, monetary policy may be able to affect such broad aggregates as growth and unemployment. As monetary policy in such circumstances lowers the real value of nominal contracts, political divisions are expected between borrowers and savers. A few specific industries favor "loose money," especially housing construction and some consumer durables, which depend heavily on the real cost of consumer credit; the financial sector and creditors usually want tight money. As closed-economy monetary policy affects the nominal price level but not relative prices among goods and services, it has broad but diffuse economic and political effects.

For these reasons, it is reasonable to expect monetary politics in a closed economy to involve relatively broad-gauged political divisions. A few narrow groups may have intense concerns – the housing construction industry, the financial sector – but it is the broad mass of producers and consumers that is affected by general macroeconomic trends.

Conditions are different in an economy open on current and capital account. Financial integration constrains domestic interest rates to world levels, while commercial integration binds the price of tradable goods.<sup>4</sup> In such an economy, monetary policy has a direct effect on the exchange rate: monetary expansion drives the currency down, makes locally produced goods cheaper relative to imports, and lowers their international (foreign-currency) price. Of course, monetary policy can also affect the nominal price level and interest rates, which adjust in line with real or expected movements in the exchange rate. But for our purposes the important point is that monetary policy in an open economy is intimately connected to the value of the national currency.

While closed-economy monetary policy has few effects on relative prices other than those of nominally denominated contracts, open-economy monetary policy directly affects a wide range of relative prices, especially between tradable and nontradable goods and services. Industries concerned about import and export competition are typically more clearly defined groups than net nominal debtors and creditors, and the impact of a depreciation or appreciation on them is typically more direct than the changes in the overall nominal price level for debtors or creditors. This leads me to anticipate that monetary policy will be more politically salient when it affects the exchange rate, more contentious in an open than in a closed economy.

The first implication of this analysis is that economic integration increases the sociopolitical prominence of monetary policy. It does so by giving monetary policy a more direct impact on relative prices of relevance to well-defined groups of producers and consumers than in a closed economy. In an open economy, the politics of monetary policy tend to be organized around the concentrated distributional effects of exchange rate movements, and thus are likely to resemble interest group politics involving such things as tariffs (for which, after all, a real depreciation can be a substitute).

The second implication is that economic internationalization alters political divisions over monetary policy. In a closed economy, the principal conflict is between those on either side of nominal debt contracts, along with a few industries strongly affected by the ease of borrowing. In an open economy, monetary policy's inevitable effect on the exchange rate brings into play quite different socioeconomic groups.<sup>5</sup>

Groups disagree over the desired currency value. Tradables producers favor depreciation of the currency to raise the (domestic-currency) price of goods they export, and of foreign goods imported in competition with them. Nontradables producers favor an appreciated currency to raise the price of their products relative to tradable goods. This is a different sort of division than that expected in a closed economy: the tradables-nontradables (open economy) division is quite distinct from the debtor-creditor (closed economy) division.

In addition, an open economy faces a choice about whether to fix or float the currency, which is typically much less significant in a closed economy. On this dimension, those heavily committed to cross-border trade and payments stand to lose from currency volatility, and are more inclined toward a fixed rate. The more attractive international economic opportunities are, the greater the incentive for those who can take advantage of them to press for a stable currency. In this context, the higher the level of international trade and payments, the more economic actors with existing or potential global activities want exchange rate stability.

However, those who operate on domestic markets alone have little interest in increasing the predictability of currency values. This includes most producers of nontraded goods and services, as well as tradables producers who are domestic in orientation, such as import-competers. Indeed, for them the surrender of monetary autonomy required by fixing the exchange rate is an unmitigated sacrifice – a price whose volatility they do not care about is stabilized at the cost of the government giving up the ability to affect domestic monetary conditions.

Economic integration, then, alters political divisions over monetary policy. Closed-economy monetary policy largely involves broad macroeconomic aggregates; its politics typically divide nominal debtors and creditors.

Open-economy monetary policy largely involves the relationship between tradables and nontradables prices, and the predictability of the exchange rate; its politics divide tradables and nontradables producers, as well as domestically and internationally oriented groups.

Commercial openness has analogous effects on the monetary policy views of economic actors. It makes the fortunes of larger segments of society dependent upon international relative price movements. This leads to stronger demands to use currency policies to counteract adverse international price trends.

Tradables producers are especially sensitive to the exchange rate; as more goods become tradable, more producers are more concerned about currency values.<sup>6</sup> Even nontradables producers care more about exchange rates as trade expands, for the import component of their inputs rises. Increased trade intensifies the interest of producers in moving exchange rates in their favor: in a closed economy the exchange rate is a weak tool to affect relative prices, but in an open economy it can be powerful.<sup>7</sup>

It is necessary to qualify virtually all of these observations.<sup>8</sup> For current purposes my point is simply that economic internationalization has two general effects on the domestic politics of monetary policy. First, monetary policy shifts from having its principal impact by way of the nominal price level to primarily affecting the relative prices of tradables and nontradables, thereby implicating more concentrated and defined economic interests. This makes monetary politics more contentious in an open than in a closed economy.

Second, the distributional effects of monetary policy change in line with the greater importance of the exchange rate, which in turn affects the political lineup. Conflict ensues between supporters of a higher and lower exchange rate, especially tradables and nontradables producers. Those with an interest in a stable currency square off against those primarily oriented to the domestic market. Political divisions develop over the level of the exchange rate and the degree of exchange-rate stability.

A third implication can be drawn from this analysis. When monetary policy is associated with currency values, it has effects similar to trade policy. Depreciation is functionally equivalent to an increase in trade protection or export subsidies, while appreciation has effects similar to a trade barrier reduction or export tax. However, a simple rise or fall of the nominal price level has no systematic impact on the relative price of traded goods, and therefore is unrelated to trade policy. In an open economy, trade protection can be used to mitigate pressure for monetary expansion (depreciation) and vice versa, but this is not true in a closed economy.

In an open economy, then, monetary and trade policies are potential substitutes, but this is not the case in a closed economy. This fact may have important ramifications. Producers are more likely to be able to organize

for product-specific trade protection than for an economy-wide devaluation. However, it may be easier to organize a broad prodevaluation coalition than a protectionist logroll. Without exploring more detailed effects of this, I observe simply that in an open economy there is likely to be a strong connection between trade and monetary policies, while no such connection should be present in a closed economy.

A somewhat more speculative set of expectations has to do with how, in the American political setting, monetary politics find their institutional expression.<sup>9</sup> It is widely believed that members of Congress, with geographically defined electoral concerns, are especially susceptible to specific groups with relatively large numbers – such as labor unions or farmers. The executive with its national constituency, on the other hand, is especially focused on such issues of aggregate economic concern as growth and inflation. The reason commonly adduced is that members of Congress do not fully internalize the political benefits (or costs) of national policy, and have less incentive to worry about it than the President, who is held responsible (or credited) for national effects (Lohmann and O'Halloran 1994; for other treatments see, for example, McCubbins, Noll, and Weingast 1987; Weingast and Moran 1983).<sup>10</sup>

In a closed American economy, the diffuse concern of the broad electorate for national economic conditions gives the Executive branch the strongest incentive to attend to monetary policy. This should lead the President, with an eye to national electoral considerations, to play a more important part in formulating closed-economy monetary policy than Congress. Groups concerned with monetary policy, such as the housing and financial sectors, may focus on such agencies as the Federal Reserve System with particular responsibilities for money and finance. Monetary politics should involve primarily the Executive and the Fed in a closed economy, and we might best analyze it in terms of such aggregate political considerations as electoral cycles.

On the other hand, open-economy monetary policy draws well-defined producers into the political fray. This should lead Congress to want a major role in monetary policy, as large groups – manufacturing industries, farmers – are mobilized on the issue. Members of Congress from manufacturing or farming districts realize political benefits (or pay costs) for policies that affect relative prices crucial to their constituents. Economic openness should lead to more Congressional involvement in monetary policy.

These considerations can be brought to bear on the historical and contemporary American record. No detailed or rigorous evaluation of the argument is possible in this limited space, but I do find support for the plausibility of the approach. In what follows, I present two sets of such evidence. The first is a survey of the ebb and flow of American monetary politics from the 1860s through the 1960s, which covers periods of economic openness and closure. The second is a more detailed assessment of develop-

ments since 1970, undertaken in part because of the naturally greater interest in the implications of my argument for contemporary trends. In this second discussion, I evaluate the degree to which gradually increasing economic openness has been associated with the effects I anticipate.

The United States in the last century has in fact gone through three phases. From the Civil War through the early 1930s it was a relatively open economy. Between the 1930s and the 1960s it was a relatively closed economy, while since about 1970 the U.S. economy has become increasingly open to goods and capital movements. I expect these shifts to be accompanied by changes in the political prominence, political cleavages, and Congressional activity associated with the making of monetary policy in the United States.

