

Global Monetary Governance

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Global Monetary Governance

Benjamin J. Cohen has long been recognized as one of the world's leading authorities on the political economy of international money and finance. This book provides an overview of his contribution to the field, grouped around the central theme of global monetary governance.

Divided into three sections, the first four essays address the changing nature of challenges to international monetary management, with particular emphasis on the impact of financial liberalization on efforts to promote monetary reform or cooperation. These papers stress the extent to which the role of states in systemic governance has been transformed by the accelerating growth of private capital mobility. A second set of essays turns to efforts to deal effectively with financial crises, exploring the reciprocal influences between governments and banks in the management of international debt problems. Case studies include the Asian financial crisis and several other key instances of instability in world markets. The final set of essays addresses implications of the remarkable growth in recent years of cross-border currency competition – the “new geography of money,” where governing authority appears to be exercised now more by market forces than by sovereign states.

Cohen concludes by evaluating the merits and prospects of alternative policy options available to governments and explores some of the geopolitical ramifications involved. The papers are placed in historical and intellectual context by an introduction outlining the development of Cohen's thought. *Global Monetary Governance* will be useful to all students of international political economy or international money/finance.

Benjamin J. Cohen is Louis G. Lancaster Professor of International Political Economy, University of California, Santa Barbara, USA.

For Peter, Edna, Fritz, Susan, and Martin
With everlasting gratitude

Preface

Over the course of a career spanning more than four and a half decades, one naturally accumulates quite a few debts of gratitude. This book is dedicated to five individuals who were particularly important influences on my life when my interest in global monetary governance was first being formed. Each occupies a very special place in my heart.

First was Peter Kenen, a world-class international economist and, I am proud to say, my mentor. Peter was the first to introduce me to the mysteries of international trade and finance, both in the classroom and as the supervisor of my doctoral dissertation. Through the force of his formidable intellect as well as through the depth of the passion he brought to the scholarly enterprise, he inspired me to pursue my fascination with global monetary issues – in effect, to follow in his footsteps. It was as a result of a phone call from Peter that I was offered my first job after graduate school, as a research economist at the Federal Reserve Bank of New York.

Next was Edna Ehrlich, a kind and gentle woman who was my Division chief at the New York Fed. Responsible for our work assignments, Edna graciously relieved me of most routine duties so I could concentrate on more fundamental research. In return, I did my best to justify her faith in me, though I was never able to proofread my own work as carefully as she would have liked. One paper that I wrote at her behest was directly responsible for the invitation I received to accept my first teaching appointment, at Princeton University in 1964.

At Princeton I came under the wing of Fritz Machlup, one of the leading international economists of his day. A transplanted Viennese Austrian, Fritz had a formal manner that may have seemed distant and disinterested; it was only after seven years of addressing one another as Professor, for example, that he suggested we might now shift to a first-name basis. But he was in fact a caring and thoughtful gentleman who took pains to further the career of a younger colleague. In 1968, unbeknownst to me, he nominated me for an International Affairs Fellowship at the Council on Foreign Relations, thus enabling me to travel to London for a year to write a book on the pound sterling. (This was in the fellowship program's first year, when I had the honor of receiving an award in the company of a handful of future stars of the academic firmament, including Robert Keohane and Graham Allison.) And shortly thereafter it was Fritz who

proposed me for an available faculty position at the Fletcher School of Law and Diplomacy at Tufts University, where I was to teach from 1971 until 1991.

A fourth influence was Susan Strange, whose role in defining the course of my career is described in the Introduction to this volume. Susan was the first serious scholar I met who really made me think about the political dimension of international economic relations. She was like an Old Testament prophet, persistently challenging me and others to abandon our wastrel ways. The mutual neglect that had long prevailed between international economics and international relations, she urged us, must be overcome. No one who knew her would deny that she was an excellent motivator.

Finally, there was Martin Kessler, editor at the New York publishing house Basic Books, who in 1970 invited me to commission and edit a series of original treatises on international political economy – the first such project ever conceived. Ultimately, five books were published in the Political Economy of International Relations Series, including Robert Gilpin's classic *U.S. Power and the Multinational Corporation* as well as two volumes of my own, *The Question of Imperialism* and *Organizing the World's Money*. The rest, as they say, is history.

In addition, I wish to thank Craig Fowlie of Routledge, who first proposed the idea of putting together this collection of papers. I am grateful to him for the confidence he expressed in me and my work. Apart from the Introduction, which was written expressly for this volume, all of the chapters appear here as they did when they were originally published.

I also wish to thank my good friends Dave Andrews, Eric Helleiner, Randy Henning and Lou Pauly for helpful comments on my Introduction, and Heather Arnold for her efficient research assistance.

