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Currency and Coercion in the Twenty-First Century

Jonathan Kirshner

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JONATHAN KIRSHNER

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Abstract

Most scholarship on monetary power has emphasized the experiences of the twentieth century, and in particular, 1914-1989, the period between the First World War and the end of the Cold War. In the early twenty-first century, however, two conditions, less salient during those seventy-five years, are of dramatically increased significance: globalization and unipolarity. How do these factors affect the prospects for and practice of monetary power? This chapter considers how globalization (and also unipolarity) recast the practice of currency manipulation, monetary dependence, and systemic disruption—the three principal types of money power I considered in *Currency and Coercion*. In each case, financial globalization importantly transforms the nature of monetary diplomacy, requiring a shift in the analysis to place much greater emphasis on the relationship between states and markets. But financial globalization does not reduce the significance of monetary power as a feature of world politics. The goals of this chapter are to illustrate the continued role of monetary power and to assess the nature of this transformation.

Keywords

monetary relations, globalization, international relations theory.

Introduction

Most scholarship on monetary power—and especially those studies that have focused on the manipulation of currency values and monetary arrangements to advance political goals—have emphasized the experiences of the twentieth century, and in particular, 1914-1989, the period between the First World War and the end of the Cold War.[1] In the early twenty-first century, however, two conditions, less salient during those seventy-five years, are of dramatically increased significance: globalization and unipolarity. How do these factors affect the prospects for and practice of monetary power? In particular, it is important to consider whether financial globalization—that is, the presence of very large, integrated and influential currency markets—radically circumscribes the capabilities of states to practice monetary diplomacy. This paper argues that although the consequences of globalized finance are profound, those consequences recast rather than reduce the significance of monetary diplomacy in contemporary international relations. By shifting the analysis from an almost exclusive focus on state-to-state interactions to one that places much greater emphasis on the relationship between states and markets, it can be illustrated that even in an era of globalization international monetary relations remain an area of political competition. As long as there are states and money, states will attempt to manipulate monetary relations to advance their political objectives.

Two clarifying comments are in order. First, the catch word 'globalization' captures a number of processes that occur across several dimensions—such as information flows, economic exchange, and marketization—but obviously, for monetary power, one aspect of the intensification of economic exchange, financial globalization, is of paramount concern. It should be clear that the analysis that follows does *not* presume that globalization is novel, irreversible or irresistible. Rather, the point of departure is that it is currently here and it matters.[2] Second, contemporary globalization takes place in a specific political context—that of U.S. preponderance or unipolarity. While space constrains do not permit a lengthy elaboration of its consequences, it is crucial to recognize that unipolarity powerfully shapes the possibility, politics, and nature of globalization, and shapes the political practice of contemporary monetary power.[3]

This paper proceeds in three parts, sections that consider how globalization (and also unipolarity) recast the practice of currency manipulation, monetary dependence, and systemic disruption—the three principal types of money power I considered in *Currency and Coercion*. [4] In each case, financial globalization importantly transforms the nature of monetary diplomacy, but it does not reduce the significance of monetary power as a feature of world politics. The goals of this paper are to illustrate the continued role of monetary power and to assess the nature of this transformation.

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1 See for example Paul Einzig, 1931. *Behind the Scenes of International Finance*. London: McMillan; Charles Kindleberger, 1972. 'The International Monetary Politics of a Near-Great Power: Two French Episodes, 1926-1936 and 1960-70', *Economic Notes*, 1, pp. 30-44; Jonathan Kirshner, 1995. *Currency and Coercion: The Political Economy of International Monetary Power*. Princeton: Princeton University Press. For a good critique of this literature, see Benjamin Cohen, 2000. 'Money and Power in World Politics', in: T. Lawton, J. Rosenau, and A. Verdun, (eds.), *Strange Power: Shaping the Parameters of International Relations and International Political Economy*. Aldershot: Ashgate, ch. 6.

2 As Andrews has argued, financial globalization (or more specifically, the level of capital mobility) 'systematically alters state calculation and behavior'. David Andrews, 1994. 'Capital Mobility and State Autonomy: Towards a Structural Theory of International Monetary Relations', *International Studies Quarterly*, 38 (2), pp. 193-218, for quote, p. 202.

3 On globalization generally, see David Held, *et al.*, 1999. *Global Transformations: Politics, Economics and Culture*. Stanford: Stanford University Press; on globalization and the troika of information, exchange, and marketization, and for more on globalization and unipolarity, see Jonathan Kirshner, 'Globalization and National Security', in J. Kirshner, (ed.), *Globalization and National Security* (Forthcoming).

4 While I retain my original taxonomy, these concepts can be mapped onto the framework outlined by Andrews in: David M. Andrews, forthcoming 2006. 'Introduction', in: David M. Andrews, (ed.), *International Monetary Power*. Ithaca NY: Cornell University Press. Revised versions of EUI-WP RSCAS Nos. 2005/07-2005/15 will be included in this book.

Currency Manipulation

Of the three types of monetary power, the practice of currency manipulation would at first glance appear to be the one most inhibited in an era of globalization. This is a logical deductive inference—given a floating exchange rate and the enormous size of financial markets, it is certainly much more challenging for even the most powerful states in the system in most cases to successfully engage in the archetypical act of predatory currency manipulation—selling a target's currency in the open market to force depreciation as an act of coercion. The ratio of government reserves to market transactions has diminished considerably, to the disadvantage of states, limiting the ability of states by dint of their own efforts to significantly alter the value of a currency widely traded in free markets around the world. However, there are a number of factors that should caution against overstating the extent and novelty of the constraints placed on predatory currency manipulation under globalization. It was always understood that the opportunities for the practice of monetary power in general would be less common than other forms of economic coercion (such as trade sanctions) and that the market's response would always influence the prospects for successful manipulation.[5] Under globalization, obviously, this 'market response' will in general be of even greater importance. But when considered closely, this suggests not that predatory manipulation will necessarily be dramatically rarer, but rather that it will be differently circumscribed; potential manipulators will find the ground relatively more fertile in settings where markets are thin, incomplete and regulated, while efforts to nudge more robust currencies against the wind of market sentiment will be even less likely than ever to bear fruit. This, it should be noted, is consistent with Henning's conclusion in his contribution to this collection of working papers.[6] But the greater importance of market sentiment and market response that will reduce the vulnerability of some currencies cuts both ways. Given the proliferation of small states and new currency issues, markets are arguably more likely to exacerbate rather than alleviate the distress of many potential targets of currency manipulation. (The IMF catalogues 146 separate currencies, with 41 counties participating in 'exchange agreements with no separate legal tender'.[7]) Additionally, there are other techniques of predatory manipulation than selling a freely floating currency—given the disruptive nature of international financial markets, for example, many small states seek to employ devices to limit the fluctuations of their currencies. These require measures to sustain the stability of the arrangement chosen, efforts that are more rather than less vulnerable given challenges posed by the tides of enormous global financial flows. Once again, this suggests that globalization will recast rather than reduce the practice of currency manipulation—these new vulnerabilities, for example, will certainly increase the demand for 'protective' currency manipulation.

Thus, given the size and speed of contemporary exchange markets, whether floating or somehow pegged, the currencies of small states remain vulnerable. Additionally, the proliferation of currencies and greater political contestation (especially in 'weak' states) suggests that there will, in contemporary politics, typically be marginal currencies operating at the fringes of international markets. These settings will be conducive to the practice of currency manipulation, both positive and negative. Indeed, despite the fact that predatory currency manipulation has been relatively rare in history, 'good old fashioned' currency manipulation has been practiced in the era of globalization, as can be seen in the aftermath of the first Gulf War.

Plots Against the Iraqi Dinar

After the first Gulf war, Iraq became a small hothouse of currency manipulation as several states, including Iraq, introduced various monetary schemes devised to advance their strategic goals. The first rounds in this

5 Jonathan Kirshner, *Currency and Coercion*, pp. 31, 37-38.

6 C. Randall Henning, 2005. *The Exchange Rate Weapon, Macroeconomic Conflict and Shifting Structure of the Global Economy*. EUI Working Papers RSCAS No. 2005/11.

7 International Monetary Fund, 2003. *Annual Report on Exchange Arrangements and Exchange Restrictions 2003*. Washington DC: International Monetary Fund, pp. 9-10.

conflict were aimed at Saddam Hussein's regime, a function of the fact that Iraq was especially vulnerable currency manipulation as an (unintended) consequence U.N. sanctions. This, coupled with the existence of a vast array of hostile neighbours that surrounded Iraq (with the exception of Jordan), not to mention the significant internal opposition to the regime, facilitated efforts to undermine the Iraqi Dinar.

