



PROJECT MUSE®

Debating the Global Financial Architecture

Armijo, Leslie Elliott

Published by State University of New York Press

Armijo, Leslie Elliott.

Debating the Global Financial Architecture.

State University of New York Press, 2002.

Project MUSE.muse.jhu.edu/book/4560.



➔ For additional information about this book

<https://muse.jhu.edu/book/4560>

Chapter 1

THE TERMS OF THE DEBATE: WHAT'S DEMOCRACY GOT TO DO WITH IT?

Leslie Elliott Armijo

At the dawn of the twenty-first century, reform of the global financial architecture has become a burning issue, albeit almost exclusively within an extraordinarily narrow circle of policymakers and interested parties. The current debate results from a series of high-profile financial crises in the 1990s. In 1992 and 1993 troubles in Western Europe's Exchange Rate Mechanism (ERM) cost the German government at least \$1 billion and the Swedish government as much as \$26 billion and brought fame and wealth to financier George Soros, who correctly bet against the British pound sterling. In 1994 and 1995 the Mexican peso crisis and subsequent "tequila effect" devastated emerging markets throughout Latin America and other countries as far flung as Canada and the Philippines. And from 1997 to 1999 the East Asian financial crisis brought down Indonesia's Suharto after thirty years in power, and exposed the feet of clay of several of the much admired Asian tigers. Front page pictures of Indonesian President Suharto signing a loan agreement with International Monetary Fund Managing Director Michel Camdessus looking over his shoulder, and of newly elected Korean President Kim Dae Jung exchanging a hearty handshake and photo opportunity with George Soros, defined the moment. Less noticed outside financial circles was the eleventh-hour weekend rescue of Long-Term Capital Management, a little known American hedge fund, in the fall of 1998, just after the Russian financial crisis and just prior to the Brazilian one. The rescue relied on "voluntary contributions" of funds from major private U.S. banks, but was urgently coordinated by Gerald Corrigan, Chairman of the New York Federal Reserve Bank. These events spawned a flurry of commissions and studies.

This book, written in 1999 and 2000, contains observations on both the process and the content of proposed reforms. The authors are political scientists and economists. These disciplines not being as close as they once were, my overview chapter sets itself definitional as well as analytical tasks. I also hope to suggest that neither the economic perspective (more oriented toward the *con-*

tent and economic results of the global financial architecture), nor the political one (typically focused on actors, perceptions, preferences, power, and decision-making *processes*) is alone adequate to comprehend or make policy for international monetary and financial relations. At the same time, I argue a substantive thesis: an international financial architecture that is *consistent with underlying global political and social realities* will be both more effective and more enduring than one that is not.

Section one reviews the functions of an international financial architecture. Section two summarizes the main institutions of the four historical financial architectures since the mid-nineteenth century, briefly evaluating each. Section three explores the implications of three secular trends in the international political economy for understanding the performance of past and potential future international financial architectures. *Technological advancement* can render what were once perfectly adequate regulatory frameworks newly incompetent. Gradually *declining United States hegemony* seems to make greater multilateral cooperation over reform of the global financial architecture imperative—though never easy to achieve. The *spread of mass democracy* to so-called emerging market countries implies that any international monetary regime that does not provide at least minimal buffering to the domestic economies of developing countries will be inherently unstable and unsustainable for those countries, with potentially dangerous consequences for the advanced capitalist countries as well. The uncomfortable conclusion of the section is that a debate over the future financial architecture that continues to be overwhelmingly dominated by the preferences of interests located within the United States may not produce a reform blueprint that can last. I note that this statement is positive, not normative. Section four summarizes the ideas and interests behind four dominant contemporary perspectives on global financial reform. Unfortunately, the most influential positions in the contemporary debate largely ignore the questions of international political feasibility and long-term political sustainability raised in this book.

THE FUNCTIONS OF AN INTERNATIONAL FINANCIAL ARCHITECTURE

The global financial architecture is what contemporary international relations theorists term an “international regime,” designating a set of “principles, norms, rules, and procedures” in an international issue arena (Krasner 1982).¹ The international financial architecture consists of a loose set of multilateral agreements and understandings, among a core group of powerful capitalist states, about the rules and norms that govern, and/or should govern, cross-border money and credit transactions of all kinds. These understandings may be informal, written, and/or embodied in shared expectations about the normal operations of ongoing international or transnational organizations. The most obvious and

influential actors in the international financial and monetary regulatory arena are nation-states, which are the primary focus of my analysis. Private actors, from multinational banks to nongovernmental organizations, also are intermittent players at the international level, as well as working actively within national borders to influence the global economic policy stances of governments. The international financial institutions (IFIs) and various multilateral forums are simultaneously locations within which bargaining occurs and independent participants in their own right.

An initial and often overlooked observation is that an international financial architecture only becomes necessary where two conditions hold. First, international trade is primarily through purchase, not barter. Second, some significant portion of the money in circulation within and between the major economies of the system is of uncertain value or entirely lacking in intrinsic worth, the latter being the case with all paper currency. In order to accept currency, or even coins of ambiguous provenance and quality, in settlement sellers need to believe that this money will retain its value when they in turn spend it. Maintaining the value of international money is thus the most essential point of the exercise. It is noteworthy that the world progressed from a nineteenth-century situation in which major currencies were redeemable in gold at a fixed rate, to a system in which major currencies were redeemable at a fixed rate in a key currency, the U.S. dollar, itself redeemable at a fixed rate in gold. Since the early 1970s, however, major currencies have been redeemable at a floating—and thus fundamentally uncertain—rate in a key currency, typically the U.S. dollar. The U.S. dollar meanwhile is itself redeemable at a floating, and thus fundamentally uncertain, rate in other major currencies. One begins to understand the overwhelming importance of credibility to the system.

International economists typically assess alternative international financial arrangements in terms of the way they fulfill three tasks: *adjustment*, *liquidity*, and provision of a lender of last resort, or more generally, *stability*.

Adjustment

The core meaning of adjustment is coping with the adverse domestic economic consequences of structural trade imbalances. The underlying assumption is that international trade is good. Free trade allows beneficial specialization via each country's comparative advantage, as given by its relative endowments of factors of production such as labor, capital, and land. Trade raises world income and benefits each country, at least as an aggregate, and is thus worth preserving and expanding. However, in the real world a country's exports and imports to the rest of the world frequently will not balance, either in the short-term or over a longer period such as a year, the latter situation constituting a "structural" im-

Table 1.1 Functions of an International Financial Architecture

<i>Task</i>	<i>Adjustment</i>	<i>Liquidity</i>	<i>Stability</i>
Main Purpose	Rebalance external accounts, making trade possible	Support growth	Prevent international crises
Main Processes	<ul style="list-style-type: none"> • Exchange rate regime • Regulation (or not) of private capital flows 	<ul style="list-style-type: none"> • Reserve standard • Regulation (or not) of private capital flows • IFI investment and lending (or not) 	<ul style="list-style-type: none"> • Lender of last resort • Data collection and dissemination • Regulation (or not) of private capital flows
Major Institutional Alternatives	<ul style="list-style-type: none"> • Fixed exchange rates • Intermediate regimes (adjustable peg, crawling peg, managed float) • Freely floating exchange rates 	<ul style="list-style-type: none"> • Reserve standard: <ul style="list-style-type: none"> (a) gold (b) gold exchange (c) key currency (d) multiple key currencies • Private capital flows <ul style="list-style-type: none"> (a) laissez-faire (b) purely national regulation (c) multilateral regulation 	<ul style="list-style-type: none"> • Crisis management is: <ul style="list-style-type: none"> • Ad hoc • Partially institutionalized • Both institutionalized and explicitly representative

balance. Unless trade is by barter, accounts are settled in money, with exporters in any given country usually preferring to be paid in their national currency. A trade deficit implies a demand at home for foreign goods, which must ultimately be purchased with foreign money, that is greater than the offsetting demand of foreigners for the home country's goods, and thus for the home country's money. This generates a net outflow of the first country's stocks of foreign money, or foreign exchange reserves. A trade surplus in the second country meanwhile provokes the accumulation of reserves. A trade imbalance cannot continue indefinitely. Either the parties somehow must adjust, or trade itself will cease.

Capital account flows, or cross-border investments unconnected to the exchange of goods or services, may also generate trade-inhibiting external imbalances. For example, persistent net inflows may result when a country's real domestic interest rate (the price that large borrowers, such as private banks or the government, pay for the loan of funds) exceeds that prevailing in global markets. Under floating exchange rates, such net capital inflows may result in a

currency that is overvalued relative to its domestic purchasing power. Alternatively, capital flight (that is, large net capital outflows unwanted by the national authorities) may put unsustainable downward pressure on a fixed exchange rate. Both of these problems may occur even when the country's underlying trade accounts remain in rough balance.

There are three principal institutional alternatives for solving an external imbalance through the global financial system. In a world of freely convertible national monies, exchange rates may either be fixed or float. Under *fixed exchange rates* a deficit nation is, in principle, automatically on a diet or a budget. When the foreign exchange is gone, nothing more can be imported. As the quantity of reserves (gold and foreign exchange held by the central bank as backing for the paper currency) shrinks, the monetary authority withdraws credit from the national economy, provoking a fall in overall economic activity.² Less money for the same amount of goods soon results in reduced consumption and investment, including diminished demand for imports, and/or falling prices. Meanwhile, the trading partner with a surplus has an economic expansion; as its central bank uses the excess reserves to expand credit, its import demand rises. Voilà, equilibration has occurred. The gold standard, in which all major currencies are pegged to and convertible in gold, is a special case of a fixed exchange rate regime. A gold exchange standard means that a dominant currency, such as the U.S. dollar, is convertible in gold; other major currencies freely convert into dollars.

The most serious implementation problem for fixed exchange rates is that national governments resist the supposedly automatic discipline of allowing the country's trade position to determine the level of domestic activity. The cure, economy-wide recession (less frequently expansion) seems worse than the disease, so adjustment is postponed, perhaps indefinitely, while the deficit country keeps the problem from worsening by employing trade barriers and/or capital controls. Yet when an objective need for adjustment is finessed, fixed rates become risky. Speculators, recognizing an unsustainable trade imbalance, usually a deficit, "bet against the currency," engaging in a "war" with the central bank to force an emergency devaluation. When it arrives, such a devaluation provides a deep shock to the domestic economy, dramatically and with no warning reducing the country's purchasing power as imports, and by implication domestic products that compete with imports, now suddenly become much more costly. The depth of the shock depends upon the country's degree of trade integration. Larger, more insular countries have less to fear from sudden, unexpected exchange rate movements than do smaller, more internationalized economies.

Under *floating rates* the relative prices of currencies are set in a market in which prices can change at any pace from monthly to every few seconds, depending upon the trading technology. In principle, a trade deficit causes the price of a currency to fall relative to one or more trading partners, making exports cheaper and thus more desirable abroad, while the reverse is true for imported

goods, thus provoking a rebalancing of the country's trade account. The mechanism is simple and elegant and requires no centralized decision making or oversight. The drawbacks of floating exchange rates appear mainly in practice. Although floating rates are meant to facilitate trade, they actually can discourage it, as sellers and buyers resist entering into contracts with their local prices unspecified. Floating rates also allow for, and perhaps render irresistible, currency speculation, in which individuals hoard (or sell) national monies, not for the purpose of purchasing goods or services, but on a bet that exchange rates will rise (or fall). A little such speculation usefully greases the wheels, but when the volume of foreign exchange trading vastly outstrips the money value of total trade, as has increasingly been the case in the world since the 1980s, adjustment to an underlying trade imbalance is no longer what actually is driving foreign exchange markets (see the chapters by Benjamin J. Cohen and David Felix). A principal drawback to freely floating rates, particularly in a world of rapid and deep foreign exchange trading, is that they are vulnerable to speculative overshooting. The relative prices of currencies become delinked from countries' present, or likely future, relative trade positions. In other words, the intended solution to external imbalances instead worsens the problem.

A third institutional possibility for achieving adjustment to trade imbalances is some form of *intermediate regime*, such as an "adjustable peg" (that is, fixed rates until the objective need for readjustment can be ascertained by some authoritative and prespecified decision process, whether multilateral or purely national) or a "managed float" (in which central bankers intervene in foreign exchange markets with the purpose of countering speculation around the "true" value of a given currency).

The preceding paragraphs assumed that all major countries in the system would adopt the same exchange rate regime. Both fixed and floating rates function more smoothly if governments in all of the major economies adhere to similar rules. Yet given the absence of world government, there is of course no military or other overt political sanction that major independent powers can exercise against one another in order to force compliance. Moreover, different adjustment mechanisms may favor one or another country. Generally, however, floating rates tend to drive out fixed rates, as in the short run a national government that can readily manipulate the value of its currency has an advantage, causing currency traders to shun fixed rate monies unless they can be very confident of the incumbent government's determination not to devalue, and to forswear domestic economic policies that might later provoke an unwanted devaluation.

National governments may also employ controls and regulations on private capital flows as an aid to balancing their external accounts, ranging from the creation of desirable financial assets available only to those with foreign exchange to quantitative controls on cross-border flows. Finally, national governments may borrow, or lend (that is, invest), abroad. We are accustomed to

conceiving of capital controls or inducements, and of government decisions to borrow or lend internationally, as purely national decisions. However, there is no inherent technical reason why such policies cannot be the subject of international bargaining, agreement, and implementation.

Liquidity

An international financial architecture also must ensure liquidity, or make available money and credit. In a national economy additions to liquidity come about through injections of cash or credit into the domestic money supply, as when a central bank purchases outstanding government bonds or lowers interest rates. If a nation's money supply fails to increase gradually over time, then any incipient increase in production of goods and services will be stifled by insufficient financing, as the price of money is bid up and investment slows. Similarly, the provision of net additions to liquidity in the global system is an important determinant of world economic growth.

An international financial architecture sets several kinds of standards that have critical implications for systemic liquidity. First, what money will be used for payments across borders? That is, what is the architecture's implicit or explicit reserve standard? Second, what, if any, constraints will individual states, or the international community as a whole, impose on private decisions to transport funds across borders? Third, does the international community as a whole—or do leading members of it—take any explicit collective responsibility for the provision of systemic liquidity? For providing credit and investment funds to individual countries?

International payments can be based on a *money of intrinsic value*, such as gold or silver, or on a paper currency credibly redeemable in precious metals. Under this system, of which the gold standard was an example, the world's money supply increases only when there are new discoveries of precious metals, which unavoidably leaves international liquidity growth to chance. Under a *gold exchange* system, a country willing to convert its home paper currency into gold on demand becomes the key currency country of the system. In this case, new additions to global liquidity can result either from the discovery of gold or the individual decisions of foreign private citizens and foreign central banks to increase their holdings of the key currency outside the country of its origin.³ The advantage of this arrangement is that expansion of the world's money supply is not left entirely to chance. A crucial disadvantage, from the viewpoint of non-key currency countries, is that the key currency country may use its monetary influence to enhance its overall national power.

A third possibility is a straightforward *key currency* system, in which other countries hold quantities of the key currency as their main reserve asset—even though the key currency country no longer agrees to redeem this currency in

gold. This is a risky system in that there is little to fall back on if the key currency is ever seriously questioned. Fortunately, participants in a pure key currency system each have a strong individual incentive to maintain the stability of the system.⁴ The fourth alternative is a system of *multiple key currencies*, in which two or more currencies are widely held as reserves, perhaps by different regional blocs. It is hard to know whether such a system is more or less risky than one in which a single reserve currency dominates. However, as long as most countries perceive key currency status as a power resource, such a multipolar system is quite likely to be less stable in configuration than a hegemonic monetary system, as the leaders of rival blocs compete (Cohen 2000). A move toward regional trading blocs could reinforce a trend toward regional monetary blocs, and vice versa.

Like both adjustment and stability, liquidity also is affected by the ways in which national governments regulate private international capital flows. On the one hand, this is an issue of substance: are there no controls, few controls, many controls? What kind of controls are there: taxes, quantitative ceilings, preferential interest rates for foreign exchange? On the other hand, and perhaps more fundamentally, it is an issue of process: who decides and how? We have then three broad institutional alternatives. First is a system norm of *few or no controls*, with most limits to private freedom of capital movement being defined as illegitimate. Second is a system norm of *national decision making* about barriers to private cross-border financial flows (a prescription about process), perhaps combined with another system norm about the acceptable range of capital freedoms or capital controls (a prescription about substance). The third alternative is a system norm, and its attendant institutions and procedures, for *collective or multilateral decision making*, possibly bundled with a substantive prescription as well.

Finally, once there is a precedent for collective negotiations or simply authoritative discussion about regulation of private, voluntary capital, then the subject of jointly managed and publicly funded flows may arise. If multilateral public funds are proposed only to serve as an occasional lender of last resort, then such funds have only incidental implications for liquidity. Since the mid-twentieth century, however, permanent multilateral bureaucracies, collectively known as the international financial institutions (IFIs), have been assigned the tasks of managing global liquidity (mainly through the International Monetary Fund) and, at least fitfully, of ensuring a supply of development credit to individual countries (via the World Bank and regional development banks).