## II. MONETARY POLITICS IN OPEN AND CLOSED ECONOMIES, 1870-1970

From the 1860s until World War One, and again in the 1920s, international trade and investment were at extremely high levels. Between the 1930s and the late 1960s, however, the U.S. economy was relatively closed on current and capital account. The reflection of this in the United States was simple: between the Civil War and the 1930s, the U.S. economy was closely integrated with the rest of the world, while in the later period the United States was quite closed to international trade and payments.<sup>11</sup>

Table 1 presents some data meant only to be indicative, for measuring capital and goods market integration is difficult.<sup>12</sup> However, trade flows and investment stocks as shares of Gross National Product (GNP) are reasonable measures for a preliminary assessment. The former show a dramatic drop from the 11 to 15 percent range between 1869 and 1929, to six or seven percent through the 1960s. The latter drop from the 24 to 28 percent range in the first period to 13 to 15 percent in the second. In both instances, trade flows and cross-border investment stocks from the 1930s to the 1960s are about half of what they were from the Civil War to the Depression. It might also be noted that both trade and investment figures have risen continually from 1970 to the present, to well above pre-1930 levels. Of course, aggregate figures mask very important details. This is especially true as regards the concentration of American exports in primary products in the early period: in the 1880s a fifth of the country's farm output was exported, and in 1879 exports were 30 percent of American wheat and 60 percent of cotton production.

The analytical discussion above has four implications for the differences between monetary politics in these two periods, one with a generally open world and U.S. economy, one in which both were far more closed. First, in an open economy monetary policy should be closely related to the ex-

Table 1. *Indicators of the openness of the U.S. economy, 1869–1992*

A. Merchandise trade as a share of Gross National Product <sup>a</sup>			
Period	Total trade, annual average Billion dollars	GNP, annual average Billion dollars	Trade/GNP in percent
1869–78	\$1.1	\$7.4	15.3%
1879–88	1.5	11.2	13.6%
1889–1900	1.9	14.4	13.1%
1901–13	3.3	29.5	11.1%
1920–9	10.7	88.6	12.0%
1930–9	5.0	76.5	6.5%
1946–59	23.9	345.1	6.9%
1960–9	48.8	683.0	7.1%
1970–9	205.2	1632.9	12.6%
1980–92	664.8	4355.6	15.3%

B. Cross-border investment stock as a share of Gross National Product <sup>b</sup>				
Year	(A)	(B)	(C)	(D)
	Foreign private assets in US, Billion dollars	US assets abroad, Billion dollars	GNP, Billion dollars	(A+B)/C, percent
1869	\$1.5	\$0.1	\$6.6	24.2%
1897	3.4	0.7	14.6	28.1%
1914 <sup>c</sup>	7.2	3.5	38.6	27.7%
1930	8.4	17.2	90.4	28.3%
1950	19.5	19.0	284.8	13.5%
1960	28.9	49.3	506.5	15.4%
1970	80.7	118.8	992.7	20.1%
1980	309.4	516.6	2633.1	31.4%
1992 <sup>d</sup>	1380.7	1105.4	6045.8	41.1%

<sup>a</sup> = Total trade is equal to merchandise exports plus merchandise imports.

<sup>b</sup> = Includes only private assets, both short- and long-term.

<sup>c</sup> = Cross-border assets figures for 1914 are as of June 30, before the outbreak of World War One.

<sup>d</sup> = Based on the valuation of foreign direct investment at current cost. Valuation at market value would increase U.S. assets abroad by \$110.0 billion and foreign assets in the United States by \$200.1 billion, for a total of 5.1 percent of GNP. Excludes cross-border assets and liabilities of US banks not included elsewhere, which are largely intra-firm transfers that tend to cancel each other out. These are \$666.9 billion and \$700.7, respectively, for a total of 22.6 percent of GNP.

Sources: *Historical Statistics of the United States, Colonial Times to 1970* (Washington: Government Printing Office, 1974): 224, 565, and 864–5. *Economic Report of the President*, various issues.

change rate, implicate clearly defined interests, and achieve political prominence. In a closed economy, on the other hand, monetary policy should be of interest primarily to broad macroeconomic aggregates, and clear distributional divisions should be uncommon.

Second, when world trade and investment are very large and the economy open, political divisions should be very different than in the closed-economy period. In the open economy I expect tradables producers to be especially desirous of a weak (depreciated) currency, nontradables producers of a strong (appreciated) currency; internationally oriented economic actors should be especially concerned to ensure currency stability, domestically oriented actors indifferent or opposed. In the closed economy, to the extent that political differences are clear they should be between net debtors and net creditors.

Third, there should be a strong connection between monetary and trade politics in an open economy, but not in a closed economy. Fourth, in an open U.S. economy the making of monetary policy should be of great concern to Congress, as it implicates the interests of well-defined groups of electoral importance. Closed-economy monetary policy should evince much less congressional interest. Unfortunately, simple measures to assess these contentions are not readily available. In what follows, I briefly present the historical record to indicate that the evidence does seem to bear out these expectations. I should note that this historical narrative contains little that is particularly novel or controversial; what is new is my attempt to understand it in a broader analytical context.

Monetary politics between 1865 and the early 1930s was always salient, but erupted with special vehemence in three periods: Greenback populism (1865–79), silver populism (1888–96), and price stability (1920–35).<sup>13</sup> The first episode stemmed from the fact that the dollar was taken off gold in 1862 amidst wartime inflation (the standard history is Unger 1964). After the Civil War “hard money” advocates wanted to go back to gold at the prewar parity, which implied a substantial real appreciation. Their principal base was in the international financial and commercial communities. Wall Street was heavily oriented toward marketing American securities in Europe, and this business depended on the reliability of the dollar. American international bankers and traders believed, probably correctly, that their international business would suffer unless the United States was on gold. The attempt to get back onto gold did indeed cause a major real appreciation: as indicated in Table 2, tradables prices dropped much more rapidly than nontradables prices.

Supporters of “soft money” wanted to stay on the depreciated paper currency (greenbacks) introduced during the war. The strongest original proponents of greenbacks were iron and steel manufacturers, who regarded a depreciated dollar as a complement to the tariffs they desired.

Table 2. *Relative price indices, 1869–1894 (1869=100, 1879=100)*

Product	1869	1879 / 1879	1894
<i>Traded goods</i>			
Agriculture	100	68 / 100	81
Manufacturing	100	66 / 100	66
Mining	100	56 / 100	75
<i>Nontraded goods and services</i>			
Construction	100	75 / 100	116

Sources: Calculated from Robert Gallman, "Commodity Output, 1839–1899." In *Trends in the American Economy in the Nineteenth Century*, Studies in Income and Wealth vol. 24 (Princeton: Princeton University Press, 1960): 13–43. Gallman's Variant A is used for construction.

Along with them were the railroad industry and associated nontradables producers, who had come to value the reflationary policies a floating currency allowed.

After 1873 international price movements brought two more important groups into the Greenback camp. In that year, prices of both silver and many agricultural products began to drop rapidly. Silver prices were driven down as European countries went onto a monometallic gold standard and sold off their silver stocks, and as rich new silver deposits were discovered. Grain prices declined largely as falling transport prices made possible the opening of the Great Plains, the pampas, and other areas.

Farmers swung over to the movement, recognizing that a depreciated currency meant higher dollar prices for their crops. Silver miners similarly joined as silver prices plummeted. The silver connection is complicated. Over the course of the 1870s, the Greenback movement modified its position to favor the free coinage of silver at a 16:1 ratio against gold. This would have kept the country off gold and on a depreciated silver standard. The economic implications were similar to those of a depreciated paper currency, except for the direct subsidy to silver producers (the government would have been obligated to purchase silver at well above the market rate). The tactical result of the turn from Greenbacks to silver was to ensure the support of silver miners, who had great influence in the sparsely populated Rocky Mountain West and thereby controlled many Senate seats.

Congress was favorable to Greenback and silver ideas, and the return to gold was only effected by President Ulysses Grant manipulating a lame-duck Congress in January 1875. The Resumption Act so passed was repealed by Congress repeatedly after that, but the two-thirds majority to

override the presidential veto was not forthcoming. The country returned to gold on January 1, 1879.

Antigold sentiment grew again as world farm prices headed down in the late 1880s, and accelerated with the agricultural depression that began in 1888 (see Table 2). Farmers were well aware that reflation and devaluation under the silverite banner would raise agricultural prices. The silver miners, for obvious reasons, continued to support silver monetization. The Populists thus called for a paper money-silver standard, with a depreciated dollar fluctuating against gold (Hicks 1931 remains an excellent general survey).

Northeastern commercial and financial interests remained at the core of the hard-money camp. The bankers' position had, if anything, hardened. Not only had international trade and investment grown dramatically since the 1870s, Wall Street now hoped to become a leading international financial center, for which ironclad commitment to gold was a prerequisite. Manufacturers were less committed to soft money than they had been in the 1870s, for three reasons. First, declining prices of manufactured products were more than compensated by rapid productivity increases, so that few manufacturers felt substantially disadvantaged by the real appreciation. Second, by the 1890s some of American industry had become internationally oriented: manufactured exports had expanded and foreign direct investment was increasing (Lake 1988: 91–118 provides a survey of American trade policy in this period). Third and probably most important, import-competing manufacturers had been able to secure high tariffs. Trade protection accomplished much of what silver would have, and had (unlike silver) been obtained.

After nearly a decade of agitation, the issue came to a head in the 1896 presidential election, which was fought largely over the gold standard. Democrats and Populists jointly fielded William Jennings Bryan, who ran against the "cross of gold" upon which, Bryan thundered, the country was being crucified. The Republicans, in response, cobbled together a hard money-high tariff coalition. Presidential candidate William McKinley had impeccable protectionist credentials, having designed the tariff of 1890; despite long-standing support for silver, he switched to gold in 1896. The McKinley coalition of hard-money international trading and financial interests and high-tariff manufacturers narrowly defeated Bryan's farmer-miner coalition.