Reports of currency manipulation against Iraq surfaced in November 1991, when the Governor of Iraq's Central bank declared that 'foreign quarters were behind the pumping of forged money for circulation in Iraq with the aim to sabotage the country's national economy'.[8] While the government declared victory over the would-be economic saboteurs, within months, it was clear that the regime faced a serious counterfeiting problem. The Iraqi currency was relatively easy to copy because sanctions prevented the government from importing notes from Europe, as it had done in the past, following the common practice of many states, contracting out the production of currency to firms that specialized in the business.[9]

That the Dinar was being counterfeited was beyond doubt; exactly who was behind the operation (or perhaps, who *wasn't*) is less clear. The U.S. was most often considered to be the chief counterfeiter, under the auspices of the CIA scheme known as 'Operation Meseraagh', the Arabic word for laundry. This was certainly more than plausible; the U.S. was seeking to undermine Saddam Hussein's regime, and had pulled this arrow from its quiver in the past, counterfeiting the North Vietnamese currency in the early 1970s.[10] But other reports claimed that separate operations were initiated by Saudi Arabia, Iran and Israel, to name but a few. Sixty miles south of the Artic circle in the sleepy Swedish town of Pitea, a counterfeiting ring produced about $28 million worth of fake Dinars. In Bialystok Poland, 30,000 fake banknotes were made at a printing plant on behalf of a mysterious figure who claimed the effort was designed to advance the Kurdish cause. But he soon ran afoul of the Polish authorities, which suspected that the man known only as 'Ibrihim S.' was simply in it for the money, and planned to try and pass the notes in European exchange markets. No charges were brought against representatives of the printing plant, on the grounds that 'the prosecution believes they were misled'—suggesting that had were the counterfeiting of the Iraqi Dinar truly in the service of the Kurdish cause, it would have been perfectly legal in Poland.[11]

Whatever the source, the notes were smuggled easily across the Jordanian, Saudi, Turkish and Iranian borders, and contributed to Iraq's monetary disorder, exacerbating an inflation that was fuelled by the government's already excessive resort to the monetary printing press. The forgeries were difficult to distinguish from the official notes issued by the government, and some accounts held that one out of every eight bills in the country were fakes. The regime made numerous efforts to address the challenge, introducing a new denomination, the five Dinar note (which was also designed to deal with a shortage in small change); at the other end of the monetary spectrum the commonly copied 100 Dinar note was recalled and discontinued. The watermark on official currency was changed at least four times, and the counterfeiting was made a capital crime (though this last measure was admittedly less extraordinary in context).[12]

Iraq found itself vulnerable to currency manipulation not only because its currency was so easily forged; there was also the problem of the 'Swiss Dinars'—Iraqi currency that was produced in Europe before the war and still in circulation side by side with the government's new emissions. The 'original' Dinars (as the Swiss notes were often called) were easily distinguishable from the 'dented' Dinars printed

8 'Iraq Combats Forgery of its Currency', *Xinhua News Agency*, November 2, 1991.

9 The British firm De La Rue, for example, states that it is 'involved in the production of over 150 national currencies'.

10 Robert W. Chandler, 1981. *War of Ideas: The U.S. Propaganda Campaign in Vietnam*. Boulder: Westview Press, pp. 117, 123.

11 Youssef M. Ibrihim, 1992. 'Fake Money Flood is Aimed at Crippling Iraq's Economy', *New York Times*, May 27; Robert Aaron, 1992. 'Is the CIA Flooding Iraq with Fake Dinar Bills?' *The Toronto Star*, July 18; 'Fake Iraqi Cash Claim', *Herald Sun*, March 16, 1992; Kevin McKiernan, 1992. 'Kurdistan's Season of Hope', *Los Angeles Times Magazine*, August 23, ('both the CIA and Iran [are] flooding Iraq with phony bills'); Ireneusz Dudziec, 1992. 'Iraqi Dinars Forged in Poland', *Polish News Bulletin*, October 5; 'Police: Ring Printed Counterfeit Iraqi Dinars', *Associated Press*, November 3, 1992.

12 Wilkinson, 1992. 'First: Smart Bombs. Now: Funny Money', *Newsweek*, June 8, p. 37; 'Iraq Issues New Currency Note to Fight Forgery', *Moneyclips*, March 9, 1992; Ibrihim, 'Fake Money Flood'; Aaron, 'Is the CIA Flooding Iraq?'

in Iraq. In local currency markets there was a high premium for original Dinars, even though the regime made it a crime to distinguish between the two. Of great concern was that foreigners might try to foment monetary chaos in Iraq by playing the Dinar market to create instability in the rate of exchange between the two. The government explicitly accused Saudi Arabia and Kuwait of accumulating billions of Swiss Dinars, which state run radio described as 'time bombs' that could be used to sabotage the economy.[13]

Parry and Thrust: The Iraqi Currency Exchange

Seizing the initiative, on May 3, 1993 Saddam Hussein's government announced a new currency manoeuvre. Effective immediately, all 25 Dinar notes printed before the war would no longer be legal tender in Iraq. The country's borders were to be sealed for one week, during which Iraqis would have the opportunity to exchange their Swiss Dinars at face value in exchange for local Dinars. The border closure was so abrupt that hundreds of travellers were stranded on both sides of the Iraq-Jordanian border—Iraq's only open international frontier and sole access to international markets—normally traversed by one to two thousand Iraqis each day.[14]

The emergency measure was initially interpreted as last gasp defensive manoeuvre, a 'sign of desperation' and 'evidence that the economy was crumbling under sanctions'.[15] But it very quickly became clear that Hussein's parry was at the same time a powerful thrust, and one that stuck terrible blows at two targets, Jordan and the Iraqi Kurds dwelling in de-facto autonomy in Iraq's northern region.

The currency switch caused both panic and anger in Jordan. As Gresham's law (bad money drives out good) would have anticipated, many Jordanians had accumulated large stocks of Swiss Dinars. These good notes—in fixed supply and difficult to counterfeit—were hoarded and held as a store of value (or traded in exchange markets for hard currencies where they fetched more than three times what the new issues did), while the dented Dinars were used as a medium of exchange. Thus, at the time the border was sealed tens of thousands of ordinary Jordanians were in possession of vast stocks of cash whose value evaporated with the wave of a hand, and crowds overwhelmed local exchange houses, only to be turned away by currency dealers. Scenes from monetary disasters in history were briefly replayed on the streets of Amman, as some expressed their anger by lighting cigarettes with worthless notes bearing the image of Saddam Hussein; a few less fortunate, their life savings wiped out, succumbed to heart attacks.[16]

The Jordanian government appealed to Iraq to allow Jordanians to exchange their cancelled notes, or at least to provide some compensation to those who collectively lost an estimated $250 million. But Baghdad Central Bank Governor Tareq al-Tukmaji announced that no exceptions would be made for those holding Swiss Dinars abroad; he suggested that any foreigners who held the notes did so illegally and with the intention of harming the Iraqi economy. This was a patently false claim—the use of Iraqi currency in Jordan was approved by the Baghdad government and representatives of official Iraqi agencies routinely engaged in such transactions themselves, using the currency to buy essential goods only available to sanctions-constricted Iraq on the Jordanian market. Indeed, if anything, the

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13 'The Money War on Iraq', *Mideast Mirror* (UK), January 21, 1993; 'Iraq Dinar', *Agence France Presse*, May 11, 1993; 'Iraq Claims Triumph over 'Time Bomb' Dinars Stashed in Gulf States', *Agence France Presse*, May 11, 1993.

14 David Hirst, 1993. 'Iraq Closes Border to Rescue Currency', *The Guardian*, May 6.

15 James Whittington, 1993. 'Sanctions Bite Hard on Hungry Iraqis: Border Closure is an Attempt to Halt Economic Collapse', *The Financial Times*, May 6; Christopher Walker, 1993. 'Iraqis Shut Borders and Ban Banknotes to Halt Speculators', *The Times* (London), May 6.

