

# MUST



# AMERICA



# DECLINE?

by *Richard Rosecrance*



America's muscular response to the Iraqi invasion of Kuwait has temporarily stilled all talk of American decline. Yet the national alarm over the expense of Operation Desert Shield, the urgent demands for more help from U.S. allies, and the extraordinary enlistment of Soviet support at Helsinki are all reminders of how much the world has changed. While America's military strength remains much greater than that of its allies, its economic strength does not. No longer is the United States willing—or, many would say, able—to shoulder the world's burdens. Does this mean that it is on the same long, downward slope of history that earlier great powers have traveled? Is its decline only relative? Or has it actually emerged victorious from the trials of the postwar period? These are the questions that scholars, politicians, and others have been debating during the past few years. As the turn-of-the-century cartoon on this page suggests, the debate is not entirely new. Published after the Spanish-American War, just as the United States was taking its place on the world stage, the cartoon warned against assuming the burdens of empire. Today, the costs of U.S. commitments abroad are still the chief issue. Here, Richard Rosecrance reviews the recent debate. He fears that the United States is indeed slipping. But unlike the great powers of the past, Rosecrance believes, the United States has an opportunity to renew itself.

**T**here are today three fundamental views of the American future. One is that the United States, like 19th-century Britain before it, has lapsed into a terminal condition of economic lethargy and decline. A second view is that while the na-

tion has experienced its ups and downs, its position has not appreciably changed. The third view, which I share, is that the United States has demonstrably declined but that it can and will come back.

The "declinists"—a group which includes academicians such as David Calleo and politicians such as Colorado's former

governor Richard D. Lamm—point out that while shortly after World War II the United States accounted for 45 to 50 percent of world gross national product (GNP), it now claims only 21 percent, and its share could soon shrink below 16 percent. Part of this decline was to be expected as Western Europe, Japan, and East Asia recovered after World War II. But the declinists argue that the reversal of American fortunes is greater than these figures indicate. From being the leading industrial exporting country, the United States has fallen to third place behind Germany and Japan. It has run a trade deficit every year since 1975. (Today's current account deficit is about \$109 billion.) To satisfy Americans' hunger for imports of everything from autos and mineral water to machine tools and computers, the country has become the world's largest debtor. U.S. foreign debt now exceeds \$600 billion and at current rates will reach \$1 trillion during the early 1990s. All told, the national debt—which the Reagan administration ran up to unprecedented heights—and the private debt accumulated by U.S. companies and consumers has soared to some \$7 trillion. That represents nearly 140 percent of the nation's total annual output, or more than one-third of world GNP. Thus, even if America regains its equilibrium in trade in five years, which it may be able to do if it is moderately lucky, ballooning interest and dividend payments to foreigners could wipe out much of its progress.

In industry after industry, U.S. companies have lost their lead. The *Wall Street Journal* recently put the matter with stark clarity: "While U.S. manufacturers in 1969

produced 82 percent of the nation's television sets, 88 percent of its cars and 90 percent of its machine tools, [in 1988] they made hardly any TVs, and gave up half the domestic machine-tool market and 30 percent of the auto market. Even in a new industry like semiconductors, this country's world market share has shrunk to 15 percent from 85 percent in 1980."

When America lost its lead in cars, consumer electronics, and advanced machine tools, people consoled themselves with the thought that the United States was tops in finance and services. But in each realm Japan and other nations have caught up. Now, there is not a single American bank among the world's top 10; all of them are Japanese. In biotechnology, civilian aircraft, and advanced semiconductors and computers, Japan is beating at the U.S. door. Even the American farmer's once unassailable boast that he was the world's most efficient producer of food is being challenged. Wheat growers in Argentina are already more efficient than their American counterparts, and farmers in Australia and Thailand are rapidly improving.

The prophets of American decline believe that Yale historian Paul Kennedy's somber study, *The Rise and Fall of the Great Powers* (1987), foretells the American future. They point out that intelligent Dutchmen of the 17th century and prescient 19th-century Britons were well aware of the plight of their nations yet were unable to halt the decline. What awaits the United States in the 21st century? Kennedy writes: "The only answer to the question increasingly debated by the public of whether the United States can preserve its existing posi-

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tion is 'no'—for it simply has not been given to any one society to remain *permanently* ahead of all the others, because that would imply a freezing of the differentiated pattern of growth rates, technological advance, and military developments which has existed since time immemorial."

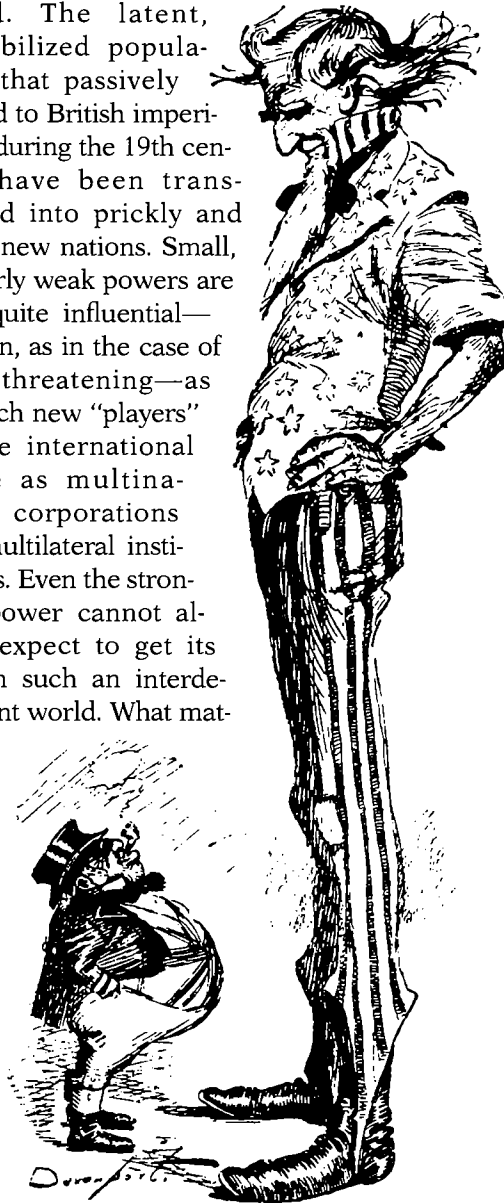
**T**he second school of thought on American decline offers a much more reassuring view. The thinkers in this camp maintain either that the United States has not declined or that any decline is temporary and explicable, harmless, or easily remedied. [See box, p. 72.]

Some conclude that America has suffered only minor reverses and that there is no project it cannot accomplish if citizens are willing to pay for it through new taxes. In *Can America Compete?* (1984), Robert Z. Lawrence of the Brookings Institution speaks for a group that maintains that the manufacturing sector is as vibrant as ever. And even if manufacturing has declined, others argue, the United States can compete as effectively as ever in services. Still others observe that there is nothing dramatically new in America's relative economic situation. During the mid-1960s the United States produced about 24 percent of world GNP; today the figure is about 22 percent. In fact, the U.S. share of world GNP is not much smaller than it was in 1938.

To the degree that America has measurably declined, defenders of the status quo argue, this is because of, not despite, American policy. Thus, Harvard's Joseph Nye notes that, during the late 1940s, "rather than seeking hegemony over its allies, the United States opted to stimulate their economic revival and create a strategic partnership balancing Soviet power."