Stability

The third function of an enduring international financial architecture is providing stability by preventing major systemic crisis and reducing “financial

contagion,” that is, the cross-border transmission of national crises. The need to encourage stability follows from the unique nature of financial markets, which are infinitely more prone than goods markets to bubbles and crashes (Kindleberger 1978). Individual firms in financial markets, such as banks, are uniquely vulnerable to one another in that the bad fortunes of one bank, rather than being a source of joy to its competitors, instead may threaten other initially healthy banks, either because of interlinked deposits or simply because depositors in general panic and begin a run on all financial institutions in that market. Because credit is an essential input to all modern business activity, a banking collapse brings the entire economy to a halt. All of these characteristics of purely domestic financial markets also hold internationally as soon as national financial markets become interdependent, with the added complications in the international arena of exchange rate issues and a multiplicity of regulatory authorities, national and perhaps also multinational.

Many analysts discuss the stability function in terms of alternative institutional arrangements for provision of a *lender of last resort* (LLR) (see Eichengreen [1989] 2000). An LLR is an entity willing to make a judgment that a particular financial institution or borrower (note that all commercial banks borrow from their depositors) facing bankruptcy is in a condition of *illiquidity*, or a temporary inability to repay debt, and not one of *insolvency*, or a fundamental and more or less permanent inability to repay. In practice, and not only in the contemporary era, the distressed borrower often has been a sovereign state. Once a finding of illiquidity is in, the LLR extends an emergency loan to the distressed debtor, hoping to avert panic withdrawals while giving the debtor some breathing space. In addition, in some circumstances the LLR may decide to rescue an insolvent and thus unworthy debtor, not for its own sake but to preserve the health of the larger financial system—or, in the case of countries, for the sake of the strategic value of the borrowing country to the state or states that control the LLR decision. Other substantive responses to the ever present possibility of financial crises are international prudential regulations (a type of capital control, it should be clearly noted), and mechanisms for full and transparent disclosure of national, often government, financial information to the global markets, which is supposed to reveal incipient problems before they arise.

One way to think about alternative institutional frameworks for ensuring stability would be to list different possible international institutions that might be created, from the currently existing International Monetary Fund to proposed new institutions such as a world bankruptcy court, global credit rating institution, or an expanded IMF formally tasked with acting as the world’s lender of last resort (Eichengreen 1999 and Blecker 1999 review many of these proposals). A world bankruptcy court, for example, could be empowered to forbid creditors from seizing a borrower’s assets while it restructured and tried to

devise a viable plan for paying the debt.⁵ The sheer multiplicity of options, however, suggests a categorization based on process. Novel and unexpected financial crises will arise occasionally in any system, the interesting question is how the implicit or explicit regulatory architecture shapes the system's responses to crisis.

The first alternative is *ad hoc crisis management* by the great power(s) of the era. Under this scenario, there are no permanent international institutions or even standing committees. Crises are dealt with by the most powerful state, or hegemon, which acts in what its leaders perceive to be its own national interests, perhaps with the assistance of other great powers. A second model is that of *partially institutionalized crisis prevention and management* by the great powers. The key difference from the preceding alternative is that in this case collective efforts have been made, and ongoing, formal, multilateral institutions and mechanisms constructed, prior to the onset of crisis. Partially institutionalized crisis prevention and management by definition coexists with ad hoc crisis response. A third institutional alternative has not yet existed in practice, yet is possible. This is *institutionalized and explicitly representative multilateral crisis prevention and management*. The third model differs from the second in two particulars. First, at least limited supranational authority for crisis management exists, to which national governments in principle are prepared to defer. Second, the process through which individuals are selected to direct the supranational regulatory institution(s) is both transparent and explicitly representative of member states. The new European Central Bank approximates this model at the regional level.

HISTORICAL FINANCIAL ARCHITECTURES

There have been four major international financial architectures since the mid-nineteenth century. The earliest and most recent periods have enjoyed the reputation, if not always the reality, of having evolved naturally in response to market mechanisms rather than resulting from heavy-handed interference by national governments, while the middle two periods saw self-conscious multilateral attempts at architectural design. The most accessible, entertaining, and current source on the evolution of the international financial architecture is surely that of Barry Eichengreen (1996; revised in 1998 for the paperback edition cited here), from whom many of my facts are borrowed, but who is of course not responsible for my interpretations. This section briefly describes the major institutions each architecture employed. I also risk a personal, but perhaps not uninformed, judgment on the overall efficacy of the architecture during each period, in terms of the goals set for it by politically dominant contemporaries.

Table 1.2 Historical Financial Architectures

<i>Financial Architecture</i>	<i>Adjustment</i>	<i>Liquidity</i>	<i>Stability</i>
Classical Gold Standard ~1870–1914	<ul style="list-style-type: none"> • Fixed exchange rates • Flexible domestic prices 	<ul style="list-style-type: none"> • Gold • Free capital flows 	<ul style="list-style-type: none"> • Ad hoc crisis management
Interwar Drift 1919–1939	<ul style="list-style-type: none"> • Free float, then fixed rates, then managed float • Increasing capital controls in period 	<ul style="list-style-type: none"> • Gold and gold exchange • De facto national regulation of private flows 	<ul style="list-style-type: none"> • Ad hoc crisis management
Bretton Woods System 1944– ~1971	<ul style="list-style-type: none"> • Quasi-fixed (“adjustable peg”) • Capital controls 	<ul style="list-style-type: none"> • Gold exchange (U.S. dollar) • National regulation of private flows • Some collective responsibility for liquidity in world (IMF) and individual states (WB) 	<ul style="list-style-type: none"> • Partially institutionalized crisis management (IMF)
Post-Bretton Woods System ~ 1973–Present	<ul style="list-style-type: none"> • Progressively freer float (major states) • Decreasing capital controls in period, although domestic prices remain inflexible (major states) 	<ul style="list-style-type: none"> • U.S. dollar • System norm of national (de)regulation of private flows • Some collective responsibility for liquidity 	<ul style="list-style-type: none"> • Partially institutionalized crisis management (G7, IMF, and so forth) • Limited joint re-regulation of private flows for international prudential reasons

Classical Gold Standard (1870–1914)

In 1717 the English mint set a relative price for gold and silver that undervalued silver, thus driving this alternative money out of circulation. Set along one path by this historical accident, over the subsequent century England gradually adopted the gold standard. By 1821 England, the major economy in

Europe, was fully on gold. Portugal, whose major trading partner was England, had followed by midcentury. When Germany, the second largest economy and a rising power, chose to tie its marks to gold in 1871, others soon followed. The classical gold standard was an implicit international regime, without written rules or formal multilateral agreements, yet possessed of rules, norms, and expected behaviors well understood in the finance ministries of participating countries (Simmons 1994, 21–40). Eichengreen (1996, 13–25) attributes both the slow start and subsequent rapid spread of the gold standard to network externalities, whereby smaller countries reaped transaction and other advantages from choosing the same monetary arrangements as the major powers.

Adjustment under the gold standard was via fixed exchange rates, as each currency was convertible into gold at a preset rate. Adjustment also required free movement of gold; importers into the trade deficit country would take the local currency they received as payment and redeem it for gold, supplied by the central bank of the trade deficit country. As the gold backing for the domestic money supply in the trade deficit country shrank, credit would tighten, the economy would slow, and prices would fall. Since unionization had not yet made wages sticky downwards, deflation could begin relatively rapidly. The classical gold standard thus also needed flexible prices, and citizen tolerance of sometimes dramatic swings in the level of domestic economic activity, in order to function. Moreover, national central banks, and the political authorities to which they were subject, had to be willing to retain an immutable domestic exchange rate between the national currency and gold; that is, participant countries had to resist the lure of domestic inflation to solve public revenue problems. During the four and a half decades in which this financial architecture regulated international monetary relations, countries adhered to gold standard norms with remarkable fealty. When the requirements of gold standard participation strained national economic management, countries instead drew back from the concurrent free trade regime, with chronically trade deficit countries erecting tariffs to avoid the necessity for subsequent adjustment through the monetary system. Thus Germany, France, and many other European countries at the core of the world economy began to increase tariffs in the 1880s and the 1890s, following two long decades in which trade barriers had generally fallen (Krasner 1976). But they remained on the gold standard.

As gold was the ultimate unit of value, new discoveries of gold were the source of *liquidity* for the world monetary system. Such a rule had the advantage of being automatic, that is, of not requiring active management by any state or institution. The amount of liquidity in the system was not subject to political control by a hegemon or cabal of dominant states. During the nineteenth and very early twentieth centuries, there were some new discoveries of gold. Nonetheless, the shift from bimetallism (a combined gold and silver standard) to a purely gold standard was deflationary in most countries. In Britain itself the

domestic price level fell by 37 percent between 1873 and 1886 (Eichengreen 1996, 19). The worldwide deflation of the 1870s was quite probably heightened, if not caused, by the widespread shift to the gold standard by the major economies of the time. During these decades, private investors often provided liquidity for countries with trade deficits; so long as monetary management was credibly tight, providers of inward capital flows could expect to be rewarded with higher interest rates in the trade deficit economy (Eichengreen 1996, 31–32). Maintenance of convertibility remained a powerful norm of the system, so currency risk for foreign investors was minimal. Net foreign investment flows, well above what was needed to rebalance trade, also grew, arguably adding to the global efficiency of investment. The total dollar value of world foreign investment in 1914 was more than five times that of 1870 (Pollard 1985, 492).

The regime's implicit prescriptions for achieving *stability* were more vague. Under the classical gold standard the markets (that is, private financial actors, each acting in a decentralized, self-interested fashion) expected that national authorities (central banks and finance ministries) would intervene procyclically in order to hasten the deflation, or less often the inflation, needed to reequilibrate the trade balance. Because they believed this, private investors were willing to bring capital into a country with a trade deficit, in the expectation of making a profit as the money supply tightened and interest rates rose. Though not based on written international covenants, the classical gold standard regime also led to informal and productive consultation and subsequent mutual adjustment among key countries, especially in times of crisis.⁶

In its own terms the classical gold standard performed excellently. Adjustment to trade imbalances was typically rapid and effective. Less happily, the rapid and effective adjustment mechanism of the classical gold standard, which reequilibrated trade imbalances through sharp shifts in domestic prices and levels of economic activity, was harsh for ordinary citizens, many of whom lost employment during an era in which there was no social safety net, and for businesses, which experienced waves of bankruptcies during economic downturns. In terms of the financial architecture's own goals, however, these seeming drawbacks were virtues, as they demonstrated the credibility of the financial framework. The gold standard—along with the world's first widespread regime of mostly free trade—coincided with tremendous and sustained expansion in the world economy. As compared to the period from 1820 to 1870, both world gross domestic product (GDP) and GDP per capita rates nearly doubled from 1870 to 1900, reaching rates of 1.9 and 1.1 percent respectively. Growth and per capita growth rose further to 2.2 and 1.2 percent from 1900 to 1929 (Maddison 1995, 227–228). Finally, the financial architecture, though not without crises among both core and peripheral members, yielded remarkable stability in the system. Rule following plus periodic central bank coordination resulted in most threatened financial crises in the advanced economies of the day being blunted or avoided.

Interwar Drift (1919–1939), including the Restored Gold Standard (1926–1931)

The established systems for trade, payments, and foreign investment all broke down during the Great War, partly because shipping was subject to enemy attack, but also because belligerent governments commandeered both goods and their citizens' savings for the war effort. Following the end of the war in 1919, governments were anxious to reestablish international trade and payments. The gold standard, which apparently had worked so well before the war, was the obvious choice for the financial architecture. Yet it could not be reestablished immediately, as most governments recognized that an early commitment to exchange their national monies for gold would result in a loss of their remaining gold reserves. Only the U.S. dollar was convertible in the early 1920s.

There were three distinct *de facto* financial architectures during the two interwar decades (Eichengreen 1996, 45–92; Kindleberger 1986; Simmons 1994). From *the War's end through 1925* most currencies of the major economies floated freely, their prices set by market supply and demand. Private capital moved easily among the major economies. Under this system, *adjustment* to trade imbalances worked reasonably well in a narrow and technical sense, in that the prices of national currencies (and thus of goods and services denominated in those currencies) were set by market supply and demand. However, exchange rates were notoriously volatile, leading to great uncertainty for both importers and exporters, and thus depressing trade. *Liquidity* meanwhile suffered from two problems. The more serious and structural systemic flaw was the global shortage of gold—the only store of value that most governments and markets ultimately trusted—which imposed a deflationary bias not only on the early 1920s but throughout the interwar period. Added to this fundamental bind were several related imbalances in international capital flows that resulted from the short-sighted reparations and official debt repayment arrangements constructed by the victors of World War I.⁷

The floating rate, *laissez-faire* system of the early 1920s performed worst of all in the task of *stability*. The problem was not simply that exchange rates were volatile. Under floating rates and open capital flows currency traders responded not only to realized trade imbalances but also to expectations about the domestic economy, in particular its inflationary potential. At the end of the Great War, returning servicemen had embarrassed their governments into granting, for the first time in much of Western Europe, universal male suffrage, including in Britain, long the financial center of the global economy. Working men, now the majority in the electorate, preferred jobs to a stable currency. Private investors responded accordingly, fleeing countries whenever left-leaning politicians appeared to be scoring even minor victories. International financial credibility, previously mainly a problem for hard-pressed monarchs fighting expensive wars,

in the 1920s became an ever present worry for finance ministers in all broadly democratic polities, a designation that then included all of the core capitalist states, even Germany. Private investors' lack of confidence in governments—even when actual budget and trade deficits were perfectly reasonable—rendered the floating rate system of the early 1920s highly volatile and thus fatally unstable.

Policymakers and pundits thought the solution was to reestablish predictability by bringing back the gold standard, or at least a gold exchange standard. Countries in Central Europe that had experienced hyperinflation in the immediate postwar years were the first to re-peg to gold.⁸ In 1925 Britain, under a Conservative government, restored sterling convertibility at the prewar parity, a decision that left the pound objectively overvalued, somewhere between 5 and 15 percent, reducing the competitiveness of British industry and pushing already troubling unemployment even higher (Eichengreen 1996, 59–60). France restored convertibility the following year, but only after devaluing relative to the franc's prewar value.

Between 1926 and 1931 all four of the major economies—the United States, Germany, Britain, and France—plus most of their close neighbors and allies, adhered to a restored gold standard, one whose only noticeable technical difference from its illustrious prewar predecessor appeared to be the intentionally expanded reserve role for foreign exchange. But the interwar gold exchange standard flopped. The first problem was that *adjustment* to trade imbalances was no longer rapid, automatic, and smooth: labor unions, and occasionally even their employers, resisted the drop in the nominal wage that was supposed to begin the necessary cycle of domestic deflation. Despite the gold standard, therefore, domestic price levels did not adjust to re-equilibrate trade imbalances. Instead, gold drained from Britain, for example, and entered both France and Germany, whose central banks in the late 1920s enjoyed domestic political support for tight money policies because of popular memories of high inflation in the early 1920s. *Liquidity* was problematic for the same reason it had been in the freely floating days of the early 1920s: investors declined to trust currencies backed by foreign exchange, preferring only gold, but there was insufficient gold to support the expansion in the world economy that had occurred since the early twentieth century. Countries whose central banks held foreign exchange as reserves, or foolishly expanded the domestic money supply in response to domestic economic conditions, were punished by private capital flight. The overall result was a purely monetary drag on world economic growth (Friedman 1992).

The restored gold standard also failed to deliver *stability* (Kindleberger 1986). The combination of the French franc's devalued rate plus the Bank of France's extremely tight and conservative domestic monetary policy exacerbated Britain's competitive problems. In 1928 and 1929 the banking systems of Austria, Hungary, and then Germany crashed as industrial borrowers could not meet their nominal debt obligations under conditions of deflation. In 1929 the U.S.

stock market also crashed, despite the efforts of the Federal Reserve Bank prior to the crash to induce investors to switch out of corporate stocks by setting high interest rates. The combination of the dramatic fall in banks' own net worth (because of their large holdings of corporate stocks) and tight money generated a huge banking crisis in the United States. Britain suspended convertibility and devalued in 1931. The United States went off of gold under newly inaugurated President Franklin Delano Roosevelt in early 1933, and the dollar fell almost 40 percent in nine months.

From 1932 to 1939 most countries followed a managed float—a term that here denotes the efforts of individual countries, through foreign exchange intervention by their central banks, to stabilize their exchange rates, but does not imply that coordinated, multilateral efforts were common. From the beginning, the managed float of the 1930s was a system that limped. *Adjustment* was minimal. Currencies were not convertible and few governments permitted free movement of capital. Under floating rates, trade rebalancing was supposed to happen via exchange rate movements. Yet the bad experience with high exchange rate volatility in the early 1920s initially led most governments in the 1930s to intervene to counter market movements, hoping to dampen wild exchange rate swings. In addition, the lack of trust and coordination among the governments of the major economies rendered such national exchange rate interventions both expensive and ineffective.⁹ The other strategies for re-equilibration were “competitive devaluation”¹⁰ and trade protectionism, as in the United States' infamous Smoot-Hawley Tariff of 1930. *Liquidity* remained uncertain and insufficient: the markets trusted only gold, and occasionally U.S. dollars, yet there was not enough gold to support economic expansion. Empirically, the system was *stable* in that it did not generate major crises before it was broken up by the coming of the Second World War. However, the lack of financial crises largely resulted from the degree to which most countries had isolated themselves from previously open international financial markets: these costs were felt everywhere in reduced trade and growth. Most of the putative stability, that is, came from nationally imposed capital controls, which exacted a high efficiency cost in terms of both foregone trade and investment.

Despite the best intentions of finance ministers and central bankers, none of the financial architectures of the interwar years was a success, though contemporaries had a hard time understanding exactly why.

