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Leadership Begins at Home: The Domestic  
Sources of International Monetary Power

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*The Domestic Sources of International Monetary Power*

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## **Abstract**

I build on existing literature on monetary policy to argue that two initial prerequisites of international monetary leadership derive from a particular set of domestic policies and institutional arrangements. First, currency leadership requires a relatively conservative monetary policy embedded in the lead country's domestic political and economic institutions. This credible policy framework helps to produce willing followership on the part of private market agents and other national monetary authorities. Second, currency leadership also depends upon a related set of institutional arrangements that facilitate the emergence of relatively developed financial markets. Once established, the prerequisites for ongoing international monetary leadership are less onerous, and the potential for the exercise of coercive power over other actors is greater. In the short run, an established leader may use its monopoly power to delay adjustment and to deflect adjustment costs onto other states. In the long run, such policies promote countervailing responses by private sector and state actors that diminish the leader's monetary power. As the British, American and German cases demonstrate, only through the ongoing persuasion of market agents can international monetary leadership be sustained.

## **Keywords**

monetary relations, policy leadership, domestic institutions.

## Introduction<sup>1</sup>

Currency leaders, as others in this volume demonstrate, enjoy various forms of international monetary influence and power, including the power to delay and the power to deflect.<sup>2</sup> The ‘exorbitant privilege’ of currency leaders, above all the ability to finance external deficits by issuing IOUs, has received much attention.<sup>3</sup> But what produces currency leaders? What, in other words, are the sources of international monetary power?

In this chapter, I build on existing literature on monetary policy to argue that two initial prerequisites of international monetary leadership derive from a particular set of policies and domestic institutional arrangements. First, currency leadership requires a relatively conservative monetary policy from the leader that is credibly embedded in its domestic political and economic institutions. This credible policy framework helps to produce willing followership on the part of the key audience, private market agents, as well as other national monetary authorities. Second, currency leadership also depends upon a related set of institutional arrangements that facilitate the emergence of highly developed financial markets. I discuss other prerequisites for monetary leadership below, but the argument places most emphasis upon these two.

The prerequisites for *ongoing* international monetary leadership are less onerous than the initial prerequisites; the potential for the exercise of coercive power over other actors is correspondingly greater. In the short run, an established leader may use its monopoly power to exert substantial influence over other states’ policies, even if this exercise of power is seen as illegitimate by followers. The sources of ongoing monopoly power (implying the absence of serious rival currencies) include network externalities, deep domestic capital markets in the lead country, inertia on the part of followers, and political linkages between leader and followers. For example, the US was able to exploit its currency leadership position in the 1960s and 1970s, delaying the costs of adjustment and deflecting them onto others.

In the long run, however, the initial prerequisites of monetary leadership still hold, though in diluted form. Excessively expansionary US monetary policy in the late 1970s threatened to undermine the willingness of private market agents to continue to hold dollar assets, requiring a shift back to a more conservative and credible US monetary policy after 1979. The British case in the early 20<sup>th</sup> century also demonstrates that fundamental shifts in the leader’s domestic institutional framework can result in a rapid erosion of the status of the lead currency, particularly when potential rival currencies exist. Monetary leadership can only be sustained through the ongoing persuasion of market agents.

The rest of this chapter is organized around three main questions. First, what is the nature of international monetary leadership? This section is mainly concerned with definitions and in situating the argument in relation to the existing literature on leadership and hegemony. Second, what is the nature of monetary ‘followership’, for both other states and private sector actors? Third, what are the limits to monetary leadership, and, as regards the theme of this volume, to the power that monetary leaders enjoy? A final section concludes.

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1 Draft as of 5 July 2004. I would like to thank David Andrews, Eric Helleiner, Randy Henning, Jerry Cohen, Jonathan Kirschner, Scott Cooper, Bob Hancké, and various other participants at the Florence conference for their very helpful comments on an earlier draft of this chapter. None are responsible for any remaining errors.

2 See Benjamin J. Cohen, 2005. *The Macroeconomic Foundation of Monetary Power*. EUI Working Papers RSCAS No. 2005/08.

3 Matthias Kaelberer, 2005. *Money, Markets and Power: Explaining Patterns of Pegged Exchange Rate Regimes*. EUI Working Papers RSCAS No. 2005/12.

## What is Monetary Leadership?

Monetary power has long been associated in our subject with the role of dominant or hegemonic countries in the international political economy.<sup>4</sup> This idea has a longer heritage than so-called hegemonic stability theory (HST), but it achieved its fullest expression in this theory from the mid-1970s. As is well known, Kindleberger<sup>5</sup> himself, on which much of this literature drew, employed the term ‘leadership’ rather than hegemony. He argued that international monetary leaders, such as pre-1914 Britain and post-1945 America, provided a collective good in the form of a common currency and a counter-cyclical monetary stabilization policy at the international level. As Lake<sup>6</sup> observes, collective goods or leadership theory is more applicable to international money than to trade, where, he argues, hegemonic coercion is more relevant.<sup>7</sup> Here, I follow Lake and Kindleberger in employing the term international monetary leadership rather than hegemony. Nevertheless, I argue that the foundations of such leadership can also create the pre-conditions for the exercise of coercive, exploitative hegemonic power.<sup>8</sup>

Most now accept that HST erred in overlooking domestic factors, not least in the hegemon itself. However, leadership theory<sup>9</sup> also typically ignores domestic factors, making it poorly equipped to explain the nature and sources of monetary leadership. First, such models exclude private sector actors, an important constituency amongst monetary followers that has received surprisingly little attention in the hegemony/leadership literature.<sup>10</sup> Second, such models omit the domestic political and institutional factors that are basic pre-conditions of monetary leadership.<sup>11</sup>

I explore both of these issues in the following section, and argue that these aspects relate to an important element of *legitimacy* enjoyed by the leader that helps explain why followership can be largely voluntary in nature. Persuasion is more typical of monetary leadership than is explicit (hegemonic) coercion. Market agents in particular are difficult to coerce, and must generally be persuaded of the advantages of using and holding the lead currency. However, the dividing line between persuasion and coercion, particularly of other states, is often difficult to draw in practice.