Still another explanation advanced for waning American influence is that we now live in a more complicated and obdurate

world. The latent, unmobilized populations that passively yielded to British imperialism during the 19th century have been transformed into prickly and tough new nations. Small, formerly weak powers are now quite influential—or even, as in the case of Iraq, threatening—as are such new "players" on the international scene as multinational corporations and multilateral institutions. Even the strongest power cannot always expect to get its way in such an interdependent world. What mat-



1898. *John Bull meets Uncle Sam.*

ters now, in this view, is not military and economic power but the power to persuade.

Furthermore, the argument goes, if the United States has declined, so has Japan. During the 1960s Japan grew by more than 10 percent per year. Since then it has been

averaging around four percent annual growth. The result is a comfortable sort of "convergence." Harvard's Samuel Huntington writes: "There is little reason why the Japanese economy as a whole should grow much faster than the U.S. economy, and there is little reason why an individual U.S. worker should be significantly more productive than a Japanese worker. On such indices of economic performance, one should expect long-term convergence among countries at similar levels of economic development and with economies of comparable complexity."

Converging rates of growth, however, mean that the United States can maintain its lead. *Discriminate Deterrence* (1988), a major study by a panel of experts (including Huntington) convened by the U.S. Department of Defense, plots U.S. economic growth for the next two decades at 2.6 percent annually and Japanese growth at 2.8 percent. By the year 2010, U.S. GNP will reach nearly \$8 trillion (in 1986 dollars); China and Japan will be next at nearly \$4 trillion each; the Soviet Union will follow at \$2.9 trillion.\*

Still other writers who are content with American economic performance take a "so what?" attitude toward decline. In the new "one world" economy, U.S. trade deficits with Japan and South Korea don't matter any more than Maine's trade deficit with California. Capital travels freely across national frontiers, and the fortunes of one entity do not mean much so long as the system as a whole works.

Federal budget deficits? As a percentage of GNP the deficit has declined from a max-

\*However, these estimates are unduly favorable to the United States. The assumed Japanese growth rate of 2.8 percent may understate the actual by as much as 1.5 percentage points. The Chinese growth rate starts from a current base of \$1.2 trillion, instead of the \$600 billion usually employed. And the Chinese estimates were made before Tiananmen Square and the leadership's retreat from reform. More realistic estimates put Japan at \$5.8 trillion in the year 2010, second to the United States at \$7.4 trillion, with China at \$3.2 trillion and the Soviet Union at \$3.0 trillion.

imum of 6 percent of GNP in 1983 to only 3.5 percent today—less than that sustained easily by Japan during the mid-1970s. In any event, the argument goes, the deficit will continue to decline for the next few years. Robert Eisner, a prominent economist from Northwestern University, insists that the deficit is actually a plus, a stimulus that we cannot do without.

Not surprisingly, those who deny that America has declined believe it can continue to shoulder substantial military and diplomatic commitments. Since the United States could afford to devote 10 percent of its GNP to national security during the 1950s and 9 percent during the Kennedy administration, it can certainly spend 6.5 percent or perhaps a bit less now that the Cold War is over. If the deficit eventually must be cut, a one-third reduction might be effected simply by imposing, say, a higher tax on gasoline. And as Valéry Giscard d'Estaing, the former president of France, commented to the *Wall Street Journal*, "It's hard to take seriously that a nation has deep problems if they can be fixed with a 50-cent-a-gallon gasoline tax."

A subgroup within the second school accepts part of the "decline" thesis but believes that the argument has been carried too far. Princeton's Aaron Friedberg, for example, contends that military spending was not responsible for the decline of the great powers of the past. At worst, defense burdens accentuated the problems of countries already facing economic weakness. Friedberg believes that increases in consumption or in social-welfare spending are at the bottom of most stories of decline, including that of the United States today. [See box, p. 78.]

**T**he third possible perspective on decline, and the one I hold, is that the United States *has* demonstrably declined but that it can and will come back.

The evidence of American decline is irrefutable. In 1929, well before it reaped the artificial advantage of victory in World War II, the United States claimed more than 43 percent of world manufacturing production. Today, it claims only 22 percent. Assuming no change in current trends, one can foresee a much less comfortable future for the United States than the one outlined by the Pentagon's experts in *Discriminate Deterrence*. Twenty years from now, Japan will be a close second to the United States, with the momentum to pull ahead during the decade of the 2020s. China will have ousted the Soviet Union from third place and will be growing rapidly. And if the European Community achieves its goal of thorough political and economic integration after 1992, it could challenge U.S. leadership. The resulting multipolar world will be a much more uncertain place than today's relatively simple world order. The result easily could be a return to the conditions of the 1930s: not necessarily war but momentous conflicts over trade and the creation of hostile tariff blocs. Only a continuously growing American and world market will prevent such economic conflicts.

A vast literature exists on what happens when a previously dominant economic power declines. Many scholars conclude that without a single leader, the international order founders. Rising challengers refuse to pay the costs—such as providing loans or markets to nations in distress—of keeping the international economic system open. The three or four successor nations tend to implement high-tariff policies, stunting world trade, as happened in the Great Depression. History is conclusive on this score: It is far better to have one large power at the helm of the international economy. The United States, however, may not be able to continue its leadership role. Even today, the United States and its closest

allies in Western Europe cannot agree on many important measures of economic and trade policy. Will a triumphant Japan and a resurgent China feel any greater compulsion to reach an accommodation with the United States 20 years from now?

In the future, it will take a higher U.S. growth rate—an eminently attainable 3 percent or more per year—and a dynamic American marketplace to convince others that they need to respond to U.S. policies and open their economies to foreign trade. To achieve faster growth, however, there must be a massive change in American priorities. National security must be redefined to include the strength and productivity of the economy, which is after all the base on which military capability rests. Some budget savings from reduced U.S. commitments overseas—plus, perhaps, domestic budget cuts and tax increases—will be needed to promote an economic resurgence that will eventually allow the United States to return to its leading role on the world stage.

If American fortunes are to be revived, the nation's leaders will have to challenge Americans to renounce the ethic of "borrow and spend." Special incentives ought to be extended to Americans who save for retirement or for the education of their children. Rampant inflation during the 1970s schooled a generation of Americans to buy rather than save, to borrow rather than invest. History suggests that great civilizations have been fatally weakened through such self-indulgence. David Landes, the great historian of the Industrial Revolution, rendered the pattern in generational terms:

Thus the Britain of the late 19th century basked complacently in the sunset of economic hegemony. In many firms, the grandfather who started the business and built it by unremitting application and by thrift bordering on miserliness had long

## AMERICA TRIUMPHANT: A DISSENTING VIEW

If power is the ability of one country to persuade others to pursue its purposes, the United States has used its power with extraordinary success during the postwar period.

After World War II, America created a world community in which it deliberately shared its economic and industrial power in order to encourage other countries to adopt its purposes: more open political systems and more competitive economic markets. Today, all of the world's industrial countries, many developing ones, and even the socialist countries are democratic and market-oriented or struggling to become so. America now has less relative economic power, to be sure, but it also needs less to promote its most basic political and economic purposes.

Does that suggest that America has declined or that it has used its power successfully?