Bretton Woods Regime (1944–73)

The experiences of the Great Depression and the Second World War, not to mention the theories and persuasive efforts of crucial individuals such as John Maynard Keynes, altered the reigning ideological parameters in the major powers

of the international system (Hall 1989). After the war, Western Europe embraced national economic planning and even the United States began to rely on Keynesian demand management by the federal government. Moreover, influential intellectuals blamed the war itself on isolationism and lack of mutual cooperation among the major powers. The hostility between the Western Allies and the Soviet Union at the war's end also aided multilateralism among the capitalist democracies by giving the West an enemy to unite against. For all of these reasons, financial and economic policymakers in the soon-to-be-victorious Allies supported the convening of a multicountry conference at Bretton Woods, New Hampshire, in 1944 to work out a new, cooperative, and explicit financial and economic architecture for the postwar era (Helleiner 1994). The biggest change from the past, therefore, was not in any of the specific arrangements per se: the interwar period had seen experimentation with a great many permutations of particular rules. Rather, intentional multilateral management by the representatives of sovereign states—with decision power concentrated in the great powers of the time, particularly the United States and Britain—was the bedrock of the new international financial regime. The United Nations, a resurrection and rethinking of the failed League of Nations of the early 1920s, embodied a similar cooperative and multilateral understanding about how to ensure world peace.

Harry Dexter White and John Maynard Keynes, negotiators for the United States and Britain, respectively, dominated the talks that led up to the Bretton Woods agreement. With respect to *adjustment*, neither floating rates nor the gold exchange standard of the interwar years had proved effective. The proposed solution was an “adjustable peg,” that is, a fixed rate system (which it was hoped could avoid the instability of floating rates), with major currencies convertible into U.S. dollars, these in turn to be convertible at a fixed par value into gold. To avoid the phenomenon of countries entering seemingly permanently into either surplus or deficit, exchange rates were to be periodically adjustable—but only when a country was willing to request multilateral permission, in the form of acceptance by the International Monetary Fund. The IMF was a new institution charged with the ongoing tasks of monitoring international trade and payments, providing incentives for good monetary and fiscal behavior by member countries, and extending relatively short-term assistance to member countries experiencing temporary balance of payments problems.¹¹

In the long run, the worst performance of the BW architecture was in the arena of adjustment. The intended reason for IMF pre-certification of currency devaluations or revaluations was to prevent countries from engaging in them frivolously, such as for the purpose of gaining a temporary trade advantage from devaluation vis-à-vis a competitor. However, in practice countries seldom consulted the IMF ahead of time, as they reasonably feared that news of the planned devaluation might leak beforehand to the financial markets. Moreover, most countries proved very reluctant to devalue, which was perceived as a loss of

prestige and credibility for the government. So the “adjustable” pegs behaved like firmly fixed rates, and were not really available as an instrument to adjust national economies to trade imbalances through shifts in trade prices. At the same time, governments in the post–World War II era were even less interested than those in the interwar years in implementing the technically appropriate adjustment mechanism for fixed exchange rates: tight money and austerity to reduce domestic economic activity and thus shrink a trade deficit, and the reverse for a trade surplus. So adjustment was finessed by trade barriers and/or postponed by capital inflows.

The United States, at the core of the system, did not have balanced trade accounts. For approximately the first fifteen years, the United States ran a continual trade surplus and Western Europe and the rest of the world a corresponding deficit. This was so even though most European currencies were not even convertible on current account until 1959, meaning that these governments rationed all access to foreign currency, even for permissible merchandise imports. Up through the early 1960s, large net capital outflows from the United States made this structural imbalance possible by relieving pressure on the currencies of trade deficit countries. Thereafter, the positions reversed, with the U.S. merchandise trade surplus steadily shrinking to nothing in 1971. Moreover, and utterly perversely from a purely technical viewpoint, the United States continued to be a large net exporter of capital. Consequently, U.S. official reserve assets of gold and foreign exchange shrunk steadily after 1957, eventually provoking the unilateral American actions that ended the Bretton Woods regime (Odell 1982, 203–206 and *passim*). Further stories of persistent non-adjustment could be told of many other core countries. The fundamental problem was that national policymakers were unwilling to subordinate domestic macroeconomic policies to the goal of defending the exchange rate, a necessary component of a fixed exchange rate regime with even limited free private capital flows (Mundell 1960).

The postwar agreement on *liquidity* was pragmatic: the dollar was the only currency strong enough to be immediately convertible after the war. IMF member countries, including all of the core capitalist states (and soon the major defeated states as well, though not the Soviet bloc) were encouraged to hold their reserves in the form of both gold and U.S. dollars, so that global growth would not be entirely dependent upon new gold discoveries. As compared to earlier decades (or the present!), policymakers had scant faith in the ability of private voluntary capital flows to provide liquidity either for easing temporary balance of payments pressures in specific countries or for greasing the wheels of global growth more generally. The IMF, therefore, would have at its disposal quotas of the national currencies of all member countries. It could lend foreign exchange out to countries with temporary trade imbalances at prespecified rates of interest and with increasingly tough “conditionality,” that is, requirements for domestic policy reform, typically fiscal and monetary tightening. The BW financial

architecture, meanwhile, left decisions about controls on private cross-border financial flows up to national governments. Although IMF member countries were encouraged to restore current account convertibility quickly, the IMF Articles of Agreement explicitly legitimated enduring national barriers to cross-border capital flows. Interestingly, the designers of the BW architecture also viewed the intentional promotion of long-term international investment as a legitimate core goal of a successful financial architecture. The IMF's sister organization, today known as the World Bank, used its initial capital subscriptions from member countries to borrow long-term in private capital markets, while loaning long-term to governments for specific capital investment projects.

Over the subsequent three decades the provision of liquidity under the Bretton Woods system was generally satisfactory, although the actual arrangements were not quite those initially envisioned. The U.S. dollar so effectively augmented monetary gold that world growth hummed (see the chapter by David Felix). There was no liquidity constraint at the system level. In many respects dollar holdings were even more attractive for central banks than gold, in that dollar holdings frequently took the form of interest-earning Treasury securities. This highly effective solution to the global liquidity dilemma, a major problem under the interwar financial architecture, of course was intimately linked to the failure of the United States to equilibrate its trade and payments imbalances. The world economy needed liquidity, and the United States was a large net emitter of dollars. As early as 1960, dollars held outside the United States exceeded the total American stock of monetary gold (Eichengreen 1996, 116). A rush by foreigners to convert their dollars in principle would have bankrupted the key currency country. In the 1960s, the U.S. government also began to worry about the large sums of U.S. private investment abroad and tried to limit it with outward capital controls (Hawley 1987). Naturally the Europeans, the other major players in the postwar decades, were not unaware of the power this unique ability to print and spend money abroad gave the United States. They tried unsuccessfully to place the function of global liquidity provision back with the IMF, first through obligatory quota increases and later through the creation of a new international "currency" backed by the basket of national currencies held by the IMF.¹² Like it or not, the Bretton Woods key currency system both required and perpetuated U.S. financial hegemony.

Perhaps the most important function initially envisioned for the IMF, meanwhile, was that of ensuring *stability* in international financial markets. If countries followed procedure and checked with the IMF's board of governors before they devalued, then the waves of "competitive devaluations" that were perceived to have generated so much trouble in the 1930s could be avoided. Moreover, the BW conferees expected that the IMF could and should function as the world's lender of last resort, extending credit to national central banks whose gold and foreign exchange reserves were under threat, perhaps due to

a panic that went far beyond any objective domestic or international economic policy flaws. White, Keynes, and their peers from less dominant countries agreed that many of the financial, currency, and banking crises that spread rapidly from neighbor to neighbor in 1928 through the early 1930s might have been avoided had a decisive LLR stepped in to stem the panic at any of several crucial stages.

Governance of the International Monetary Fund, it should be noted, was designed to reflect, at least roughly, the economic—and, less explicitly but no less surely, the military and strategic—strength of the member countries, with votes on the governing board being proportional to financial contributions. This scheme of representation, similar to the veto of the permanent members of the Security Council in the United Nations, was intended to give powerful countries a reason to believe that they received a net benefit from the creation of multilateral institutions, even though they could not wholly control them. The big differences between the BW system and the previous financial architectures, it bears reemphasizing, lay in the new architecture's emphasis on continuous, regularized, multilateral cooperation and international monetary governance.

The BW financial architecture in fact provided satisfactory international financial stability for nearly thirty years. Of course there were various crises, including a run on sterling in 1947, an emergency devaluation of the pound in 1949, and large capital outflows in the United States following the election of Democrat John F. Kennedy in late 1959. But all were handled by means of partially institutionalized crisis management by the great powers, particularly the United States, Britain, France, and Germany, who in each case supported one another's currencies and/or arranged a consensual exchange rate realignment. Interestingly, the governments of the core capitalist states soon discovered that they had more freedom of action if they simply bypassed the IMF, in which numerous small states also held membership, and dealt directly with one another. The United States set this pattern early on.¹³ That is, ad hoc crisis management became more important than originally envisioned, and institutionalized multilateral monetary governance somewhat less so, over the years.

Even the end of the Bretton Woods financial architecture, which generally is referred to as a "crisis," can instead be understood as illustrating the regime's remarkable ability to handle serious disagreements among key actors, and to finesse fundamental economic disequilibria. The lack of a well-functioning adjustment mechanism, plus the U.S. dollar's key role in providing liquidity, meant that trade imbalances and their attendant stresses were bound to accumulate. The United States argued that it should not have to devalue the dollar in relation to gold: American leaders wanted to keep their decades old relationship of \$35 to the ounce of gold 9/10 fine—even though nonmonetary gold was by the late 1960s worth considerably more than this. The Europeans, particularly the French and the Germans, were unwilling to revalue their currencies, which

had transactional and reputational costs, when they viewed the problem as principally of American making.¹⁴

Just as the U.S. trade balance was dipping into deficits in 1971, President Richard Nixon and Treasury Secretary John Connolly acted to avert a run on the dollar by announcing that it was no longer automatically convertible into gold. They addressed the trade problem directly by imposing a temporary across-the-board import surcharge of 10 percent, an instance of using the United States huge market power as a blunt weapon to force its major trading partners to revalue. In the end they did revalue, while the United States also agreed to devalue (Odell 1982). There was some acrimony, but no crisis. The major powers announced a new, more balanced system of fixed rates in 1973. However, in the absence of any significant alterations in the financial architecture, the markets found the new parities not credible, and runs on various major currencies forced them to float in the mid-1970s. In other words, the stability framework of partially institutionalized consultations (sometimes through the IMF, other times outside), along with ad hoc management by the major players (a designation that covers both the United States' dramatic but not wild decision to break the link with gold and other countries' considered responses), was remarkably successful in avoiding breakdowns of international trade or payments and in protecting domestic financial systems.

Post-Bretton Woods Financial Architecture (1973–Present)

With the shift of major countries to floating exchange rates, the adjustment (or non-adjustment) mechanism of the Bretton Woods financial architecture was gone. The big contrast between the subsequent architecture, often unimaginatively designated the “post–Bretton Woods” (PBW) system, and its famous predecessor was that the newer architecture was not, at least initially, carefully negotiated among the contracting parties. The current arrangements have been termed a “non-system,” though this is not quite the case. Soon after the decisions to float, the major powers formed the Group of Seven (G7), a forum of finance ministers and central bank governors from the United States, Germany, Japan, Britain, France, Italy, and Canada, with a brief to consult regularly on monetary and economic affairs of mutual interest (Bergsten and Henning 1996). During the next decades, other partially intersecting groupings also provided informal system management, including the Bank for International Settlements (BIS), the central bankers' organization founded in 1930, which since the early 1960s has brought together central bankers in the core economies on a monthly basis. The IMF, moreover, continues to receive regular reports from all of its members, and to offer them regular advice, though only borrowers are obliged to accept it!

On the surface, the *adjustment* mechanism differs dramatically from that of the BW regime. Since the mid-1970s, most of the major economies have had floating exchange rates, while smaller countries most often have pegged, either to the currency of their major trading partner or to a trade-weighted basket of currencies. In principle, this means that adjustment comes via shifts in relative prices of imports and locally produced goods. There has been considerable exchange rate volatility, even among the major economies (see the chapters by David Felix and Erik Jones). The G7 countries on occasion have engaged in joint intervention to manage exchange rates, such as via the so-called Plaza Accord in 1985 to push the dollar down (Henning 1994) or, more recently, in the autumn of 2000 to support the euro. Many international economists would like to see the exchange rates of major currencies managed more actively, arguing that much of the volatility is unnecessary and harmful to economic growth (for example, Bergsten 1998; Coeuré and Pisani-Ferry 1999). Nonetheless, the yen rose 45 percent against the dollar and 65 percent against the euro between its lowest point in 1998 and its highest one in the first half of 2000, suggesting that exchange rate volatility is not abating (BIS 2000, 84).

As noted, in the past capital controls frequently have substituted for domestic price flexibility in periods of floating exchange rates. One principal trend for the post-Bretton Woods “non-system” has been toward national deregulation of private international capital flows, as well as a complementary breaking down of barriers among previously distinct segments of domestic financial markets in the major industrial countries. The United States had implemented fairly free external private capital flows by the late 1970s, and since the 1980s has lobbied hard for other countries to do likewise (Armijo 2000). Had it not been for the 1997–1999 Asian financial crisis, the IMF in 1998 would have followed through with its intended rewriting of its Articles of Agreement to incorporate, for the first time, a formal obligation of all members to move rapidly toward full capital account convertibility. The quantity and volatility of capital circulating in global financial markets has ballooned enormously since the late 1970s, in tandem with the relaxation of capital controls worldwide (see the chapters by Felix and Cohen below). However, the combination of floating exchange rates and increasingly free capital movements has not made adjustment to external imbalances easy or automatic. Among the more serious problems are inflexible domestic prices and incomes (especially in the industrial countries) and huge speculative swings in the capital account, delinked from any plausible changes in the trade balance or the real domestic economy (especially in the developing countries).

Overall, adjustment under the post-Bretton Woods financial architecture frequently has been unsatisfactory. Because both foreign central banks and foreign private citizens want to hold dollars, the U.S. currency has remained overvalued, thus rendering imports into the United States artificially cheap and provoking an

ever larger trade deficit. Private capital flows were supposed to ease the adjustment process, not postpone it indefinitely, but this seems to be what has happened. After about 1971 the U.S. trade balance was steadily negative. In 1981, the entire current account became negative, thus transforming the United States into a net capital importer. In 1998, the U.S. net foreign asset position became negative for the first time since World War II, indicating that foreigners owned more U.S. real and financial property than American citizens did abroad (BIS 2000).

The reserve standard in the PBW era has been the unadorned U.S. dollar, which today is convertible only into goods, services, or other currencies, at real rates that fluctuate with the market. *Liquidity* has been much less problematic than adjustment for the system, in that the United States' external deficits have provided ample credit for the global economy most of the time. The global financial architecture proved adequate to the task of recycling the so-called "petrodollars" accumulated by oil exporting countries in the 1970s and "solving" the Latin America debt crisis of the 1980s, at least from the viewpoint of the major creditor banks, whose insolvency would have threatened the economies of the G7 countries and thus the global economy (Kapstein 1994). At the same time, the credibility of international finance continues to be tightly wedded to the fortunes of the U.S. dollar, which remains the world's key currency. In the late 1990s a few pundits began seriously questioning whether the dollar's dominance could or should last (see Cohen 2000, as well as the chapters by Henry Laurence and Erik Jones in this volume). Yet the technical, not to mention the political, challenges of a world of multiple key currencies remain nebulous. A worrisome thought is that a regime of competing reserve currencies might provide much weaker incentives on the part of any given participant to support the value and credibility of any given key currency.

It is largely because of doubts about the current regime's ability to continue to ensure *stability* that the contemporary debate over reform of the international financial architecture has arisen. As in the Bretton Woods period, crisis management under the PBW financial architecture has been partially institutionalized. Since its formation in the mid-1970s the G7 has performed most of the global economic steering functions that ostensibly were to have occurred within the IMF. The seemingly odd transformation of the G7 into the G8 with the addition of Russia in the 1990s merely reflects the fact that the G7 is an organization of core capitalist states, who use it to manage the global political economy as they see fit.¹⁵ The European Community, after 1979 through the European Monetary System, has played a similar collective crisis management role in monetary affairs at the regional level (see Eichengreen 1996, 152-181 and this volume's chapter by Erik Jones). System management in times of acute crisis, however, has in most instances fallen to the United States, or to Germany for European panics. For example, U.S. treasury secretaries coordinated the rich

country responses to the 1980s Latin American debt crisis, the 1994–95 Mexican and Latin American peso crisis and the 1997–1999 Asian financial crisis (see the chapter by Mark Brawley). At the close of the twentieth century, the global financial and monetary system remained infinitely more centralized in its resources and governance practices than, for example, the global trading system.