The third episode stretched from soon after the end of World War One until the middle 1930s.<sup>14</sup> Although the war had interrupted international trade and finance, these revived very rapidly after 1922. However, farm prices fell dramatically right after the war and remained depressed; between 1919 and 1928 they declined nearly twice as much as building materials, a typical nontradable (see Table 3). Internationally oriented firms re-

Table 3. *Representative relative price indices, 1919–1933 (1919=100, 1928=100)*

Product category	1919	1928 / 1928	1933
<i>Traded goods</i>			
Farm products	100	67 / 100	51
Metal products	100	75 / 100	83
<i>Nontraded goods and services</i>			
Building materials	100	82 / 100	82

Source: Calculated from George Warren and Frank Pearson, *Gold and Prices* (New York: John Wiley and Sons, 1935): 30–2.

mained adamant about the importance of currency stability, while farmers were concerned to engineer a devaluation. Farmers and many manufacturers indeed pressed for “price stability,” government policy to reverse post-war price trends. They blamed much of the relative decline of tradables prices on the new Federal Reserve’s commitment to gold. As before, support for gold came from international financial, commercial, and industrial interests, the core of the “internationalist” foreign policy bloc for whom the global role of the dollar was important. Once again, many manufacturers were indifferent, as they were largely shielded from import competition by high tariffs.

These debates involved both the content of monetary policy and the structure of the Federal Reserve. Hard-money supporters wanted to leave monetary policy in the hands of the New York Fed. Soft-money advocates wanted policy set by the Board in Washington, and wanted the Board to be controlled by Congress. Dozens of bills were introduced to force more reflationary monetary policy, devaluation, and Congressional control of the Fed. All of the bills were blocked by the Executive and the Senate, which was dominated by financial conservative Carter Glass of the Senate Banking and Commerce Committee.

Conflict over monetary policy increased during the Depression.<sup>15</sup> The hardest-hit victims of price trends in the early Depression were producers of traded goods and especially farmers (see Table 3). Between 1929 and 1933, as GNP fell 46 percent in nominal terms, output of durable goods fell 67 percent and that of farm products 53 percent; services output fell 28 percent. Meanwhile, the Fed was torn between domestic and international demands. Defense of the dollar exacerbated the domestic downturn, and provoked domestic protests.<sup>16</sup>

Congress made repeated attempts to force reflation and devaluation, but the Republican White House and Senate blocked these attempts

(Batchelder and Glasner 1992; Crawford 1940: 14ff.) Crawford and Glasner (1992). As the Depression dragged on and the world economy spiralled downward, sympathy for devaluation grew, especially after the British went off gold in 1931. Even many paragons of gold-standard orthodoxy came to regard easier money as temporarily necessary.<sup>17</sup> In the 1932 elections, in addition, the Democrats took control of the Senate and the presidency. In April 1933 the Roosevelt administration took the dollar off gold and, from October 1933 to January 1934, reduced the gold value of the dollar, depreciating it 44 percent from its March 1933 level against the pound.<sup>18</sup>

For over thirty years after the mid-1930s, the world economy was relatively weakly integrated, and the United States was largely closed to world trade and payments. Monetary politics in this period was quite subdued, especially relative to the roaring debates of the decades before 1935. The exchange rate was rarely called into question, and there was little political conflict over monetary issues. There is some evidence for the impact of broad national (especially presidential) electoral considerations on monetary policy. Although this is a hotly debated topic, many analysts believe that such factors as the approach of a national election affected monetary policy (examples include Alesina and Sachs 1988, Beck 1991, and Grier 1987).

While objective measures of the phenomenon are hard to imagine, few observers would question the assertion that monetary policy from the 1930s through the late 1960s was far less politically pronounced than it had been in the previous seventy years. Nor was there any clear connection between national trade policy and monetary policy in this period.

In addition to this reduction in the political prominence of monetary policy, there were important developments in the locus of monetary decision making. After 1930 monetary and exchange rate policies increasingly shifted away from Congress and toward the Federal Reserve and the Treasury, respectively.

This pattern of relative Congressional passivity began during the New Deal (Crawford 1940, Green 1981). The Banking Acts of 1933 and 1935 reorganized the Federal Reserve to increase the authority of the Board in Washington and expand the influence of the Executive on the Board. The Gold Reserve Act of 1934 vested control of the exchange rate in the Secretary of the Treasury.<sup>19</sup> This reassignment and division of monetary policy was deepened with the 1951 Treasury Accord, which gave the Federal Reserve formal authority to engage in monetary policy without regard for the Treasury's borrowing costs (Eichengreen 1985:66–81; for background, Kettl and Garber 1991). And in 1961, at the time of the creation of bilateral "swap" arrangements among major economic powers, the Treasury and the Fed agreed that the Fed would operate in currency markets with its own funds. This removed currency policy even further from the legislative arena.<sup>20</sup>

From the 1930s until the early 1970s, American monetary and exchange rate policy evolved in relative isolation from Congressional scrutiny. Exactly how and why this came to pass and endure are important questions which exceed the scope of this paper. Nor should the fact of delegation be taken to imply necessarily that Congress does not influence policy (McCubbins, Noll, and Weingast 1987). However, for whatever reasons and in whatever ways, Congressional activism on monetary policy declined substantially after 1930.<sup>21</sup>

This overview tends to bear out my expectations. When international economic activity was extremely important to the United States and the U.S. economy was quite open, monetary policy was closely related to exchange rate issues (the gold standard), pitted tradables against nontradables producers and internationally against domestically oriented sectors, was a focus of congressional attention, and was linked to trade policy. In the relatively closed American economy between the 1930s and the late 1960s, the politics of monetary policy in the United States looked very different indeed. There was no connection drawn between macroeconomic conditions and the exchange rate – no assault on the gold barricades. There was little attention to the issue by major interest groups – no return to the crackling politics of the 1890s or the 1920s. Congress paid little mind to the monetary arena, and trade and monetary policy evolved on separate tracks. I believe that the small scale of international economic activity, and the concomitant relative closure of the U.S. economy, go a long way toward explaining this trend.

If my argument is correct, changes in the world economy and America's position in it after the late 1960s should have altered the politics of monetary policy. It is to an evaluation of this expectation that I now turn.

### III. MONETARY POLITICS IN AN INCREASINGLY OPEN ECONOMY, 1969 TO THE PRESENT

World trade and payments have grown at an extraordinary pace since the 1960s, and with them American integration into the world economy. The figures in Table 1 indicate that both trade and investment flows have grown at an extremely rapid rate since 1970; these measures now indicate an American economy at least as open as that of the late nineteenth century.

My argument implies that these changes should be leading to patterns of monetary politics similar to those observed before 1935. More Americans are interested in international economic activities, thus concerned about currency stability; and more Americans are exposed to adverse international price trends, thus prone to demand devaluation. I expect an increasing link between monetary policy and the exchange rate; greater interest group activity on the topic; more congressional interest in the issue; and ties between monetary and trade policy. In this section, I argue that there

are many indications of a trend in this direction. The fact that economic internationalization has been growing gradually since the late 1960s means that I expect at most incremental change, and again it is hard to provide systematic evidence to this effect. However, I believe that such a trend is observable. Its operation can be seen, to differing degrees and in different ways, in the 1969–73 period during which the dollar went off gold, the late 1970s dollar depreciation, and the early and mid-1980s dollar appreciation. Without claiming that the following survey proves my point, I submit that it suggests that such changes in the politics of monetary policy are under way.

### *Devaluation and the end of Bretton Woods, 1969–1973*

Over the course of the late 1960s, the dollar appreciated in real terms against the currencies of its principal trading partners.<sup>22</sup> This had its biggest impact on American import-competers: between 1967 and 1970 nontradables prices increased more than twice as rapidly as tradables prices, putting substantial price pressure on tradables producers (see Table 4).<sup>23</sup> Between 1967 and 1971 merchandise exports rose 24 percent in real terms, while merchandise imports rose 47 percent and durable goods imports 55 percent. The automotive trade balance, strongly positive throughout the postwar era, turned negative in 1968 and by 1971 it was \$2.9 billion in deficit; total merchandise trade went into deficit in 1971 (*Economic Report of the President*, various issues).

Many American industries were concerned about the price pressure they faced as imports surged. Some argued that monetary policy was too tight and that the currencies of America's trading partners (especially Germany and Japan) were undervalued. However, most private-sector attention focused on trade policy. Manufacturers in such affected sectors as textiles, footwear, and steel, clamored for protection from imports. The AFL-CIO switched from general support for trade liberalization to pressure for trade protection, and protectionist political activity reached its highest point since World War Two.

The country's internationally oriented banks and corporations generally supported stable exchange rates, but there were two confounding realities. First, defending the dollar almost certainly meant maintaining capital controls, which international firms opposed.<sup>24</sup> Second, the real appreciation was exacerbating protectionist sentiment, which was worrisome to firms with important overseas activities. Global firms had strong reasons to counter growing protectionist pressures, and indeed more than sixty leading American corporations formed the Emergency Committee for American Trade (ECAT) to lobby against trade protection.<sup>25</sup>

As the dollar came under increasing attack, many free traders began to

Table 4. *Representative relative price indices, 1967–1973 (1967=100, 1970=100)*

Product category	1967	1970 / 1970	1973
<i>Traded goods</i>			
Industrial commodities	100	110 / 100	115
Finished goods	100	110 / 100	116
Motor vehicles	100	109 / 100	109
Farm products	100	111 / 100	143
<i>Nontraded goods and services</i>			
Shelter	100	124 / 100	114
All services	100	122 / 100	114
Public transportation	100	129 / 100	112
Medical care services	100	124 / 100	116

Source: *Economic Report of the President*, various issues. Constructed from producers' and consumers' price indices for the goods and services in question.

see a dollar devaluation as the lesser of two evils: better a depreciated dollar than either trade protection or capital controls, or both. As Peter Peterson, a Wall Street fixture who served as Commerce Secretary during the first Nixon administration, put it a couple of years after the events, "It was my view then that had we not taken that very vigorous action on the dollar, it was the sure road to protectionism" (Peterson 1973: 40).