Those who argue that America is in decline focus only on narrow measures of industrial and economic power. They ignore completely the political environment in which material power is exercised. Yet the political context is what distinguishes America's position today from that of Great Britain a century ago. Great Britain lost relative power in a world that was polarizing between the autocratic purposes of a Prussian-dominated Germany and the republican purposes of France and Great Britain. America has lost relative power in a world that is coalescing around the very democratic and market standards it has long championed.

In a neighborhood of friendly states, the importance of material power is diminished, just as it is reduced when a marriage of two partners is strong. One may wish to carry some in-

surance policies against trouble, but these should not cost much (since the risks are low) and should not be a cause for conflict.

Yet those who focus on America's relative decline and ignore today's more benign political environment advocate policies that would produce greater conflict with America's friends and allies. They see Japan as the new enemy (replacing the Soviet Union) and call for nationalist policies to protect and subsidize American industry. Not only would such policies destroy political community; they would fail economically. Without an industrial policy, America came back during the 1980s and began growing almost as quickly as Japan. It did so by returning, at least partially, to the economic policies of the earlier postwar period, when America laid the foundation for the prosperous and close political community that exists today.

From 1947 to 1967, the United States pursued efficient economic policies—what I call the triad of postwar economic rearmament—involving moderate budget deficits (equal to an average of .2 percent of GNP annually), disciplined monetary policies (keeping inflation below one percent), and restrained regulation of industry. Under U.S. leadership, allied countries pursued similar policies, albeit with higher inflation in Europe and more interventionism in Japan. The resulting prosperity allowed for an unprecedented reduction of trade barriers and a quantum increase in world trade.

Europe and Japan grew faster than the United States, both because they started from further behind and because, as followers, they enjoyed the "advantages of backwardness"—

died; the father who took over and, starting with larger ambitions, raised it to undreamed-of heights, had passed on the reins; now it was the turn of the third generation, the children of affluence. . . . Many of them retired and forced the conversion of their firms into joint-stock companies. Others stayed on and went through the motions of entrepreneurship between the long weekends; they worked at play and played at work.

The pattern Landes describes sounds eerily familiar. Great Britain went through its decadent phase during the Edwardian period,

before World War I. The United States appears to have entered a similar phase today. Financial strategies maximizing short-term profits replace the long-term goals of increasing industrial competitiveness and market share. The industrial pioneers' ethic of hard work and team effort degenerates into the selfishness and conspicuous consumption of the grandsons and granddaughters. In sum, if critics of the contemporary American situation are correct, the United States has now entered a well-nigh

the ability to borrow technology and knowledge cheaply from the United States. But the United States did not stand still. It grew faster during this period than it had before, and as other countries caught up, their rates of growth began to slow.

During the 1970s, America abandoned prudent economic policies and paid dearly for it. But its fortunes revived again during the 1980s when it returned partially to the successful monetary and regulatory policies of the 1950s and 1960s. During the Reagan years, American manufacturing productivity grew at a 3.5 percent annual rate, faster than it did during the "golden era" of 1948-1973 and only a little slower than Japan's recent growth rate. The U.S. share of the manufacturing output and employment of the industrialized countries actually increased, offering no evidence whatsoever of the "deindustrialization" so often invoked by advocates of industrial policy.

Why have these achievements been obscured? Largely because America failed to reverse the disastrous fiscal policies of the 1970s. Budget deficits continued to grow during the 1980s, raising interest rates, sucking in capital and imports, increasing national and international debt, and leaving the impression of a country in decline.

What would happen if America finally reduced its budget deficit? The record of the 1950s and 1960s suggests that, with the "triad" back in place, the United States would flourish once again (and, unlike in the 1980s, on a sustainable basis), helping to pull along the democratizing nations of Eastern Europe and the

developing world, just as earlier U.S. policies to promote free societies, stable prices, and open markets worked so powerfully to build today's community of open and prosperous industrial societies. America would trade further material power, at no loss to its own economic well-being, to bring other countries of the East and South into the Western political community of open societies and competitive markets.

The United States has a unique role to play. American democracy is a powerful example of how to blend diversity with tolerance, how to pursue openness, not as a way to combat nationalism but as an integral part of national identity itself. And other nations would also follow its example if the United States were to return to prudent policies of fiscal and economic management.

Japan and Germany have become powerful competitors of the United States. But they are also politically more friendly and more open to this country than they have ever been in their histories. Japan is becoming more open, slowly, to be sure, but steadily. Newly reunited Germany is electing to remain in the North Atlantic Treaty Organization, under U.S. nuclear protection, and is not only the most powerful economy in the European Community but also the one most inclined to keep European markets open to Japan and the United States.

It is far more important to preserve and broaden this political community than to bemoan America's loss of relative material power—a loss which has been well spent to create a more democratic and peaceful world.

—Henry R. Nau

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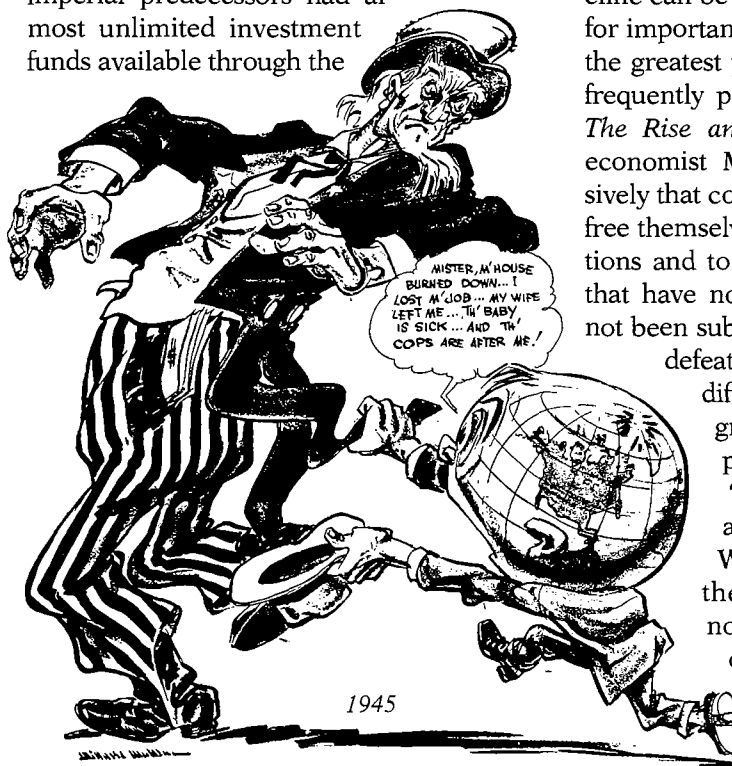
irreversible decline.

**B**ut pessimists, even historically trained ones, are not always right. Nations can decline and rise again. Both Germany and Japan appeared to have reached their economic summits during the 1930s. Yet, after sharp declines, both experienced a remarkable renaissance after World War II. Tsarist Russia reached a major economic peak in 1913, but Stalinist Russia grew rapidly through the late 1920s

and 1930s. True, Russia had to experience a revolution and Japan and Germany had to be defeated in war to trigger the economic transformation. And it also seems to be true that no declining power of hegemonic rank has ever made a real comeback. Spain, Holland, and England never came close to regaining their former status.

But with the possible exception of Russia, none of these nations was a continent-sized power endowed with enormous resources and a large, well-educated

population. None, including Russia, possessed, as the United States does today, a vast and sophisticated industry and the ability to create technology of the highest order. Despite certain parallels with the past, the United States remains in a distinctive position. No hegemonic state in other periods of history remained far ahead of its competitors in the total production of goods and services. None of the imperial predecessors had almost unlimited investment funds available through the



contributions of other nations. No other state was dominant in research in pure science.