In somewhat uneasy coexistence with the emerging PBW norm of capital account deregulation is a recent trend by the major advanced industrial countries to re-regulate, through multilateral channels, certain global capital flows that they consider dangerous. Those capital controls that might protect industrial country banks, depositors, and investors tend to be conceived of as “prudential regulation,” which makes them ideologically acceptable. For example, bank regulators from the major advanced industrial countries negotiated through the BIS to arrive in 1988 at consensual standards for regulating transnational commercial banks, the “Basle Capital Adequacy” ratios (Kapstein 1994). National securities regulators, some public and some private, in the 1980s and 1990s began meeting under the auspices of the International Organization of Securities Commissions (IOSCO) to standardize domestic capital markets legislation worldwide (Porter 1999). In mid-2000, negotiators from the Organization for Economic Cooperation and Development (OECD) countries finally seemed to have agreed on a comprehensive set of capital controls, with stringent penalties for noncompliance, to reduce global money laundering through small, financially open tax haven countries, such as Bermuda or the Cayman Islands—although the laissez-faire administration of U.S. President George W. Bush was unwilling to support these multilateral controls until after the September 11, 2001 attacks on the United States. However, there is no agreement—and precious little high-level discussion within forums controlled by the G7—on collective institutional innovations to curb the kinds of volatile capital flows that in the 1990s ravaged the economies of so many developing countries. Despite limited multilateral cooperation on “prudential” norms and greater data sharing (“transparency”), the dominant trend today is for external financial liberalization.

There are good reasons to question the future stability of the post-Bretton Woods international financial architecture. The volatility and sheer quantity of private capital in the international system continue to increase rapidly. Moreover, the size of emergency financial bailout packages increased markedly in the 1990s. For example, in December, 2000, the IMF coordinated a credit line of \$37 billion for Argentina, representing an extraordinary 13 percent of that country’s GDP. In the previous five years, even larger packages in terms of absolute amounts or their weight in the recipient’s economy had gone to Mexico, Thailand, Korea, and Indonesia. At the same time, both opinion leaders and the attentive portions of the public around the world—but most significantly in the core capitalist states—since the mid-1990s have been increasingly dissatisfied

with the crisis management performance of the IMF, the “markets,” and dominant governments such as that of the United States. One consequence has been the present debate over reform of the international financial architecture.

A Rough Assessment

Table 1.3 assays a more formal rating exercise. It should not be taken too seriously, but at the same time its ranking of the four historical architectures is unlikely to be very controversial. I subjectively judge each historical financial regime in terms of how well it fulfilled the basic functions of adjustment, liquidity, and stability, *as understood by policymakers and opinion leaders of the time*. In other words, the standards of judgment explicitly are not constant—which is more than half of the point of the exercise. Politically relevant contemporary observers of the classical gold standard, who were of course members of the elite, found domestic deflation an acceptable means of adjustment to a trade deficit, and recognized that flexible prices, incomes, and capital flows, along with Bank of England leadership, provided the system with considerable stability, even when particular actors, or markets, experienced crises. Astute finance ministers, however, recognized that leaving liquidity growth entirely to chance was not optimal. On a scale of 0 (unsatisfactory), 1 (mostly unsatisfactory), 2 (mostly satisfactory), or 3 (satisfactory) for performance in each important function of a financial architecture, one might award the classical gold standard a score of “excellent,” or roughly 89 percent satisfactory, as shown in the table. It is no wonder that the financial architecture of the gold standard was fervently professed at the time, stood as a beacon of stability for envious interwar policymakers, and retains committed adherents even today.

In contrast, the monetary experiments of the interwar period have had few defenders, then or now. I assess the interwar financial and monetary experiments as a group as “mostly unsatisfactory” in terms of both adjustment and liquidity, and “unsatisfactory” in the provision of stability, for a score of 2/9 or only 22 percent satisfactory performance. Most observers, I believe, would rate the Bretton Woods financial architecture as a success, though perhaps not quite as seamless a triumph *in terms of the goals of incumbent policymakers in the major states* as the pre–World War I architecture. The BW architecture provided liquidity and stability, though imperfect adjustment was a constant source of friction among the major industrial states. I award it 7 of 9 possible points, for an overall score of “good.”

In the final quarter of the twentieth century, as in the third quarter, global liquidity growth has not been a problem, as the world has remained willing to absorb any overhang of U.S. dollars. But, despite the shift to floating exchange rates, adjustment to trade imbalances has been neither easy nor automatic, while

Table 1.3 Performance of Historical Financial Architectures

<i>International Financial Architecture</i>	<i>Adjustment Satisfactory?</i>	<i>Liquidity Satisfactory?</i>	<i>Stability Satisfactory?</i>	<i>Overall*</i>
Classical Gold Standard ~ 1870–1914	Yes	Mostly yes	Yes	Excellent (89%)
Interwar Drift 1919–1939	Mostly no	Mostly no	No	Poor (22%)
Bretton Woods System 1944–~1971	Mostly no	Yes	Yes	Good (78%)
Post–Bretton Woods System ~ 1973–Present	Mostly no	Yes	Mostly yes to 1990, but less so thereafter	Good to Fair (67% and falling)

*Overall score calculated on the basis of equal weights for satisfactory performance in each function, with “no” = 0, “mostly no” = 1, “mostly yes” = 2, and “yes” = 3. Note that the assessment, while subjective, is intended to reflect the views of national policymakers in key countries during each period.

imbalances originating in the capital account seem to have become a permanent feature of the system. Moreover, maintaining stability has required much more active intervention and management by the major states than their leaders initially expected or would have preferred. By the late 1990s, the PBW architecture’s ability to prevent or ameliorate future crises was enough in question that an authority such as Paul Volcker, a former chairman of the U.S. Federal Reserve Bank, could write in the conservative *Financial Times*, “The problems we see with such force today are systemic—they arise from within the ordinary workings of global financial capitalism” (1998, n.p.). In the view of many contemporaries, the performance of the post–Bretton Woods financial architecture was, by the turn of the twenty-first century, rapidly slipping from “good” to “fair.”

THE SOCIAL EMBEDDEDNESS OF FINANCIAL ARCHITECTURE: THE TERMS OF THE DEBATE THAT MIGHT BE

What makes for a successful financial architecture? Suppose we accept the rough relative judgments of the preceding section. What explains these outcomes? This section reviews several attempts to account for the variable performance of past financial architectures, in the hope that they might prove enlightening for

understanding present challenges. My conclusion is that an international monetary framework that is inconsistent with underlying political and social realities is unlikely to work very well or last very long. Today's significant world political trends are, first, increasing multipolarity in the interstate system and, second, the rise of mass procedural political democracy as the dominant form of organizing domestic political life. An international financial architecture that ignores these global shifts will be precarious.

The Perfect Set of Rules?

One answer is that there is a *single best financial architecture* for all historical circumstances, at least if we limit ourselves to the modern industrial world. Quite a number of reasonable people accept this notion, mostly those with an overriding faith in free markets not only as a panacea for world economic troubles, but as a solution for many political disagreements as well. As noted, the majority of policymakers during the interwar years believed that the classical gold standard financial architecture would work automatically and elegantly, if only governments would be responsible and recreate it forthwith. The failures of the interwar monetary experiments did much to discredit this faith. However, the belief that a restored gold standard, or perhaps a rigorous gold exchange standard with little to no monetary policy discretion for individual countries, could solve today's myriad problems of adjustment, liquidity, and stability is far from dead. The editors of the *Wall Street Journal*, a far from inconsequential media outlet, frequently lament the loss of the certainties of the gold standard, and even advocate a return to such a financial architecture or its close equivalent. By the logic of the "one best design" hypothesis, international financial instability is explained by the imperfect policies adopted by national leaders, who need to be educated to the error of their ways: the political realm tends to be viewed primarily as an impediment to sensible reform. This teleology is popular with those whom I identify in section four as *laissez-faire* liberalizers, and with a few anti-globalizers, but remains unconvincing to the majority of observers.

Technological Determinism

An alternative view holds that the global stage of *economic and technological advancement* determines the appropriate financial architecture. There is no one best set of monetary rules and institutions for all time; instead, financial regulation must be modernized along with our modes of transport and communication. The principal argument of contemporary technological determinists is that today's globalization of capital flows is fundamentally a result of advances

in telecommunications and computers, enabling such innovations as nearly instantaneous settlement of market trades and twenty-four-hour global trading.

Interestingly, this thesis can lead to two somewhat different conclusions. The first and more widespread is that external financial markets liberalization and ever deepening global integration is inevitable and not really controllable by governments. If one kind of capital movement is prohibited, those desiring it will simply find disguised ways to perform the same transfer, and these subterfuges will be both more destabilizing and less efficient than the prohibited flow itself would have been (see, for example, Bryant 1987). By this logic, adjustment and liquidity will be autonomously provided by the markets, and the only recourse for governments wishing to regulate for purposes of stability is to press one another for publication of more timely and accurate accounting of capital flows and related macroeconomic indicators. Neither control nor regulation of jet speed international capital flows may be possible, but better, more timely, more transparent information can help the markets to cope, perhaps reducing overshooting or even irrational panics.

Yet the same facts can lead to the opposite conclusion. Perhaps the heightened contemporary interdependence of previously national markets enhances both the necessity for and the possibility of achieving cooperative multilateral regulation. As countries' national strategies for achieving trade adjustment, smooth monetary expansion at a rate commensurate with real economic growth, and monetary and financial stability all become more vulnerable to exogenous shocks, the logical response is increasingly to relocate regulation from the national to the international level. After all, this reasoning seems to be reflected in the decision of most of the members of the European Community to move to outright monetary union (see the chapter by Erik Jones). Where once national, or even subnational, financial regulation was technically appropriate, over the past two or three decades it has become increasingly inappropriate.

Alternatively, one might view the problem less as an economist would (asking what the appropriate set of regulations should be) and more through the lens of a political scientist (by inquiring into the decision process and its legitimacy). That is, we might instead proceed within a different intellectual framework, one which emphasizes the fundamental and inescapable implications of the social systems within which international financial architectures operate. Political and other social scientists have long argued that social and economic institutions that are congruent with underlying distributions of social and political power tend to function more smoothly than regulatory or legal frameworks that presuppose a different set of actors, preferences, and capabilities. Both of the remaining two interpretations of the performance of alternative historical financial architectures discussed in this section share the view that different social systems require distinct types of international rules for money and credit.

Hegemonic Stability

The *theory of hegemonic stability*, also discussed at some length in the chapter by Mark Brawley below, focuses at the international level of analysis.¹⁶ The label has been applied, usually by third parties, to the work of scholars such as Charles Kindleberger ([1973] 1986, 1981), Stephen Krasner (1976), and Robert Gilpin (1987, 2000). The core hypothesis suggests that an open international political economy, including an international financial architecture supportive of vibrant trade and free markets, will run most smoothly and effectively when a single dominant state, the *hegemon*, steps forward to manage the system, identifying success or failure with its own national assumptions. Abstracting from specific approaches and analyses, the argument rests on two broad assumptions (Conybeare 1984; Snidal 1985; Lake 1993). The first is that no market, including financial markets, operates automatically. Instead, markets operate within a socially constructed framework of expectations and protections for participants, a framework which does not exist within a state of nature and cannot ever be taken for granted. For example, markets depend on expectations of continued free trade, universalistic rather than particularistic treatment of buyers and sellers (“everyone’s money is the same color”), expectations that written contracts will be honored, and an understood network of consequences for noncompliance. Markets thus require a scaffolding of rules and institutions which, in turn, need conscious, active management.

A crucial second assumption is that hegemonic management, or decision making by a single leader or single dominant state, is considerably easier and more efficient than collective management, all other dimensions being equal.¹⁷ System management requires expenditure of scarce resources. If there are multiple managers, not only may they disagree about policy design and implementation, but each may be tempted to “free ride,” or to contribute little to the joint regulatory effort, while reaping the collective benefits of financial adjustment, liquidity, and stability, from which it is difficult to exclude any participant. A hegemon can make decisions more quickly. At the same time, a hegemon typically also can skew an international economic regime so that it receives a larger than average share of the benefits, as an (implicit) return for paying the lion’s share of regime maintenance costs.¹⁸ For example, a country that maintains the global financial architecture probably also provides the key reserve currency and has the dominant and most profitable international financial sector. The main implication of hegemonic stability theory for our purposes is its hypothesis that the international financial architecture, whatever its specific institutional arrangements, will work best when the international balance of power is such that one country is considerably more influential and possessed of resources than its fellows, and when that country desires, for its own reasons, to manage a reasonably open international financial architecture.¹⁹

The theory of hegemonic stability thus has something important to say about why and when financial architectures fail or succeed. Suppose we define a hegemon as a country whose total capabilities—including both standard “power resources” such as military strength, population, and gross national product, as well as such difficult to measure qualities as the “credibility” of its institutions with international investors—are enough larger than those of its nearest competitors that, when it expresses a decisive preference in the international sphere, other countries feel obliged to go along, either because the hegemon somehow compels them to, or simply because the hegemon provides a convenient means for solving problems of coordination.²⁰ Realized hegemony is actual international leadership. This, in turn, is a function of a state’s capabilities, its desire to exercise leadership, and, to some extent, how others in the system perceive such leadership, which is to say, whether others find leadership useful or onerous.

Instances of realized international hegemony have coincided with those historical financial architectures that commonly are judged to have been the greatest successes, as shown in the first column of table 1.5.²¹ The pre-World War I era was a period of British hegemony, both economic and, to a lesser extent, military. Britain’s ability to lead in the economic and monetary arena was based upon its share of world overseas investments, still 44 percent in 1914, its leadership in trade, London’s role as the international financial center, the overwhelming dominance of sterling in international transactions and global foreign exchange reserves, the credibility of the Bank of England, and, last but hardly least, on its government’s demonstrated willingness to manage a relatively open global trading and financial regime among the major capitalist states of the time.²² That is, I assess the period as hegemonic, even though by the turn of the century the United States, and on some dimensions both the United States and Germany, had overtaken Britain on several objective measures of economic and military capability, including share of world industrial production, iron and steel consumption, energy consumption, and GDP (Lairson and Skidmore 1997, 45–48; Maddison 1995, 182). The classical gold standard architecture arguably worked because Great Britain stood ready to defend the pound, the integrity of the currencies of its major trading and strategic partners in Europe, and to maintain open markets even while others reimposed protectionism in the very late nineteenth-century.

In contrast, the tragedy of the interwar years was that the only state that might have possessed the capabilities to assume a global leadership role, the United States, was uninterested in doing so. The U.S. refusal was evidenced in the security realm by its failure to join the League of Nations, and in the economic realm by its inability to see the possible value, both for itself and for the interstate system, of paying some of the upfront costs of maintaining a liberal international economy. Such costs to the United States might have included more open domestic markets, more liberal capital exports (private or if necessary

public, as was the case following World War II), and greater willingness to risk inflation to maintain growth of the U.S. economy, which even then was the engine for much of the rest of the world (see especially Kindleberger [1973] 1986). Britain tried to reconstruct the gold standard in the 1920s, but was not up to the task, particularly given its prestige-driven decision to restore sterling's prewar gold parity, despite England's considerable wartime inflation. Overall, the interstate system during the interwar years was multipolar, not hegemonic. There were three strong powers: the United States, Germany, and Britain. Unfortunately, there was no leadership during the 1920s and 1930s that was both sufficiently strong and committed to the maintenance of an open global economy. Consequently, both the liberal trading system and the financial architectures that might have supported it collapsed.

By the close of World War II, the question of international primacy across a range of both military and economic capabilities had been settled in favor of the United States. The United States accepted its position of leadership and was willing to exercise it, if not altruistically then at least responsibly. Moreover, the security threat to the capitalist democracies from the Soviet Union and its allies served as a powerful incentive for both Western Europe and Japan to accept U.S. leadership in the Cold War, which was waged through military, economic, and political means. Through the Bretton Woods agreement, and successive actions both cooperative and unilateral, the United States thereafter imposed its economic preferences upon the international system, but also acted to stabilize the world economy, opening its markets to foreign imports by debtor countries, sending large amounts of capital abroad, and providing the liquidity needed for global expansion (Gilpin 1987). One consequence was unprecedented global growth.

The hegemonic stability hypothesis also offers a potentially straightforward explanation for the breakdown of the BW regime. Just as the international monetary framework created at Bretton Woods was cracking, proximately impelled by the self-interested policy choices of the Nixon Administration, the United States' relative primacy in the economic sphere also was declining. As shown in Table 1.4, the American share of the total gross domestic product (GDP) of all of the high-income members of the OECD fell from 52 percent in 1960 to 47 percent in 1970. In other words, what really happened in the early 1970s was that the United States, no longer possessed of the abundant resources necessary to lead, had opted to try to protect itself, even though this undercut a global financial architecture that had proven extremely felicitous, at least from the viewpoint of ensuring global economic growth (see the chapter by David Felix). Nonetheless, it is controversial to suggest that the Bretton Woods international financial architecture broke down in the early 1970s because of a decline in U.S. capabilities relative to those of the other great powers. Mark Brawley in this volume, for example, argues not that the United States was less hege-

monic, but that its self-interest in providing global monetary leadership had changed. One could just as easily be surprised that a fixed rate regime endured as long as it did, given its difficulties in providing adjustment (Eichengreen 1996, 123).

In any case, by the yardstick for recognizing hegemony suggested in this chapter, which is effective international leadership on issues chosen by the putative hegemon, the United States in the final decades of the twentieth century arguably was as much a hegemon in the monetary and financial arena as ever.²³ So is the United States today a declining or a reigning hegemon? Two observations seem clear. First, as an economic power, the United States in the first decade of the twenty-first century continues to be first among equals, and its policymakers succeed in shaping international agreements an extraordinary share of the time, particularly in the monetary and financial arena. Second, however, the degree by which American capabilities today exceed those of its allies and potential rivals is substantially less than it was during the immediate postwar decades. I suggest that the current international balance of power represents a case of gradually declining U.S. dominance, and consequently a situation of rising global multipolarity. If the theory of hegemonic stability is valid, then designing and managing an effective international financial architecture for the twenty-first century therefore will be a more difficult task than constructing and maintaining the Bretton Woods regime was. Some partisans of the theory would stop here. However, one also could go beyond this prediction to reason that, given declining hegemony, future world financial governance will be particularly problematic if the United States resists the orderly replacement of unilateral leadership with institutionalized, multilateral, and somewhat representative decision making in global monetary relations. (It is not as though a new, as yet reluctant, hegemon were waiting in the wings, as arguably was the case during the interwar years.)