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1 Introduction

Back in my student days, nearly half a century ago, the issue of global monetary governance attracted little attention from scholars of international affairs. The celebrated conference at Bretton Woods, New Hampshire, in 1944, which had resulted in the creation of the International Monetary Fund (IMF), was supposed to permanently relegate management of monetary relations to the realm of “low politics.” The aim of the Bretton Woods “system” was to “depoliticize” the challenge of governance – to ensure that problems of money and finance would be left largely to the technicians to resolve. Insofar as possible, debates over exchange rates or the balance of payments would be severed from the “high politics” of national security and interstate rivalries. What was there in the intricacies of finance that could possibly be of interest to specialists in international relations?

At the time, the wall between low politics and high politics in international affairs seemed natural, reflecting the academic world’s larger divide between the established disciplines of economics and political science. Ever since the late nineteenth century, international economics and international relations (IR) had been treated as distinctly separate specialties, each with its own language, concerns, and standards. Communication between the two was rare. For the most part, scholars working on either side of the wall simply did not speak to each other.

My own experience as a university student was typical. In my one IR course, taken while still an undergraduate, the emphasis was all on the high politics of conflict and national survival in a dangerous, anarchic world. The policy agenda was preoccupied, not to say obsessed, with the Cold War and the threat of nuclear weapons. The low politics of economic relations were not really deserving of serious attention. Conversely, in the several courses on international economics that I sat through, first as an undergraduate and later in pursuit of a PhD, the spotlight was on issues of efficiency and stabilization, with public policy evaluated solely in terms of its implications for consumer welfare. No account was taken of the influence of differing institutional contexts or the political underpinnings of economic relations. The only dimension of power acknowledged was market power, stripped of any connection to interstate politics or issues of war and peace. When I wrote my doctoral dissertation, in the early 1960s, it hardly occurred to me to link analysis of monetary relations to broader issues of world politics.

Today, of course, we know better. Monetary relations are nothing if not political. Global monetary governance is, by definition, high politics. But awareness grew

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slowly, spurred by the birth of the new field of International Political Economy (IPE) in the late 1960s and early 1970s. Gradually a pioneer generation of scholars began to explore diverse political dimensions of the international monetary system. In 1968, economist Richard Cooper published *The Economics of Interdependence* (Cooper 1968), highlighting the political challenges posed by an accelerating interdependence of national economies. Adjustment to widening payments imbalances imposed difficult choices on governments, risking tension and conflict among states. The same theme was also developed by Charles Kindleberger in a short treatise entitled *Power and Money*, published in 1970 (Kindleberger 1970), soon to be followed by his justly celebrated *The World in Depression* (Kindleberger 1973). And in 1971 came Susan Strange's monumental *Sterling and British Policy*, stressing the politics of international currency use.

Until exposed to pioneering efforts like these, my own career path remained firmly on the economics side of the wall between the disciplines. With my PhD in hand, I worked for two years as a research economist at the Federal Reserve Bank of New York, and even after beginning my teaching career at Princeton University in 1964, I continued to stick to the standards of orthodox economic analysis. A turning point came in 1968, when I arrived in London to spend a year writing a book on the pound sterling (Cohen 1971). If I was going to research the pound, I was told, I should meet Susan Strange, who was working on *Sterling and British Policy* at the time. So I sought her out. When we got together, I dutifully told her about my plan to do a strictly economic cost-benefit calculus of sterling's role as an international currency. "Oh, Jerry," she replied, squinting at me through hooded eyes, "you can't possibly write about the pound without talking about the politics, too" – a remonstrance that she would subsequently repeat on every possible occasion. At the time I resisted, with a stubbornness born of my conventional economics training. The loss was mine: her book turned out to be far more interesting.

Ultimately, however, Strange's message did get through. By the time I got back to the United States, I was determined – thanks, in good part, to her – to dip my toe into this new current of International Political Economy. In time this led me to produce a successor to my sterling book, *Organizing the World's Money* (Cohen 1977), which may legitimately be described as the first comprehensive integration of the economic and political dimensions of global monetary relations. *Organizing the World's Money* marked the completion of my conversion to the emerging field of IPE – "one of the rare cases of an economist," one observer wrote of me, "who came in from the cold of the dismal science" (Underhill 2000: 811). For a third of a century, I have continued to explore the political economy of a diverse range of monetary and financial issues, often prefiguring new analytical perspectives.

After all this time I may claim, perhaps immodestly, to have attained something of the aura of senior-scholar status. In a recent *estschrift* produced in my honor (Andrews *et al.* 2002), the editors described me as "a political economist of the first rank . . . among the first to explore systematically the interaction between the 'high politics' of foreign affairs and the 'low politics' of economic management."