Despite some similarities, my argument differs in emphasis from that of Ruggie<sup>12</sup> and Ikenberry and Kupchan<sup>13</sup>, who argue that authoritative leadership of the Weberian variety derives from normative

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4 E.g.: Robert Gilpin, 1975. *US Power and the Multinational Corporation*. New York: Basic Books, and Robert Gilpin, 1987. *The Political Economy of International Relations*. Princeton: Princeton University Press. For a critical review of this literature and its empirical claims, see Barry J. Eichengreen, 1989. ‘Hegemonic Stability Theories of the International Monetary System’, in: Richard N. Cooper, (ed.), *Can Nations Agree? Issues in International Economic Cooperation*. Washington D.C.: Brookings Institution, pp. 255-98; and Andrew Walter, 1993. *World Power and World Money*. New York and London: Harvester Wheatsheaf.

5 Charles P. Kindleberger, 1973. *The World in Depression, 1929-1939*. London: Allen and Unwin; and Kindleberger, 1986. ‘International Public Goods Without International Government’, *American Economic Review*, 71 (6), pp. 1-13.

6 David A. Lake, 1993. ‘Leadership, Hegemony, and the International Economy: Naked Emperor or Tattered Monarch with Potential?’, *International Studies Quarterly*, 37 (4), pp. 459-489, for reference p. 460.

7 On trade, see Stephen D Krasner, 1976. ‘State Power and the Structure of International Trade’, *World Politics*, 28, pp. 317-43. On public goods approaches, see Duncan Snidal, 1985. ‘The Limits of Hegemonic Stability Theory’, *International Organization*, 39, pp. 579-614.

8 In developing a theory of international monetary leadership, I also hope to fill a gap in my own earlier work (Walter, *World Power*), which argued that HST could not explain the rise and fall of international monetary stability.

9 E.g., Snidal, ‘The Limits of Hegemonic Stability Theory’.

10 Joanne S. Gowa, 1984. ‘Hegemons, IOs and Markets: The Case of the Substitution Account’, *International Organization*, 38, pp. 661-84, and Benjamin J. Cohen, 1998. *The Geography of Money*. Ithaca: Cornell University Press, are exceptions.

11 For a similar argument, see J. Lawrence Broz, 1999. ‘Origins of the Federal Reserve System: International Incentives and the Domestic Free Rider Problem’, *International Organization*, 53, pp. 39-70.

12 John G. Ruggie, 1982. ‘International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order’, *International Organization*, 36 (2), pp. 379-415.

convergence between the leader and its followers. Although some degree of intellectual and normative convergence was evident in the British and US cases of international monetary leadership, I argue that an element of *divergence* is essential to successful monetary leadership. A successful monetary leader needs, among other things, to be *more* monetarily ‘conservative’ than most other countries.

It is also necessary to distinguish between two aspects of international monetary leadership, currency leadership and liquidity leadership.<sup>14</sup> Currency leadership occurs when a national currency plays a dominant role as an anchor, vehicle and investment currency for international transactions between actors, both public sector and private sector, in the world economy.<sup>15</sup> Liquidity leadership occurs when one or more countries provide short and longer-term liquidity to the world economy in a stabilizing, counter-cyclical fashion. The consensus now differs from Kindleberger’s original contention<sup>16</sup> that there could be only ‘one stabilizer’ in the area of liquidity provision.<sup>17</sup> Liquidity leadership tends to be provided collectively rather than singly, in contrast to currency leadership.<sup>18</sup> Given the primary focus of this volume on monetary rather than financial issues, I focus here upon currency leadership. Another reason is that currency leadership is logically prior to liquidity leadership.<sup>19</sup>

### Why Follow the Leader?

The literature has tried to explain currency followership in two main ways. The first and most common approach focuses upon the material incentives for followers that the leader directly or indirectly provides.<sup>20</sup> The second focuses on the way in which followers, through a process of normative socialization, come to accept the leader’s economic policy preferences as in their own interest.

#### *Material Incentives*

Standard leadership theory has not explored the question as to why states follow the leader. Indeed, this is a trivial question in a public goods framework, since follower countries have no material incentive not to consume the public good. The nature of the exchange rate system, the mode, degree of institutionalisation and conditionality attached to international liquidity provision, etc, are all second order questions for public goods theory.<sup>21</sup> However, these kinds of details matter considerably for followership in practice. Britain and the US both provided currency leadership in their respective eras

(Contd.) \_\_\_\_\_

13 John G. Ikenberry and Charles A. Kupchan, 1990. ‘Socialization and Hegemonic Power’, *International Organization*, 44 (3), pp. 283-315.

14 Charles Kindleberger sees both of these as important aspects of international monetary leadership, but places most emphasis on the second. See his *The World in Depression* and ‘International Public Goods Without International Government’, and Lake, ‘Leadership, Hegemony, and the International Economy’, pp. 462-3.

15 For an extensive treatment, see Benjamin J. Cohen, 2004. *The Future of Money*, Princeton: Princeton University Press.

16 Kindleberger, *The World in Depression*, p. 305.

17 Theoretically, there was no good foundation for this argument: Russell Hardin, 1982. *Collective Action*. Baltimore: Johns Hopkins University Press, and Snidal, ‘Limits of Hegemonic Stability Theory’.

18 J. Lawrence Broz, 1997. ‘The Domestic Politics of International Monetary Order: The Gold Standard’, in: D. Skidmore, (ed.), *Contested Social Orders and International Politics*, Nashville: Vanderbilt University Press, pp. 53-91, and Eichengreen, ‘Hegemonic Stability Theories’.

19 When follower countries hold a center country’s liabilities as foreign exchange reserves, producing international currency leadership, they will also be likely to favour liquidity provision in this currency. There can be reverse linkages between the two. As I argue below, collective liquidity provision in the British case before 1914 and the American case in the 1960s helped to maintain single currency leadership.

20 Cohen, *Future of Money*, distinguishes between tighter and looser forms of state followership, from ‘dollarization’ to simple pegging to an anchor currency. Here, for simplicity, I focus on the latter, since it is the most common form of followership by other major states.

21 Lake, ‘Leadership, Hegemony, and the International Economy’, p. 484.

of pre-eminence, but the difference, for example, between a gold standard and a gold exchange standard is fundamental, particularly in terms of the systemic distribution of adjustment costs. Similarly, any government that has accepted conditions upon borrowing from a major creditor country or through the IMF and World Bank would tell us that the details matter greatly.