The electoral cycle also exerted an influence. President Richard Nixon had, in his view, lost the 1960 presidential election due to tight monetary policy, and wanted to avoid a repeat of this experience. In the troubled conditions of 1970 and 1971, he was concerned to ensure recovery before the 1972 presidential election. Nixon may have come to regard the fixed-rate system (and the value of the dollar within it) as an impediment to his electoral aspirations. The commitment to gold appeared to restrict economic policy autonomy in the runup to an important election (Gowa 1983; Woolley 1984: 154–80; 1995).

As the dollar appreciated in real terms, there was some legislative pressure for easier money and for action on the exchange rate. In June 1971, Henry Reuss of the Congressional Subcommittee on International Exchange and Payments proposed legislation to float the dollar, and on August 6 a Subcommittee report called for devaluation – which may have helped push the Administration toward the eventual August 15 devaluation.

Although Congress appeared to want easier money and devaluation, it was certainly not as active in monetary politics in the early 1970s as it had been before 1935. Its most important role in foreign economic policy was in

threatening protectionist legislation. In 1970 the protectionist "Mills Bill" was voted out of the House Ways and Means Committee, but did not pass the Senate. In 1971 Congressional action centered on the Foreign Trade and Investment Act, better known as the Burke–Hartke bill. This represented the most serious challenge to liberal American trade policy since the Depression. Although Burke–Hartke failed of passage, the battle over it revealed the depth and breadth of protectionist sentiment.

The early 1970s saw a general increase in Congressional monetary activism. After becoming chair of the House Banking Committee in 1975, Henry Reuss led attempts to reduce Fed independence. In March 1975 Congress passed House Concurrent Resolution 133 demanding more Fed reporting to Congress; in November 1977 the Federal Reserve Act was amended along these lines. This reflected the highest level of Congressional involvement in monetary policy since the mid-1930s.<sup>26</sup>

Eventually the Nixon administration devalued the dollar, defused most protectionist pressure, and removed capital controls. Over the course of 1970, the Administration took an increasingly aggressive stand against import competition, especially from the Japanese and the Germans. On August 15, 1971, President Nixon took the dollar off gold, as part of a package that included domestic wage and price controls and a ten percent surcharge on imports. By December 1971, the principal monetary powers had negotiated a revision of exchange rates that included an 8 percent dollar devaluation. In February 1973 Nixon devalued the dollar a further ten percent, as the Bretton Woods system collapsed definitively. As Table 4 shows, the dollar devaluations reversed adverse relative price trends for tradables producers: tradables prices rose at roughly the same pace as nontradables from 1970 to 1973.

The pattern revealed here is consonant with conditions midway between the polar open- and closed-economy circumstances central to my argument. On the one hand, many of the debates over monetary policy were tied to the value and fixing of the dollar, and much of the interest-group lineup was as expected. On the other hand, international monetary policy was largely subordinate to other issues. Import competing manufacturers focused more on trade policy than on the dollar; internationalist groups emphasized opposing protection and getting capital controls removed. While Congress was more active on monetary policy than it had been for over thirty years, it devoted most of its energy to trade policy. And broad electoral considerations were important to the policy outcomes. All in all, this case sits somewhere between the general disregard of exchange rates between 1935 and 1970, on the one hand, and the strong and explicit attention paid to exchange rates before 1935, on the other. This is perhaps not surprising, as the level of economic integration was substantially lower than it had been in earlier periods – or was to become.

*Dollar depreciation and defense, 1977–1979*

Jimmy Carter became president at a time of increasing vulnerability of American industry to imports. Given the influence of the labor movement in the Democratic Party of the 1970s, and organized labor's concentration in import-competing industries, it is not surprising that the Carter Administration oversaw a depreciation of the dollar. In this episode explicit links were drawn between domestic monetary conditions and the value of the dollar. Inasmuch as the dollar depreciation satisfied those groups most heavily represented in Congress, especially tradables producers, there was little need for Congressional activity on the topic. What political pressure was brought to bear on monetary policy largely came from internationally-oriented businesses wary of the administration's willingness to let the dollar drop on the foreign exchanges.

Almost immediately after taking office, the Carter Administration undertook to ease monetary policy. Policy was motivated by two interconnected goals: first, to stimulate the German, Japanese, and American economies to expand simultaneously (the "locomotive" approach), and second, to encourage a revaluation of the mark and the yen relative to the dollar. On the first front, the Administration pushed with limited success for coordinated reflation in the "trilateral" economies. On the second front, the administration engineered a depreciation in order both to help American tradables producers and to stimulate the economy more generally.

Through Carter's first year in office, Nixon appointee Arthur Burns was still Chairman of the Fed Board, but Treasury Secretary Michael Blumenthal was outspoken in expressing Administration opinion. The result was a depreciation of the dollar by 4 percent in real terms between the election and August 1977.<sup>27</sup> On world financial markets, the Administration was viewed as "talking down" the dollar – also labeled "malign neglect" or "open mouth operations."<sup>28</sup>

In October 1977 the dollar began to fall rapidly, and by January 1978 it had dropped by a further 10 percent against the mark and yen. The fall was not eased by the appointment of G. William Miller to succeed Burns in December 1977 – indeed, announcement of his nomination led the mark and the Swiss franc to rise two percent against the dollar in one day.

The dollar depreciation appeared in line with Congressional desires. In the late Ford Administration, Henry Reuss had called for a depreciation against the yen, and the Carter team in fact brought this about. The dollar's slide was, however, cause for concern on world financial markets and among internationally oriented American businesses. Representatives of the financial community especially argued against a weak dollar; cautionary notes were also sounded by the President of the Federal Reserve Board of New York, although Paul Volcker appeared to have little influence on

Fed policy. The dollar depreciation seemed to have the support of Congress and the Executive, especially as the currency stabilized over the summer of 1978.

Eventually the dollar began to drop again. A new anti-inflation package did little to slow the fall, and by now the Administration was under intense pressure from the international business community, and from other major OECD nations, to support the dollar. On November 1 Carter announced a dollar defense package that included tighter monetary policy and \$30 billion to bolster the currency on the foreign exchanges, with only modest effect. In July 1979 Carter replaced Miller with Paul Volcker, which presaged more stringent monetary policy and an aggressive defense of the dollar.

This episode is not easy to analyze, for the politics of American monetary and exchange rate policy in the Carter Administration have never been thoroughly investigated. A few broad tendencies present themselves, however. Price trends in the late 1970s can be observed in Table 5. As the dollar depreciated, tradables producers did relatively well. Tradables prices indeed rose roughly in tandem with nontradables prices in the period. Some tradables sectors, notably autos and agriculture, faced difficulties – and indeed clamored for and obtained support in the early 1980s. However, between 1976 and 1980, relative prices of tradables moved quite favorably. By one reckoning the dollar depreciated 12 percent between the first quarter of 1977 and the second quarter of 1980, so that U.S. import prices rose by 9 percent more than the U.S. GNP deflator.<sup>29</sup> The rise in the relative price of imports had a positive impact on tradables producers, and manufacturing especially expanded. In fact, 1979 represents the high point of industrial employment in the United States.

In this context, soft-money interest groups represented in Congress had little reason to complain. As the Administration managed a dollar decline, especially relative to the yen, tradables producers faced favorable conditions. Trade policy disputes moderated, although a few sectors (notably steel) continued to lobby for protection. The major political pressure on the Administration's policies came from American international banks and corporations uneasy about or opposed to currency volatility. These were reinforced by assaults on the dollar on international currency markets, and by insistence from European and Japanese governments that the U.S. support the dollar.

The Carter experience diverges somewhat from traditional patterns, inasmuch as for a time the Executive pursued policies desired by soft-money interests. However, interest-group alignments tend to track my expectations. Tradables producers were pleased with the dollar depreciation, while internationally oriented firms – especially the international financial community – protested the dollar's decline. Tradables producers

Table 5. *Representative relative price indices, 1976–1985 (1976=100, 1980=100)*

Product	1976	1980 / 1980	1985
<i>Traded goods</i>			
Industrial commodities	100	152 / 100	118
Finished goods	100	145 / 100	119
Motor vehicles <sup>a</sup>	100	135 / 100	128
Farm products	100	130 / 100	92
<i>Nontraded goods and services</i>			
Shelter	100	156 / 100	136
All services	100	149 / 100	141
Public transportation	100	145 / 100	160
Medical care services	100	145 / 100	151

<sup>a</sup> Motor vehicles price trends in the early 1980s were distorted by the imposition of "voluntary" restraints on imports. Presumably, in the absence of these trade barriers motor vehicle prices would have risen more slowly.

Source: *Economic Report of the President*, various issues. Constructed from producers' and consumers' price indices for the goods and services in question.

got what they wanted, which explains their relative silence. Hard-money interests lobbied the Fed and the Administration but were unsuccessful until 1979. At the same time, broad popular concern with inflation was growing, and this may also have contributed to the shift in Administration policy.