16 Chris Hedges, 1993. 'Fortunes in Iraqi Bills Gone Overnight', *New York Times*, May 16; Ed Blanche, 1993. 'Iraq Invalidates 25-Dinar Banknotes, Closes Borders', *Associated Press*, May 5; 'Jordanians Mock Worthless Iraqi Banknotes', *Reuters*, May 6, 1993; 'Two Die of Heart Attacks over Iraqi Dinar Crisis', *Agence France Presse*, May 11, 1993. Many in Jordan (and elsewhere in the region) also apparently hoarded the Swiss notes speculating that their value might rise when sanctions against Iraq were lifted.

reverse was true. Reports circulated that Baghdad had smuggled huge amounts of Swiss notes into Jordan and exchanged them for dollars just days before they were declared invalid.[17]

Not surprisingly, the move led to considerable bitterness in Jordan, which had, almost alone, supported Iraq in the Gulf war (and provided intelligence and spare parts), and after the war was widely considered to be lax (at best) in its enforcement of UN sanctions. However, rather than an oversight, Baghdad's currency manoeuvre would appear in part to have been purposely directed against Jordan's King Hussein, whose support of Iraq was wavering. For six months the King had been backing away from his support for Iraqi regime—cautiously, given Saddam's broad popularity in Jordan—by calling for pluralism, democracy and respect for human rights in Iraq, in numerous statements and interviews that were widely interpreted as suggesting that it was perhaps time for Saddam to go. Iraq's monetary stab in the back was either designed to serve as a warning to the King, or, having assessed that the relationship could not be salvaged, as part of an effort to bring down the regime. This would also explain why Iraq took the additional measure of halting oil shipments to Jordan during the week the border was closed.[18] In either case the move did bring about a rupture in Jordanian-Iraqi relations as King Hussein, capitalizing on the blow to Saddam's popularity in Jordan as a consequence of the currency exchange, publicly broke with Iraq, sought rapprochement with Saudi Arabia, and attempted to mend fences with the West.[19]

Saddam's Currency Manipulation Against the Kurds

Jordan would have been the most vulnerable party in the repudiation of the Swiss Dinar, but for the imagination of the Iraqi regime. For Iraq not only sealed its external borders, preventing foreigners from participating in the currency exchange (and repudiating the claim those notes once held on Iraqi goods and services) it sealed one of its internal borders as well. In northern Iraq, the Kurds, under the protection of the U.S. Air force, enjoyed virtual autonomy from the central government in Baghdad. During the exchange week those in the north were prevented from crossing into central Iraq and prohibited from participating in the currency exchange. Since the region, as part of Iraq, had no 'local' currency of its own, the repudiation of the Swiss Dinar wiped out the Kurds international purchasing power. It was a technique used with great effectiveness by the central government in Nigeria during its civil war with Biafra in 1968.[20]

The Kurds had relied exclusively on the Swiss notes, disdaining the dented Dinars produced in Baghdad as a symbolic gesture of their autonomy from Baghdad, and this only compounded the crisis. The blow 'rocked the economy', creating a discombobulated present and an uncertain future. Petrol prices quickly tripled, and Kurdish officials told the U.N. that this 'new economic war against Kurdistan' threatened the region with 'economic devastation'. By one estimate one third of the region's wealth had 'evaporated'. Kurdish officials appealed for western help, asking the international community to force Iraq to allow for the exchange of notes held in Iraqi Kurdistan, or to release frozen Iraqi assets to the Kurds as compensation. Neither measure was embraced.[21]

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17 'Jordanian Columnist: Ban the Dinar', *Mideast Mirror* (UK), May, 7, 1993; 'Iraq Shuts Border to Cancelled Currency', *United Press International*, May 10, 1993; 'Amman Stops Iraqi Dinar Dealings', *Mideast Mirror* (UK), May 10, 1993.

18 'King Hussein Urges End to Saddam's Rule', *Toronto Star*, November 8, 1992; Hedges, 'Fortunes in Iraqi Bulls Gone'; 'Amman Stops Iraqi Dinar Dealings', *Mideast Mirror*; 'Iraq Shuts Border', *United Press International*.

19 'King Hussein Invited to White House in June', *Agence France Presse*, May 19, 1993; 'King Hussein Says he Cannot Continue Supporting Baghdad', *Mideast Mirror* (UK), May 24, 1993; 'Jordan's King Urges Press to Jilt Saddam', *The Guardian* (London), May 26, 1993; Ruth Sinai, 1993. 'Jordan's Hussein Calls for Democracy in Iraq', *Associated Press* June 22.

20 On the Nigerian episode see Kirshner, *Currency and Coercion*, pp. 102-6.

21 'Iraqi Kurds Seek Ways of Countering Baghdad's Monetary Moves', *Agence France Presse*, May 6, 1993; Hugh Pope, 1993. 'Saddam's Dinar Ploy Bankrupts Kurds', *The Independent* (London), May 15; Clare Pointon, 1993. 'Banned Dinars Send Kurds Economy into a Tailspin', *The Guardian* (London), May 10; 'Iraqi Dinar', *Agence France Presse*.

The Kurdish leadership faced multiple dilemmas. As an internal medium of exchange, they had little choice but to continue to rely on the Swiss notes. However, in communicating with the general public, explicitly promoting this course might encourage foreign merchants stuck with the worthless notes to dump them in the region. Nor could they simply introduce their own currency—as one Kurdish representative explained in calling for an international solution to the crisis: 'we don't have the legal power to print our own money'. Such a step would be seen as a major move toward independence, a white hot political potato for most of the countries in the region. Indeed, Turkish officials saw the whole currency affair as an effort by Saddam Hussein to destabilize Turkey, by forcing the Kurds' hand and 'trying to confront Turkey with the prospect of an increasingly independent Iraqi Kurdistan, something Ankara has strongly opposed'.[22]

One possibility that was considered was for the Iraqi Kurds to adopt the Turkish Lira, creating a Lira Zone in northern Iraq. Fraught with its own complexities and political implications, this was nonetheless ultimately viewed as the least unattractive option by the Iraqi Kurds, and they did formally request that Turkey consider the option. The measure had some appeal for Turkey, as it would presumably increase Turkish influence in the region and forestall any further momentum towards independence; for these reasons the idea was endorsed by the Turkish Daily News. But the government was uncertain, divided and inhibited by concerns for the Lira itself; inflation in Turkey was galloping along at 60% and the Turkish currency was no model of stability.[23]

Ultimately, inertia carried the day, and the Iraqi Kurds carried on with the Swiss Dinar, as the creation of a Kurdish currency remained too politically explosive, and local currencies such as the Iranian Riyal or the Turkish Lira struggled with their own weaknesses and instability. The option was never satisfactory, especially as the number of notes diminished through wear and tear they could not be replaced, creating a constant monetary shortage. Eventually U.S. dollars were used to buy up those Swiss notes still in the hands of Turkish and Iranian merchants; in 2002 as an 'emergency interim measure' the Kurdish authorities stores of Swiss print 1 Dinar notes that had long been retired. At the same time there remained the constant fear that Saddam Hussein (or for that matter the Iranians or the Syrians, as some rumours held) might dump the massive stores of Swiss notes he held since the note exchange, in an effort to cripple the Kurdish economy. The Iraqi government, on the other hand, continued to periodically insist that it was the victim of currency manipulation by Saudi Arabia and Kuwait. All of this was put to rest after the second gulf war, as the U.S. phased in, from October 15 2003 through January 15, 2004, a 'new Iraqi Dinar' that replaced both the Swiss Dinar still used in the north and the 'old Iraqi Dinar' that was circulating in the rest of the country.

Currency Manipulation under Globalization

As illustrated by the events described above, there is good reason to believe that currency manipulation will continue to be a feature of International Relations under globalization, just as it was in the statist era. Globalization will nonetheless have two systematic effects on its practice. First, as suggested by the Gulf cases, it seems likely that predatory currency manipulation will be less viable against widely traded, widely held currencies, but perhaps more viable against less commonly held and traded currencies (of which there are now more that ever), and especially in those circumstances where markets are thin, incomplete, and vulnerable to regulation. (According to the Bank for International Settlements, trade in five currencies accounts for 85% of all foreign exchange

22 Pointon, 'Banned Dinars Send Kurds Economy into a Tailspin'; John Murry Brown, 1993. 'Kurds Seek Access to Turkish Lira', *The Financial Times*, May 28; 'Iraq Claims Triumph Over 'Time Bomb' Dinars', *Agence France Presse*; 'Ankara Divided Over Kurdish Request for Circulation of Turkish Lira in Northern Iraq', *Mideast Mirror* (UK), May 18, 1993.