Table 1.4 shows that the U.S. share of the GDP of the advanced capitalist countries fell from 52 percent in 1960 to only 35 percent in 1980, declining more slowly through the 1980s to reach 34 percent in 1990. In the 1970s and especially the 1980s there was every evidence that the relative primacy of the United States was declining; America was becoming, in the words of Richard Rosecrance (1976), an “ordinary country.” A spate of scholarly analyses in the late 1980s and early 1990s tried to understand the sources of America’s apparent decline, with many predicting increased economic and political uncertainty, not only for the United States but also—and this point is the crucial one—for the global postwar international political and economic system(s) as well. Robert Gilpin (1987) and others, for example, worried over the growing prominence of Japan in global capital markets, wondering whether the share of total new U.S. Treasury issues purchased by Japanese financial institutions was lulling the United States into a dangerous state of dependency. Paul Kennedy (1987) also concluded

Table 1.4 Rising Multipolarity? GDP at Market Prices

	1960	1970	1980	1990	1998
U.S. as % of GDP of High Income OECD Members*	52	47	35	34	38
5 EMCs** as % of GDP of High-Income OECD Members	13	11	12	10	13
5 EMCs as % of GDP of U.S.	25	24	34	30	35

* High income OECD includes the United States.

** The 5 emerging market countries (EMCs) are Brazil, China, India, Korea, and Mexico.

Source: World Bank, World Development Indicators 2000, CD-ROM.

that the relative power of the United States in the world was bound to decline. Others, such as Joseph Nye (1990), emphasized the myriad dimensions along which the United States remained overwhelmingly dominant.

In the 1990s the angst in U.S. policymaking circles over hegemonic decline quieted.²⁴ During this decade, the United States experienced a resurgence in international influence across a range of indicators. The breakup of the USSR, and Russia's rapid demotion from superpower to great power to big emerging market, suddenly left the United States as the sole superpower in the military and security arena, which was a sobering experience for the other advanced capitalist democracies. Moreover, the American economy was buoyant with astonishingly low inflation in the 1990s, a success story that strongly contrasted to stagnation in Japan and adjustment rigidity and high unemployment ("Eurosclerosis") in France, Germany, and most of the rest of Western Europe. The United States' share of the GDP of high-income OECD countries rose again, going from 34 percent in 1990 to 38 percent at the end of the decade. As recently as 1995, the U.S. economy was 103 percent of that of the eleven countries that in 1999 jointly formed the European Monetary Union. Yet by the close of 1999, this ratio had risen to 136 percent, partly due to the surprising weakness of the new currency, the euro, since its introduction in January, 1999.²⁵ Even in the international monetary and financial sphere, an arena in which the U.S. dollar's dominance had declined steadily for decades, the dollar rode a power surge. The share of the United States in total world official foreign exchange reserves had fallen from over 90 percent in the 1950s to only 50.6 percent by 1990. Yet the financial turmoil of the 1990s, along with the strong dollar and opportunities for investors in the U.S. stock market, caused the dollar

share of world reserves to swell to 66.2 percent by the end of 1999 (IMF Annual Report 2000). As of the dawn of the twenty-first century, the United States was still enjoying what Ethan B. Kapstein and Michael Mastanduno (1999) called its “unipolar moment” (see also Cohen 2001). Therefore, the hypothesis that rising international financial instability in the 1990s might be partly explained by the *weakness* of the United States seems on the surface implausible.

But is it? What are reasonable expectations for relative shifts in a variety of international political and economic capabilities over the medium term? Despite the impressive shadow of the United States in the 1990s, there are good reasons to believe that the gradual shift to multipolarity will continue. Since Japan and the countries of Western Europe now have mature postindustrial economies, there is no reason to suppose that their long-term growth trajectory will outpace that of the United States, except temporarily, perhaps in a reversal of the United States’ relatively faster growth in the 1990s. However, European Monetary Union, to the surprise of many, came into being on schedule in 1999. Also probable is continued progress toward stronger political union, such as forging of a common foreign policy. Were the EMU to evolve toward anything like a political federation of Europe, then today’s unipolar moment surely would be over.

Moreover, new major powers may arise. Although the relative combined share of five large emerging-market economies in the world economy has not yet changed in the postwar period as a whole (see table 1.4), the combination of democratic government plus market reforms could change this result.²⁶ Economic theory suggests that late industrializers should grow faster than mature economies. More immediately, the greater relative influence of Western Europe and Japan, in 2000 as compared to 1970 or even 1980, suggests that developing countries have a greater value as allies—either for the United States or for a combination of other great powers aligned against the United States on a given issue—in various international bargaining relationships than ever was the case before. In a situation in which coalitions are necessary to prevail, relatively weak swing players sometimes exercise disproportionate influence, as any student of parliamentary government knows.

I conclude that increasing multipolarity, rather than continued U.S. hegemony, is the dominant underlying trend over the medium term. If it is also true that a well functioning global financial architecture, whatever its specific institutions, requires ongoing active management, then the theory of hegemonic stability suggests that we should be concerned, because effective collective or cooperative management always is more difficult to carry through than are clear commands emanating from a single authoritative leader. The function of maintaining system stability in the post-Bretton Woods era has been shared between formal institutions of collective responsibility, the IMF and especially the G7, and ad hoc crisis management by the continuing monetary hegemon, the United States. So far this mixed arrangement has operated reasonably smoothly, but

only because the United States has been willing to play a leading role in the several emerging market financial crises of the 1990s (see Mark Brawley's chapter). In the absence of an obvious external security threat such as that provided by the Soviet Union during the Cold War, however, domestic politics in the United States became increasingly hostile to U.S. international leadership, especially when foreign policy involved either commitment of U.S. resources or formal multilateral cooperation. As this book was in press, the terrorist attacks of September, 2001 dramatically heightened the salience of international affairs for the U.S. Congress and the American public, leading the United States to attack Afghanistan and openly ponder extending the war to Iraq. Structurally, however, the international distribution of economic power continues to shift toward multipolarity. For example, as the world's largest debtor nation, the United States implicitly is vulnerable to the willingness of foreign individuals and central banks to continue to hold U.S. dollars. Recent American military assertiveness may imply an enhanced willingness to lead. Still, the unipolar moment cannot be prolonged indefinitely.

The theory of hegemonic stability provides a plausible, if hardly conclusive, understanding of the relative success of the four international financial architectures over the past century and a half, suggesting that the two periods in which there was a clear hegemon had more effective international financial architectures. If we also take the conclusions of the technological determinists seriously (and these two approaches are by no means mutually inconsistent), then we are left to observe that the United States' capabilities for global economic leadership are quite likely weakening just at the moment that the international financial architecture is in need of substantial reform in order to cope with the demands of accelerated monetary globalization. The moderate version of the hypothesis of hegemonic stability does not claim that *only* hegemonic leadership can design and maintain effective global economic regimes, but does suggest that multilateral reform and regime maintenance is more difficult, and thus less likely. According to this version of the theory, the relative decline of the United States is ominous for the effectiveness of the international financial regime. At the same time, an unwillingness of the United States to accept hegemonic decline and preemptively strengthen institutions of collective global leadership further prejudices the future of the world's monetary architecture.

Democratic Consistency

A quite different body of contemporary political theory also may have something important to say about the performance of past and future financial architectures. What I term the *hypothesis of democratic consistency* is my more general reformulation of the analysis made by Beth Simmons (1994), Barry Eichengreen

(1996), and others of the domestic political causes of the failures of the interwar attempts to reestablish the gold standard. This hypothesis states that once countries become mass democracies, their leaders inevitably confront strong electoral incentives to minimize national participation in global financial architectures, such as that of the classical gold standard, that periodically deliver violent shocks to the domestic economy. Instead, elected leaders with mass constituencies, assuming that these leaders are rational, will try to create global financial architectures that buffer the domestic economy from such shocks.

The hypothesis rests on three assumptions. First, all national political leaders without exception, including authoritarian rulers and leaders of elite democracies, are responsive to a group of politically relevant constituents, a set whose membership varies from one political system to another.²⁷ One of the demands any politically relevant group of constituents will make is for reasonably stable and, if possible, improving material outcomes. Those with political voice almost always will condition their support on credible assurances from the leader that he/she has given adequate attention to their material well-being. A second assumption is that where the set of relevant constituents of a national leader is small, it often is possible to skew the economic regulatory framework so that favored groups can protect themselves even though the national economy as a whole endures periodic violent shocks. Thus, for example, financial capital and a small wealthy stratum with access to investment in diversified financial assets may protect themselves or even profit from periodic sharp deflationary shocks, such as those generated by adjustment under the classical gold standard. If political incumbents are responsive only to a small elite, then these leaders face no strong pressure to devote material or international bargaining resources to securing institutions that might buffer the domestic population as a whole from, for example, harsh exogenous shocks created by the adjustment mechanism built into a particular international financial architecture (Armijo 2001).

The third assumption underlying the hypothesis of democratic consistency is simply the converse of the second. When national political leaders instead must respond to a broad mass constituency, it will not be possible to offer everyone a targeted means of escape from overall national macroeconomic conditions. Leaders who do not succeed in providing a reasonably stable national macroeconomic environment will not be able to retain office. Instead they will be replaced by new incumbents who recognize that their tenure largely depends on their solicitude for the material needs of ordinary citizens. Therefore, leaders in mass electoral democracies confront a powerful incentive to provide buffering of global economic and financial shocks for their domestic populations. Under these conditions, political incumbents will face a strong disincentive to participate in an international financial architecture in which adjustment to trade imbalances occurs by means of dramatic fluctuations in either the level of domestic economic activity (as under fixed exchange rates with *laissez-faire* private capital

movements) or the relative domestic prices of tradable and nontradable sectors (as under floating rates with free capital flows). Political incumbents will also be under great pressure to avoid the collapse of the currency and/or the national banking system. If participating in a given global financial architecture is tantamount to committing political suicide, then rational democratic leaders should either try to negotiate cooperative rules of a new international financial architecture that can buffer the domestic economy from the full force of exogenous shocks, or they should try to delink from the global economy at a national level, perhaps via capital controls or trade barriers.²⁸

Table 1.5 summarizes the argument in this section. Column one judges each period as hegemonic or multipolar, a point I return to below. Like the

Table 1.5 Politics and International Financial Architectures

<i>International Financial Architecture</i>	<i>International Balance of Power</i>	<i>Prevalence of Mass Democracy</i>	<i>Democratic "Sensitivity" of Financial Architecture</i>	<i>Financial Regime is Politically . . .</i>
Classical Gold Standard ~ 1870–1914	• Hegemonic	• Extremely rare	• Very low	• Consistent
Interwar Experimentation 1919–1939	• Multipolar	• Core capitalist states get universal male suffrage (female follows)	• Low	• Inconsistent
Bretton Woods System 1944– ~ 1971	• Hegemonic (among participants in the global trade and payments systems)	• Core capitalist states are mass democracies • Few democracies in periphery	• High for core capitalist states • Moderate for periphery	• Consistent
Post–Bretton Woods System ~ 1973–Present	• Hegemonic, but becoming multipolar	• Core capitalist states are mass democracies • Periphery also has many mass democracies from mid 1980s on	• Moderate for core capitalist states • Low for periphery	• Increasingly inconsistent

theory of hegemonic stability, the hypothesis of democratic consistency also has a plausible explanation of the relative success of the four financial architectures since the mid-nineteenth century, as shown in the third and fourth columns of the table. The classical gold standard operated during an era in which mass democracy was extremely rare. Among the great and middle powers of the time, only the United States instituted near universal suffrage for adult white males in the nineteenth-century (Rueschemeyer, Stephens, and Stephens 1992, 122–126). Although adjustment under the gold standard was harsh, European governments of the time did not have to answer to ordinary workingmen, but only to landed and/or industrial elites, whose interests generally were served by maintaining the value of the currency.²⁹ Moreover, the links between monetary and exchange rate policies, on the one hand, and employment and the domestic price level, on the other, were not well understood, even by scholars and policymakers, much less the general public. Overall, the democratic “sensitivity” of the international financial architecture, and thus of the national financial architectures of countries that participated in the international regime, was quite low. Yet the prevalence of mass democracy also was very low, so the global financial architecture did not pose a problem for most national leaders. The classical gold standard was politically *consistent* international financial architecture.

After World War I, however, veterans of its horrors demanded and received greater rights, including the rights to vote and to unionize, in most of the core capitalist countries (Rueschemeyer, Stephens, and Stephens 1992, 79–154). Politicians had to reach out to labor constituencies to win elections. Universal male suffrage arrived first; female voting rights usually followed. Gradually national economic policies shifted toward Keynesian macroeconomic management in most countries, though specific national institutions shaped the speed and direction of change (Weir and Skocpol 1985).³⁰ Thus, while governments were doggedly trying to reestablish the gold standard, its normal operation was becoming less and less politically viable domestically.³¹ The interwar attempts at recreating the apparent successes of the prewar era failed because Britain was no longer a credible hegemon and gold standard discipline was politically *inconsistent* with mass democracy in the industrial core countries.

The Bretton Woods regime, negotiated near the end of another terrible war with mass participation, was the international complement of the Keynesian welfare state that had been established domestically in the advanced capitalist democracies. The monetary and financial aspects of the Bretton Woods system, which combined fixed exchange rates with pervasive controls on private capital movements, served to buffer the domestic populations in the core capitalist states from most of the dramatic shocks that could be delivered by the international financial markets of the time. John Gerard Ruggie (1982) has referred to these arrangements as the compromise of “embedded liberalism,” in which classically liberal ideas and arrangements for free international trade (and free convertibility

on current account, at least in principle) were embedded in domestic regulatory frameworks that kept an uneasy compromise between the international imperative of free trade and capital flows and the national one of maintaining employment. As we have seen, the Bretton Woods financial architecture worked quite well for several decades, despite its evident failure to really deliver the promised adjustment. Although the BW architecture was designed to benefit the core capitalist countries, most developing countries pegged their currencies to those of their major trading partner among the core capitalist states, and thus also were somewhat shielded from exogenous financial shocks. In any case, and this point is crucial, most developing countries were not yet mass democracies.³² Unlike the situation during the interwar years, most democratically elected national leaders in the postwar decades found their participation in the BW international financial regime politically *consistent* with their domestic obligations.

If we move to the post-Bretton Woods period, however, we notice an emerging serious mismatch of political reality and international financial architecture. As already noted, the PBW financial architecture has not been a product of intentional negotiation among the major state actors in the global political economy. Rather, it resulted from the breakdown of the BW fixed exchange rate regime in 1971–1973. Since then, marginal adjustments in the framework mainly have resulted from the periodic meetings of the G7 financial ministers and central bankers. There has been no intentional, self-conscious, multilateral redesign effort. In the 1970s and 1980s, the ad hoc governance of international monetary affairs did not cause many problems. In the 1990s, however, the acceleration of global financial flows, and their consequent near total divorce from behaviors that plausibly could be called trade balancing, generated increasing worry among the policy elite in the advanced industrial countries. Washington, D.C., policy analysts C. Fred Bergsten and C. Randall Henning (1996) lament a new “consensus for inaction” among the G7 countries, while Harvard economist Dani Rodrik writes that “globalization [of investment and capital flows] . . . results in increased demands on the state to provide social insurance while reducing the ability of the state to perform that role effectively. . . . [T]he ability of the owners of capital to move in and out of the domestic economy with relative ease imposes a negative externality on other groups (such as labor) with more limited mobility” (1997, 53–55). Fears that the advanced capitalist democracies have been engaged in a regulatory “race to the bottom” fueled by heightened global capital mobility have been explored in both in academic and more popular venues (Moses 1994; Schwartz 1994; Solomon 1995; Barber 1996; Greider 1997), although some argue that most of the angst is wrongheaded or at least wildly overblown (Garrett 1998; Drezner 2000).

Thus far, and despite the worries, publics in the core capitalist democracies have felt only relatively mild direct effects from the heightened exchange rate and financial volatility of the 1990s. Developing countries, however, have

been in the center of financial market storms. Floating exchange rates, in general, have been disastrous for domestic economic stability in developing countries, even as these countries have increasingly found it impossible to maintain fixed exchange rates, especially with increased financial volatility in the 1990s (see Hausmann et al. 1999). The pressure from global private investors, advanced industrial countries (especially the United States), and the IMF for developing countries to rapidly liberalize their capital accounts clearly increased the vulnerability of many developing countries to financial crises such as the peso and tequila crisis of 1995 and the East Asian crisis of 1997 to 1999.