#### *Dollar appreciation, 1981–1985*

The dollar rose continually from late 1980 through the middle of 1985. This appreciation had two sources. The first was the Federal Reserve's restrictive monetary policies initiated after the appointment of Paul Volcker as Fed chairman in July 1979, and tightened continually through the early 1980s. The second was the federal budget deficits caused largely by the Reagan Administration's tax reductions and increases in military spending. Both policies tended to raise interest rates in the United States, draw funds toward the dollar and boost the value of the American currency. Although figures vary according to how they are calculated, one series shows a real appreciation of the dollar of 64 percent between the inauguration of Ronald Reagan in January 1981 and its peak in March 1985, after which it declined 12 percent to September 1985, when the major financial powers agreed to coordinate attempts to bring down the dollar.<sup>30</sup>

Relative prices in the United States reflected the dollar appreciation, as

tradables prices fell relative to nontradables (see Table 5). The index of finished goods prices rose 19 percent between 1980 and 1985, while the index of all services prices rose more than twice as much, by 41 percent. Specific goods and services show some variation, of course. With import quotas imposed, automobile prices rose more rapidly than other tradables, while farm prices actually dropped by 8 percent; public transportation and medical care prices rose even more rapidly than other nontradables.

Producers of tradable goods came under severe price pressure as the dollar appreciated. By one measure, between the second quarter of 1980 and the first quarter of 1985 U.S. import prices *dropped* by 29 percent relative to the American GNP deflator (Federal Reserve Bank of St. Louis 1986: 1). As a result manufactured imports went from 20 to 32 percent of total manufactured output, while manufactured exports dropped from 26 to 18 percent of output; manufacturing trade went from a surplus equal to 6 percent of output in 1980 to a deficit equal to 14 percent of output in 1985. During these years the American trade deficit went from \$12 billion to \$136 billion in 1982 dollars. Heightened foreign competition contributed to a 5 percent drop in tradables employment between 1980 and August 1985, at a time when nontradables employment grew 13 percent (Frankel 1985: 31).

Many of my analytical expectations were borne out in this period. American monetary and exchange-rate policy were linked in both markets and politics. Interest group activity on the dollar was fiercer than at any time since the 1930s, and found its outlet through major Congressional initiatives on the exchange rate. And trade policy was almost immediately drawn into the monetary and exchange-rate debate.<sup>31</sup>

As the dollar rose, American tradables producers demanded relief from the decline in the relative price of their products. Not only were American goods being priced out of third markets, they were losing major market share at home. The charge against the strong dollar was led by Lee Morgan, president of Caterpillar Tractors, beginning in late 1982. Calling the strong dollar "the single most important trade issue facing the U.S." (Destler and Henning 1989: 33), Morgan mobilized American industry around bringing the currency down. Agitation to weaken the dollar grew as the currency rose: in the middle of 1983 the Business Roundtable supported Morgan, and the National Association of Manufacturers followed suit in February 1984. By 1985 even those who had previously supported the Administration had become hostile or neutral (*ibid*: 35-7).

Congress was deeply involved at every step of the way. Indeed, congressional activism on monetary policy reached a high point in the early 1980s. Between 1979 and 1985, an annual average of 65 bills, resolutions, and proposals concerning monetary policy were introduced into Congress; after the dollar declined, between 1986 and 1989, the number went down to ten a year (Akhtar and Howe 1991: A-22). Perhaps the most striking instance

was congressional debate over a 1983 Administration bill to increase the American quota in the International Monetary Fund, generally a pro forma procedure agreed upon by all member states. The IMF quota bill took on the character of a referendum on the Administration's international monetary policies, whose unpopularity very nearly led to the bill's failure.

Soon after, Republican Senator Charles Percy of Illinois, a major manufacturing state and Caterpillar's home base, introduced a resolution calling on the Administration to negotiate a coordinated reduction in the value of the dollar; the resolution passed the Senate unanimously. The Reagan Administration was unresponsive, and in May 1985 the Senate passed another resolution calling for any measures necessary, including unilateral exchange market intervention, to depreciate the dollar. By late 1985, there were seven bills before Congress that included specific reference to exchange rate issues (Destler and Henning 1989: 107–10).

Tradables producers frustrated by their apparent inability to affect exchange-rate policy soon turned their attention to trade policy. The connection was clearly perceived and widely remarked upon, as by Republican Senator John Danforth: "No trade agreements, however sound, no trade laws, however enforced, will give Americans a fair chance to compete in the international marketplace if an overvalued dollar has the same effect as a 25–50 percent [foreign] tariff" (ibid: 104).

Although a dollar depreciation would have had the desired effect, it seemed that no amount of private and Congressional pressure would induce Paul Volcker to loosen Fed policy, or the Reagan Administration to raise taxes and reduce spending, or the monetary authorities to intervene to drive the dollar down.<sup>32</sup> Congress could affect trade policy more directly, however, and import-competing manufacturers turned their attention to this arena. A flurry of trade bills was introduced, leading up to major protectionist legislation sponsored in 1985 by Democrats Lloyd Bentsen in the Senate, and Dan Rostenkowski and Richard Gephardt in the House. Affected manufacturers also used administrative means to obtain relief from import competition. They filed an unprecedented number of complaints with the International Trade Commission: antidumping cases, for example, rose from an annual average of 24 between 1977 and 1981, to an annual average of 61 between 1982 and 1984 (Deardorff and Stern 1987: 26, 23).

Internationally oriented sectors in the United States were threatened by the growth of American economic nationalism. Large segments of the American economy were increasingly tied into the world economy. As in the last years of Bretton Woods, American international banks and corporations were unconcerned by the strong dollar – and may have appreciated its impact on their businesses (Destler and Henning 1989: 131–6). But

support for (or indifference to) the dollar appreciation was tempered by the realization that it was inflaming protectionist sentiment in the United States.

The preferred way to moderate the dollar's rise, in the view of the international business community, was to reduce the fiscal deficit. Looser monetary policy or exchange-market intervention raised the specter of a Carter-style dollar depreciation. The budget deficits, on the other hand, were not beneficial to global businesses and indeed came close to implying future monetary laxness. Better to increase taxes and reduce spending than to risk future inflation. Led by Peter Peterson, major internationally oriented corporate leaders began in early 1983 to lobby for a reduction in the budget deficit. This "Bipartisan Appeal" was signed by five former Treasury secretaries, along with representatives of the country's most important financial institutions and multinational firms.<sup>33</sup> Import-competing industries were conspicuously underrepresented. Although the effort did not meet with striking success, it is possible that its very visible nature contributed to legislative and executive attempts to control the deficit.

Nonetheless, the dollar remained strong through 1984 and into 1985, while pressure for policies to protect American tradables producers became increasingly intense. In a major shift, in early 1985 the Administration began to indicate that it regarded the dollar as "too strong." In January 1985 the Group of Five made some mild statements that were taken to imply general agreement on the desirability of a dollar depreciation. Whether in response to these changes in policy or to economic fundamentals, the American currency began declining in March 1985. By August it had gone down about 10 percent, but began moving upward again in the late summer. Finally, in September 1985, meeting at the Plaza Hotel in New York, the Group of Five finance ministers announced that they would undertake coordinated intervention to reduce the value of the dollar. Over the succeeding twelve months the dollar fell by over 20 percent, and by the end of 1987 it was back near the levels of 1980.

In this period, many developments were in line with my analytical expectations. The link between domestic macroeconomic policy and the exchange rate was drawn by all involved in the debate, and the topic was extremely visible. Both interest group and Congressional activity on monetary and exchange rate issues were more significant than at any time since the 1930s. Clear links were drawn to trade policy.

After the spectacular appreciation and depreciation of the early and middle 1980s, the dollar's movements were much less dramatic. Since 1987, the American currency has been relatively stable, and relatively weak. From 1987 to 1993, the dollar declined by 3.8 percent against a trade-weighted index (and by just 1.1 percent in real terms). Against the country's principal sources of import competition, the currency declined much

more substantially: by 23.2 percent against the yen and by 8 percent against the Deutsche Mark (*Economic Report of the President*, various issues). It seems likely that the general weakness of the dollar gave tradables producers little to complain about, while its general stability gave those worried about currency volatility little cause for concern. Whatever the reason, political attention to exchange rates in the United States clearly subsided after 1987.

It would be a great exaggeration to argue that American monetary politics has come to look anything like what it did in the 1890s. However, the experiences of the 1980s do appear to diverge substantially from the subdued and diffuse discussions of monetary policy that prevailed between the 1930s and the 1960s; in the early and middle part of the decade, especially, there seemed some similarities to patterns of the era before 1935. This is not to insist on the repetition of history, only on recurrence of certain underlying economic conditions of potential political importance.

Complementary evidence is available concerning the economic developments I associate with my political argument. A study by de Kock and DeLeire (1994) indeed found a substantial increase in the importance of the exchange rate in American monetary policy in recent years. Most relevant to my purposes is that while the exchange rate accounted for nearly none of the transmission from monetary policy to output in the United States before 1982 (the researchers' dividing line), it has accounted for about one-third since then. This is consonant with my argument; if this change has taken place, it would be surprising if analogous political changes were *not* in train.