23 Andrew Finkel, 1993. 'Saddam's Currency Tactic Steps up Pressure on Kurds', *The Times* (London), May 17; 'Demirel Urged to Push for Turkish Lira Zone in Northern Iraq', *Mideast Mirror* (UK), May 21, 1993; 'Iraqi Kurds Plead to Use Turkish Lira', *Agence France Presse*, May 15, 1993; 'Ankara Divided Over Kurdish Request', *Mideast Mirror* (UK).

transactions; the next five bring the total to 92.55 %.[24]) Second, more subtly and more importantly, globalization will recast the ways in which currency manipulation are most commonly practiced. It should be noted that predatory manipulation is only one part of the currency manipulation story, and perhaps that part of the story that is the least affected by the need to shift from a state-state to a state-system perspective. With this shift, any brief survey of international finance under globalization makes clear that the system as a whole is crisis prone and that there is more, rather than less, politically consequential currency instability.[25] Under such conditions, a more salient change is that other forms of currency manipulation are likely to become both more common and more important—for those states in a position to practice them. In particular, what I have called 'passive' and 'protective' currency manipulation are each likely, under globalization, to attain increased political significance. Opportunities for passive manipulation—failing to provide help to a country in distress, or extorting concessions from such a country in exchange for such help; as well as opportunities for protective manipulation—the positive side of that same coin, proliferate in this context. The United States in particular is well placed to use its recourses, or to wield its enormous influence in international institutions, to help out (or fail to help out) those in distress.

Monetary Dependence

The politics of international monetary arrangements centred around one currency are also transposed, not mitigated, by the consequences of unipolarity and globalization. Ironically, the relative increase in U.S. power has made monetary conflict between competing currency areas more rather than less likely. Further, the pressures of and instabilities associated with globalization have made participation in such arrangements more rather than less attractive. And the traditional effort by leading states to cultivate monetary dependence in an effort to advance political goals continues uninterrupted into the twenty-first century.

The shift from bipolarity to unipolarity has increased the likelihood of economic conflict, including currency competition, among the former participants in the anti-Soviet coalition, the U.S., Western Europe, and Japan.[26] The source of this emerging conflict is often misattributed; it is not that US hegemony at the centre of a stable cold-war alliance system allowed the Americans in particular to disregard concerns for 'relative gains'. The pursuit of relative gains is not a function of anarchy, but rather it is virtually inherent in the process of negotiation between civil parties within states where there can be no plausible link back to fears for anarchy.[27] Rather, during the cold war shared concerns for security provided an emergency brake on the economic conflict—all sides had strong incentives not to let such conflicts get out of hand lest they undermine crucial military alliances. Without this fear to reign in behaviour, economic conflicts will become more uninhibited. This will not only make conflicts over currency matters more likely, but the increasing recognition of the prospects for such conflicts will give an impetus to the coalescing of monetary areas.

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24 The next fifteen currencies share about four percent of the market, which means that the top 25 currencies account for 96.6 of all currency trades. The rest of the world's currencies account for the remaining 3.4%, with the largest individual share in this group accounting for one-twentieth of one percent. Bank for International Settlements, 2002. *Triennial Central Bank Survey: Foreign Exchange and Derivatives Market Activity in 2001*. Basel: Bank for International Settlements, p. 9; Bank for International Settlements, 2001. 'Press Release: Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2001: Preliminary Global Data', October 9, 2001, p. 6.

25 See for example Barry Eichengreen, 2002. *Financial Crises*. Oxford: Oxford University Press; John Eatwell and Lance Taylor, 2000. *Global Finance at Risk*. New York: The New Press; Alexandre Lamfalussy, 2002. *Financial Crises in Emerging Markets: An Essay on Financial Globalisation and Fragility*. New Haven: Yale University Press.

26 Fred Bergsten, 2001. 'America's Two Front Economic Conflict', *Foreign Affairs*, 80 (2), March/April.

27 The collective bargaining agreement of the National Basketball Association, for example, sets player's salaries at 48.04% of Basketball Related Income (BRI). Joanne Gowa, 1984. 'Bipolarity, Multipolarity and Free Trade', *American Political Science Review*, 85 (4), December; Joseph Grieco, 1993. 'Understanding the Problem of International Cooperation: The Limits of Neoliberal Institutionalism and the Future of Realist Theory', in: D. Baldwin, (ed.), *Neorealism and Neoliberalism: The Contemporary Debate*. New York: Columbia University Press.

Globalization will contribute further to this by creating incentives for states to create, join and support regional currency organizations. Again, this is more readily seen by shifting the focus from state-state relations to the state-system perspective. The awesome power of global financial markets creates often unwelcome pressures for macroeconomic convergence; globalized markets are also remarkable conductors of financial instability, two acutely felt reasons why states will look to regional shelters from those monetary storms. For many states, ceding some monetary authority to participate in a currency area will net more insulation and autonomy than going it alone.

The Search for Influence and Autonomy

One aspect of political behaviour that has not changed as a function of either unipolarity or globalization are the efforts by states to extend their influence by situating themselves at the centre of a regional monetary order. It remains difficult to quantify the benefits that states enjoy from such monetary leadership, because the most important benefits accrue from changes in perceived interests rather than in the exercise of overt coercion. This argument, which derives from Albert Hirschman's classic book *National Power and the Structure of Foreign Trade*, is underappreciated in the International Relations literature.[28] Hirschman was concerned with the political consequences of asymmetric economic relationships, and *National Power* illustrated this with a study of German trade strategy in the inter-war period. Hirschman demonstrates, both theoretically and with a study of the inter-war period, how asymmetric trade relationships can accrue political benefits to the larger state. One reason for this is due to the phenomenon whereby trade between a large state and a small state can account for a very large percentage of the total commerce of the latter, while representing only small share of the large state's total trade. This type of relationship provides an imposing coercive lever because any interruption in the relationship would cause much greater distress in the small state than it would in the large one. Thus threats to end or to interrupt the relationship, both explicit and implicit, provide power to the larger state. This coercive potential is well recognized in the literature.[29]

But there is much more to Hirschman's *National Power* than a story about coercion; there is also an important argument about influence.[30] Hirschman does develop more fully and systematically the mechanics of coercion, but he also illustrates the crucial significance of influence.[31] In practice, this less visible mechanism is the more common and more consequential stuff of international relations. As *National Power* shows, behind the headlines and with little fanfare, the pattern of international economic relations affects domestic politics, which in turn shapes national interests. This is always the case but most significant in asymmetric relations, where the effects on the smaller state can be quite considerable. A free trade agreement, for example, between a large state and a small state will, over time, shape the way in which the small state will perceive its own interests—specifically, it will place greater value on the relationship with the larger state and see its interests as converging with those of its partner. Magnified in the small state is that participation in the agreement will, by definition, strengthen those who benefit from the agreement relative to those who do not. As the relationship is sustained the reshuffling of power, interests and incentives among firms, sectors and political coalitions will increasingly reflect these new realities. Additionally, private (and public) decisions based on the new incentives created by the agreement give firms and other actors a stake in their country's continued participation, and they will direct their political energies to that end. In

28 Albert Hirschman, 1980/1945. *National Power and the Structure of Foreign Trade*. Berkeley: University of California.

29 See for example Stephen Krasner, 1976. 'State Power and the Structure of International Trade', *World Politics*, 28 (3), pp. 317-43.

30 Rawi Abdelal and Jonathan Kirshner, 1999-2000. 'Strategy, Economic Relations, and the Definition of National Interests', *Security Studies*, 9 (1-2), Autumn/Winter.

31 Hirschman, *National Power*, pp. 18, 28, 29, 34, 37.

Hirschman's words, 'these regions or industries will exert a powerful influence in favor of a 'friendly' attitude toward the state to the imports of which they owe their existence.'[32]

While *National Power* of course focused on trade relations, parallel arguments hold for currency arrangements as well.[33] It for this reason—chasing the prospects of political influence—that has led most great powers (and some not-so-great powers) throughout history to try and extend their monetary influence by positioning themselves at the centre of an attractive (to some potential participants) international currency nexus. The significance of this sort of 'structural power' is addressed in Helleiner's contribution to this collection of working papers.[34] Both globalization and unipolarity create additional incentives for states that might be capable to consider some form of monetary leadership. Globalization presents greater financial instability and reduced macroeconomic autonomy; the increased economic scale offered by regional monetary arrangements can provide some insulation from global shocks and, to an extent determined by the nature of the agreement, coordination that can enhance the collective policy autonomy of the group as a whole. Unipolarity—which represents both the absence of a common threat and the inclination, however subtle, to lean against or at least to mitigate U.S. influence—also provides additional incentives for states seek politically countervailing monetary arrangements.