Does this matter, from the viewpoint of the international financial architecture, taken as a whole? Perhaps. The hypothesis of democratic consistency suggests that the demands imposed by the PBW global financial architecture are increasingly inconsistent with the domestic political systems of many new democracies, particularly those “emerging market” countries whose participation in the world political economy is significant and likely to become more so. The “third wave” of democracy led to the redemocratization of many Latin American polities in the early 1980s, and continued in the late 1980s and early 1990s as many East Asian and most Eastern European countries became democratic, as did several African countries, some more securely than others (Huntington 1991; Diamond 1999). In country after country, newly democratic leaders suddenly had to consider the responses of mass constituencies. Posttransition “honeymoons” often cushioned leaders against their populations’ ire for some time, but democratic constituencies have gradually demanded improved economic outcomes. To the extent that the pretransition authoritarian regimes had presided over highly inflationary macroeconomic environments, as was often the case in Latin America, programs of extreme domestic austerity have pleased both international financial markets and domestic voters, at least for awhile. However, mass constituencies eventually demand of their governments both stable prices and economic growth. Heightened financial liberalization has delivered neither for poor countries. Increasingly, there is a conflict between the extreme openness and macroeconomic orthodoxy demanded of developing countries by the post-Bretton Woods financial architecture and the new reality of democratic governance within these countries (Armijo 1999). Even the relatively prosperous and politically stable Asian tigers, long known for their responsible domestic fiscal and monetary policy, were bludgeoned by the late 1990s Asian financial crisis.

If developing countries, singly or as a group, are largely irrelevant to the international political economy, then the economic and political inappropriateness of the contemporary international financial architecture for them has no impact on the functioning of the global financial architecture as a whole. But this calculation changes if emerging-market countries are becoming more important as players—perhaps because of rising multipolarity in the interstate system as a whole, or perhaps simply because of the greater likelihood of financial contagion

as financial globalization continues to increase. If they have some global influence, then developing countries' anger with the lack of buffering for their economies built into the current system has negative implications even for the advanced industrial democracies, whose populations have not felt the effects of acute financial crisis since the 1930s. If newly democratic countries possess a useful bargaining chip or two—perhaps a pledge of forbearance from industrializing by means of polluting technologies, or simply an implicit promise not to disintegrate and export their angry citizens and ideologies?—then previously excluded countries may gradually oblige their inclusion in the institutions of global economic and financial management. The hypothesis of democratic consistency predicts that a continued and worsening failure of the international financial architecture to buffer the populations of newly and weakly democratic states from the full brutality of global capital storms will either destabilize democracy in the developing world, and perhaps export financial contagion and political unrest to the core economies into the bargain—or will induce developing country leaders to contemplate policies to delink from the global economy, an option likely to slow economic growth in the periphery and increase pressures for emigration to industrial countries, at a minimum. Democratically elected leaders in developing countries cannot afford to engineer their countries' full participation in open international markets unless the twenty-first-century international financial architecture can find a way to bring their societies, as well as those of the rich countries, under the protective umbrella of something like the Bretton Woods regime's "compromise of embedded liberalism."

In sum, three trends have undermined the overall political viability of the PBW financial architecture. First, the interstate balance of power is becoming less hegemonic, but the international financial architecture as yet has no increased provision for multilateral, representative crisis management. Second, floating exchange rates combined with progressively freer capital movements have undermined the effectiveness of domestic macroeconomic policies, undercutting the "compromise of embedded liberalism" in the industrial world (Andrews 1994). Third, the majority of the states in the global periphery are now mass democracies, whose populations now demand of their leaders protections from imported economic chaos similar to those that the BW regime organized for the core capitalist world. For all of these reasons, the current financial architecture is increasingly politically *inconsistent*.

Interpreting the Historical Record: A Synthesis

This section has examined the plausibility of various alternative interpretations of the reasons for success or failure of previous international financial regimes, as well as the present one. It should be noted that these interpretations

are not necessarily rivals, in the sense that the truth of one must imply the falsity of another. What jumps out from the analysis is that *each* of three separate arguments—privileging the importance of, respectively, technological modernization, hegemonic leadership, and democratic consistency—predicts that the current post-Bretton Woods financial architecture, if left alone, in future will become increasingly ineffective. If computerized trading technology truly changes everything, then it follows that the inherited regulatory framework for global finance is becoming ever more obsolete. If the international balance of power is moving toward multipolarity, then a global financial architecture that, de facto, relies upon the U.S. treasury secretary to ride to the rescue is precarious indeed. Finally, if interdependence plus multipolarity suggest that emerging-market countries are today of relatively greater importance to global economic management—even if developing countries can only exercise decisive influence on occasions when the advanced industrial countries disagree—then the deep incompatibility of democratic governance in the periphery with the extreme financial openness demanded by the PBW financial architecture becomes a problem for the health of the system, not simply for emerging market countries themselves.

LAISSEZ-FAIRE, TRANSPARENCY, CAPITAL CONTROLS, AND AUTARKY: THE TERMS OF THE DEBATE THAT IS

Meanwhile, the concerns most frequently expressed in the actual debate over reform of the global financial architecture are rather different. With a few notable exceptions, the centers of discussion most likely to influence actual outcomes are located in the advanced capitalist countries, particularly the United States. The concerns of the industrial world dominate most of the multilateral studies and influential policy papers being produced and widely discussed today (see the chapters by Fernández-Arias and Hausmann, Goyal, Laurence, and Porter and Wood).³³ The final section of this chapter therefore seeks to characterize not the debate that might or should be, but rather the one that is. Combatants might usefully be divided into adherents of four broad, composite positions, which I label “laissez-faire liberalizers,” “transparency advocates,” “financial stabilizers,” and “anti-globalizers” (see table 1.6).

Laissez-Faire Liberalizers

The economic analysis of the laissez-faire liberalizers is that free global capital markets maximize efficiency. Markets are understood as freestanding and autonomous in their workings, needing very little other than reputation and good information flows to restrain criminal or unethical behavior. A central tenet of

Table 1.6 Debating the Global Financial Architecture Today

<i>Preferences</i>	<i>Adjustment Preferences</i>	<i>Liquidity Preferences</i>	<i>Stability</i>
Laissez-Faire Liberalizers	<ul style="list-style-type: none"> • Automatic, with no room for political discretion • Either a hard fixed rate (as a gold standard) or a pure float 	<ul style="list-style-type: none"> • Gold, gold exchange, or dollar standard • End all capital controls immediately 	<ul style="list-style-type: none"> • Many would abolish IMF, World Bank • U.S. and other G7 governments should not bail out countries or banks
Transparency Advocates	<ul style="list-style-type: none"> • Free float or managed float for major currencies 	<ul style="list-style-type: none"> • Dollar standard. • Gradually liberalize capital flows, with interim opt out for developing countries 	<ul style="list-style-type: none"> • Greater transparency; standardization • Great power crisis management, ad hoc and institutionalized (G7, IMF)
Financial Stabilizers	<ul style="list-style-type: none"> • Managed float for major currencies 	<ul style="list-style-type: none"> • Dollar standard or regional currency blocs • Skeptical of external financial liberalization • Ensure investment in developing countries 	<ul style="list-style-type: none"> • Multilateral, even supranational, crisis prevention and management
Anti-Globalizers	<ul style="list-style-type: none"> • Fixed exchange rates??? 	<ul style="list-style-type: none"> • Preserve national currencies • Oppose free global capital flows, long-term and short-term 	<ul style="list-style-type: none"> • National regulation only • Left: abolish IFIs unless democratic • Right: abolish IFIs

this view is that regulation, including most prudential regulation that limits possibly risky behavior in advance, does more harm than good. Many laissez-faire liberalizers are particularly hostile to the notion that well-functioning financial markets require a lender of last resort in order to protect financial institutions facing temporary liquidity problems from becoming insolvent. Bank runs, capital flight, and speculative attacks on a country's currency are an unfortunate

consequence of the high levels of risk inherent in financial markets. The only way to reduce risk, maximal liberalizers would argue, is to eliminate the problem of "moral hazard." Once a lender of last resort exists, even if there is no explicit commitment but merely a perception that debtors (including banks) in trouble will be rescued, then all players, both creditors and debtors, face a deeply deleterious incentive to engage in more risky (but more profitable) behavior than they otherwise might, since no player expects to bear the full cost alone if the risk goes bad. In the aggregate, the safest financial market is one *without* a safety net, because only then will reckless behavior effectively be deterred. A few deaths may be necessary to prove the point, but casualties will be fewer in the long run.

Laissez-faire liberalizers are not in complete agreement over the ideal adjustment mechanism for the world economy. Some, like the editorial page staff of the *Wall Street Journal*, periodically yearn for a revived gold or gold exchange standard as a mechanism for imposing impersonal discipline on spendthrift politicians who otherwise might be tempted to use trade and capital controls to equilibrate their balance of payments. Other laissez-faire advocates prefer floating exchange rates, seeing even the possibility of overshooting and volatility as salutary curbs on domestic policy profligacy. With respect to liquidity, all wholehearted liberalizers would abolish virtually all capital controls. In the interests of international financial stability, they would act boldly to eliminate moral hazard. Many also would close the World Bank and/or the International Monetary Fund, viewing official development assistance, coordination of country debt "bailouts," and even limited and short-term balance of payments support to governments as illegitimate and counterproductive (see Edwards 1998).

Prominent U.S. theorists of radically free capital markets at the international level include Nobel laureate Milton Friedman, former Secretary of State and the Treasury George Shultz, and free market economist Allan Meltzer, head of the expert committee appointed by the Republican-dominated United States Congress to inquire into the Asian financial crisis (see Friedman 1992; Schultz, Simon, and Wriston 1998; Brunner and Meltzer 1993; and C. Fred Bergsten's chapter in this volume). The Institute for International Finance (IIF) is a research institute and advocacy group whose members include most of the world's largest and most influential multinational banks and financial institutions, particularly but not exclusively those headquartered in the United States. Its members, whose earnings depend on international lending, investments, and financial arbitrage, enthusiastically support rapid and thoroughgoing liberalization of existing barriers to cross-border capital flows, but are understandably ambivalent about disestablishing the IMF, whose rescue and structural adjustment packages have enabled many of them to continue to receive payments from countries that otherwise would have been in default (IIF 1999). The Cato Institute, a libertarian think tank and sometime advocacy group, wants to abolish all capital controls

and the IMF immediately, and promotes these ideas on its website and in its publications (Dorn 1999).

Through the Cato Institute, and similar conservative U.S. think tanks, the economic ideology that truly free markets can operate largely independently of government oversight and regulation is married to a deep suspicion of liberal internationalism. Many *laissez-faire* liberalizers in the United States critique their country's involvement in virtually all international institutions—from the United Nations to the World Criminal Court, the 1997 Kyoto Protocol on the environment, and the IMF—on the grounds that such international organizations infringe national sovereignty. The constituency for the “new sovereigntists” (Spiro 2000), especially in the United States, also includes many whom I would term anti-globalizers, and provides a politically salient link between the conservative intellectuals and global financiers who are the core supporters of maximal financial market liberalization and the more numerous conservative populists and nativists who distrust all international organizations, including but not limited to the International Monetary Fund and World Bank.

How influential is this view? The views of wholehearted financial liberalizers are strongest and closest to the centers of power in the United States, especially since the confirmation of George W. Bush as the victor in the U.S. 2000 presidential election, but also find resonance in monetarist and conservative circles in Germany, Britain, Chile, and a limited number of other countries. In practical terms, perhaps the main achievement of the *laissez-faire* liberalizers has been to convince many policymakers, particularly in the United States and other G7 countries, that it is inappropriate even to consider the existence or consequences of power relationships in the global monetary sphere. This view comes perilously close to declaring that governments should not interfere in markets, and concluding that therefore governments, especially powerful ones, do not interfere. Moreover, financial markets should be decentralized, not oligopolized, and therefore international financial oligopoly does not and cannot exist (for a contrary view, see Haley 1999). In other words, those who disproportionately benefit from the unequal power relations that do exist in the international political economy are rendered cognitively unable to recognize that power enters into the question at all (see Gilpin 1987, chapter 1 and *passim*). Ideologically consistent *laissez-faire* liberalizers, therefore, are impatient with and even contemptuous of the theory of hegemonic stability—a subtlety their detractors frequently do not recognize.

Transparency Advocates

A second loose association of participants in the debate over the global financial architecture might be labeled transparency advocates. In general, they support free markets and free trade. They are distressed over the frequency of

deep financial crises in developing countries, and also recognize that the advanced industrial world is not immune, only lucky thus far. But transparency advocates recognize few viable options for responding to the problems of financial globalization, because they consider themselves to be realists on one or both of two dimensions. First, they doubt whether national and partial capital controls can work. True, fully liberalized global private capital flows in fact might be dangerous. But there is no going back now. Many transparency advocates, in other words, are technological determinists. Second, most transparency advocates believe that even if strengthened multilateral global financial regulation might be technically feasible, supranational regulation is and will continue to be a political nonstarter. Given this conclusion, publicly admitting the need for strong international supervision and guidance of world financial markets serves only the purpose of undermining confidence, precisely the worst possible outcome. Instead, these would-be responsible realists embrace the solution of greater “transparency” in financial markets, by which is meant fuller and more timely reporting of international financial assets and liabilities by all governments. The core faith of this approach is that better informed market participants will be both less likely to engage in risky behavior and less likely to panic when market indicators suddenly reverse themselves.

With respect to adjustment, most transparency advocates would retain the current system of floating exchange rates, noting that it has worked reasonably well thus far, though several would prefer to see greater cooperation among the United States, Japan, and now the European Monetary Union (as represented by the European Central Bank?) to jointly reduce exchange rate fluctuations. Most of these moderate liberalizers would stick with the dollar standard—they are pragmatists, after all—and endorse further loosening of capital controls worldwide. In contrast to the *laissez-faire* liberalizers, however, many transparency advocates would allow significant phase-in time for developing countries, recognizing that their relatively shallow financial markets experience much more intense domestic macroeconomic turbulence than the deeper and broader financial markets of the advanced capitalist world. It has not escaped these pragmatists’ notice that such countries as Malaysia and Chile employed capital controls in the 1990s, seemingly with reasonably good results (see the chapter by Benjamin J. Cohen).

The views of most transparency advocates on architectural reform to ensure stability are either centrist and pragmatic, or selfish and exclusionary, depending upon one’s viewpoint. Most would like to see greater, and more institutionalized, cooperation among the major powers to manage the international financial system. Regularized great power consultation through such bodies as the G7 would not only serve to prevent or ease global monetary crises, but also should serve as a venue for the governments of Japan, Western Europe, and Canada to debate issues of global liquidity growth with the United States, which still holds the predominance of power in this arena. Transparency

advocates typically do not concern themselves with issues of representation or equity in global economic management, partly because experienced policymakers understand that collective management by even a few great powers is a difficult task.

As of the very early twenty-first century, the views of transparency advocates undoubtedly dominated the debate over the international financial architecture. The resolutely non-radical views of the transparency advocates are the majority position throughout the U.S. and British foreign policy establishments, on both sides of the partisan aisle in both countries. The recent U.S. Council on Foreign Relations report on international financial reform (see the chapter by Bergsten) reflects them, as also do the three reports of the Group of Twenty-Two (G22), an official multilateral forum with membership of both advanced industrial and developing countries, organized by U.S. policymakers (see Eichengreen 1999 and this volume's chapter by Porter and Wood). Eichengreen's (1999) primer on the international financial architecture debate, and many of the publications of the Institute for International Economics, also belong here. Transparency is now the home, hearth, and apple pie of global financial reform, endorsed by virtually every expert commission across the political spectrum, and thus has some of the characteristics of a lowest common denominator.

The transparency advocates are successful because they propose the least change from the current status quo. The uncomfortable question is whether their consensus and minimalist solutions adequately address either the technical problems of global financial regulation or the less recognized underlying questions of political leadership and representation raised in this book.

Financial Stabilizers

The financial stabilizers include a number of prominent defectors from the transparency advocates, generally individuals who have concluded that a simple shift to greater openness, combined with technical assistance to developing countries around such issues as modernizing their securities markets law and corporate governance statutes, is an insufficient response to the heightened risk of an international financial meltdown in a world of globalized capital markets (see the chapter by Benjamin J. Cohen). Financial stabilizers believe that continuing with the status quo is dangerous, because liberalized financial markets are inherently unstable (see the chapter by David Felix). Members of this group believe that global finance requires global regulation, perhaps including elements of a genuinely supranational authority. Financial stabilizers are much more sensitive to the international distribution of power, both military and economic, than are members of the first two groups, and many make the unequal distribution of costs among the victims of financial crashes or associated eco-

conomic slowdowns central to their analysis (see the chapters by Eduardo Fernández-Arias and Ricardo Hausmann, and by Ashima Goyal).

Financial stabilizers desire an exchange rate regime that makes national adjustment to trade imbalances effective. However, like the designers of the Bretton Woods monetary regime, they rank exchange rate stability and external equilibration as less compelling objectives than the maintenance of domestic macroeconomic health. Most financial stabilizers put their faith in an actively and collaboratively managed float among the currencies of the great powers, like that of the current post-Bretton Woods international financial regime, only more so. The liquidity preference of those who fear international financial crises and cross-border contagion is generally for the continuation of the present dollar standard for international transactions. Financial stabilizers, as I have defined this term, are not nostalgic for either a gold or a gold exchange standard, *per se*, although they greatly appreciate the predictability and buffering that the Bretton Woods financial architecture was able to offer domestic economies. Some go so far as to advocate regional currency blocs, arguing that otherwise developing countries will never escape the burden of their national currencies' "original sin" of not being "credible" with footloose global investors (Hausmann et al. 1999; see also Fernández-Arias and Hausmann in this volume). The spread of regional currency blocs would lead most of Latin America to dollarize, and much of the Middle East and some of Africa to adopt the euro, although there is no such straightforward choice for Asia (Cohen 2000, and the chapter by Henry Laurence). The first such large currency bloc that was not a colonial holdover, of course, came into existence in early 1999 as the European Monetary Union (see the chapter by Erik Jones).