As world financial and commercial flows have grown rapidly, and American involvement in them has grown apace, American monetary policy has been changing. It has come to implicate the exchange rate, and in this process monetary politics in the United States are becoming more conflictual, more dominated by clear interest group pressures, more the stuff of Congressional activity, and more closely associated with trade policy.

#### IV. OBSERVATIONS AND IMPLICATIONS

I reiterate that the historical survey presented here does not constitute systematic empirical evidence for my argument. However, I do believe that this look at the historical evidence does tend to support the notion that changing levels of international economic integration are associated with changes in the making of American monetary policy. Economic integration changes the way in which monetary policy takes effect, making the exchange rate crucial. High levels of international trade and payments appear to increase the desire of American international businesses to reduce currency volatility. Commercial and financial openness heighten the vulnerabil-

ity of many Americans to global price trends, and seem to increase the importance of the exchange rate as they try to counteract adverse price movements. In this way, the analysis in this paper is very much in line with the underlying argument of this volume that economic internationalization profoundly affects domestic politics.

None of this is meant as a full explanation of American monetary policy, or of the impact of international economic changes on American politics. It is meant to insist on the importance of introducing open-economy considerations into analysis of American monetary politics. However, the historical record also gives rise to some points that require clarification, to potential alternative explanations for the trends observed, and to some related observations.

Two preliminary clarifications are in order. First, my argument about the kinds of cleavages anticipated is not meant to imply that the relevant actors used the sorts of categories employed in my analysis. Indeed, many of the terms in question did not exist until recently. My argument is about the political cleavages I expect given a set of economic conditions. This depends on socioeconomic and political actors having a sense of what their interests are. It does *not* depend on their defining their interests as I do after the fact. My framework explains why farmers and manufacturers preferred certain monetary policies in the 1870s, 1890s, 1920s, and 1980s; it does not explain why these demands took different forms or met with different amounts of success. Mine is an *analytical* argument, not a claim to *describe* the way political actors thought or talked about the issues.

A second clarification is to make explicit my downplaying of a common insistence, in the historical literature, that monetary populism pitted indebted farmers against mortgage bankers. I do not dispute the division, but argue that it is inadequate to explain the debates. There are both analytical and empirical reasons to believe that political conflict in earlier eras was strongly affected by the tradables–nontradables divide.<sup>34</sup>

Several explanations that might be alternative to my own can be aduced. To do so is somewhat artificial, for to my knowledge the explanations have never been presented in the literature. While few scholars would disagree with my broad characterization of the ebb and flow of monetary politics in the past 120 years – especially in comparing the period before 1935 and that between 1935 and 1970 – there have been no scholarly attempts to explain this ebb and flow (so far as I know). Nonetheless, some potential arguments can be deduced.

One explanation for the quiescence of American debates over monetary policy before 1970 might have to do with America's international position. American monetary policy may rarely have been at issue because it was unconstrained: the United States so dominated the world economy that its

policies determined global monetary conditions, so that there was no tradeoff between domestic and international concerns. This might be combined with the assertion that monetary consensus was due to the strictures of the Bretton Woods system within which the dollar's value was fixed at \$35 per ounce of gold.

Both assertions point to potentially important international factors, but neither helps explain much variation across time. The United States was at least as large relative to the world economy, and world financial markets, in the 1920s as it was in the 1960s. This means that – even without any such intent on the part of American policymakers – monetary policy in the United States had substantial international effects in the 1920s and 1930s. However, domestic debates over American monetary policy were extremely heated in the earlier period and virtually nonexistent in the later one. As for the constraints of Bretton Woods, while the existence of the regime raised the costs of devaluation, in the early 1970s the U.S. did in fact devalue, international monetary regime or no. The point is that few political actors appear to have cared enough to make the exchange rate a policy issue until the 1970s.

Another potential explanatory rival might focus on the independent importance of the institutional changes discussed above. Some might argue that the decline in prominence of monetary politics was a *result* of Congressional delegation rather than a cause. This might be because Congress recognized the efficiency gains to be made by delegating responsibility to an independent agency. In this view the Fed was in fact implementing true Congressional preferences, just in a way that protected Congress from responsibility for unpopular policies.<sup>35</sup>

This view does not accord with two facts. First, the institutional structure of monetary policy-making was hotly debated from 1907 until 1935, and interest group and Congressional preferences over institutions were well established. It was hardly the case that in the 1930s Congress sneaked institutional changes past unwitting constituents: for the previous fifty years constituents had been bombarding Congress with insistent institutional demands. In the 1930s these demands simply dissipated. Second, apparent Congressional willingness to give the Fed free rein in monetary policy declined precipitously after 1970. Congress ignored monetary and exchange rate policy so long as they did not implicate the interests of constituencies of electoral importance, as in the closed U.S. economy between 1935 and the late 1960s.

I do not mean to insist that there is no truth to these arguments, only that they do not clearly supplant my own. A fuller evaluation of the argument would require a more explicit formulation of alternative hypotheses, and more systematic empirical evidence. In the meantime, several observations

can be made on the basis of the analysis and evidence presented here. Some follow directly from my argument; others point in somewhat different directions.

First, political activity on exchange rates appears asymmetrical. That is, while both real appreciations and depreciations have distributional effects, real appreciations give rise to a much more significant political response. As the dollar fell in real terms in the late 1890s, late 1970s, or late 1980s, there were few political repercussions. On the other hand, the real appreciations of the 1870s and early 1890s, late 1960s, and early 1970s, and again of the early 1980s, brought forth major reactions in both monetary and trade policies.

Relative price movements that hurt tradables producers thus appear more politically salient than those that hurt nontradables producers; a real appreciation seems more politically significant than a real depreciation. This may be because the costs of an appreciation are more concentrated than its benefits, or conversely that the benefits of a depreciation are more concentrated than its costs. A real depreciation (appreciation) helps (hurts) tradables producers in a direct and highly visible way. Inasmuch as the principal negative impact of a real depreciation is on consumers of tradables, the result may simply be a subset of the common phenomenon that producers tend to be better organized than consumers.

A related puzzle is why political demands appear much more strident when economic agents are faced with negative price trends. That is, demand for a depreciation appears to arise only when the currency appreciates or when tradables prices decline for other reasons. There is no reason why tradables producers should not try to benefit from depreciation at any time, but they seem to demand depreciation far more insistently in the wake of contrary price movements. Like the demand for trade protection, there is no obvious basis for this not to be constant. However, just as the demand for protection is countercyclical, so too does the demand for depreciation seem a function of past appreciation. Why this is so remains to be explained.

Second, there are important differences in the degree to which the relative price changes to which economic agents respond are truly exogenous. There is little question that the decline of grain prices in the late nineteenth century or the 1920s can be taken as given by broader trends in the world economy (although, of course, the actions of American farmers affected these, too). However, the real appreciation of the 1870s was the result of expectations that the dollar would return to gold, while the real appreciations of 1968–71 and 1980–5 were largely the result of American economic policy trends. A full explanation of these episodes would indeed have to uncover the reasons for the underlying trends that led to the real appreciations, while I have focused only on the political response to them.

Third, an important feature of exchange rate politics before 1935 and

during the Bretton Woods period was the link generally drawn between the level of the exchange rate and its flexibility. There is no necessary tie between the two: one could prefer a depreciated fixed rate, or an appreciated floating rate. However, in practice interest groups divided into two broad camps. "Hard money" interests wanted a strong fixed rate; "soft money" interests wanted a devaluation and a floating rate. In other words, preferences about stabilizing the exchange rate were elided with views on whether to devalue the dollar.

How and why the elision of the two dimensions of currency policy took place is important to a full understanding of the interest-group and legislative politics of the era, as well as to policy outcomes. One possibility, which seems to accord with the evidence, is that the most intense preferences over exchange rates are in fact those for stability, on the one hand, and for depreciation, on the other. For reasons described above, preferences for flexibility and appreciation (such as those of nontradables producers for strong floating rates) may not be particularly intense and the groups may not be particularly concentrated. But this is only speculation.

Fourth, although I have addressed some institutional issues I have focused on interests. One thing appears clear from the historical record: Congress has typically been especially sensitive to the demands of tradables producers, while the Executive and the Fed have tended to be more responsive to the international business community. I presented some conjectures above as to why this might be the case, but they are not rigorously derived. Similarly, my discussion of how and why Congress delegated exchange-rate policy in the 1930s was superficial. For now the institutional characteristics of American monetary policy, and the evolution of these institutions over time, remain to be fully explained.

Fifth, especially in the more recent periods I have downplayed the importance of inflation aversion on the part of the general populace. This was typically not an issue before World War II, when deflation was perceived as more of a problem. But there is little doubt, for example, that during the late 1970s there was an increase in popular dissatisfaction with inflation, and that this sentiment contributed to the reversal of monetary policy in 1979–81. What remains to be explored is exactly how much these broad pressures mattered to policy.

Finally, I have said relatively little about the relationship among policy preferences, institutions, and outcomes. My argument is about the prominence, nature, and institutional representation of the political divisions expected over monetary policy in closed and open economies. This is of course a crucial building block for a broader analysis that can try to explain the *results* of these political debates, but it is not such an explanation. It is only a first step, albeit a necessary one, on the road to a much more complex analysis. The sorts of factors discussed in the contribution to this

volume by Geoffrey Garrett and Peter Lange are undoubtedly crucial to understanding policy outcomes in this realm.

#### CONCLUSIONS

The politics of a nation's monetary policy are significantly affected by changes in the degree to which it is economically integrated with the rest of the world. Economic internationalization is associated with changes in domestic and international monetary politics.