Thus, the stage is set for an increase in competition for monetary influence, and the coalescing of new monetary relationships. It is important to emphasize that this need not (indeed, that it does not) imply closure, draconian discrimination or continuous economic warfare between competing centres of monetary influence. But it does suggest that there are now significant pressures toward a recasting of international monetary relations around regional arrangements, which will create new sources of political influence and new axes of economic conflict. Both the search for autonomy and influence, and the recognition by states of the high stakes involved in the struggle for monetary influence, can be seen in Japan's post-Asian Crisis efforts to exert monetary influence, and in the fierce opposition of the U.S. (and also China).

Competition for Monetary Influence in Asia

Since the late 1980s Japan had harboured aspirations to a greater leadership role in international monetary affairs, in order to enhance its international influence but also to circumscribe U.S. monetary power.[35] These ambitions were put on the back burner with Japan's sustained economic malaise in the 1990s, but the Asian financial crisis created both an opportunity and an incentive to revisit the question of the internationalization of the Yen and Japan's monetary leadership in Asia more broadly.

Global financial instability strengthened those voices in Japan who argued that an internationalized yen might insulate Japan from the increasingly crisis prone system; moreover, there was broad dissatisfaction with the response of the IMF (and by implication, the United States) to the Asian Financial Crisis. While officials in Washington attributed the crisis to fundamental flaws in the 'East Asian model', in Tokyo the crisis was seen as reflecting problems inherent in a system of fully liberalized international capital. Government Ministers in Japan repeatedly raised the issue that reform was required in the architecture of the international financial system, and expressed displeasure at the invasiveness of IMF conditions.[36] Neither the U.S. Government nor the International Monetary Fund,

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32 Hirschman, *National Power*, p. 29.

33 Kirshner, *Currency and Coercion*, chapter 4, and Scott Cooper's contribution to this collection of working papers: Scott Cooper, 2005. *Defining the Limits of Monetary Power within Currency Areas*. EUI Working Papers RSCAS No. 2005/09.

34 Eric Helleiner, 2005. *Structural Power in International Monetary Relations*. EUI Working Papers RSCAS No. 2005/10.

35 On Japan's increasing assertiveness in the late 1980s, see Eric Helleiner, 1992. 'Japan and the Changing Global Financial Order', *International Journal*, 47 (Spring), esp. pp. 434-37.

36 Kiichi Miyazawa, (Minister of Finance), 1998. 'Towards a New Financial Architecture', Speech delivered at the Foreign Correspondents Club of Japan, 15 December, available on: http://www.mof.go.jp/english/if/e1e057.htm; Eisuke Sakakibara, (Vice Minister of Finance), 1999. 'Reform of the International Financial Architecture', Speech delivered at the *Symposium on Building the Financial System of the 21st Century*, Kyoto Japan 25 June, available on:

however, would entertain the notion that the crisis had an important international component or that perhaps the consideration of some regulation of short term capital flows was in order.[37]

The crisis thus reinvigorated discussions in Japan about whether the time had come to more aggressively promote the internationalization of the Yen, a once-hot topic that had been dormant for several years. While Japan was interested in claiming a greater leadership role in the region, viewing the behaviour of the US and the IMF as 'a direct challenge to their country's economic and ideological interests', the debate was also, as William Grimes has pointed out 'fundamentally one about *insulation*', and the hope that an internationalized Yen would 'stabilize Japan's international environment.[38]

The most celebrated (and ill-fated) outcome of Japan's new assertiveness was Tokyo's proposal, floated in the summer of 1997, for an Asian Monetary Fund (AMF). The concept was never fully developed, but would have been bankrolled by $50 billion from Japan with an additional $50 billion in contributions from other Asian countries, and, crucially, would have provided emergency assistance to Asian states facing financial crisis loans without the types of conditions associated with IMF assistance.[39]

Leaders in both Tokyo and Washington understood that the stakes over the AMF were more geopolitical than economic—an effort to expand Japan's influence in the region at the expense of U.S. interests. Thus the Ministry of Finance quietly coordinated its proposal exclusively with other Asian nations, leaving the U.S. to be 'caught by surprise' by the plan, which only heightened the tensions—as one account stated simply 'American officials were enraged'.[40] In the end, the original AMF proposal never got very far—most importantly due to 'heated' and 'vehement' U.S. opposition.[41] But other factors played a role as well—including the strong opposition of China. Beijing also interpreted the AMF proposal in geopolitical terms. Pursuing its own strategy of expanding political influence through the cultivation of economic ties, China saw the AMF as an effort by Japan to assert regional leadership at the expense of its chief Asian rival.[42]

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http://www.mof.go.jp/english/if/if004.htm; Haruhiko Kuroda, (Vice Minister of Finance), 2000. 'Information Technology, Globalization, and International Financial Architecture', Speech delivered at Foreign Correspondents Club of Japan 15 June, available on: http://www.mof.go.jp/english/if/if018.htm. See also Michael Green, 2001. *Japan's Reluctant Realism: Foreign Policy Challenges in an Era of Uncertain Power*. New York: Palgrave, pp. 259-60; and Christopher Hughes, 2000. 'Japanese Policy and the East Asian Crisis: Abject Defeat or Quiet Victory?', *Review of International Political Economy*, 7 (2) Summer, pp. 241, 242.

37 Jonathan Kirshner, 2003. 'Explaining Choices About Money: Disentangling Power, Ideas and Conflict', in: J. Kirshner, (ed.), *Monetary Orders: Ambiguous Economics, Ubiquitous Politics*. Ithaca: Cornell University Press, esp. pp. 270-79.

38 Saori Katada, 2002. 'Japan and Asian Monetary Regionalization: Cultivating a New Regional Leadership Role After the Asian Financial Crisis', *Geopolitics*, 7 (1), Summer, p. 86 (first quote); William Grimes, 2003. 'Internationalization of the Yen and the New Politics of Monetary Insulation', in: J. Kirshner, (ed.), *Monetary Orders: Ambiguous Economics, Ubiquitous Politics*. Ithaca: Cornell University Press, pp. 173, 181 (quote, emphasis in original), 185 (quote); see also Paul Bowles, 2002. 'Asia's Post-Crisis Regionalism: Bringing the State Back in, Keeping the (United) States Out', *Review of International Political Economy*, 9 (2), Summer, pp. 231, 248.

39 Eric Altbach, 1997. 'The Asian Monetary Fund Proposal: A Case Study of Japanese Regional Leadership', *Japan Economic Institute Report*, 47, (December 19); Fred Bergsten, 1998. 'Reviving the Asian Monetary Fund', *International Economics Policy Briefs*, 98 (8), Washington, DC: Institute for International Economics.

40 Green, *Japan's Reluctant Realism*, pp. 230-1, 245 (first quote), 248; Paul Bluestein, 2001. *The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF*. New York: Public Affairs, pp. 165-6.

41 Eric Helleiner, 'Still an Extraordinary Power, But for How Much Longer? The United States in World Finance', in: T. Lawton, J. Rosenau and A. Verdun, (eds.), 2000. *Strange Power: Shaping the Parameters of International Relations and International Political Economy*. Aldershot: Ashgate, p. 236; Philip Lipscy, 2003. 'Japan's Asian Monetary Fund Proposal', *Stanford Journal of East Asian Affairs*, 3 (1), Spring, p. 93; Christopher Johnstone, 1999. 'Paradigms Lost: Japan's Asia Policy in a Time of Growing Chinese Power', *Contemporary Southeast Asia*, 21 (3), December, p. 377; Altbach, 'The Asian Monetary Fund Proposal', pp. 2, 10 (quotes).

42 Katada, 'Japan and Asian Monetary Regionalization', pp. 87, 104, 105; Grimes, 'Internationalization of the Yen', p. 173; Johnstone, 'Paradigms Lost', p. 381; Green, *Japan's Reluctant Realism*, p. 230. For an example of China's ambitions, see Jane Perlez, 2003. 'With U.S. Busy, China is Romping with Neighbors', *New York Times*, December 3.