Furthermore, the United States, unlike its hegemonic counterparts of yesteryear, is bargaining to maintain its position. Britain failed to negotiate an opening of German or American markets at the end of the 19th century, when economic decay had begun to undermine British industry. Holland could not persuade Britain to reduce its

prohibitive tariffs during the mid-17th century. The United States, however, in tough trade negotiations with the Japanese and others, has shown that it is not willing to offer an unlimited market to nations that are closed to American goods.

In history, it is traditional to chart rise and then decline. Historians have assumed that nations, like biological organisms, rise to power and then age and wither. But decline can be the prelude to rebirth. Indeed, for important countries (though not yet for the greatest powers) decline and loss have frequently preceded economic revival. In *The Rise and Decline of Nations* (1982), economist Mancur Olson argues persuasively that countries need a jarring shock to free themselves from old habits and institutions and to regenerate growth. Countries that have not declined enough, that have not been subjected to the national shock of

defeat and despair, have had more difficulty maintaining economic growth than those that have. Japan, West Germany, France, the "little dragons" of East Asia, and the small democracies of Western and Central Europe—these gained a powerful economic impetus from defeat and occupation in war. By contrast, Britain, Canada, Australia, New Zealand, and the United States—victors all—were not prodded to strive

for economic resurgence and revival.

Rather, the victors chugged along on a curve of moderate military and tepid economic success, spending (in the British and American cases) large amounts on arms and ultimately enfeebling themselves. The worst outcome of a challenge, therefore, is an expensive but narrow triumph.

Victory in two world wars sanctioned a history of indolent economic efforts and impaired social progress in Britain. In the

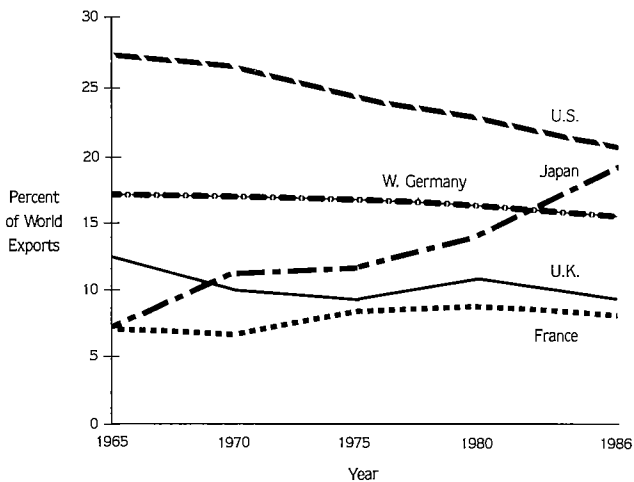


**COMPARING PRODUCTIVITY GROWTH RATES, 1870-1979**  
(Growth Rates of GDP Per Work Hour)

Country	1870-1880	1880-1890	1890-1900	1900-1913	1913-1929	1929-1938	1938-1950	1950-1960	1960-1970	1970-1979
W. Germany	1.50	2.15	2.42	1.41	1.40	2.34	-0.40	6.64	5.29	4.50
France	2.32	0.90	2.02	1.82	2.34	2.83	0.75	4.39	5.38	4.09
Japan	1.87	1.72	2.11	1.88	3.42	3.41	-3.20	5.57	9.96	5.03
U.K.	1.16	1.20	1.24	0.90	1.44	0.87	2.21	2.19	3.56	2.77
U.S.	2.28	1.86	1.96	1.98	2.39	0.74	4.03	2.41	2.51	1.92

Source: *Productivity and American Leadership* (1989), by William J. Baumol, Sue Anne Batey Blackman, and Edward N. Wolff.

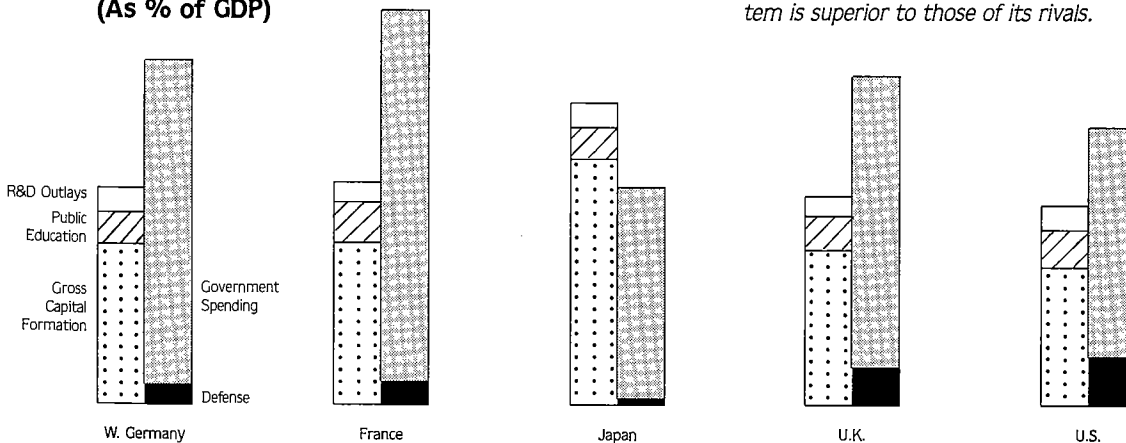
**THE GLOBAL HIGH TECHNOLOGY MARKETPLACE**



Source: National Science Foundation

Statistics provide a mixed picture of U.S. economic performance. Despite a lagging productivity growth rate (above), the U.S. economy remains the world's most productive. Its gross domestic product (GDP) per work hour reached \$8.28 in 1979, while that of Japan was \$4.39. Because of that enormous lead, U.S. growth rates can lag behind those of competitors without immediately threatening U.S. leadership. As the table above shows, that is what has happened since the Great Depression. New data suggest that U.S. productivity growth picked up during the 1980s, but a three percent growth rate may be needed to prevent the United States from falling behind by the year 2020. The global high technology marketplace (left) offers more discouragement: The United States is losing ground rapidly. Finally, the graphs below show how elusive are the sources of national distress. For example, only France devotes a larger share of its GDP to education. Yet few would argue that the U.S. education system is superior to those of its rivals.

**SOME ECONOMIC INDICATORS**  
(As % of GDP)



Source: Organization for Economic Cooperation and Development.

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United States, the Cold War failed to produce the needed reevaluation of economic strategies. (The loss in Vietnam was not a sufficient social shock; in fact, Vietnam was a reverse shock that caused Americans to become alienated from their government and to distrust authority.) The superpower arms race inhibited needed reinvestment in the civilian economy of both adversaries. In Paul Kennedy's words, military "overstretch" and heavy defense spending captured the very investment capital that was needed to regenerate economic growth.

Yet the matter is not so simple, for military spending may not disable an economy if domestic consumption is held in check. This was undoubtedly the case in Britain's costly wars with Napoleonic France between 1795 and 1812, which did not short-circuit the Industrial Revolution in Great Britain. Military spending may even spur industrial growth if there is a great deal of idle industrial capacity. It was chiefly through rearmament outlays, not New Deal social spending, that President Franklin D. Roosevelt finally got America out of the Great Depression. The surge of defense spending during the Korean War did not create inflation or divert civilian investment; it reversed the recession of 1949 and stimulated a boom. Likewise, there appears to be little question that military spending under the Reagan administration helped lift the nation out of the recession of 1981–82.