Many financial stabilizers are explicitly concerned with the provision of international money and credit, as this is a crucial determinant of future world economic growth. Moreover, many or most financial stabilizers think the global financial architecture should assertively promote medium and long-term investment—private or if necessary public, as through the IFIs—in developing countries as a positive good, for which there is both an efficiency and a fairness rationale. Consequently, many financial stabilizers, whether in Japan, Europe, or developing countries, would strongly prefer more cooperative, and even explicitly representative, management of global money supply growth, as well as more transparent rules for allocating credits from the international financial institutions such as the IMF or World Bank (Mayobre 1999). At the same time, most would prefer to limit very short-term capital flows, arguing that they typically do not reflect underlying economic fundamentals such as a country's trade position or the quality of its investment opportunities. Knowing that countries pay a price for unilaterally imposing capital controls or any other significant new financial regulation, stabilizers would prefer joint regulatory action, presumably with the great powers taking the lead (Ocampo 1999). Similarly, analysts and advocates

in this group would like to see the lender of last resort function, and other crisis prevention and management measures, be collective and more representative. Innovations that have been suggested include a global bankruptcy court, making the IMF into a formal lender of last resort, and a global credit rating agency (Blecker 1999, 85–146). Devesh Kapur (2000) recently observed that a good place to start in making the international financial institutions, along with other international organizations, more representative and responsible would be to formalize the present clientelistic and ad hoc selection process for their leaders!

The majority of national governments—excepting those crucial ones in the United States and Britain—lean toward the financial stabilizers' positions, including most of the remaining G7 countries (Kirtton 2000; see also this volume's chapters by Laurence and Goyal). The European Monetary Union can be understood as an ambitious policy response to the concerns raised by the financial stabilizers' analysis. Other prominent financial stabilizers include Nobel Laureate James Tobin, proposer of the famous "Tobin tax" on short-term international capital flows; former World Bank chief economist Joseph Stiglitz, who publicly criticized the IMF in 1998 for its handling of the Asian financial crisis; the United Nations Economic Commission on Latin America and the Caribbean (ECLAC); the Division on Transnational Corporations and Investment of the United Nations Conference on Trade and Development; and recently even financier George Soros (Tobin 1978; Stiglitz 1998, 2000; Ocampo 1999; Soros 1998). In the 1990s, several highly respected, traditional free market economists endorsed a notion that directly contradicts the core intellectual premise of all laissez-faire liberalizers and some transparency advocates. Notable free traders such as Jagdish Bhagwati (1998) concluded that international capital markets are fundamentally *dissimilar* to global markets for goods and services: they are not self-equilibrating, and therefore need careful oversight and regulation. The World Bank in the late 1990s placed itself somewhat cautiously in the camp of financial stabilizers, while several of the regional development banks, very aware of the devastation of financial crises in emerging markets, are more wholehearted in their belief that unchecked financial liberalization is dangerous.

The influence of the financial stabilizers in those international committees that have the capability of affecting actual reforms of the global financial architecture is hard to know. Those who feel most strongly are the governments of developing countries, who have relatively little clout. Advanced industrial countries other than the United States have considerably more potential influence, yet are more united in their opposition to U.S. hegemony than in supporting any concrete alternative proposals. Since the financial crises of the 1990s, however, prominent scholars and policymakers among the transparency advocates have begun to take the analyses of the financial stabilizers more seriously. Unfortunately, the United States' present international bargaining stance of transparency advocacy is under strong pressure from the United States Congress, where both

laissez-faire liberalizers and anti-globalizers are prominent, and from the U.S. private financial sector, a strong supporter of laissez-faire liberalism. Under the circumstances, the conversion of a few academics and midlevel policymakers doesn't much matter.

Anti-Globalizers

I term the last broad group of interests and advocates the *anti-globalizers*. Those in this group are deeply skeptical of free trade, and thus much less willing than adherents of the other three positions to evaluate designs for monetary and financial affairs in terms of their ability to promote trade. Similar mistrust of both trade and international financial integration uneasily unites strong partisans of both the political left and right. Many anti-globalizers, especially those on the right, suspect all international initiatives, especially those organized by national governments, although others, almost invariably on the left, are committed internationalists, albeit ones that trust nongovernmental organizations (NGOs) significantly more than national governments. Most distrust corporations, particularly large transnational firms. What unites this group is less an economic analysis per se than a skepticism about established power structures, and a preference for the little guy over the Goliath of big government. In this sense, members of this group, including both those whose overall social, religious, and political orientation is on the left and those identified on most issues with the conservative right, are populists.

Most anti-globalizers don't want to have to think about assuring adjustment, liquidity, and stability in the global financial system. They resent both volatile exchange rates and the adoption of foreign monies. Their preference, if they are forced to articulate one, is for fixed rates and use of their own national currency. They have no desire to return to the gold standard, but, unless Americans, resent the hegemony of the U.S. dollar. They favor both trade and capital controls, including barriers to both short-term flows and long-term foreign direct investment. This group opposes globalization of everything from culture to finance, perceiving it as handing control from real people to faceless giant corporations, and assumes that the remedy for international financial instability is less porous borders and self-reliance. Those on the political right perceive the international financial institutions as threats to national sovereignty, often seeing satanic overtones in the very existence of international organizations. Those on the left fervently support multilateralism and multiculturalism in principle, yet believe most existing international organizations, and almost certainly the IMF and World Bank, to be corrupted and compromised almost beyond redemption. Activists in either camp, however, often can unite on issues such as reducing foreign aid, cutting back or eliminating contributions to and/or cooperation with the international

financial institutions, and opposing novel schemes for heightened international economic cooperation, such as the European Monetary Union, which likely would not have come into being had not the French public narrowly ratified the Maastricht Treaty in September 1992, only a few months after the Danes narrowly rejected it.

Anti-globalists include intellectuals, politicians, and members of social strata discomfited by globalization. Unlike the other three influential currents of opinion on reform of the international financial architecture, all of which are overwhelmingly elitist coalitions of technocrats, intellectuals, business leaders, and responsive politicians, the anti-globalization alliance has significant popular support in national legislatures and among church and religious groups and community organizers. Most of the political clout of the position comes from activists residing in advanced industrial countries, though left anti-globalizers in the advanced industrial countries have forged important links with groups, often minorities or the relatively disadvantaged, in developing countries through such organizations as the Rainforest Alliance, the networks of NGOs opposed to the North American Free Trade Association (NAFTA) and the World Trade Organization (WTO), and the Jubilee 2000 movement for international debt forgiveness for highly indebted poor countries. Leaders of the left anti-globalizers in the United States include Ralph Nader, Green Party candidate for president in 2000; the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), the United States' most influential labor confederation; and the Reverend Jesse Jackson, African American activist and former Democratic presidential candidate. The message is spread by activist coalitions such as the International Forum on Globalization, whose affiliates include the Friends of the Earth, the Third World Network, the Institute for Policy Studies, and Public Citizen (IFG 1999; see also Armijo 2000).

Right anti-globalizers tend toward nativism and chauvinism, either of which render international links more difficult. But they have wide popular appeal in countries experiencing strains from trade and financial opening, from Australia to Central and Eastern Europe, India, and Indonesia. They frequently elect politicians and control sizeable blocs in national legislatures, including the United States Congress. In the United States, 1992 Reform Party presidential candidate Ross Perot, Christian conservative and sometime presidential candidate Pat Buchanan, and numerous members of Congress, from former House Majority Leader Dick Armey to Chairman of the Senate Foreign Relations Committee Jesse Helms, all have opposed inward and/or outward foreign investment, U.S. contributions to the international financial institutions, the early 1995 financial rescue package for Mexico, and other core elements of contemporary financial internationalism. They share a deep, often religiously based, suspicion of "one-worldism" with the libertarian intellectuals among the laissez-faire liberalizers. On matters of specific policy, the right anti-globalizers, and sometimes also left anti-globalizers, often are willing to unite with the radical free marketeers to

bash the established organizations of the post-Bretton Woods international financial architecture, the IMF and World Bank, along with other institutions of incipient global governance, such as the United Nations.

CONCLUSIONS: DEMOCRACY AND INTERNATIONAL FINANCIAL REFORM

This chapter began by defining three core functions that any international financial regime must facilitate: national adjustment to external imbalances, provision of liquidity or credit to the global economy, and a mechanism to manage crises and provide monetary and financial stability. I described four historical financial architectures and ranked them. The classical gold standard performed brilliantly, in terms of its ability to satisfy the needs of the relevant political actors of its time. The Bretton Woods financial architecture, though very different in most of its technical particulars, was nearly as successful. In contrast, the interwar attempts to restore the gold standard were a disaster. Arguably their failure had more to do with their political unsuitability than specific technical flaws. Today's ad hoc post-Bretton Woods financial architecture has performed adequately since the mid-1970s, but since the 1990s has been under obvious—and occasionally frightening—strain. In my view, technical modernization is important, but if the global financial architecture of the twenty-first century is not also *politically consistent*, then it probably will not endure. Unfortunately, the shape of the current debate over reform primarily reflects the distribution of elite opinion within the United States—not that in the larger world.

The financial architecture debate has not yet internalized either of two crucial political transformations around the world: emerging global multipolarity and the spread of mass democracy to developing countries. The unexpected violent attacks on the United States in late 2001 demonstrated the necessity of multilateralism to the hitherto notably unilateralist administration of U.S. President George W. Bush. Moreover, numerous pundits immediately thereafter highlighted the strong empirical association between democratic societies and the inculcation of cultural and religious tolerance in their citizens, suggesting an excellent reason for the advanced industrial world to support democracy in poor countries. Nevertheless, the current minimalist and hegemonic post-Bretton Woods international financial architecture makes it difficult for elected leaders in poor countries to maintain both domestic mass democracy and external economic integration, because the PBW financial architecture requires developing country publics to endure precisely those extremes of economic volatility that citizens in the Western democracies made clear to their leaders in the 1930s that they would no longer tolerate. In the future, questions of participation and political process will be as relevant to the search for a credible and legitimate global financial

architecture as are the myriad technical problems of regulating cross-border money and credit flows.

NOTES

I thank Mark Brawley, David Felix, Ashima Goyal, Eric Helleiner, Kaizad Mistry, Eric Wibbels, and an anonymous reviewer for comments, as well as the other contributors to this book, who graciously let me read their chapters before I had to write mine. Special thanks go to my students at Reed College in 1999–2000 for their thoughtful responses to many of these ideas.

1. Old and new classics on “international regimes” include Krasner 1983; Keohane 1988; Hasenclever, Mayer, and Rittberger 1997; and Katzenstein, Keohane, and Krasner 1999.

2. The expansion or contraction due to the injection or withdrawal of reserves from a country’s central bank is magnified under the now nearly ubiquitous system of “fractional reserve banking.” This means that the central bank only holds reserves adequate to redeem some fraction (often less than 10 percent) of the country’s paper currency held by the public. Were the credibility of the currency ever to be challenged, the central bank would shortly run out of reserves.

3. Imagine that a U.S. trade deficit generates a net outflow of dollars from the United States. If foreigners choose to hold or invest those dollars abroad (instead of redeeming them for goods, gold, or foreign currency held by the United States), then the international money supply has increased by that amount.

4. This statement is more true for national governments than for private financial actors, who may be tempted to profit from speculating against one or more currencies, on the assumption that the governments of the core capitalist powers will intervene to prevent system breakdown.

5. In the absence of such a standstill agreement, all creditors have an incentive to get their money out of the troubled firm (or country) rapidly, in order not to be left last in line. Once the process is triggered, even fundamentally solvent (but illiquid) borrowers can quickly be ruined.

6. In several important crises, central banks intervened to help one another through liquidity crises, acting as lenders of last resort (LLRs). For example, during the Barings Crisis of 1890 the Bank of England borrowed from the French central bank, while the Russian monetary authority also pledged further assistance as necessary (Eichengreen 1996, 34). European bankers correctly perceived the governments of peripheral countries, such as those in Latin America, as less deeply committed to domestic price and financial stability, and were reluctant to lend funds to support a given parity of the currency with gold.

7. Britain and France together owed the U.S. government \$10 billion for wartime loans, which taxpayers in either Europe or the in the United States would have to absorb.

In 1921 the Reparations Commission found that defeated Germany owed Britain and France the amazing sum of \$33 billion in war reparations, although the amount remained under constant negotiation for more than a decade (Lairson and Skidmore 1997, 55). Ultimately, Germany paid around \$2 billion during the 1920s to the European Allies, who in turn repaid about \$1 billion to the United States (Eichengreen 1996, 69). The United States had a strong currency, an abundance of monetary gold—nearly 45 percent of the world's supply in 1926 (Eichengreen 1996, 67)—and a persistent trade surplus, because its industrial base had not been bombed. Private investment flows from the United States to Europe, including Germany, provided liquidity until the late 1920s, but were not a reliable source of financing. Once private financing from the United States dried up, the system would become illiquid quickly.

8. These were Austria, Germany, Hungary, and Poland.

9. For example, both the French and the Americans had long suspected that the British desire to let central banks hold reserves in foreign exchange, as well as in gold, was a ploy to promote the use of sterling. The Americans, French, and British agreed in 1936 to limit future competitive devaluations.

10. Contrary to much received wisdom, Barry Eichengreen concludes that “currency depreciation in the 1930s was part of the solution to the Depression, not part of the problem,” (1996, 89), arguing that the competitive stimulus of increased exports in major economies (even if only temporary, as trading partners responded in kind) was practically the only engine of growth in the world economy.

11. The original BW agreement also contained a clause, for which Keynes had fought hard, empowering the IMF to bless trade retaliation against countries with persistent surpluses by certifying them as “scarce currency” countries, that is, countries whose currencies were much in demand.

12. These were the “special drawing rights” (SDRs), created in 1969. But real countries wanted to hold gold or dollars, sterling, marks, or yen—not SDRs, backed only by an international institution.

13. In the preliminary discussions for the BW conference, the American negotiator, White, shot down the suggestion by Keynes that the proposed world fund have an initial U.S. contribution of \$23 billion, countering with the much lower figure of \$2 billion. \$2.75 billion was the final figure. The World Bank had similarly scant initial resources, despite the fact that both delegations imagined that its initial task would be to give significant aid for the reconstruction of Europe. Within a few years, however, U.S. policymakers realized that the minimum funds needed to influence the economic recovery of Western Europe, and to limit the attractiveness of Communism and Socialism, were much larger. Through the Marshall Plan, the United States transferred \$13 billion in reconstruction aid to Western Europe through the early 1950s (Eichengreen 1996, 96–98).

14. As long as the other core capitalist states were willing to run a trade surplus with the United States, the United States could “export inflation.” Foreign central banks would either have to expand their domestic money supplies to accommodate the additional dollar reserves they held, or increase the public debt in the course of “sterilizing”

the inflows by additional borrowing from their domestic publics to shrink the money supply.

15. Russia is not a core capitalist economy, but it does have nuclear weapons and the West desperately wants to retain it as a partner in the uncertain post-Cold War world.

16. Kenneth Waltz (1959, 1979) observed that theories of international politics have been pitched at three levels, that of the individual leader (as in psychological or “great man” interpretations of history), the state (as in predictions that authoritarian political systems will generate different foreign policy preferences and actions than democratic ones), or the international system itself (as in theories abstracting from the characteristics of both individual leaders and domestic politics and focusing exclusively on the “balance of power” or distribution of capabilities among nation-states in the international arena).

17. Theorists such as Charles Kindleberger (1981, [1973] 1986) and Robert Gilpin (1987, 2000) suggest that hegemonic management of international economic arrangements in an “anarchic world” (that is, a global political economy without an overarching world government) is likely to be more stable and successful than collective management. Others have argued that once a successful international economic regime is established by a dominant state, thereafter cooperative, multilateral management can be almost as effective as continued hegemonic leadership (Keohane 1984; Oye 1986).

18. In asking whether hegemony is “good” for the system, Robert Pahre (1999) defines a hegemon as “benevolent” (in that it pays more for the provision of public goods enjoyed by all than it gets back in terms of special privileges) or “malevolent” (in that it forces other system participants to contribute proportionately more resources to essential regime maintenance than it does). Most hegemonic stability theorists are less focused on the distribution of (the relative) gains from hegemony. They want to know if hegemony improves the likelihood that a reasonably effective international financial architecture (that is, one providing viable, if not always “just,” outcomes in terms of adjustment, liquidity, and stability) will be constructed and maintained.

19. A hegemon could, of course, prefer autarkic global economic relations. In such a situation, there also will not be an effective and successful international financial architecture.

20. I admit to theoretical vagaries in this definition. For example, I begin by intimating that I intend to assess “power” on the basis of objective capabilities, but, in the end, state that power will be known by the demonstration of influence, where A has influence over B if A successfully persuades B to make a choice or perform an action that B otherwise would not have. Nor have I specified exactly how I will assess capabilities. Still, my definition works well with our *intuitive* sense of a hegemon, which is a country that is sufficiently prominent, or shall we say dominant, among its fellows as to exercise “leadership,” *either* in the sense of a) apparently dictating many, or even most, of the rules of international interaction, or in the quite different sense of b) making choices, which it has no ability at all to impose, that others accept for the purpose of solving coordination and/or collective action problems (Keohane 1984; Hasenclever, Mayer, and Rittberger 1997).