The collapse of the AMF left Japan's monetary ambitions down but not out. In October 1998, Tokyo proposed the 'New Miyazawa Plan', at the centre of which was the establishment of a fund of up to $30 billion to provide short and medium term loans to Asian nations. This was followed by other efforts, such as the Chiang Mai Initiative to coordinate currency swaps. Compared to the AMF these arrangements were all more modest, and bowed to political realities—they were coordinated with both the U.S. and the IMF. But they reflected the underlying motivations that contributed to the original AMF proposal—the push for a greater international role for the yen in the wake of the instabilities reflected by the Asian Financial Crisis and to counter the influence of the U.S. and the IMF in Asia—reactions to globalization and unipolarity.[43]

This continuing divergence between Japan and the U.S. on questions of monetary order was reflected in the dramatically different responses each nation had to Malaysia's decision in September 1998 to impose capital controls in response to the Asian Financial Crisis.[44] While officials from the U.S. and the IMF heaped scathing criticism on the Malaysian government, Japan fully supported the measure. In December Finance Minister Miyazawa stated publicly that in some cases it was appropriate to re-introduce or 'maintain market friendly controls', and Malaysia became the first country to receive assistance under the New Miyazawa initiative. After the country had sustained (with reasonable economic success) its controls for a full year, Malaysia 'received cheers' from the Japanese government and from other parts of Asia as well.[45] Those cheers were not for Malaysia's economic endurance—rather they were echoes from the arena of competition for global monetary influence.

The Continuing Politics of Monetary Geography

The competition for monetary influence is certainly not limited to Asia; indeed, many observers anticipate a global jockeying for influence between the world's two most important issues, neither of which is produced in Asia—the dollar and the Euro. How serious a threat the Euro poses to the global supremacy of the dollar remains an open question. Some prominent commentators such as Fred Bergsten argue that the Euro will almost inevitably become a peer competitor to the dollar. Although 'incumbency advantages' enjoyed by the dollar will delay this development, it is solely a matter of time—and some hints do suggest that the Euro may be gaining firmer footing—such as reports that China will likely diversify its reserve portfolio to increase its Euro holdings, and the recent sharp revision by the IMF of the share of Euros in foreign exchange reserves; Euro holdings in 2002 are now said to be at 18.7% rather than 14.6%, as previously reported.[46]

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43 Saori Katada, 2001. 'Determining Factors in Japan's Cooperation and Non-Cooperation with the United States: The Case of the Asian Financial Crisis Management, 1997-1999', in: A. Miyashita and Y. Sato, (eds.), *Japanese Foreign Policy in Asia and the Pacific: Domestic Interests, American Pressure, and Regional Integration*. Palgrave: New York, pp. 161, 169. Katada argues that domestic financial concerns that surfaced in Japan in 1997 also contributed to the demise of the AMF, suggesting that Japan would reassert its international ambitions as domestic economic pressures eased (p. 162). See also Hughes, 'Japanese Policy', pp. 245-7; Bowles, 'Asia's Post-Crisis Regionalism', pp. 239, 240; Lipscy, 'Japan's Asian Monetary Fund'; Council on Foreign Exchange and Other Transactions, 1999. 'Internationalization of the Yen for the 21st Century', Report 20 April, available on: http://www.mof.go.jp/english/if/e1b064a.htm. On the Chaing Mai initiative, see C. Randall Henning, 2002. 'East Asian Financial Cooperation', *Policy Analyses in International Economics*, 68.

44 On this episode see Rawi Abdelal and Laura Alfaro, 2002. 'Malaysia: Capital and Control', *Harvard Business School, Case # N9-702-040*, (3/14/2002); Prema-Chandra Athukorala, 2001. *Crisis and Recovery in Malaysia: The Role of Capital Controls*. Cheltenham: Edward Elgar; Mark Beeson, 2000. 'Mahathir and the Markets: Globalization and the Pursuit of Economic Autonomy in Malaysia', *Pacific Affairs*, 73 (2).

45 Rudi Dornbusch, 2001. *Malaysia: Was it Different*. National Bureau of Economic Research, Working Paper no. 8325 (June), p.1; Miyazawa, 'New Financial Architecture', p. 3 (quote); Katada, 'Japan and Asian Monetary Regionalization', pp. 87 (quote), 97; Abdelal and Alfaro, 'Malaysia', p.12.

46 Fred Bergsten, 'The Euro Versus the Dollar: Will there be a Struggle for Dominance?', Paper presented at the *American Economic Association*, January 4; International Monetary Fund, 'Revised IMF *Annual Report* Data on Official Foreign Exchange Reserves', Press Release, November 19; Mingqi Xu, 2000. 'The Impact of the Euro on the International

Others such as Benjamin Cohen remain sceptical that the Euro will rival the dollar any time in the foreseeable future, suggesting that the lag time provided by incumbency advantages will be considerable. Further, the Euro is hampered by a number of characteristics that make it ill suited to serve as the (or a) 'world's currency': there is an anti-growth bias in management of the Euro, rendering Euro denominated assets less attractive, and, as McNamara and Meunier have noted, the particular formation of the Euro left the currency without a clear political authority on the world stage—a 'single voice' that represents the Euro in the international arena. Cohen also points out to exchange rate junkies that the recent appreciation of the Euro and weakness in the dollar tells much less about the fate of key currencies than the extent to which they are used by private actors and held as reserves; two factors that continue to favour the dollar.[47]

While both monetary power and the politics of monetary dependence will remain important regardless of how this competition plays out, it is perhaps worth speculating on the implications of a perspective that privileges the role of power in explaining monetary relations. Rather than an incremental process, as suggested by both the euro-optimists and euro-pessimists above,[48] a power perspective would anticipate the more rapid emergence of significant currency rivalry, as the joint effects of globalization and unipolarity produce a sudden violent shift away from the dollar.

One consequence of global capital deregulation associated with financial globalization is that the attractiveness of the dollar as reserve asset—one of the pillars that support the dominance of the dollar—might in fact be a double edged sword. The oceans of dollars held abroad—over one trillion dollars—could serve as fuel to the fire started by a relatively moderate financial crisis involving the United States. For while the U.S. has been relatively empowered (compared to other states) by the process of financial globalization, at the same time it is also more vulnerable to financial crisis than at any time since the second world war.

Moreover, the wheels have been greased. The U.S. federal budget deficit has soared, and its trade deficit is setting record after record. However imperfectly theory meets with practice, these deficits wave red flags at dollar holders about the future value of the greenback, as they imply pressure on inflation and the exchange rate. These flags will loom large if there is a moderate sized financial disturbance involving the United States. At the same time, unipolarity has contributed to American unilateralism (and wariness of U.S. power) in a way that is creating political space between the U.S. and many other parts of the world.[49] Should the dollar buckle, rather that a rush to preserve the status quo, there might be a more subtle movement to recast the monetary order to the detriment of the dollar.

However, whether or not this dollar doomsday scenario occurs, what is of greater significance for present purposes is the recognition, readily and explicitly recognized by most participants in this debate, that whatever monetary conflict exists is of fundamentally political origin and political consequence. Or, in the words of Hubert Zimmermann, the Euro is 'based on the assumption that monetary power matters'.[50]

States will seek and do seek to extend the international use of their currency in order to increase their political influence. In the contemporary era, the pressures of financial globalization as well as the politics of unipolarity create additional incentives for this behaviour. As Martin Feldstein has argued, there is 'no doubt' that the real rationale for EMU is political, not economic', as the aggregation of European resources provides some insulation from global instability, and holds the potential of

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Stability: A Chinese Perspective', in: R. Mundell and A. Clesse, (eds.), *The Euro as a Stabilizer in the International Economic System*. Boston: Kluwer Academic Publishers, p. 266.

47 Benjamin Cohen, 2003. 'Global Currency Rivalry: Can the Euro Ever Challenge the Dollar?', *Journal of Common Market Studies*, 41, pp. 575-595; Kathleen McNamara and Sophie Meunier, 2002. 'Between National Sovereignty and International Power: What External Voice for the Euro?', *International Affairs*, 78 (4), p. 850.