Excess capacity and civilian consumption, then, have to be included in any account of the effect of military spending upon economic growth. In Britain during the first half of the 19th century, investment and savings remained very significant, while consumption was modest. After mid-century, however, investment began to decline and the British economy was propped up by increased consumption. Military spending was not destructive because from the Crimean War (1854–56) until the very

end of the 19th century (with the Boer War and the beginning of the naval race with Germany) England did not need to re-arm. Its navy was antiquated but still much larger than that of any possible foe, and its overseas empire was quiet, needing little policing. Even after 1897, there was no initial disadvantage because England had excess capacity remaining from the depression of 1873–96. It was not really until World War I that military spending displaced civilian investment. And it was not until the 1920s, and particularly the 1930s, that British governments began to worry about the tradeoff between military preparedness and industrial rejuvenation.

All imperial powers have had to balance consumption, investment, and the costs of empire. During the early 17th century, the Spanish indulged in an orgy of consumption which raised prices and wages. Military demands pushed inflation up more, but the remaining price increases stemmed from the inflationary effects of the vast inflow of bullion from Peru and Mexico. As a result, Madrid lagged behind in productive investment in new products. Spain's traditional wares—silk, textiles, leather, wood, wool, and iron—were priced out of their customary markets in Europe.

A century later, Holland imposed confiscatory taxes to finance its wars against Louis XIV of France. Prices surged, reducing the competitiveness of Dutch goods. In the later stage of the Dutch Empire, inflation encouraged lavish spending by the once somber burghers. Dutch merchants failed to reinvest sufficiently in the now less profitable foreign trade, preferring to send their money to London, where the return was higher. Meanwhile, the streets of Holland's towns and cities were filled with the destitute. In this phase, short-term economic profits for the upper and middle classes took precedence over building a strong national economy at home.

Thus economic growth appears to require both heavy savings and investment, with consumption remaining at a relatively fixed share of GNP, and low military and foreign-policy outlays, except during economic downturns. Rising powers typically find these conditions easier to meet than mature ones. The rising power, however, eventually confronts either rival military powers or the necessity to provide consumers with rewards for their past sacrifices. If both occur at the same time, the nation is forced to deplete its productive assets.

When Great Britain was on the rise, its people invested and saved and aimed for long-term growth. As the British achieved preeminence, however, they began

to yield to the temptation to relax and enjoy their position. Short-term returns became important to appease stockholders and investors and to minimize risk. Factory owners hung on to aging equipment and frequently ne-

glected to make new investments unless they were justified by immediate profits. Thus, after 1870, British manufacturers spent less to create new products than did their counterparts in Germany and the United States. They did less to improve worker productivity, and they acquiesced in a less educated and less technically proficient labor force than that of their rivals. When they found fewer profitable investment opportunities at home they increasingly chose to send their money overseas.

This worked so long as foreign investments and the British money market provided for a balance-of-payments surplus. When those overseas investments were sold off to finance two world wars, how-

ever, Britain had to fall back on merchandise exports at just the time when its past comparative advantages were disappearing.

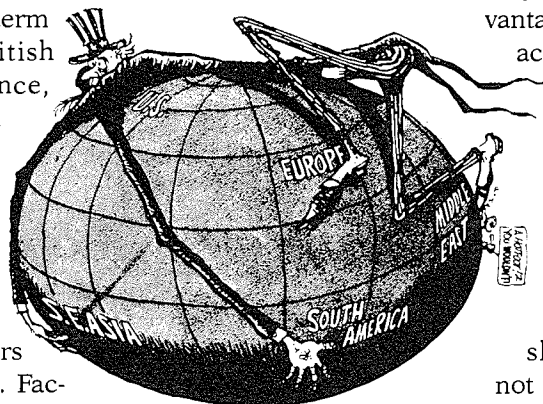
The first indications of decline showed up in productivity. At the peak of its economic power during the third quarter of the century, Britain's labor and capital productivity grew at the solid rate of 1.2 percent per year. For the next 40 years, however, it fell to only 0.4 percent. During the same period productivity rose by 0.9 percent in Germany annually and by 1.2 percent in America. Some economic historians have explained the dynamics of national decline by claiming that the "advantages of backwardness"

accrue to rising economies, which can

simply exploit the industrial lessons and technologies already created by others. This is no doubt true. But Britain during this period slowed down relative not only to its rising competitors but to its own past performance.

The failure to invest was complicated by conflicts between labor and management. Increasing unionization led to worker demands for higher wages and shorter hours. If these had been offset by higher productivity, there would have been no disadvantage, but they were not. Unlike some of its rivals, Britain did not offer enough incentives to improve the performance of labor. Under pressure to reduce costs, British managers were likely to trim wages rather than install labor-saving machinery. But wage reductions alienated workers and further reduced productivity.

The result was that the British worker was neither as well trained nor as motivated as his opposite numbers in Germany



1967

## IN SEARCH OF THE PEACE DIVIDEND

The day of reckoning is fast approaching for the critics who have persistently linked America's declining "competitiveness" to its large military burdens. They have made much of the fact that, compared to such economic rivals as Japan, the United States has been devoting a far bigger share of its gross domestic product (GDP) to the military since 1945 and a far smaller portion to private investment. [See chart, p. 75.] To these observers, Japan's relative economic ascendancy is no mystery. According to MIT's Lester Thurow, since the end of World War II the United States has "essentially taken defense out of investment [and] the consequences have now caught up with us to produce an uncompetitive economy."

Thurow's diagnosis of the "American disease" points to a simple and obvious cure: Cut defense spending. Investment, productivity, and international competitiveness should all rise automatically.

The problem with this analysis, both as an explanation and as a prescription, is that it overlooks the other uses to which national income has been, and could be, put. If the United States has devoted a smaller share of its GDP to private investment than has Japan, it is not only because it has been spending more on defense. Throughout the postwar period, the U.S. government has also spent considerably more on non-defense programs, and it has encouraged much higher levels of private consumption by its citizens.

To speak of a simple, inverse relationship between defense and investment is to ignore the larger and more complex *four-way* trade-off among defense, private investment, private consumption, and the various forms of non-defense government spending. As we enter the post-Cold War era, every dollar cut from defense will not inevitably be invested by American business in the new technology, equipment, and factories that the nation needs so badly. Some of the savings could be channeled into various worthwhile forms of "public investment," such as education, research, and physical infrastructure (e.g., roads, harbors, airports) that would enhance U.S. competitiveness. But a large chunk of the "peace dividend" could just as easily wind up as still more private consumption, or it could be diverted into federal entitlements and other programs that may be politically popular but that make a contribution to the nation's future well-being that is, at

best, questionable.

What will determine the destination of the one, two, or even three percent of GDP that may be freed by defense cuts? In large measure, decisions about taxes and spending that are made in Washington. If the aim is to enhance American competitiveness, the best approach would be to apply most of the savings to lowering the federal budget deficit. This would reduce the demand for capital, permitting interest rates to fall and encouraging private investment. A smaller defense budget should also make it easier selectively to expand public investment in education, research, and infrastructure. Given the multitude of claims already staked on the "peace dividend" and the vagaries of the federal budget process, a perfect mix of these two policies will not be achieved. It remains to be seen whether or not one can even be approximated.