Allied to public goods theory is the idea that the use of a single money, like the spread of English as a global language or eBay as an Internet auction platform, has positive network externalities: the more actors that use it the greater the benefit to all users.<sup>22</sup> This approach has some important implications. First, it usefully emphasizes the benefits of a single international currency to *private* sector agents, not just states. Indeed, it is private market agents rather other states that confer key currency status upon a particular currency. Second, since money has some of the qualities of a ‘natural’ monopoly, it suggests that monetary leadership may persist even when the original conditions producing it have changed. As with all monopolies, there exists an ever-present temptation for the monopolist to exploit its position. This potential for abuse helps to explain why most followers tend to diversify their currency portfolios rather than rely completely upon a single international currency.<sup>23</sup>

Still left unanswered, however, is why a particular currency and country come to lead in the first place. There are two main kinds of material follower incentives: ones that derive from the structure of the international political and economic system, and ones that derive from the perceived relative monetary advantages of domestic policies and institutions in the leading country itself.

In terms of international incentives, the size of a particular country, its importance in international trade and its initial ability to run current account surpluses provide incentives for other countries and private sector agents to utilize its currency in third party transactions and to hold assets denominated in its currency.<sup>24</sup> A substantial export dependence on the leader’s market may provide a powerful material incentive to follow the leader generally on economic policy matters. However, trade patterns are not the only factor in currency leadership. In the later stages of Britain’s and America’s leadership eras, other countries came to challenge their dominant international trading positions, but the challenge to their currency leadership role was in both cases much less severe. Hence, some countries are much more important in international trade than in international money, such as Germany before 1914 and Japan since the 1970s.

A similar incentive for currency followership is produced by asymmetries of financial development in the world economy. The existence of relatively deep, stable, efficient and open financial markets in one country will encourage both public and private sector agents to have confidence in transacting in and holding assets denominated in its currency. Of course, the role of London and New York in the respective currency leadership of Britain and the US has long been recognized, and currency leadership contributed to their financial development. However, we still need to explain why these countries achieved relative financial development prior to their currency leadership.

Before turning to this, there is a third, non-economic incentive for monetary followership. International security relationships may create supplementary incentives for followership by states (though not for private sector agents). Although security factors tend mainly to receive attention in the literature on hegemony and international trade,<sup>25</sup> US currency leadership in the 1950s and 1960s cannot be understood without them. West Germany’s commitment to the US dollar was substantially reinforced by its dependence upon the American security umbrella. The Blessing letter of March 1967,

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22 Charles P. Kindleberger, 1967. ‘The Politics of International Money and World Language’, *Princeton Essays in International Finance* 61; Paul De Grauwe, 1996. *International Money*. 2<sup>nd</sup> edition. Oxford: Oxford University Press, p. 2.

23 See Cohen, *Geography of Money*, and Peter Lindert, 1969. ‘Key Currencies and Gold, 1900-1913’, *Princeton Essays in International Finance* 24 (August).

24 Broz, ‘Origins’, p. 48; Cohen, *Future of Money*, p. 11.

25 Joanne S. Gowa, 1994. *Allies, Adversaries and International Trade*. Princeton: Princeton University Press; Krasner, ‘State Power’; Lake, ‘Leadership, Hegemony, and the International Economy’, pp. 470-2.

in which the Bundesbank's President pledged not to convert its dollar reserves into gold (as the disloyal French had been doing), must be understood in this context. The US alliance subsequently became less of a constraining factor, as détente was consolidated and as German fears of the inflationary consequences of a pure dollar standard (from 1968) came to the fore.

Security incentives for followership may help when economic incentives are weak or diminishing, but they are unlikely to play a central role for long. Although it is difficult to imagine how a country could attain international monetary leadership without playing an important role in international trade, security incentives for followership may not be necessary. The British-led international gold standard before 1914 owed little to security alliances. Indeed, ad hoc central bank cooperation during this era seemed relatively insulated from the more fluid great power alliances of the time. French and Russian financial assistance to the Bank of England in the Barings crisis of 1890, despite their unresolved imperial rivalries with Britain, is indicative.<sup>26</sup> Like trade incentives, security incentives provide insufficient explanations of monetary leadership and followership.

In the absence of supportive domestic monetary policies and institutions, the international factors discussed above will not be sufficient to produce monetary leadership and willing followership. As Cohen<sup>27</sup> notes, a viable lead currency must have a 'proven track record of relatively low inflation and inflation variability'. But what assures market agents that such a track record will be reproduced in the future? There is now a good deal of literature, much of it stemming from the seminal article by North and Weingast,<sup>28</sup> that focuses upon the domestic institutional foundations of financial development. In this view, the founding of institutions of limited government in late 17<sup>th</sup> century Britain, by substantially reducing the likelihood of default against private sector creditors, was a key step in the development of deep money and capital markets in London.<sup>29</sup> The implication of this argument is that in the modern world, international monetary leaders are only likely to arise under conditions of limited, constitutional government. A complementary theory is that financial development is a product of a society's legal institutions.<sup>30</sup> These authors find from cross-country evidence that English common law, with its pro-creditor rights bias, is most conducive to financial sector development, with the French civil law system least conducive.<sup>31</sup> We can infer from this that not only must government be constitutionally limited for deep financial markets to emerge, but creditor rights must also be effectively protected in the law.

It is important to note that not only the potential for outright default matters for followers, but also the potential for partial default via inflation. The use of fiat money creates a potential for inflation, and a commitment to a low inflation monetary policy is unlikely to be credible in the absence of institutional factors that constrain its use.<sup>32</sup> This could include the delegation of monetary policy to an independent central bank, or the support of a dominant political constituency for conservative monetary policies.<sup>33</sup>

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26 Charles P. Kindleberger, 1984. *A Financial History of Western Europe*. London: Allen & Unwin, p. 282, claims that the Bank of England's refusal to accept the Prussian National Bank's offer of financial assistance in 1873 was driven by strategic or political sensitivities. This remains a relatively under-explored aspect of international monetary cooperation and conflict.