48 See for example, Benjamin Cohen, 2004. *The Future of Money*. Princeton: Princeton University Press, esp. ch. 3.

49 Robert Jervis, 2003. 'Understanding the Bush Doctrine', *Political Science Quarterly*, 118 (3), Fall.

50 Hubert Zimmermann, 2003. 'Ever Challenging the Buck? The Euro and the Question of Power in International Monetary Governance'.

offering an essential element to any political counterweight to the United States. This may become increasingly important if the divergent foreign policy visions of the EU and the US create increasingly greater political space between the two entities.[51]

European monetary politics are also illustrative of a more general point—regardless of the level of globalization, the geography of money—what currency is used where—continues to be governed by political rather than economic factors. Only politics, for example, can account for the monetary choices made by the republics established in the wake of the collapse of the Soviet Union—economic costs and benefits would offer little guide. Similarly, choices about dollarization in Latin America will also be in response to political factors, as the economic costs and benefits of dollarization remain modest, ambiguous and contingent. The 'supply side' of this equation—U.S. pressure for formal dollarization—will also follow this same pattern, a function of international politics, and unlikely unless it becomes 'necessary' as a defensive move against an increasingly assertive Euro or in the wake of a sudden realignment of the global monetary order.[52]

Financial globalization also creates incentives for smaller states to affiliate with regional monetary associations or to seek cover by closely associating in one way or another with a great monetary power. Not counting the Euro Area, twenty-nine countries have gone so far as to abandon their own legal tender in favour of foreign currencies; another forty-two have fixed peg arrangements against a single currency. As discussed, the principal effect of this will be to reinforce and help shape political preferences in these asymmetric relationships. But it should be kept in mind as well these relationships, as always, also create vulnerabilities, which could conceivably be exploited by the monetary leaders in exceptional circumstances. In 1988, for example, the U.S. capitalized on Panama's use of the U.S. dollar as its legal tender, turning Panama's reliance on the greenback into an important economic weapon during the confrontation between the U.S. with the Noriega regime.[53]

Systemic Disruption

Systemic disruption—threats to destabilize the system, in almost all cases in order to extort political side payments[54]—also remains an important feature of international relations. As with currency manipulation and monetary dependence, however, it is necessary to recast the analysis to account for unipolarity and (especially) globalization. This can also be illustrated by refining what is still the best metaphor for strategic disruption—boat rocking—and Shelling's analyses of the manipulation of risk.[55] The state-state version of this fable focused on the occupants of the boat and the explicit negotiations between them—one state rocking the boat, the other protesting (or pretending not to care). In the state-system fable, rather than overtly rocking—one state—that state with the power to set

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51 Martin Feldstein, 1997. 'The EMU and International Conflict', *Foreign Affairs*, 76 (6), November/December, pp. 60 (quote), 72, 73; see also McNamara and Meunier, 'Between National Sovereignty', p. 849; Cohen, 'Global Currency Rivalry'. On the possibility of emerging rifts between the US and Europe, see Charles Kupchan, 2002. *The End of the American Era*. New York: Knopf.

52 Marco del Negro, Alejandro Hernandez-Delgado, Owen Humpage and Elizabeth Huybens, 2001. 'Introduction: Context, Issues and Contributions', *Journal of Money, Credit and Banking*, 33 (2), May, pp. 310-11; Jurgen Schuldt, 2003. 'Latin American Official Dollarization: Political Economy Aspects', in: Dominick Salvatore, James Dean and Thomas Willett, (eds.), *The Dollarization Debate*. Oxford: Oxford University Press, pp. 243, 251; Cohen, *Global Currency Rivalry*, p. 236, 'political considerations will be decisive'. See also Rawi Abdelal, 2001. *National Purpose in the World Economy*. Ithaca: Cornell University Press.

53 International Monetary Fund, *Annual Report*, p. 9; On Panama, see Kirshner, *Currency and Coercion*, pp. 159-164.

54 States may also seek to destroy the system (or undermine the viability of a sub-system) as an end in itself; in practice, 'strategic' disruption is much more likely.

55 Thomas Schelling, 1960. *The Strategy of Conflict*. Cambridge: Harvard University Press; Thomas Schelling, 1966. *Arms and Influence*. New Haven: Yale University Press.

the boat's course; steers the craft towards stormy waters. This manoeuvre changes the underlying setting in a way that privileges the most powerful.

Still a story about the manipulation of risk, and still risky business,[56] this technique alters the prevailing systemic conditions that affect all in a way that relatively empowers the already powerful. Thus strategic disruption under globalization is transformed from an instrument of economic coercion whereby second-tier powers found a conduit to take on those at the top (strategic disruption from below) to an instrument of the powerful—those mighty enough to alter very the rules of the game in a way the benefits the strong at the relative expense of the weak (strategic disruption from above)!

Awareness of this type of structural power can help explain U.S. efforts to render illegitimate any forms of capital control, and its efforts to promote complete and comprehensive financial liberalization, even in the absence of evidence to support the position that such deregulation is optimal from an economic perspective, and in the wake of spectacular and unanticipated disruptions such as the East Asian Financial Crisis.[57] For while a world of completely unregulated capital is risky, it is perhaps the least risky for the U.S. Given the hegemonic position of the American economy (even despite the vulnerabilities discussed above), it is a relatively less likely candidate for financial crisis, even in a world where such crises are more common—indeed, financial crises elsewhere might contribute to 'flight to quality', with capital seeking refuge on perceived islands of relative stability such as the United States. Further, as home to powerful private financial actors and with rich and deeply institutionalized domestic financial markets, America is especially well situated to thrive competitively in a world of deregulated international markets. For these reasons, the U.S. can afford to adopt a position of 'benign neglect' in many cases around the globe where financial crises occur. Most pointedly, when crises do occur, given its resources and influence in international institutions such as the IMF, the U.S. can set conditions for those who seek help.[58] This can be seen in the case of South Korea in the wake of the East Asian financial crisis.

International Instability and Korean Domestic Reforms

When the Asian Financial Crisis reached Korea in the closing months of 1997, Korea sought the assistance of the IMF, and was successful in reaching an agreement that provided unprecedented financial support. In exchange for that support, however, Korea agreed to a comprehensive set of conditions.[59] These conditions fell into two categories—one group of reforms were obviously related to the financial crisis—such as those regarding the restructuring, prudential regulation, transparency of the banking and financial sector. But a second set of reforms demanded in exchange for IMF assistance—the elimination of ceilings on foreign holdings of bonds and equities, abolishing restrictions on foreign ownership of land,

56 There is no guarantee, of course, that the stormy seas might overcome even the most powerful. But strategic disruption is always a risky business, as France found out in the 1930s.

57 See Kirshner, 'Explaining Choices', esp. pp. 270-1.

58 On the international politics that sustain a system of economic instability, see Mark Blyth, 2003. 'The Political Power of Financial Ideas: Transparency, Risk, and Distribution in Global Finance', in: J. Kirshner, (ed.), *Monetary Orders: Ambiguous Economics, Ubiquitous Politics*. Ithaca: Cornell University Press, esp. pp. 239, 256; Great power indifference is characterized as 'benign neglect' in Graham Bird and Ramkishen Rajan, 2002. 'The Evolving Asian Financial Architecture', *Essays in International Economics, 26*, Princeton: Princeton University Press, p. 7.

59 Uk Heo, 2001. 'South Korea: Democratization, Financial Crisis, and the Decline of the Developmental State', in: S. Horowitz and U. Heo, (eds.), *The Political Economy of International Financial Crises: Interest Groups, Ideologies, and Institutions*. London: Rowman and Littlefield; Kiseok Hong and Jong-Wha Lee, 2000. 'Korea: Returning to Sustainable Growth?', in W. Woo, J. Sachs, and K Schwab, (eds.), *The Asian Financial Crisis: Lessons for a Resilient Asia*. Cambridge: MIT Press.

dismantling of trade barriers, acceleration of capital account liberalization, and a reduction on the restrictions on corporate borrowing abroad—were just as clearly unrelated to the risk of financial crisis.[60]

The economic merits of this second set of measures have come under criticism, most tellingly from some mainstream sources. These critics acknowledge that the conditions required by the IMF might improve the long-term efficiency of the Korean economy; but it is 'hard to see how they would either help resolve the crisis or prevent a future one.' According to Martin Feldstein, for example, the Korean economy, 'an economy to envy', was suffering from a crisis of 'temporary illiquidity rather than fundamental insolvency'. All the IMF needed to do was provide a bridge loan and help coordinate action by creditor banks. Instead, the IMF's reaction—insisting that the Korean economy was in need of basic structural reform if it was to have any chance at recovery—actually exacerbated Korea's difficulties. He argues that the 'IMF should eschew the temptation to use currency crises as an opportunity to force fundamental and structural reforms on countries', as was done in this instance.[61]