In financially open economies monetary policy has powerful effects on the exchange rate. Commercial openness for its part makes more economic agents sensitive to currency values. Both together imply that financial and commercial integration will lead monetary politics to focus more on the exchange rate.

As exchange rates effect changes in relative prices while an overall change in the nominal price level does not, economic integration also implies that the politics of monetary policy will become more heavily influenced by concentrated interests rather than diffuse considerations. Inasmuch as Congress is especially responsive to electorally important interest groups, and the Executive to broad macropolitical trends, the increased importance of exchange rates and their impact on the relative prices facing powerful interest groups should tend to mobilize Congress more than in a closed economy. Finally, because the exchange rate is obviously related to import competition, it should be linked in political debates to trade policy.

In this context, I compared American monetary policy in three periods: one of high levels of global trade and investment before 1935, one with relatively low levels of financial and commercial flows between the 1930s and the late 1960s, and one of growing world economic activity after 1970. The changing pattern of global economic integration appeared to be associated with changes in American monetary politics. As monetary policy shifted toward the exchange rate, interest groups became increasingly mobilized, especially when the dollar appreciated in real terms. This was also connected to increasing Congressional attention to the issue area, and to growing ties between trade and exchange-rate policy in the public arena.

The conclusions drawn here about the future of American monetary policy are tentative. Current levels of international trade and investment, although high, may not be as high as those during the classical gold standard. Perhaps more important, these levels may not be stable, as macroeconomic and sectoral difficulties inflame the desire of many to impede the free movement of goods and capital across borders. Nonetheless, if links continue to grow between the American and world economies, it is at least plausible that the sorts of monetary policy trends discussed here will become increasingly important.

- agement (all else equal, higher interest rates), but higher rates would tend to depress investment and hence lessen competitiveness.
- 15 This is not to say that new growth theory pertains to all types of government spending. For example, it would be hard to argue that family allowances or industrial subsidies constitute productivity-enhancing collective goods.
  - 16 The full Kmenta model was not used because this procedure exerts a downward bias on standard errors when applied to panel data sets with relatively short time series (as is the case here; Beck and Katz 1995).
  - 17 Coefficients from annual savings-investment regressions only characterize capital mobility across all the countries in a given year. Hence these are not suitable for analyzing the effects of cross-national – as well as intertemporal – variations in capital mobility.
  - 18 These data are described in more detail in the Appendix.
  - 19 These coefficients are not reported to simplify the presentation, but they may be obtained from the author.
  - 20 Trade constituted a lower portion of GDP in many other cases, but in all of these there were simultaneously very few controls on capital flows (as in the United States), and the combined internationalization scores (based on the sum of standardized scores for trade and capital mobility) were higher than for Finland in 1976.
  - 21 The median level of trade in 1967 was in Canada, while the median number of capital controls existed in Austria, Belgium, Japan, The Netherlands, Norway, and Sweden.
  - 22 The median level of trade in 1990 was that for the United Kingdom. The median number of capital controls occurred in Australia, Belgium, Canada, Denmark, Germany, The Netherlands, the United Kingdom, and the United States.
  - 23 Indeed, Krugman argues that the effects of trade competitiveness on the U.S. economy are still trivial.

## CHAPTER 5

- 1 Indeed I am developing more systematic evaluations. In the American context, this involves detailed analysis of the politics of a series of episodes of monetary politics. A survey similar to that presented here is in Frieden (1994b); quantitative evidence on a crucial period is in my "Monetary Populism in Nineteenth-Century America: A New Interpretation," (unpublished manuscript). Applications to contemporary European monetary politics include Frieden (1994a).
- 2 It should be clear that in the framework of this volume, the relative price changes in question referred to here primarily have to do with those affecting the overall attractiveness of international economic activities. Analysis might also focus on the impact of specific international price movements on domestic monetary politics. I discuss this in the evaluation of individual cases. For reasons of space, I emphasize the effects of increased international economic integration. The impact of particular international price changes is relatively straightforward, in any event – producers whose product prices decline want monetary policies to reverse this decline.
- 3 In most of what follows, I ignore the inevitable objections of those who, in line with the rational expectations revolution, might downplay the real impact of nominal variables. Whatever the mechanism – labor market rigidities, incomplete information, signalling a change in regime, and so forth – it seems well

- established that monetary surprises, whether by way of the nominal price level or by way of the exchange rate, have had a substantial real impact. For an interesting summary of current controversies and conundrums in international monetary economics see Krugman (1993).
- 4 To be precise, it is covered (exchange rate-adjusted) interest rates that are constrained to be equal. The insight is that of the famous Mundell–Fleming approach, which originated with Mundell (1962, 1963). The model implicit in this discussion is one in which asset prices adjust more rapidly than goods prices, and prices of tradables more rapidly than prices of nontradables. These characteristics cause the “overshooting” and real depreciation/appreciation discussed here. While controversies rage over these and other features of modern monetary economics, this perspective is as close to consensual as feasible. Its exposition can be found in any good textbook discussion of open-economy macroeconomics; a useful survey is Corden 1986.
  - 5 For a more detailed discussion of these issues, see Frieden (1991b, 1994b).
  - 6 Again, I take the tradability of goods and services as exogenous. In the terms of this volume, the cause of an increase in the share of tradables in the local economy might be an exogenous change in international transportation costs, or in the stability of the international payments system, or in other countries’ policies. In some treatments of this sort of issue, the home country’s trade policy is taken to make certain goods nontradable. Since this can confound cause and effect, I reserve my discussion of nontradability to those goods and services generally recognized to be difficult to trade across borders for technical reasons, not due to (endogenous) policy.
  - 7 Unfortunately, there is only a small empirical literature on these issues. Akhtar and Harris (1987) found that output fluctuations in the consumer and producers’ durables industries were two-thirds due to exchange rate changes and one-third to interest rate changes, while fluctuations in residential construction were entirely due to interest rate changes; see also Ceglowski and Hilton (1987: 403–500). Branson and Love (1988) focus on the differential impact of exchange rate movements, and suggestive results along similar lines are reported in Goldberg (1990).
  - 8 For example, preferences about the level of the exchange rate may well vary in intensity: the sensitivity of tradables producers to exchange rate movements is a function of the price elasticities of demand for their products. And whatever positive impact price increases may have on profitability have to be measured against the negative effects of higher prices on demand and the entry of new competitors.

Other peculiarities are also important. For example, intensive consumers of imports will be hostile to depreciation; these consumers may be concentrated industrial users of imported inputs. Overseas investors appreciate the added purchasing power that an appreciated currency gives them, but this appreciation also erodes the home-currency value of their overseas earnings.

Perhaps most important, the two dimensions are often elided, a point to which I return. A fixed rate may imply a strong currency, while a floating rate may imply a weak one. In this case, exporters would have to weigh their desire for exchange rate stability against their desire for a weak exchange rate, and determine which of the two was more important to them.

- 9 It should be noted that I claim no general applicability of this schema to other national institutional settings. While the general logic may well apply – those policymakers most likely to be held accountable for a policy’s impact have the

greatest incentive to be concerned about it – the implications will vary widely from setting to setting.

- 10 The burgeoning and important literature which applies modern political economy to American politics tends to assume institutional preferences in different ways. The variety assumed here is meant to be illustrative rather than rigorously deduced; whether it holds in practice will be seen in the historical narrative.
- 11 As mentioned above, I ignore here the fact that to some extent the gradual revival of international trade and payments in the postwar period was a result of American policy, as indeed to some degree economic closure in the 1930s also reflected U.S. government actions. For the purposes of this analysis, the overall level of international trade and investment is taken as given; a fuller analysis would have to account for reciprocal effects between American policy and the environment within which that policy was made.
- 12 This is especially because there is no necessary correlation between levels of integration and flows of goods and capital. However, scholars have attempted to test for the links between American capital markets and those on the other side of the Atlantic, especially in London. Typical studies, such as Neal (1985) and Officer (1986), focus on the covariation of interest rates in London and New York, and find the two markets very closely linked.  
Other studies indicate that American capital markets were not particularly integrated into world capital markets before 1980, after which they became increasingly so. Feldstein and Horioka (1980) demonstrated relatively low levels of international capital mobility in the postwar era; Frankel (1991) brought the data up to date and showed significant increases in American financial integration after 1979.
- 13 It should be emphasized that in what follows there is little disagreement among historians about the evidence. Virtually every scholar of the period knows who supported and opposed gold, silver, and related policy proposals. My presentation differs in ways described below from most *analyses*, that is I *explain* the political differences with different tools. However, the general contours of the facts are not in any appreciable dispute.
- 14 I ignore the 1907–13 debates over the founding of the Federal Reserve. These debates focused on the central bank's lender of last resort and international bargaining functions, on which see Broz (1993). The monetary policy aspects of the debate are relevant, but they do not differ significantly from those carried out in the 1920s, so I omit discussion of them in the interest of brevity. The outstanding source on this period is D'Arista (1971); other sources include Kettl (1986: 18–44) and Woolley (1984: 30–47).
- 15 The literature on this period is of course enormous. Analyses of events leading up to, and through, the first stage of the Great Depression include Barber (1985); Batchelder and Glasner (1992); D'Arista (1971: 117–31); Freidel (1990: 88–91, 100–5, 133–4); Friedman and Schwartz (1963: 299–419); Kettl (1986: 29–44); and Wigmore (1985).