27 Cohen, *The Future of Money*, p. 10.

28 Douglass North and Barry Weingast, 1989. 'Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England', *Journal of Economic History*, 69, pp. 803-32.

29 For a further development and modification of this argument, see David Stasavage, 2003. *Public Debt and the Birth of the Democratic State: France and Great Britain, 1688-1789*. Cambridge: Cambridge University Press.

30 Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, 1998. 'Law and Finance', *Journal of Political Economy*, 106 (6), pp. 1113-1155.

31 German and Scandinavian legal systems occupy an intermediate position.

32 Finn Kydland and Edward S. Prescott, 1977. 'Rules Rather than Discretion: The Inconsistency of Optimal Plans', *Journal of Political Economy*, 85, pp. 473-92.

33 On the former, see Kenneth Rogoff, 1985. 'The Optimal Degree of Commitment to an Intermediate Monetary Target', *Quarterly Journal of Economics*, 100, pp. 1169-90; on the latter, see Adam Posen, 1998. 'Central Bank Independence and Disinflationary Credibility: A Missing Link?', *Oxford Economic Papers*, 50, pp. 335-59.

Either way, private sector agents must be assured that institutional mechanisms are in place that will assure policy consistency. Britain's limited government and limited franchise helped to entrench the position of those in society who favoured a relatively conservative or 'hard' monetary policy, via the gold standard that was adopted in 1713. This conservative financial clique also dominated the Bank of England, a crucial institutional development that preceded the emergence of deep financial markets in Britain. As a result, the credibility of Britain's commitment to a conservative monetary policy, except during emergencies like the Napoleonic Wars, was largely unquestioned until World War I.<sup>34</sup>

By extension, this argument might apply to the American case of financial development, given the way in which its institutional framework famously decentralizes political power.<sup>35</sup> However, without a central bank until 1914, America's decentralized political institutions and its much larger economy could not alone foster financial development.<sup>36</sup> Despite a very shaky start by the US Federal Reserve, the design of America's central bank constitution also served, if not always consistently, to put into place a monetary framework that offset political pressures for inflation.<sup>37</sup> It also helped to stabilize a previously volatile domestic financial sector and, in particular, to provide New York bankers with the short term discount market they needed to assure liquidity for international holders of dollars, as the Bank of England had long done for London's financiers.<sup>38</sup> Of course, the disruptive effects of World War I also played an important role in accelerating the rise of New York relative to London.

In the early 20<sup>th</sup> century, the domestic political and institutional framework that had facilitated Britain's adherence to the gold standard began to change.<sup>39</sup> This eventually proved disastrous for Britain's position, given the emergence of a serious challenge to its monetary leadership by the US. In a series of related developments, the extension of the franchise after World War I, the rise of the trade union movement and the Labour Party, and the rise of Keynesian economic ideas eventually threatened Britain's political commitment to the gold standard.<sup>40</sup> Furthermore, the loss of outright veto power by the House of Lords in 1911 centralized political power in the hands of the British Prime Minister and Cabinet. In combination with a wider franchise and the rise of the unionised left, the potential for inflation was now much greater and sterling's credibility as an international currency was undermined.<sup>41</sup> Capital controls, imposed in the name of national macroeconomic stabilization during and after World War II, reflected this new reality and were another blow to sterling's international role. Allied with Keynesian economic policy ideas and a now wholly subordinate Bank of England, successive British cabinet governments after 1945 pursued macroeconomic policies that by the 1960s had almost completely undermined Britain's pretensions to currency leadership. Nevertheless,

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34 Barry J. Eichengreen, 1992. *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939*. New York: Oxford University Press; Giulio M. Gallarotti, 1995. *The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880-1914*. New York: Oxford University Press.

35 See Kenneth A. Schultz and Barry R. Weingast, 2003. 'The Democratic Advantage: Institutional Foundations of Financial Power in International Competition', *International Organization*, 57, pp. 3-42.

36 Broz, 'Origins'; Daniel Verdier, 2001. 'Capital Mobility and the Origins of Stock Markets', *International Organization*, 55, pp. 327-356. The American public debt market was still very small in 1914, casting doubt on the applicability of the North and Weingast thesis.

37 Jon Faust, 1996. 'Whom Can We Trust to Run the Fed? Theoretical Support for the Founders' Views', *Journal of Monetary Economics*, 37, pp. 267-83.

38 Broz, 'Origins'.

39 Some earlier works on sterling's decline tend to emphasize economic factors (e.g.: Benjamin J. Cohen, 1971. *The Future of Sterling as an International Currency*. London: Macmillan) or international political factors (e.g.: Susan Strange, 1971. *Sterling and British Policy: A Political Study of an International Currency in Decline*. London: Oxford University Press).

40 Eichengreen, *Golden Fetters*; Beth A. Simmons, 1994. *Who Adjusts? Domestic Sources of Foreign Economic Policy During the Interwar Years*. Princeton: Princeton University Press; Robert Skidelsky, 1992. *John Maynard Keynes: Vol. II: The Economist as Saviour, 1920-1937*. London: Macmillan.

41 Alec Cairncross and Barry Eichengreen, 2003. *Sterling in Decline: The Devaluations of 1931, 1949 and 1967*. 2<sup>nd</sup> edition. Houndmills: Palgrave, pp. xv, xx.

although Britain no longer satisfied the first prerequisite of monetary leadership, the second remained largely intact. London subsequently flourished as an open centre for international finance, but only by specializing in 'offshore' finance conducted in other currencies, above all the US dollar.

The erosion of the credibility of the US commitment to a stable currency after 1945 was much less marked than in the British case. The monetary link to gold, albeit in altered form, remained important for American policy, in marked contrast to Britain. By the end of the war, the US owned about three-quarters of the world's monetary gold, and the Roosevelt administration wanted to preserve the 'economic power' this represented.<sup>42</sup> America's domestic institutional structure was also a crucial aspect of the comparative resilience of its monetary leadership. In the New Deal years and in the immediate post-war years, the US Federal Reserve had been politically subordinated to the government.<sup>43</sup> From the time of the US Treasury-Federal Reserve Accord of March 1951, the latter was able, with the support of the Treasury, to regain independent control over interest rates.<sup>44</sup> The result was low levels of inflation relative to those in most other major economies (figures 1 and 2). The Federal Reserve's conservative stance was supported by successive administrations. Congress was relatively inactive in monetary and exchange rate policy because of the low incentives for collective action in these policy areas, which favoured monetary conservatism.<sup>45</sup> In the Eisenhower years the fixed gold price was seen by the administration as one of the foundations of good economic housekeeping. In the 1960s, beginning with Kennedy, the commitment to the fixed \$35 per ounce gold price became a matter of high politics.