21. My judgments as to which eras were hegemonic and multipolar probably reflects a consensus of scholars, including most of those cited here. However, Pahre (1999, 15) concludes that “there has always been a hegemon during the modern period (1815 to the present).” Waltz (1979), at the other extreme, sees the nineteenth century through the First World War as a time of multipolarity in the interstate system, with five to seven great powers at any given time. In Waltz’s view, that is, imperial Britain was considerably less than a hegemon in Europe. It was able to play the role of a balancer, shifting between rival alliance coalitions, largely because its geographic position gave it greater freedom of action than most continental European states. The source of these divergent assessments is the precise definition the researcher gives to the term “hegemon,” which can range from merely “first among equals” to the much more demanding “able to *command* the cooperation of all of the other states in the system.”

22. It should be clearly noted that the classically liberal character of Britain’s relationships with other European and North American states coexisted with distinctly mercantilist policies toward its colonies.

23. “Effective” international leadership does not necessarily mean normatively desirable, in terms of any particular hierarchy of values, or even in terms of an imagined consensus of world leaders. It merely means successful in terms of being a plausible solution to the challenges of global monetary management.

24. Mark Brawley in his chapter below gives slightly different dates to the intellectual debate.

25. Calculated from data available at World Bank website, November, 2000.

26. New research suggests a powerful link between democracy and economic growth, even when controlling for a host of other factors. See Barro 1997; Feng 1997.

27. The set of “relevant political actors” may be as small as a few regionally powerful land barons or the senior military officer corps, or as large as the entire adult population. Political participation may be constituted geographically, by economic class, by ideology, or by ascriptive characteristics such as race, ethnicity, or religion of birth.

28. Some readers may object that leaders of developing countries have no choice but to participate in the reigning international financial architecture, however much it disadvantages them. I assert that all political incumbents make real decisions, even if their best option is to select the lesser evil. The point is that leaders of mass democracies may rank their options differently than rulers who must answer only to a privileged few.

29. Britain was the major industrial power of the time. If its industrialists lost out from maintaining a strong pound vis-à-vis the currencies of Europe and the United States, they could depend upon their government to attend to their exporting needs in setting the values of currencies for the British colonies. The Indian rupee, for example, was deliberately maintained overvalued against sterling in order to aid Manchester cotton exporters.

30. Nazi Germany and fascist Italy also adopted core elements of the welfare state, arguably because their political systems, although not democratic, depended on

mass mobilization and support. In Germany/Prussia, of course, welfare state policies dated from the time of Bismarck.

31. I am suggesting that characteristics of a country's domestic political system can change the type of foreign (economic) policies its leaders adopt. International relations scholars hotly debate the degree to which countries' international policies vary according to domestic politics. Kenneth Waltz (1979) remains the foremost proponent of the "structuralist" (also known as "neorealist," as in Keohane 1986) position that *only* the distribution of capabilities in the international system fundamentally influences international relations; consequently, rational leaders of democratic states, in the aggregate, will make very similar foreign policy choices to those of authoritarian states. Waltz argues that national leaders who do not act to maximize their states' relative power against any and all potential rivals—including states with whom they have special cultural, historical, or ideological affinities—either will cause their countries to be disadvantaged internationally or will themselves be driven from power by their more pragmatic supporters. Andrew Moravcsik (1997) has recently made a persuasive case for the opposing position. Moravcsik and others suggest that states that are liberal democracies possess a somewhat different set of goals for their foreign policies than do dictatorships. These include a strong disinclination to fight other democratic states and a heightened unwillingness to subject their domestic populations to severe economic hardship simply for the sake of honoring international economic commitments, from adherence to the gold standard in the 1920s to membership in the World Trade Organization in the late 1990s.

32. India was the major democratic exception among developing countries. Arguably its decision to pursue near economic autarky, while hurting its prospects for economic growth, enabled Indian politicians to implement a redistributive national economic policy framework that was crucial to securing democracy in the early postindependence decades.

33. An intriguing and hopeful recent initiative, organized outside the G7/G8 but with high level participation from them, has been the study group on global financial issues organized in December, 2000, by United Nations Secretary General Kofi Annan, under the leadership of former Mexican president Ernesto Zedillo. Members included former U.S. Treasury Secretary Robert E. Rubin, former president of the European Commission Jacques Delors, former Deputy Director General of the International Labor Organization Mary Chinery-Hesse, and former Indian Finance Minister Manmohan Singh, as well as senior officials or former officials from Costa Rica, the Arab Fund for Economic Development, Mozambique, and the British aid organization, Oxfam (Crossette 2000).

REFERENCES

- Andrews, David M. 1994. Capital Mobility and State Autonomy: Toward a Structural Theory of International Monetary Relations *International Studies Quarterly* 38, No. 2 (June):193-218.
- Armijo, Leslie Elliott. 2000. Skewed Incentives to Liberalize International Trade, Production, and Finance. Unpublished paper, Reed College.

- . 2001. Democratic Inclusion and Macroeconomic Moderation: An Hypothesis and Preliminary Evidence. Unpublished paper, Reed College.
- , ed. 1999. *Financial Globalization and Democracy in Emerging Markets*. London: Palgrave/Macmillan.
- (BIS) Bank for International Settlements. 2000. *Annual Report*. Geneva: Bank for International Settlements.
- Barber, Benjamin R. 1996. *Jihad vs. McWorld: How Globalism and Tribalism are Reshaping the World*. New York: Ballantine Books.
- Barro, Robert J. 1997. *Determinants of Economic Growth: A Cross-Country Empirical Study*. Cambridge, Mass.: MIT Press.
- Bergsten, C. Fred. 1998. How to Target Exchange Rates. *Financial Times*, November 20.
- Bergsten, C. Fred, and C. Randall Henning. 1996. *Global Economic Leadership and the Group of Seven*. Washington, D.C.: Institute for International Economics.
- Bhagwati, Jagdish. 1998. The Capital Myth. *Foreign Affairs* (May/June).
- Blecker, Robert A. 1999. *Taming Global Finance: A Better Architecture for Growth and Equity*. Washington, D.C.: Economic Policy Institute.
- Brawley, Mark. 1993. *Liberal Leadership: Great Powers and Their Challengers in Peace and War*. Ithaca, N.Y.: Cornell University Press.
- Brunner, Karl and Allan H. Meltzer. 1993. *Money and the Economy*. Cambridge: Cambridge University Press.
- Bryant, Ralph C. 1987. *International Financial Intermediation*. Washington, D.C.: The Brookings Institution.
- Coeuré, Benoît and Jean Pisani-Ferry. 1999. The Case Against Benign Neglect of Exchange Rate Stability. *Finance and Development* 36, no. 3 (September):5–8.
- Cohen, Benjamin J. 2000. Life at the Top: International Currencies in the 21st Century. *Essays in International Finance*. Princeton, N.J.: Princeton University, International Economics.
- . 2001. Containing Backlash: Foreign Economic Policy in an Age of Globalization. In *Eagle Rules? Foreign Policy and American Primacy in the 21st Century*, ed. Robert J. Lieber. Upper Saddle River, N.J.: Prentice-Hall.
- Conybeare, John A. C. 1984. Public Goods, Prisoners' Dilemmas, and the International Political Economy. *International Studies Quarterly* 28 (March):5-22.
- Crossette, Barbara. 2000. U.N. Economic Panel to Study Help for World's Have-Nots. *New York Times*, December 16.
- Diamond, Larry. 1999. *Developing Democracy: Toward Consolidation*. Baltimore: Johns Hopkins.
- Dorn, James A. 1999. Introduction to Special Issue on the Global Financial Architecture. *The Cato Journal* 18, no. 3 (Winter).
- Drezner, Daniel W. 2000. Bottom Feeders. *Foreign Policy* 121 (November/December): 64–73.
- Edwards, Sebastian. 1998. Abolish the IMF. *Financial Times*, November 13.
- Eichengreen, Barry. 1996. *Globalizing Capital: A History of the International Monetary System*. Princeton, N.J.: Princeton University Press.
- . 1999. *Toward a New International Financial Architecture*. Washington, D.C.: Institute for International Economics.

- . [1989] 2000. Hegemonic Stability Theories of the International Monetary System. In *International Political Economy: Perspectives on Power and Wealth*, ed. Jeffrey A. Frieden and David A. Lake. 4th ed. Boston: Bedford/St. Martin's.
- Feng, Yi. 1997. Democracy, Political Stability and Economic Growth. *British Journal of Political Science* 27, no. 3 (July):391–418.
- Friedman, Milton. 1992. *Money Mischief: Episodes in Monetary History*. New York: Harcourt, Brace, Jovanovitch.
- Garrett, Geoffrey. 1998. Global Markets and National Politics: Collision Course or Virtuous Circle? *International Organization* 52, no. 4 (Autumn):787–824.
- Gilpin, Robert. 1987. *The Political Economy of International Relations*. Princeton, N.J.: Princeton University Press.
- . 2000. *The Challenge of Global Capitalism: The World Economy in the 21st Century*. Princeton, N.J.: Princeton University Press.
- Greider, William. 1997. *One World, Ready or Not: The Manic Logic of Global Capitalism*. New York: Simon and Schuster.
- Haley, Mary Ann. 1999. Emerging Market Makers: The Power of Institutional Investors. In *Financial Globalization and Democracy in Emerging Markets*, ed. Leslie Elliott Armijo. London: Palgrave/Macmillan.
- Hall, Peter A., ed. 1989. *The Political Power of Economic Ideas: Keynesianism across Nations*. Princeton, N.J.: Princeton University Press.
- Hasenclever, Andreas, Peter Mayer, and Volker Rittberger. 1997. *Theories of International Regimes*. Cambridge: Cambridge University Press.
- Hausmann, Ricardo, Michael Gavin, Carmen Pages-Serra, and Ernesto Stein. 1999. Financial Turmoil and the Choice of Exchange Rate Regime. Working Paper #400. Washington, D.C.: Inter-American Development Bank, Office of the Chief Economist.
- Hawley, James P. 1987. *Dollars and Borders: U.S. Government Attempts to Restrict Capital Flows, 1960–1980*. Armonk, N.Y.: M. E. Sharpe.
- Helleiner, Eric. 1994. *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s*. Ithaca, N.Y.: Cornell University Press.
- Henning, C. Randall. 1994. *Currencies and Politics in the United States, Germany, and Japan*. Washington, D.C.: Institute for International Economics.
- Huntington, Samuel P. 1991. *The Third Wave: Democratization in the Late Twentieth Century*. Norman: University of Oklahoma Press.
- Institute of International Finance (IIF). 1999. Summary Report on the Work of the IIF Steering Committee on Emerging Markets Finance. Washington, D.C.: Institute of International Finance.
- International Forum on Globalization (IFG). 1999. The Global Financial Crisis: Information Packet. San Francisco: International Forum on Globalization.
- Kapstein, Ethan. 1994. *Governing the Global Economy*. Cambridge, Mass.: Harvard University Press.
- Kapstein, Ethan B., and Michael Mastanduno, eds. 1999. *Unipolar Politics*. New York: Columbia University Press.
- Kapur, Devesh. 2000. Who Gets to Run the World? *Foreign Policy* 121 (November/December):44–53.
- Katzenstein, Peter J., Robert O. Keohane, and Stephen D. Krasner, eds. 1999. *Exploration and Contestation in the Study of World Politics*. Cambridge, Mass.: MIT Press.

- Kennedy, Paul M. 1987. *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000*. New York: Random House.
- Keohane, Robert O. 1984. *After Hegemony: Discord in the World Political Economy*. Princeton, N.J.: Princeton University Press.
- . 1988. International Institutions: Two Approaches. *International Studies Quarterly* 32:379–96.
- , ed. *Neorealism and Its Critics*. New York: Columbia University Press.
- Kindleberger, Charles. 1978. *Manias, Panics, and Crashes: A History of Financial Crises*. New York: Basic Books.
- . 1981. Dominance and Leadership in the International Economy. *International Studies Quarterly* 25 (June):242–254.
- . [1973] 1986. *The World in Depression, 1929–1939*. Rev. ed. Berkeley: University of California Press.
- Kirton, John. 2000. G7 and Concert Governance in the Global Financial Crisis of 1997–9. Paper presented at the annual meeting of the International Studies Association, Los Angeles, California, March 15–19, 2000.
- Krasner, Stephan. 1976. State Power and the Structure of International Trade. *World Politics* 28, no. 3 (April).
- . 1982. Regimes and the Limits of Realism: Regimes as Autonomous Variables. *International Organization* 36.
- , ed. 1983. *International Regimes*. Ithaca, N.Y.: Cornell University Press.
- Lairson, Thomas D., and David Skidmore. 1997. *International Political Economy: The Struggle for Power and Wealth*. 2nd ed. Fort Worth, Tex.: Harcourt Brace Jovanovich College Publishers.
- Lake, David A. 1993. Leadership, Hegemony, and the International Economy: Naked Emperor or Tattered Monarch with Potential? *International Studies Quarterly* 37 (December):459–89.
- Maddison, Angus. 1995. *Monitoring the World Economy, 1820–1992*. Paris: Organisation for Economic Co-operation and Development (OECD).
- Mayobre, Eduardo, ed. 1999. *G-24: The Developing Countries in the International Financial System*. Boulder, Colo.: Lynne Rienner.
- Moravcsik, Andrew. 1997. Taking Preferences Seriously: A Liberal Theory of International Politics. *International Organization* 51, no. 4 (Autumn).
- Moses, Jonathan. 1994. Abdication from National Policy Autonomy: What's Left to Leave? *Politics and Society* 22:125–148.
- Mundell, Robert A. 1960. The Monetary Dynamics of International Adjustment under Fixed and Floating Exchange Rates. *Quarterly Journal of Economics* 74, no. 2 (May):227–257.
- Nader, Ralph, ed. 1993. *The Case Against Free Trade: GATT, NAFTA, and the Globalization of Corporate Power*. San Francisco: Earth Island Press.
- Nye, Joseph S. 1990. *Bound to Lead: The Changing Nature of American Power*. New York: Basic Books.
- Ocampo, José Antonio. 1999. Reforming the International Financial Architecture: Consensus and Divergence. *Serie temas de coyuntura I*. Santiago, Chile: CEPAL/ECLAC, April.
- Odell, John S. 1982. *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change*. Princeton, N.J.: Princeton University Press.

- Oye, Kenneth A., ed. 1986. *Cooperation Under Anarchy*. Princeton, N.J.: Princeton University Press.
- Pahre, Robert. 1999. *Leading Questions: How Hegemony Affects the International Political Economy*. Ann Arbor: University of Michigan Press.
- Pollard, Sidney. 1985. Capital Exports, 1870–1914: Harmful or Beneficial? *The Economic History Review* 38, no. 4 (November).
- Porter, Tony. 1999. The Transnational Agenda for Financial Regulation in the Developing Countries. In *Financial Globalization and Democracy in Emerging Markets*, ed. Leslie Elliott Armijo. London: Palgrave/Macmillan.
- Rodrik, Dani. 1997. *Has Globalization Gone too Far?* Washington, D.C.: Institute for International Economics.
- Rosecrance, Richard N., ed. 1976. *America as an Ordinary Country: United States Foreign Policy and the Future*. Ithaca, N.Y.: Cornell University Press.
- Rueschemeyer, Dietrich, Evelyne Huber Stephens, and John D. Stephens. 1992. *Capitalist Development and Democracy*. Chicago: University of Chicago Press.
- Ruggie, John Gerard. 1982. International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order. *International Organization* 36, no. 2 (Spring).
- Schwartz, Herman M. 1994. Small States in Big Trouble. *World Politics* 46:527–555.
- Shultz, George, William E. Simon, and Walter B. Wriston. 1998. Who Needs the IMF? *Wall Street Journal*, February 3:A22.
- Simmons, Beth A. 1994. *Who Adjusts?: Domestic Sources of Foreign Economic Policy during the Interwar Years*. Princeton, N.J.: Princeton.
- Snidal, Duncan. 1985. The Limits of Hegemonic Stability Theory. *International Organization* 39 (Autumn):579–614.
- Solomon, Steven 1995. *The Confidence Game: How Unelected Central Bankers are Governing the Changed World Economy*. New York: Simon and Schuster.
- Soros, George. 1998. *The Crisis of Global Capitalism*. New York: Public Affairs Press.
- Spiro, Peter J. 2000. The New Sovereignists. *Foreign Affairs* 76, no. 6:9–15.
- Stiglitz, Joseph. 1998. Must Financial Crises Be This Frequent and This Painful? McKay Lecture, Pittsburgh, Pennsylvania, September 23.
- . 2000. The Insider: What I Learned at the World Economic Crisis. *The National Republic*, April 17.
- Tobin, James. 1978. A Proposal for International Monetary Reform. *Eastern Economic Journal*, 4.
- Volcker, Paul. 1998. Personal Views on the World Economy: Can We Bounce Back? *Financial Times*, October 7 (online). Available from: <www.ft.com>.
- Waltz, Kenneth N. 1959. *Man, the State, and War*. New York: Columbia University Press.
- . 1979. *Theory of International Politics*. Reading, Mass.: Addison-Wesley.
- Weir, Margaret, and Theda Skocpol. 1985. State Structures and the Possibilities for ‘Keynesian’ Responses to the Great Depression in Sweden, Britain, and the United States. In *Bringing the State Back In*, ed. P. B. Evans, D. Rueschemeyer, and T. Skocpol. Cambridge: Cambridge University Press.