There is a second way in which big defense budgets may have harmed the U.S. economy. The postwar effort to maintain a decisive technological lead in weaponry over the Soviets required huge government outlays for research and development (R&D) and the employment of large numbers of scientists and engineers by both government laboratories and private defense contractors. This may have bid up researchers' wages (and employers' costs), drawn scarce skilled manpower away from commercial R&D, and held back American industry's technological progress. The end of the Cold War should throw this process into reverse.

But it is not obvious that this will happen or, if it does, that the impact will be dramatic. There are powerful strategic arguments for maintaining a vigorous defense research effort, even as spending on military personnel and arms procurement is reduced. This is not to mention the powerful political arguments that surely will be advanced by self-interested defense contractors.

Even if research on new weapons *were* to be sharply scaled back, the effects might not be as great as many people expect. If, as some have alleged, close to half of the nation's scientific and engineering work force is now engaged in defense-related projects, a 50 percent drop in military R&D might free a quarter of the nation's researchers for employment on purely commercial projects. Recent surveys suggest, however, that the defense "brain drain" is much smaller. According to the Na-

tional Science Foundation, at the peak of the Reagan build-up during the mid-1980s, defense projects employed 15.5 percent of all engineers and scientists with bachelor's degrees, 19.9 percent of those with master's degrees, and only 8.5 percent of those holding Ph.D.'s. Thus, even a very large R&D cutback would have relatively modest effects. And, unfortunately for them and for their country, the people most immediately "freed" by the coming build-down (nuclear physicists, for example) will not necessarily be those best suited for civilian research projects.

Even if defense cutbacks *do* reduce the costs of private sector research, other forces may continue to inhibit American corporate R&D. Economists cite everything from the structure of the federal tax code, Wall Street's emphasis on short-term profits, the disruptive effects of mergers and acquisitions, and the functioning of the country's anti-trust laws. Some of these may be within the reach of government action, but none will be changed simply by reducing federal spending on military R&D. By itself, plainly, a defense cutback cannot be expected to stimulate a corporate research renaissance.

But there is a third possibility. If the Defense Department spends less on weapons research, more money could conceivably become available for federally financed efforts aimed directly at stimulating commercial innovation. In the past the government has deliberately avoided such programs, preferring to rely on the market and the "spinoff" from defense research to maintain America's lead in commercial technology. But many analysts now believe that defense research has become so specialized that it yields far fewer "spinoffs" than before. Reversing an earlier pattern, advances in civilian technology—e.g., microelectronics—are now finding their way into new weapons systems. But in this and a variety of other areas

that are important both for military and commercial reasons, American firms no longer hold a clear technological edge over their foreign counterparts.

As a result, there has been growing support in Congress, industry, and some parts of the executive branch for the idea that Washington ought to fund research on so-called "dual use" technologies—things like high-definition television and next-generation semiconductors, which could be useful both to the military and to industry. Some have gone one step further and urged direct federal support for purely commercial R&D.

The ideological and practical objections to any scheme that asks government bureaucrats in effect to pick winning technologies are obvious enough. Whether there may be some circumstances in which intervention is nevertheless desirable remains a subject of heated

dispute. For now, however, the question is moot. The Bush administration has made its position clear by refusing to be drawn more deeply into supporting even dual-use (let alone purely commercial) research and by reigning in government officials who disagree with its policies. (One of these,

Craig Fields, was recently dismissed from his job as chief of the Pentagon's Defense Advanced Research Projects Agency.) At least for the time being, federal support for commercial research is not going to increase no matter what happens to defense R&D.

By freeing scarce human and financial resources, the end of the Cold War creates opportunities for the future, but it does not provide any guarantees. What happens next depends on the uses to which those resources are put, and that depends not only on immutable economic principles but on the untidy world of politics, on debates that have yet to be resolved and on decisions that have yet to be made.

—Aaron Friedberg



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and the United States. Britain did not even introduce compulsory primary education until 1880. In steel and engineering, Britain tended to rely on the talented “tinkerer” rather than the trained engineer or scientist. The British generally confined their research activities to areas that would return an immediate profit, while German managers made painstaking efforts to discover and create new products in chemicals and other lines. Finally, British scientists and engineers were paid less than their American or German counterparts. At the Woolwich Arsenal, for example, chemists earned £100 a year, the same as workers.

Perhaps Britain could have compensated for deficient labor productivity with more investment. But after 1900 it sent an even greater proportion of its capital abroad. By the last decade before World War I, domestic investment had declined to 8.7 percent of GNP and more than 5 percent was invested abroad. At a time when the United States was devoting more than 21 percent and Germany 23 percent of GNP to investment at home, the British failure to reinvest was fatal.

How could this have occurred? Economic historian Arthur Lewis contends that the productivity of the British working man was already so much lower than that of his American counterpart that businessmen could not even make automatic looms, mechanical coal cutters, and other labor-saving machinery pay for themselves, at least in the short term.

Britain’s inability to make headway in the markets of its principal rivals—Germany and the United States—confronted it with several possible responses. It could have moved to higher-quality products (enhancing profits); it could have tried to reduce costs (through labor-saving devices); or it could have directed traditional products to new markets. Largely, it adopted the third alternative. As late as 1870 Europe

bought 42 percent of British exports, but by 1910 the figure had declined to 35 percent. Meanwhile, the total purchased by Africa, Asia, and Australasia rose from 29 percent to 43 percent. But this palliative would work only until Britain’s competitors turned their sights on the same markets.

A fourth tack might have led Britain to innovate and introduce new industrial products. America and Germany were rapidly turning their attention to electrical appliances, automobiles, and chemicals. Like the United States today, Britain had initial advantages in many of the new technological fields of the day. The British made the essential discoveries in steelmaking, but they often found that their designs were put into service by others. Britain built the world’s first functioning electric power station, but America and Germany spread urban electrification more quickly and then applied electric motors to industry.

Ultimately, however, it was the cost of two world wars that destroyed British economic illusions. In the first great encounter, Britain was forced to borrow nearly two-thirds of war costs from its citizens and from the United States. This might have posed no problem had British exports remained competitive, but they did not. During World War I, Britain lost its primacy in shipping and textiles and had to sell off half its foreign investments. John Maynard Keynes managed the Treasury portfolio during the war with remarkable dexterity, but on February 22, 1917, he calculated that Britain’s gold stock would not last “for more than four weeks from today.” Only America’s entry into the war saved Britain from bankruptcy. It was true, as Paul Kennedy wrote, that “The harder the British fought, the more they bankrupted themselves.”

What does the British example tell us about economic ossification and decline? From 1860 to 1913, Britain invested too lit-

tle in its home industry and consumed too much. The record does not demonstrate that military spending was the cause of British decline. Britain was failing to invest at German and American rates long before it was forced to divert funds from the civilian economy to rearmament. The war merely completed the process.

**N**ot surprisingly, the Dutch Empire, Britain, and the United States all confronted the twin problems of high consumption and large military outlays, though the sequence differed in each case. Holland had to fight Louis XIV on land and, for a time, Britain at sea. During World War I, England had the burden of maintaining its dominance at sea at precisely the same time that it had to raise an expeditionary force to resist the German challenge on the continent. It did this carefully, always husbanding its forces and hoping to keep France at the forefront of the continental military effort. But the role left for Britain was still too much for it.