However, from the mid-1960s, with productivity growth falling, political pressure on the Federal Reserve to deliver on jobs and growth increased. With the steady erosion of the external gold constraint on US policy, successive administrations from 1962 onwards were accused of exploiting their ability, due to the international reserve role of the dollar, to export inflation abroad and to shift the costs of adjustment to others.<sup>46</sup> The Federal Reserve Board remained committed to the fixed gold price and to a low inflation policy, but by the early 1970s it had well and truly lost this battle.<sup>47</sup> America's willingness to exploit its powerful position increasingly alienated loyal allies of a more conservative monetary bent, with the Germans floating the D-mark against the dollar in March 1973. By 1978, the steadily falling dollar suggested that financial markets had also lost confidence in US macroeconomic policy. Only Paul Volcker's dramatic reassertion of the US Fed's autonomy and a policy of monetary conservatism from 1979 succeeded in restoring the underpinnings of the dollar's international position.<sup>48</sup>

To summarize the argument of this section, monetary followership by private and public sector agents occurs at least in part because of the monetary policy credibility and the high financial development that flows from the leader's domestic institutional arrangements. Of course, institutions for monetary and financial conservatism at home are unlikely to produce international monetary leadership without sufficient economic size and an important international trading position: Switzerland since 1945 is a case in point. As Verdier (2001) points out, the degree of state centralization also has important effects on financial development. Furthermore, as the Volcker shift

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42 Robert Skidelsky, 2000. *John Maynard Keynes: Vol. III: Fighting for Britain, 1937-1946*. London: Macmillan, p. 317.

43 Milton Friedman and Anna J. Schwartz, 1963. *A Monetary History of the United States, 1867-1960*. Princeton: Princeton University Press, pp. 532-533.

44 Friedman and Schwartz, *Monetary History*, pp. 610-626.

45 As Joanne S. Gowa, 1988. 'Public Goods and Political Institutions: Trade and Monetary Policy Processes in the United States', *International Organization*, 42, pp. 15-32, argues, this contrasts with greater political activism in finance.

46 See De Grauwe, *International Money*, pp. 32-9.

47 Charles A. Coombs, 1976. *The Arena of International Finance*. New York: Wiley.

48 Paul Volcker and Toyoo Gyoten, 1992. *Changing Fortunes: The World's Money and the Threat to American Leadership*. New York: Times Books, ch.6.

demonstrates, individuals as well as institutions matter.<sup>49</sup> However, even though domestic political, legal and economic institutions are not determinant, they nevertheless give us greater purchase upon why Britain and then the US were the countries able and willing to provide international monetary leadership, and why others were bound to follow. Indeed, if one accepts that financial development helped to promote the general pre-eminence of the large Anglo-Saxon countries in both the economic and security realms, domestic institutions should be seen as all the more crucial.

### *Normative Convergence through Socialization*

Material incentives for followership, both international and domestic in origin, can only get us so far in explaining the detail of international monetary organization and followership. Such theories lack an account of the economic and political ideas that give substantive content to the preferences of actors and to the shape of institutional particularities of the day.

Ruggie<sup>50</sup> and Ikenberry and Kupchan<sup>51</sup> are most often associated with the theory that leadership is based upon normative convergence between elites in the major countries. Following Polanyi,<sup>52</sup> Ruggie argues that British leadership in the 19<sup>th</sup> century was founded upon the then dominant norms of *laissez-faire* and monetary discipline.<sup>53</sup> This consensus broke down in the interwar period, but the experiences of depression and war eventually resulted in a ‘shift in what we might call the balance between ‘authority’ and ‘market’ [that] fundamentally transformed state-society relations, by redefining the legitimate social purposes in pursuit of which state power was expected to be employed in the domestic economy’.<sup>54</sup> For Ruggie, this ‘embedded liberal’ compromise fundamentally distinguished American leadership from the British version that preceded it.

Nevertheless, it remains the case that British and American monetary leadership in their respective periods rested upon *relative* monetary conservatism. Britain, or more specifically the Bank of England, the City and the Treasury, adhered more strictly to monetary orthodoxy before 1914 than did the governments of Germany and France, whose more democratic political structures made them more sensitive to the real economic consequences of strict monetary orthodoxy.<sup>55</sup> The reason for this asymmetry is obvious: if a prospective monetary leader were not relatively conservative in orientation, it is unlikely private sector agents would be willing to follow in the initial stages. Money is, after all, a social convention whose value in exchange and as a store of value depends upon it being in comparatively short supply relative to other goods, services and assets.

Given the less conservative monetary reputation of the US after 1945, this argument may seem surprising. After the war, despite the impression given by some of the literature, America’s relative inflation performance after 1945 was exceptional for a few decades, particularly in the 1950s. It was comparable with that of West Germany and Switzerland and much better than Britain’s (figures 1 and 2 below). Nor should the degree to which the US in the 1960s achieved this good performance by exporting some of its monetary inflation abroad be exaggerated. After all, the Swiss and West Germans,

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49 In this case, ideology probably did not play an important part. It is clear from Volcker’s memoirs that he was not an ideological Monetarist, but rather a pragmatic central banker determined to put an end to the inflationary psychology that had become entrenched in the US in the 1970s (Volcker and Gyoten, *Changing Fortunes*, pp. 163-177).

50 Ruggie, ‘International Regimes’.

51 Ikenberry and Kupchan, ‘Socialization’.

52 Karl Polanyi, 1944. *The Great Transformation: The Political and Economic Origins of Our Time*. Boston: Beacon Press.

53 Gramscians tend to talk less of ‘norms’ than of ‘hegemonic ideologies’ and emphasize the coercive aspects of ideational power. See Stephen Gill, 1985. ‘Globalisation, market civilisation, and disciplinary neoliberalism’, *Millennium*, 24, pp. 399-423; Robert W. Cox, 1987. *Production, Power, and World Order: Social Forces in the Making of History*. New York: Columbia University Press.