Much of the sentiment for reflation and devaluation coalesced around the ideas of George Warren, a Cornell economist who believed devaluation would raise commodity prices. "Rubber-dollar Warren," as his detractors called him, has received something of an undeservedly bad press. As Eichengreen (1992: 340–1) notes, there were two sources of slippage in Warren's mechanism – between the gold price and the exchange rate, and between the exchange rate and commodity prices – so that the relationship was not unproblematic. None-

- theless, devaluation did in fact serve to raise commodity (and, more generally, tradables) prices. In some ways Warren's ideas were closer to modern real exchange rate analysis than those of his more orthodox contemporaries. For a flavor of his views, see Warren and Pearson (1935).
- 16 On which there is a small political-economy literature, which tends to argue that Fed policy responded to the needs of its member banks rather than the macroeconomy. See Anderson, Shughart, and Tollison (1988) and Epstein and Ferguson (1984).
  - 17 In March 1933, the Chairman of the Clearing House Association and President of Central Hanover Bank and Trust recognized that the gold standard could not be sustained: "in the face of today's figures we are already off the gold standard whether the fact is legally recorded or not" (Wigmore 1987: 748). After the crisis had receded, the bankers desired stabilization – and they got it, culminating in the Tripartite Agreement of 1936. An interesting incident was the involvement of Walter Lippman (Steel 1980: 302–9). Lippman was prevailed upon by Morgan's two leading partners to write a column about the need to go off gold; the column appeared on April 18, 1933, and was referred to repeatedly by Roosevelt in his justifications of his decision.
  - 18 Temin and Wigmore (1990) indeed argue that the devaluation was the crucial policy shift underlying the New Deal recovery.
  - 19 Todd (1992) presents an interesting discussion, while Sylla (1988) provides a more detached survey.
  - 20 Auerbach (1990) in fact argues that this arrangement was devised explicitly to avoid Congressional influence on exchange-rate policy. For a summary of the generally accepted legal situation, see Destler and Henning (1989: 86–8).
  - 21 Students of American foreign economic policy will recognize strong parallels between Congressional action in delegating trade and monetary policy in the New Deal. Indeed, the trade-policy equivalent of the monetary and exchange-rate policy initiatives discussed here, the Reciprocal Trade Agreements Act, was passed within a few weeks of the Gold Reserve Act (Haggard 1988).
  - 22 Classic sources for this episode are Calleo (1982: 62–117), Eckes (1975: 237–71), Gowa (1983), Odell (1982), and Solomon (1977: 176–234).
  - 23 The tradables–nontradables relationship is unambiguous, while measures of the real exchange rate are mixed: most estimates show the dollar's real appreciation in this period as about three or four percent. The principal reason for the difference is trade weights, especially the overwhelming role of Canada in U.S. trade. The issue is beyond the scope of this study; for now it is enough to note that disaggregated price trends indicate very significant pressure on tradables producers.
  - 24 Aronson (1977:137–50) discusses these developments. On the tradeoff between capital controls and fixed rates, see Maxfield 1992. It should be noted that the choices available inherently ruled out domestic macroeconomic adjustment, which would have involved substantial austerity and was generally perceived as politically infeasible.
  - 25 ECAT members had average overseas assets equal to 42 percent of total assets and foreign sales equal to 44 percent of total sales. On the general role of such groups see Destler and Odell (1987) and Milner (1988).
  - 26 Congressional intent was to get looser monetary policy and more Fed responsiveness, but the Fed's supporters were able to make the requirements as enacted relatively lax. On this episode and related developments see *Journal of Monetary Economics* (1978), Kettl (1986: 140–66), and Woolley (1984: 144–53).

- 27 All real effective exchange rate figures in this and the next section are from a series calculated by Allan Meltzer and graciously supplied by him to the author. Exchange rate statistics for the late 1970s are a bit confused, especially as the dollar moved differently against different currencies – appreciating against the Canadian dollar and depreciating against most major currencies. Given the great weight of Canada in American trade, this reduces the dollar's depreciation in calculations of the effective exchange rate. Where this appears relevant, I indicate both the effective exchange rate trend and movements against the mark and the yen. For monthly trends, I use the real effective exchange rate; this makes little difference in the short run as nominal and real rates moved quite closely together. Over the longer run, of course, they diverged somewhat.
- 28 The literature on this period includes Cohen and Meltzer (1982: 15–64), Destler and Mitsuyu (1982), Golub (1986), Greene (1984), and Kettl (1986: 167–79). On the macroeconomic diplomacy of the period see Putnam and Bayne (1984: 67–136).
- 29 Federal Reserve Bank of St. Louis 1986. To give an example of the statistical difficulties, measures of the real effective depreciation between 1976 and 1980 range from 13 percent (*Economic Report of the President*, various issues) to 2 percent (Morgan Guaranty Trust Company, various issues), passing through figures of 7 percent (Meltzer's series, mentioned above fn. 27), 8 percent (International Monetary Fund, various issues, based on wholesale price indices), and 9 percent (same source, based on relative unit labor costs). In some sense, then, the tradables–nontradables figures reported in Table 4 may be the most meaningful available, as they represent the relative price trends experienced by American producers in the American market.
- 30 Figures from the Meltzer series, described in fn. 27. The Fed series indicates a 64 percent nominal effective appreciation, and a 56 percent real effective appreciation, between 1980 and 1985; see Federal Reserve System, various issues. Over the same period Morgan Guaranty's figures indicate a 40 percent nominal and 36 percent real appreciation. The IMF's figures based on relative unit labor costs show a 38 percent real appreciation, while those based on relative wholesale prices show a real appreciation of 36 percent.
- 31 The outstanding work on this episode is Destler and Henning (1989), which presents a detailed history and expert analysis of the 1980–5 period. With a few exceptions, the analysis presented here parallels theirs. Also useful are Frankel (1994) and Funabashi (1988: 65–86).
- 32 I do not mean to take a position here on which of these policy measures, if any, would indeed have led to a depreciation. Whatever economists may decide about the matter, at the time tradables producers believed that monetary policy, fiscal policy, and intervention would have, respectively, certain, likely, and conceivable effects on the value of the dollar.
- 33 The original appeal, with the list of initial signers, appeared in national newspapers on January 25, 1983.
- 34 Indirect support for my argument can in fact be gleaned from the slender modern literature on the Populist era, especially as it finds farm prices (rather than debt) the principal determinant of monetary populist protest. For example, McGuire (1981) found Populist fervor closely related to price instability, while Bowman and Keehn (1974) found agrarian political unrest rose during periods of farm price declines.
- 35 On this aspect of the RTAA, see Haggard (1988). For examples and evalua-

tions of the enormous literature on central bank independence see Grilli, Masciandaro, and Tabellini (1991).

## CHAPTER 6

- 1 The LDP ruled virtually uninterruptedly from 1955 to 1993, with the minor exception of a brief coalition with the New Liberal Club in 1976. Sweden's Labor Party holds the record for political longevity by a smidgen, having governed from 1932 to 1976.
- 2 This point echoes arguments Milner (1988) makes about which French firms were likely to favor freer trade.
- 3 In the last election under the old rules, Japan had 1 single-member district, 4 two-member districts, 42 three-member districts, 37 four-member districts, 41 five-member districts, and one six-member district.
- 4 Though one might consider ideological spacing of LDP candidates to be a cheaper, alternative way to divide the votes, this would have posed several problems that the personal vote strategy did not. The first would be unpredictability. It would be extremely difficult to know, on the basis of platforms alone, who would vote for whom. Second, the party would have jeopardized both its party label *and* the personal vote. If LDP candidates attacked each other's platforms, voters would get little sense of the party's goals and intentions. Sufficiently negative campaigns could even lose rather than gain votes for the party. I am indebted to Gary Cox for this point. For a fuller explication of the interaction of Japan's electoral rules and the LDP's electoral strategy, see McCubbins and Rosenbluth (1995).
- 5 Because for decades Taiwan and Japan were the only two countries in the world to have multimember-district SNTV electoral rules, it is difficult to test empirically the particularism argument. But it is worth noting that in prereform Italy, where voters could rank three or four candidates in order of preference (rather than sticking to the party's order of listing), members of the Christian Democratic Party spent substantial resources building their personal support networks. In other words, Italy resembled Japan in the sense that the electoral rules gave individual candidates of the same party an incentive to compete against each other electorally (Katz 1980).
- 6 See also a May 1992 press release by a group of young LDP Dietmembers voluntarily disclosing their income and expenditures (Wakate giin no kai 1992). Their stated purpose was to spur electoral reform by horrifying the public with this glimpse of Japan's money politics. According to this report, the average annual expenditure of these primarily first- and second-term LDP members was over a million U.S. dollars (at 130 yen to the dollar) in 1991, not an election year. Japan's weak campaign finance disclosure laws made these partial revelations of LDP finances particularly valuable.
- 7 See, for example, Kawato (1992) and Soma (1986).
- 8 The argument is not that Japanese firms are relying increasingly on foreign imports and therefore want tariffs reduced. Japan's intraindustry trade is notoriously weak, more or less across the board in the manufacturing sector (Lincoln 1990). The point is rather that Japanese exporters, fearing foreign retaliation, urged the government at least to open domestic agriculture and retailing. Corporations also seemed to worry that high domestic agricultural prices contributed indirectly to higher labor costs (Honsho 1985).
- 9 See, for example, Arai (1988) and Kobayashi (1987). The variance in electoral

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