In a review essay, a younger colleague generously linked me with Strange (now regrettably deceased) as one of the two leading influences on the study of monetary governance today. Strange and I, the essay asserts, “establish landmarks around which competing schools of thought will organize.... Each author provides a new roadmap for navigating the international political space transformed by the ascendance of money” (Kirshner 2000: 408). More pithily, in private correspondence, another young colleague has called me “godfather of the monetary mafia.” I like to think he meant it as a compliment.

From the beginning, monetary governance has been a recurrent theme in my work. The challenge of governance is understood to involve all the main features of monetary relations among states – the processes and institutions of financial intermediation (mobilization of savings and allocation of credit) as well as the creation and management of money itself. Who makes the rules and who exercises authority in monetary matters? The thirteen papers collected in this volume are representative of the long-term evolution of my thinking on these questions in response to changing events and my own continuing education. Chapters are arranged under three headings: Part 1: challenges to systemic governance; Part 2: dealing with financial crisis; and Part 3: the new geography of money. Each set of chapters may be located within the wider historical setting that over time has set the agenda for my research.

The historical setting

The key feature that distinguishes the international monetary system from purely domestic analysis is the existence of separate national currencies. Legally, the concept of state sovereignty has long been understood to include an exclusive right to create and manage money. Within national frontiers no currency but the local currency is expected, normally, to serve the traditional functions of money: medium of exchange, unit of account, and store of value. Formally, there is no money for the world as a whole, though selected national currencies have informally played important international roles. Hence when we speak of the global monetary system (or, synonymously, the global financial structure), we are talking of a universe of diverse national monetary spaces, not one homogenous entity – a universe where the territorial state, still the world’s basic unit of formal governance, remains the core (though far from exclusive) actor.

The existence of separate national currencies has both economic and political implications. Economically, monetary sovereignty means that currencies that are legal tender in one place are unlikely, with few exceptions, to be fully useable elsewhere. From that tradition stems the need for mechanism and arrangements, such as the foreign-exchange market and other financial institutions, to facilitate transactions and interchanges between national moneys and credit systems. Politically, monetary sovereignty means that governments must necessarily be concerned about the balance of payments – the overall relationship between foreign revenues and expenditures. More precisely, they must somehow reconcile the twin – and often conflictual – macroeconomic policy goals of “internal

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balance” (full employment with low inflation) and “external balance” (equilibrium in the balance of payments). Since, normally, domestic money is not generally accepted outside the state’s territorial frontiers, payments deficits cannot ordinarily be managed simply by printing more of one’s own currency. Either adequate financing (“international liquidity”) must be found or appropriate policy adjustments must be undertaken via changes of domestic spending, the exchange rate, or trade and capital controls. From that tradition stems the need for mechanisms and arrangements, concerning such matters as currency values and access to credit, to minimize frictions and, if possible, to facilitate cooperation in financial management.

It is in the interaction of these twin economic and political imperatives – the ever-shifting relations among states and between states and markets – that we find the challenge of global monetary governance.

From Bretton Woods to “non-system”

The Bretton Woods system is commonly understood to refer to the monetary regime that prevailed from the end of World War II until the early 1970s. The result of protracted wartime discussions, the Bretton Woods system was history’s first example of a fully negotiated order intended to govern monetary relations among sovereign states. Based on a formally articulated set of principles and rules, the regime was designed to combine binding legal obligations with multi-lateral decisionmaking conducted through an international organization, the IMF, endowed with limited supranational authority.

Central to the Bretton Woods system was an exchange-rate regime of “adjustable pegs.” Countries were obligated to declare a par value (a parity or “peg”) for their national money and to intervene in currency markets to limit exchange-rate fluctuations within certain margins (a “band”), though they also retained the right, in accordance with agreed procedures, to alter their parity when needed to correct a “fundamental disequilibrium” in their external payments. The IMF was created to assure governments of an adequate supply of financing, if and when required, as well as to provide a permanent institutionalized forum for inter-state cooperation on monetary matters. International liquidity was to consist of national reserves of gold or currencies convertible, directly or indirectly, into gold – the so-called “gold-exchange standard” – later supplemented by Special Drawing Rights (SDRs), a negotiated form of “paper gold.” The main component of liquidity was the U.S. dollar – America’s fabled greenback – the only currency at the time that was directly convertible into gold.

The history of the Bretton Woods system is generally divided into two periods: the era of dollar “shortage,” lasting roughly until the late 1950s, when world liquidity needs were fed primarily by deficits in the U.S. balance of payments; and a subsequent period of dollar “glut,” when America’s persistent deficits culminated in termination of the greenback’s gold convertibility in 1971 and collapse of the par-value system in 1973. With the closing of Washington’s gold window, the gold-exchange standard passed into history, to be succeeded by a polyglot

collection of national currencies, gold, and SDRs in the reserves of central banks. Likewise, with the end of par values, the exchange-rate regime was transformed into a mixed bag of choices, some governments continuing to peg more or less firmly to a single “anchor” currency like the dollar or to some form of “basket” of anchor currencies while others opted for more flexible arrangements, up to and including free floating.