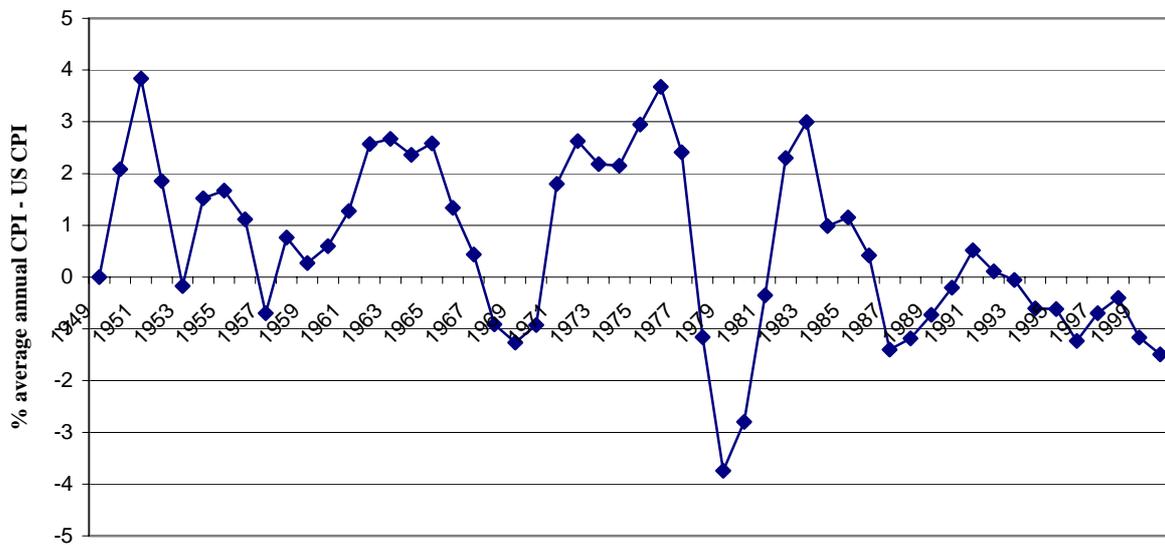
54 John G. Ruggie, ‘International Regimes’, p. 386.

55 Broz, ‘Domestic Politics’.

whose currencies tended to bear the brunt of dollar weakness, enjoyed good inflation performance through the mid-1960s despite rapid growth and considerable resistance to currency revaluation.<sup>56</sup>

Certainly, there was a general deterioration in inflation performance in the mid-1960s, but it is not until the late 1960s that US inflation begins to look ‘out of control’ by comparison with the low inflation Germans and Swiss (if not by British standards). By the early 1970s, the US reputation for relative monetary conservatism had well and truly been squandered, and the Swiss and Germans broke away from their inflationary dollar pegs. Surprisingly to many at the time, even then there was no general private (or public) sector abandonment of the dollar. In the late 1970s, with the US currency depreciating quickly and with the US government offering foreign currency-denominated bond issues and pondering (only to reject) the possibility of a ‘Substitution Account’, the dollar’s international position appeared to many to be under serious threat.<sup>57</sup> However, the dramatic tightening of monetary policy undertaken by a new Federal Reserve chairman, Paul Volcker, in retrospect proved sufficient to restore both the conservative monetary reputation of the Fed in the eyes of international financial markets and the international role of the dollar. By 1983, US inflation was back down to near-Germanic levels and has more or less stayed there since, despite periodic bouts of fiscal profligacy. The role of the dollar in private international financial markets has since undergone a minor secular decline, but it remains by some margin the leading international currency. This is in spite of the considerable swings in its value over time vis-à-vis other major currencies.

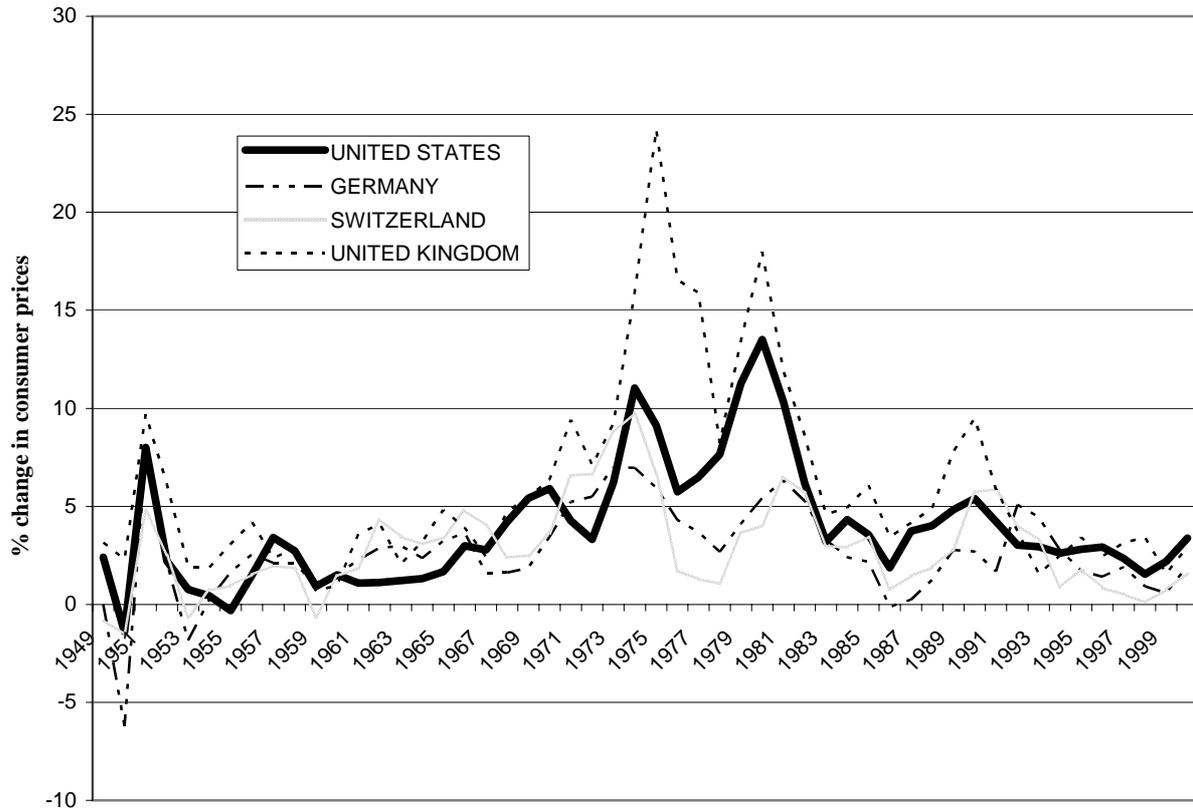
**Figure 1: Ten Major Economies: Average Inflation Differential Over US, 1949-2000**