Whatever the economic merits of the IMF's demands, however, their political attributes are unambiguous. The agreement required Korea to concede on a host of issues that had been the subject of long standing bilateral negotiations with the U.S. South Korea had always restricted FDI, and also protected its financial service sector from foreign competition, to take two examples of areas where the Americans had been pushing for some time without success. U.S. export interests had also long been pressing for greater access to the Korean market, another requirement of the IMF agreement. Thus the measures required by Korea's letter of intent, as Robert Gilpin concluded, 'included specific items that the United States had long demanded of Asian governments, and that the latter had rejected.' Joseph Stiglitz stated it more bluntly: the U.S. imposition of requirements from its trade agenda that had little to do with the crisis and 'was simply part of a crude power play'.[62]

There are few in Asia (and for that matter, elsewhere) that do not see the IMF as an agent of U.S. influence, and that bowing down to U.S. demands that the Korean market open was a quid-pro-quo for IMF assistance. And those required structural reforms, according to Feldstein, touched on areas that were 'among the most politically sensitive' in Korea.[63] Nor have U.S. government officials offered much that would contradict this perspective. It is widely understood that it was the U.S. that encouraged the IMF to focus increasingly on microeconomic reform and trade liberalization. As a result, then U.S. Deputy Treasury Secretary Lawrence Summers could boast that 'The IMF has dome more to promote America's trade and investment agenda in East Asia than 30 years of bilateral trade

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60 Chol-Hwan Chon (Governor, bank of Korea) and Kyu-Sung Lee (Minister of Finance and Economy), 1998. *Letter of Intent of the Government of Korea*, 2 May, available on: http://www.imf.org.external/np/loi/050298.htm. See also Chopra, *et al.*, 2001, pp, 55-56.

61 Martin Feldstein, 1998. 'Refocusing the IMF', *Foreign Affairs* 77 (2), pp. 24, 27, 31, 32; W. Max Corden, 2001. 'The World Financial Crisis: Are the IMF Prescriptions Right?', in: S. Horowitz and U. Heo, (eds.), *The Political Economy of International Financial Crises: Interest Groups, Ideologies, and Institutions*. London: Rowman and Littlefield, p. 59 (first quote); even though Corden offers a thoughtful and balanced assessment of the IMF's performance during the crisis, he reports 'surprise' at many of the provisions required by the letter of intent. The provision to relax restrictions on corporate foreign borrowing, he writes, 'amazes me', as such borrowing was one of the causes of the crisis. See also Jeffrey Sachs, 1998. 'Fixing the IMF Remedy', *The Banker*, February, pp. 16-18; Ha-Joon Chang, Hong Jae Park and Chul Gyue Yoo, 1998. 'Interpreting the Korean Crisis: Financial Liberalization, Industrial Policy and Corporate Governance', *Cambridge Journal of Economics*, 22, esp. p. 739.

62 Joseph Stiglitz, 2001. 'Failure of the Fund: Rethinking the IMF Response', *Harvard International Review*, Summer, p. 18; Robert Gilpin, 2000. *The Challenge of Global Capitalism: The World Economy in the 21st Century*. Princeton: Princeton University Press, pp. 157, 159.

63 Donald Kirk, 1999. *Korean Crisis: Unraveling of the Miracle in the IMF Era*. New York: Palgrave, pp. 35 'egregious imperialistic meddling', 36-8, 43, 46; John Mathews, 1998. 'Fashioning a New Korean Model Out of the Crisis: The Rebuilding of Institutional Capabilities', *Cambridge Journal of Economics*, 22, p. 752; Feldstein, 'Refocusing the IMF', p. 25; Stiglitz, 'Failure of the Fund', reports the IMF is perceived to be 'dominated by the political interests of the U.S Treasury', p. 17; see also Marcus Noland, 2000. 'Japan and the International Institutions', Paper presented at Macquarie University, Sydney Australia, July 6-7, pp. 8, 19.

negotiations', and U.S. Trade Representative Mickey Kantor hailed the IMF a 'battering ram' that was used to open Asian markets to U.S. products.[64]

The Prospects for Disruption

Technology and market forces have been important factors in the advance of financial globalization—but the promotion of global capital mobility has also been encouraged by the U.S., and these efforts have been of profound importance. As Secretary Summers stated plainly, 'financial liberalization, both domestically and internationally, is a critical part of the U.S. agenda.[65] Encouraged by an ideological commitment to capital deregulation, the promotion of financial globalization is also a policy that also serves U.S. geopolitical preferences. In the public assessment of Alan Greenspan, for example, the Asian crisis offers further evidence that 'market capitalism, as practiced in the West, especially in the United States, is the superior model'.[66] While many in the U.S. might have held this view for a long time, the end of the cold war and U.S. preponderance provided the opportunity to act on those beliefs. During the bipolar confrontation with the Soviet Union, the U.S. did not have the luxury of taking on different styles of national capitalism—it is quite reasonable to assume that if the Asian Financial Crisis had occurred during the cold war aid to Korea would have come with fewer strings.[67] Similarly, in the current era, the ability of the United States to practice strategic disruption from above is to a large extent a function of the prospects for currency rivalry and monetary dependence. If the dollar doomsday scenario occurs, then the coalescing of spheres of monetary influence will reshape U.S. incentives, and the main theatre of monetary power will shift from disruption to dependence. In this scenario, the U.S. (and other monetary leaders) will make efforts to cultivate their influence with followers, and pursue a more subtle, economically generous Hirschmanesque strategy of entrapment. Until that time, however, a monetary power perspective would expect the U.S. to continue to promote and champion global financial liberalization and to take political advantage of those financial crises that do occur, following a strategy, *à la* Schelling, of parlaying that riskier environment which relatively enhances American interests compared to those of other states.

The politics of American boat-rocking are more transparent when it is understood that the economic merits of complete financial globalization are ambiguous at best. (That is, although capital mobility in general is economically efficient, the balance of evidence suggests that the optimal level of controls on the movement of capital is greater than zero.) Thus the vehement reaction of American officials to the Malaysian controls, that 'it would be a catastrophe' if other countries followed suit, does not make sense if the analysis is limited to one that tabulates the economic costs and benefits.[68] The political benefits of financial globalization, on the other hand, are more certain—the U.S. on balance has much to gain and bears a disproportionately small share of the risks. Power in international politics is always relative; a system characterized by greater risk of financial crisis does in some ways leaves the U.S. more vulnerable, but compared to other states its power is enhanced.

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64 David Hale, 1998. 'Dodging the Bullet—This Time', *Brookings Review*, Summer, pp. 24, Summers quote, 26; *International Herald Tribune*, 14 January 1998, ('battering ram').

65 Quoted in Devesh Kapur, 1998. 'The IMF: A Cure or a Curse', *Foreign Policy*, 111 (Summer).

66 Alan Greenspan, 1998. 'The Current Asian Crisis', Testimony before the Subcommittee on Foreign Operations of the Committee on Appropriations, U.S. Senate, 3 March.

67 Bruce Cummings, 1999. 'The Asian Crisis, Democracy, and the End of 'Late' Development', in: T. Pempel, (ed.), *The Politics of the Asian Economic Crisis*. Ithaca: Cornell University Press, pp. 18, 41.

68 Abdelal and Alfaro, 'Malaysia', p. 11 (Summers quote). Other leading figures had similarly disproportionate responses to the Malaysian experiment: Michel Camdessus called the controls 'dangerous and even harmful'; Robert Wade, 1998. 'The Asian Crisis and the Global Economy: Causes, Consequences, and Cure', *Current History*, November, p. 368. Alan Greenspan in pointed testimony quickly (and erroneously in the Malaysian case) equated capital controls with 'borders closed to foreign investment' and explained that states that implement capital controls would be 'mired at a sub-optimal standard of living and slow growth rate'. Alan Greenspan, 1998. 'International Economic and Financial Systems', Testimony before the Committee on Banking and Financial Services, U.S. House of Representatives, 16 September.

With less relative vulnerability and the greatest prospects for practicing strategic disruption—manipulating the risks of crisis as well as the nature of agreements to contain them—America's international political power is enhanced in a world of globalized finance.

In sum, the contemporary international system is characterized by globalization and unipolarity. Financial globalization in particular recasts the nature of monetary power and the practice of monetary diplomacy. But it does not provide an escape from politics—even under globalization, international relations will continue to feature currency manipulation, monetary dependence, and strategic disruption. As long as there are states and currencies, the monetary system will remain an arena of political conflict.

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