By comparison, the United States today not only seeks to maintain superiority at sea but also seems likely to try to keep a substantial force on the land in Europe despite the dissipation of the Soviet threat. The Iraqi challenge could even elicit a new long-term commitment of forces in the Middle East. Even with the reduced priority given to the Strategic Defense Initiative, America continues to aim at military dominance in space. Although the United States spent heavily on defense after World War II, U.S. decline did not reach exaggerated proportions until the defense-spending binge of the Reagan administration. That was because, even more than in the Vietnam War buildup, defense expenditure was not allowed to reduce civilian consumption but was financed by domestic and international borrowing.

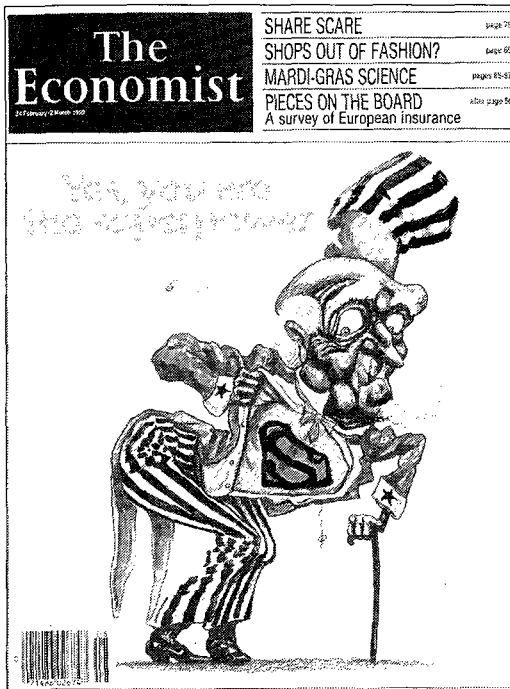
That strategy created no great difficulty

for post-Napoleonic Great Britain, because the country maintained a solid surplus in its balance of payments. By contrast, during the 1980s American exports were allowed to fall well beneath imports, and there was no immediate way to repay the nation's growing foreign debts.

The timing of big increases in military outlays can be just as important as their amount. During the Napoleonic Wars, Britain restrained domestic consumption by raising taxes, while borrowing heavily to finance its military effort. By World War I, however, consumption was already too great. Civilian investment had to be sacrificed to pay for guns and soldiers. By the time the war was over, Britain had already lost many markets; it was nearly too late to redeem its industrial future.

The yet unanswered question for the United States is whether it can increase national savings and investment in time to achieve higher rates of productivity growth. Can America surmount the limitations that history seeks to impose upon great powers?

We have already seen that no truly hegemonic power of the past has ever been able to bring itself back. The powers that have made a return (such as Japan and Germany) did so under the beneficent protection of others. But history does not lend us enough perspective to predict the consequences of America's current condition. In certain respects our situation is unparalleled. The military load on the great powers of the past was never lightened. For the United States today, a reduced military burden seems possible if we can avoid a costly permanent commitment in the Middle East. Every earlier hegemonic power had to keep looking over its shoulder to see who might be gaining on it. Spain had to worry about France and the Netherlands; Holland had to contend with France and England; and Britain could not neglect the German challenge.



1990. A British view.

During the 1990s, however, the world will confront an entirely new situation. There is and will likely be no hegemonic successor to the United States. Though there will be military threats to guard against, as the Iraqi invasion of Kuwait reminds us, no single military challenger will be capable of wresting leadership from the United States. As America looks over its shoulder, the country gaining on it is not a great military power but rather a “trading state,” Japan. There is no great and sustained territorial threat to the existing order. Thus the choices that world leaders faced in the past were different from those confronting the United States. In the past, the choice was to continue to struggle for primacy, with disastrous economic consequences, or to drop out of the great-power race. Every other great power has been forced to give up. The United States does not confront such a dilemma. It can continue, though in a slightly diminished role,

because there is no combined military and economic challenger.

History shows that a shock usually is needed to bestir the complacent social and economic system of a great power. But there are several reasons to believe that a shock short of total war will suffice to arouse the United States. First, a major economic challenge in the form of a sharp recession is sure to confront the nation in the near future. Second, there is the challenge of foreign trade. In the past, other world leaders, particularly Holland and Britain, were major trading powers, but military preoccupations prevented them from fully pursuing their trading vocation. For too long, they limped along, attempting to combine their great-power role with a flourishing export sector. By the time they realized that they could not do both, they had lost their trading advantage. The Dutch even missed the first installment of the Industrial Revolution, thereby postponing industrialization until the late 19th century. Britain still has not regained the markets and market share that it lost in World War I. The end of the Cold War spares the United States a similar fate. Unlike its predecessors, it will increasingly be able to concentrate on foreign trade.

At the same time, the international economic and financial system is now uniquely favorable to an American revival. Support for foreign trade has risen not only in the United States but around the world. Always before, there were major conflicts between countries in which capital was scarce and those in which capital was abundant. Broadly speaking, capital-abundant countries wanted low tariffs and benefited from expanding trade. By contrast, capital-scarce and land-scarce countries favored protectionism. As nation after nation (most recently South Korea) has entered the phase of capital abundance since World War II, dominant economic interests



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within these countries have also acquired an interest in low tariffs. This may well be the reason why there has been no general move to higher tariffs in the United States, despite the nation's vexing trade deficits. Certain sectors of industry have asked for and received relief, but Japan continues to sell 36 percent of its exports in the American marketplace. During the 1930s, the United States retreated behind high tariff walls; today, it remains in the international marketplace. And there are few greater incentives to modernize industry than the challenge of foreign trade.

**I**n summary, given a major shock or stimulus and a favorable international environment, nations can alter a trajectory of decline. Resurgence becomes possible when the fact of failure can no longer be denied, and when new resources become available to finance an alternative strategy. Then the challenge to the national psyche shatters past assumptions and breaks conventional patterns of behavior. The chastened state can retrench and regroup, cut military spending and consumption, and dedicate itself to a new strategy combining industrial modernization and the expansion of exports.

To be sure, too great a delay in returning to such a strategy can do irreparable harm to domestic economic institutions, making it impossible to catch up. American scientific and technical research still sets the standard for the world. Major U.S. industries, such as civil aviation, chemicals, pharmaceuticals, computers, and software, retain their leading edge. But if there is to be an American renaissance, our national neglect of these assets must end soon. There are no mysteries about what needs to

be done: Layers of bureaucracy must be stripped away from the public and private sectors; tax policies that encourage corporate indebtedness must be reversed; government deficits and other policies that raise the cost of investment capital must be erased; and it may be necessary for government to channel capital directly to industry. Above all, improvements are needed in American schools to keep U.S. workers competitive internationally.

There are two major reasons to be confident that the United States will regain its equilibrium. For perhaps the first time in modern history, international relations—in this case, international economics—is the stimulus to domestic change. In the past, international relations was governed by epoch-shaping events in individual countries—the French Revolution, the Bolshevik Revolution. Now the central realities are the rise of Japan, the archetypical trading state, and the paramount importance of international economic competition. As the Soviet Union, Eastern Europe, and China liberalize their economies, these new challenges are certain to spark a resurgence of American industry.