Source: IMF, *International Financial Statistics*, CD-Rom. The 10 countries are Canada, Japan, Belgium, France, Germany, Italy, Netherlands, Sweden, Switzerland, and the United Kingdom.

56 The ‘burden’ of inflation in the Bretton Woods system fell largely on the commodity money, gold, the dollar (and D-mark) price of which came under growing pressure in the late 1960s and which soared in the 1970s.

57 Gowa, ‘Hegemons, IOs and Markets’, p. 664.

**Figure 2: US, West German, Swiss and British Inflation, 1949-2000**

Source: IMF, International Financial Statistics, CD-Rom.

Not only private sector agents, but follower monetary authorities also tend to expect relative (though not excessive) conservatism from monetary leaders. British governments fulfilled such expectations before 1914 and tried, at great cost to the domestic economy and ultimately in vain, to do so over 1925-31. Those countries that followed the US after 1945 also expected conservatism from the center. This was obscured during the period of the post-war 'dollar shortage', but from around 1951 other governments came to rely heavily on relative US monetary conservatism. Indeed, in the debates over the problems of the gold-exchange standard in the 1960s, it often seemed as if the Europeans expected the US to sacrifice its own domestic growth and employment goals in order to shore up both the system and their own economic strategies.<sup>58</sup> This may seem hypocritical, since most European countries were at the time engaged in full employment and high growth policies that also had inflationary consequences. Ruggie (1982: 408) is right that the end of gold-dollar convertibility was consistent with the maintenance of embedded liberalism, but followership in the Bretton Woods system was also based on a US commitment—and a related follower expectation—precisely *not* to exploit the full possibilities of American monetary autonomy. Ultimately, this bargain proved unsustainable, and not surprisingly so.

This asymmetry of expectations persisted well after the demise of the gold-exchange standard system. It was evident in European and Japanese proposals for an SDR standard in the international monetary reform negotiations over 1972-74.<sup>59</sup> When European countries again tried to convince the

58 President de Gaulle would have retorted that the US needed only to scale back its imperialist ambitions abroad. However, most European governments also strongly favored a continuing American troop presence on their continent, possibly even France's. Japan's did as well.

59 John Williamson, 1977. *The Failure of World Monetary Reform, 1971-74*. New York: New York University Press.

US to move towards an SDR standard via the Substitution Account proposal in the late 1970s, the emphasis was still on the need for the US to adopt relatively conservative monetary policies for the general good. The views of a German economist writing at the time would have been widely shared by central bankers and finance ministers in other major countries:

[...] [M]onetary stability [...] can only be achieved by an economic policy which engenders trust and convinces the market that the world's major currency is once again capable of exercising its function as a store of value.<sup>60</sup>

The IPE literature has commonly seen Johnson's 'Great Society' program and pro-growth policies as key reasons for the eventual breakdown of the system, even though they reflected a normative *convergence* on the part of the US towards broad European objectives.<sup>61</sup> Ronald McKinnon, an American economist and a proponent of a formal dollar standard in the 1960s, argued that 'America's principal international monetary obligation was not the *pro forma* link to gold but rather to maintain stable dollar prices of internationally tradable goods as well as an open capital market'.<sup>62</sup> This encapsulates well the conservative 'obligation' of the currency leader from the point of view of the followers, public and private sector alike. What was so shocking to America's allies was that after Eisenhower, the US government increasingly seemed ready to abandon this 'good economic housekeeping' for objectives the followers shared!<sup>63</sup> By the time of Nixon, the US went to war on such double standards. As John Connally, Nixon's abrasive Treasury Secretary, memorably said in 1971, 'the dollar may be our currency but it's your problem'.<sup>64</sup>

It might be argued that this interpretation is inconsistent with the West German position, especially that of the conservative Bundesbank. However, political resistance in Germany to currency revaluation was strong, both in the Bundesbank and in the influential banking and industrial sectors. A majority on the Bundesbank council resisted pressure from the West German government in 1971 to move to a floating rate system, instead favouring exchange rate fixity with the dollar and capital controls as a means of remaining within the Bretton Woods system.<sup>65</sup> Even in the Bundesbank, then, the incentives to continue to follow the American leader remained strong until the last great dollar crisis of the Bretton Woods system in March 1973.<sup>66</sup> By then, the US had forfeited its claims to monetary conservatism in German eyes and had joined the ranks of the merely average OECD country.

West Germany's role in the subsequent moves towards European monetary integration also supports the argument made here. Through the 'snake' and later the European Monetary System (EMS), West Germany made a successful bid for European monetary leadership that lasted for about two decades (though the precise number of followers fluctuated considerably over time). Although other Europeans often complained about the Bundesbank's 'obsession' with low inflation, the Bundesbank and the D-mark increasingly consolidated their undisputed leadership positions within the European system. In the French franc crisis of 1982-3, President Mitterand finally opted to follow the German leader by reversing his earlier expansionary policies and pursuing a policy of convergence through the 'franc fort' policy.

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60 Dieter Gehrman, 1980. 'Substitution Account: No Solution for International Monetary System', *Intereconomics*, 3 (May-June), p. 114, cited in Gowa, 'Hegemons, IOs and Markets', p. 665, fn.16.

61 E.g.: David P. Calleo, 1982. *The Imperious Economy*. Cambridge, MA: Cambridge University Press, p. 35.

62 Ronald I. McKinnon, 1979. *Money in International Exchange: The Convertible Currency System*. New York: Oxford University Press, p. 261.