Some elements of the old system survived, of course – not least, the IMF itself, which has continued to perform vital roles as a source of finance and as a forum for interstate cooperation. Moreover, new albeit less formal mechanisms of monetary management gradually emerged to cope with subsequent threats to stability such as the oil shocks of the 1970s, the Latin American debt crisis of the 1980s, and the financial-market crises of the 1990s. Exchange-rate policies, in principle, remain subject to “multilateral surveillance” by the Fund. Access to liquidity can still be secured, though without the degree of assurance promised at Bretton Woods. And new procedures for consultation and policy coordination have been developed and regularized, not only through the IMF but also in such now well-established bodies as the Group of Seven (G-7) and the Bank for International Settlements (BIS). Still there is no question that, on balance, the system has become more decentralized and diffuse. As compared with the elaborate rule-based design laboriously negotiated at Bretton Woods, what has evolved since the early 1970s seems both less restrictive and more rudderless. In the eyes of some, it is little more than a “non-system” bordering on anarchy if not chaos.

From hegemony to “privatization”

Dominating the evolution of monetary relations over the last half-century have been two major trends in the locus of influence over outcomes. The first is a redistribution of power *among states*, principally involving a relative decline in the overwhelming preeminence once enjoyed by the United States. The second is a redistribution of power *from states to markets*, involving a relative increase in the role of non-state actors in deciding such fundamental matters as currency values or access to credit. Simultaneously, the system has become less hegemonic and more market-determined – less centralized and more “privatized,” to recall a term I introduced in this context as early as 1981 (Cohen 1981). Together, these two trends have largely defined the research agenda for students of global monetary governance.

That America’s dominance of the monetary system has declined, especially in relation to Europe and East Asia, is widely accepted. Washington cannot act with quite the same degree of authority as during the era of dollar shortage, when the United States was universally acknowledged as monetary leader. Other states have also gained an influential voice on matters of money and finance. The main question is empirical: *How much* has U.S. dominance declined? At one extreme is the view, especially common in the 1970s and 1980s, that the day of American hegemony is irretrievably over. We are faced with the challenge of living in a world “after hegemony,” wrote Robert Keohane in 1984 (Keohane 1984). The

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United States, echoed Robert Gilpin, “had forfeited its role of monetary leadership” (Gilpin 1987: 142). At the other extreme are scholars like Strange, who even in her last books continued to maintain that the supposed loss of American hegemony was little more than a “myth” (Strange 1996, 1998). Most observers today would acknowledge that reality, as is so often the case, undoubtedly lies somewhere between these polar views.

Likewise, that the role of non-state actors in the monetary system has increased is also widely accepted. In fact, the transformation has been dramatic. A half century ago, after the ravages of the Great Depression and World War II, currency and credit markets everywhere (with the notable exception of the United States) were generally weak, insular, and strictly controlled, reduced from their previously central role in the world economy to offer little more than a negligible amount of trade financing. Starting in the late 1950s, however, private lending and investment once again began to gather momentum, generating a phenomenal growth of cross-border capital mobility. First came the development of offshore currency markets – otherwise known as the Euro-currency market – and then a gradual liberalization of restrictions at the national level, all leading to a degree of financial integration not seen since the end of the nineteenth century. While it is as yet premature to speak of a single world financial market, it is by no means an exaggeration to speak of “financial globalization” – a genuine resurrection of global finance, embodying the pro-market principles of “neoliberal” economics. The monetary system was becoming increasingly privatized.

By the end of the twentieth century, the growth of capital mobility had proceeded to the point where the authority of governments seemed directly threatened. Again the main question is: *How much?* At a minimum states have been thrown on the defensive, no longer able to enforce their will without constraint. At a maximum states appear on the verge of total emasculation, with monetary sovereignty soon to be transferred in its entirety from national governments to “stateless” markets. Here too it seems most likely that reality lies somewhere in between.

Challenges to systemic governance

These twin changes in the monetary system are well reflected in the evolution of my thinking about the broad problem of systemic governance. My earliest work on the topic, best represented by *Organizing the World's Money* (Cohen 1977), was firmly state-centric in tone and focused mainly on issues of policy and statecraft, with particular emphasis on the role of the United States. Governments were the main units of interest, conceived as rational utility-maximizing agents. The essential elements of *Organizing the World's Money* are captured in Chapter 2 of this volume, the first chapter of Part 1.

A state-centric approach seemed natural to me at the time, given my background in economics. In my chosen specialty of international economics, standard theory always tended to treat governments as the equivalent of atomistic actors with well-defined utility functions. Over time, however, as financial globalization