The new emphasis on economic competition will also create a more favorable environment for an American renaissance. Because the growth of one nation does not impede that of another (and may even aid it), the pursuit of economic growth will reduce international conflict, providing the United States with the opportunity to reduce its costly foreign burdens. The challenge of international politics becomes economics and foreign trade, not warfare. Under these new conditions, the decline of nations is no longer final. Great powers can recover and ascend.

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## BACKGROUND BOOKS

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### MUST AMERICA DECLINE?

The decline and fall of nations is one of the great themes of history. It is a natural subject, as Thucydides said of history generally, for "those inquirers who desire an exact knowledge of the past as an aid to the interpretation of the future, which in the course of human things must resemble if it does not reflect it."

Over the years, the theme of decline has also proved to be a useful tool for those with an axe to grind or an agenda to promote—or, to put it more generously, those who believe that they possess profound insight into the problems of the world. A useful corrective is **The Ages of Man: From Savage to Sew-age** (Am. Heritage, 1971), by historian Marcus Cunliffe.

The first great modern study of decline was Giambattista Vico's **New Science** (1725), but it did not achieve wide recognition until the 20th century. Edward Gibbon's **Decline and Fall of the Roman Empire** (1776–88) was immediately recognized as a masterpiece. It neither reflected any large public anxiety about the fate of Gibbon's England nor contained many usable prescriptions for the future, although Gibbon did warn that barbarians in every age "have oppressed the polite and peaceful nations . . . who neglected, and still neglect, to counterbalance these natural powers by the resources of military art." But unlike the scores of writers who would later find dire lessons for their own societies in the fall of Rome, Gibbon was an optimist about the future. "Every age of the world," he wrote, "has increased, and still increases, the real wealth, the happiness, the knowledge, and perhaps the virtue, of the human race."

Not until the 20th century did decline become a major preoccupation of Western thinkers. In part due to the influential historical theories of Hegel and Marx, writers discovered many permutations of decline and inaugurated what has turned into a century-long discussion of the phenomenon in its various guises and quarters. How many books, for example, have been written about the "decline" or "twilight" of democracy during the last 50 years?

Prominent among the century's early thinkers was Germany's Oswald Spengler, whose **The Decline of the West** (1918–22) spelled out in dense and sometimes mystical prose his cy-

clical theory of civilizations. (The other major cyclical theorist of the century was Arnold Toynbee, who was more interested in the rise of civilizations than in their fall.) Spengler argued that the West had reached the point of moral and spiritual exhaustion. "Let it be realized, then: That the 19th and 20th centuries, hitherto looked on as the highest point of an ascending straight line of world-history, are in reality a stage of life which may be observed in every Culture that has ripened to its limit," he wrote.

Academics dismissed Spengler's book, but the Western public, surprisingly, liked it. And it was in America, Klaus P. Fischer writes in **History and Prophecy: Oswald Spengler and the Decline of the West** (Moore, 1977), that the book received its warmest reception. An impressive 20,000 copies were sold. "Spengler seems to have stirred the Puritan conscience in America," Fisher writes, "bringing out all the latent guilt of decadence and riotous living."

The decline of the West had already been taken up as a theme by a number of conservative critics, including Brooks and Henry Adams, two brothers descended from two American presidents. Brooks, the younger of the two, concluded in **The Law of Civilization and Decay** (1895) that Western Europe had passed its peak and that Russia and the United States were the only potential great powers left. It was not a development that filled him with joy, for he believed that the world was moving from a glorious religious-artistic age to a dreary era dominated by economics and science. In **The Education of Henry Adams** (1907), Henry developed his famous metaphor of the dynamo to describe the sterile energy that he saw as the driving force of American society. He believed that the United States was the first country in history to pass directly from barbarism to decadence, skipping the intermediate stage of civilization.

While the Adams brothers were riding upward on the American industrial elevator and fretting over America's *moral* decline, other thinkers riding downward on the British elevator had more immediate problems on their minds. Their writings, along with much that has since been written on the British experience, are thoroughly assayed in Aaron L.

Friedberg's **Weary Titan: Britain and the Experience of Relative Decline, 1895-1905** (Princeton, 1988).

Even when Britain was at its height, during the 1870s, Friedberg writes, some Britons realized that competitors were rapidly catching up. The alarm was spread by such books as Ernest E. Williams's bestselling **Made in Germany** (1896) and F. A. McKenzie's somewhat less successful **American Invaders: Their Plans, Tactics, and Progress** (1901). As in America today, a profusion of studies and statistics appeared—most of them confusing, contradictory, or simply wrong. Britain's national debate over its future did yield the makings of an "industrial policy" that might, in Friedberg's view, have kept Britain afloat. But all hope for a concerted response vanished after Joseph Chamberlain, the Conservative colonial secretary, delivered a radical protectionist speech in 1903. Hoping to galvanize debate, says Friedberg, he instead polarized it between free traders who "simply refused to admit that any problems existed," and protectionists who "blamed foreign governments for all of Britain's woes." Debates over the nation's domestic spending and imperial military commitments were no more decisively resolved. Britain tried "to play the part of a world power without being willing to pay for the privilege."

If there is a contemporary counterpart to Williams's *Made in Germany*, it is Ezra Vogel's **Japan As Number One: Lessons for America** (Harvard, 1979), an admiring study of Japan's postwar success which crystallized anxieties about the American position in the world that were in the air during the 1970s. Vogel endorses "industrial policy" and other familiar liberal economic prescriptions for U.S. renewal, but the main thrust of his analysis is cultural. "In the guise of pursuing freedoms," he warns, Americans "have supported egoism and self-interest and have damaged group or common interests."

A strong political critique was advanced by economist Mancur Olson in **The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities** (Yale, 1982). Olson argues that special-interest groups are the equivalent of cholesterol clogging the arter-

ies of the body politic. Unfortunately, Olson's book also serves as an example of how declinists are perennially undone by attributing cosmic significance to problems of the day. He cites the now-forgotten peril of "stagflation" as a key symptom of U.S. decline.

Oddly, it has been liberals who have been left to sound most of the alarms about cultural, political, and moral decay in recent times. Conservatives (with a few notable exceptions) seem to feel obliged to defend the individualist, consumerist culture that their supposed forebears, the Adams brothers, so despised. The conservative diagnosis of decline has focused on military and economic power, and it is summed up best not by any book—although Jack Kemp's **An American Renaissance** (Harper & Row, 1979) captured the spirit—but by the tax and defense programs of Ronald Reagan. Free markets and a strong defense are the main conservative themes of renewal.

Paul Kennedy's scholarly, even turgid, **Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000** (Random House, 1987) may not have been meant as a response to the Reagan program, but it certainly has been read that way. Kennedy argues that the shifting balance of economic power in the world, along with "imperial overstretch" caused by excessive U.S. commitments overseas, threaten American world leadership.

His book has touched off a far-reaching debate about the American future. (Among the notable replies to Kennedy is Joseph S. Nye, Jr.'s **Bound to Lead: The Changing Nature of American Power** [Basic, 1990].) History does not offer very much encouragement that this debate will resolve the American predicament. "It is remarkable to see how relatively numerous in declining empires are the people capable of making the right diagnosis and preaching some sensible cures," writes economist Carlo M. Cipolla in **The Economic Decline of Empires** (Methuen, 1970). "It is no less remarkable, however, that wise utterances remain generally sterile, because, as Gonzales de Cellorigo forcefully put it while watching impotently the decline of Spain, 'those who can will not and those who will cannot.'"