63 John L. Gaddis, 1982. *Strategies of Containment*. Oxford: Oxford University Press.

64 Cited in Harold James, 1996. *International Monetary Cooperation Since Bretton Woods*. Washington D.C. and New York: IMF/Oxford University Press, p. 210.

65 David Marsh, 1992. *The Bundesbank: The Bank that Rules Europe*. London: Mandarin, pp. 180-193; James, *International Monetary Cooperation*, pp. 214-216.

66 Among these incentives, in addition to those already mentioned, may have been the deep elite acceptance of American values that flowed from the post-war US-dominated occupation and reconstruction of West Germany. See Ikenberry and Kupchan, 'Socialization', p. 304.

The main threat to the EMS came in the wake of German reunification, when a ballooning fiscal deficit threatened the Bundesbank's monetary conservatism. In 1993, in a moment of hubris or desperation, the French government made the mistake of suggesting that the French franc should succeed to currency leadership within Europe (the so-called '*grande gaffe*'). The argument assumed that the French were now *more* monetarily conservative than the Germans.<sup>67</sup> Private market agents, the ultimate arbiters, did not agree, looking to Bundesbank leadership that the latter was willing to provide. This episode also suggests, as does the American case of fiscal profligacy since the 1960s, that fiscal balance is less important to monetary leadership *vis-à-vis market agents* than is the absence of monetary accommodation. Indeed, currency leadership can make it easier for the leader to finance domestic dis-saving by borrowing from abroad. However, large fiscal deficits in the center country, by raising real interest rates in the entire system, erode the legitimacy of the monetary leader *vis-à-vis other countries*. Thus, the first prerequisite of international monetary leadership might be extended to 'conservative macroeconomic policy' in general, but monetary conservatism is most important. It is also clear that monetary conservatism is a relative rather than an absolute concept; its meaning depends considerably upon the intellectual climate of the time.

### Monetary Leadership, Power, and their Limitations

As the cases of the US since the 1960s and Germany in the early 1990s suggest, established monetary leaders can exert substantial power in the international monetary system. Others have described how monetary conservatism, particularly in the German case, deflected adjustment costs onto others.<sup>68</sup> Such power derives primarily from the way in which private market agents favour the lead currency. Here, I focus on another kind of monetary power, which is the ability of the leader to depart from the first prerequisite of monetary leadership, a credibly conservative monetary policy. What are the limits to this kind of monetary power?

Once a currency leader is entrenched, the requirements for sustaining such leadership are less onerous than the initial prerequisites, and the potential for exercising coercive power over other actors is greater. As indicated earlier, this amounts to a form of monopoly power, since it is costly for other actors to shift from the use of the established lead currency to an alternative. The costs of switching will be especially high if there are large asymmetries in financial development that favour the currency leader. This consideration helps to explain why, despite the large fluctuations in the value of the dollar since 1973, there has been only a minor erosion of its position as the lead currency in the contemporary system. Network externalities compound the advantages that accrue to the lead currency, not least because its use by specialized private financial intermediaries is likely to deepen the existing cost advantages of transacting in this currency.

Clearly, the extent of such monopoly power depends upon the existence of rival lead currencies. The emergence of the US dollar in the interwar period as a serious rival to sterling substantially limited the ability of the UK authorities to exploit the monopoly power that derived from sterling's international position. Indeed, what is striking about UK policy in the 1920s is the extent to which policymakers felt constrained by their need to maintain market confidence in the peg with gold. In a sense, market agents were constraining the leader more than were other countries. As it became clear that Britain's political and economic institutions could no longer deliver a credibly conservative macroeconomic policy after the stresses of two major wars, sterling's international position was rapidly eroded *vis-à-vis* the dollar. Cultural factors slowed this decline: even in the mid-1960s,

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67 Eichengreen, *Globalizing Capital*, p. 174. In the same manner as Paul Volcker over 1979-80, the Bundesbank successfully put down this challenge at considerable cost to the German and European economies.

68 See Matthias Kaelberer, 2005. *Money, Markets and Power: Explaining Patterns of Pegged Exchange Rate Regimes*. EUI Working Papers RSCAS No. 2005/12.

formally independent countries like Australia continued to hold substantial sterling reserves, but this could not halt sterling's overall decline.

By contrast, there were no real rivals to the US dollar in the 1960s and 1970s. This, the large US economy's relatively low dependence on international trade, and America's position as alliance leader, increased the ability of American policymakers to depart from fiscal and later monetary conservatism and to deflect and delay the related adjustment costs. Similarly, the relatively unrivalled position of the D-mark in the last years of the EMS increased Germany's ability to depart from fiscal conservatism after 1990. However, given that the D-mark was not a real rival to the dollar, the Bundesbank could not afford a loose monetary policy of the kind the US Federal Reserve pursued in the 1970s.

The leader's continued exploitation of its monopoly power is likely to produce countervailing responses. As Henning<sup>69</sup> argues, EMU can be seen in part as a European response to the perceived mismanagement of the US economy and America's attempt to deflect adjustment costs onto others. Although the Euro is not yet a serious rival to the dollar,<sup>70</sup> America's continued exploitation of its dominant monetary position could eventually make it so. The time is long past when the US could use political linkage over its major allies to force them to maintain allegiance to the dollar. As we have seen, in the long run it is private market agents who are most important in terms of the maintenance of a lead currency's status. Financial liberalization in the major countries since the 1970s, encouraged by the US, has increased the options available to market agents and thereby reduced US monopoly power. In 1978-79, when private market agents seemed to be about to abandon the dollar, the US monetary authorities were forced into a dramatic policy reversal. There has since been no abandonment of this policy stance, with the debatable exception of 2002-4. In Europe in the early 1990s, market agents similarly looked for confirmation from the Bundesbank that its conservative monetary policy was not in question. Thus, in the longer run, the maintenance of currency leadership may require the centre country to pursue reasonably conservative monetary policies, even if not as strictly as at the outset of a bid for currency leadership.

Monetary power is also likely to be constrained in the longer run by the normative and institutional underpinnings of leadership itself. US monetary leadership after 1945 was founded upon a broad-based solidarity of western nations that was partly due to shared interests in the Cold War conflict and partly because of America's willingness to accept consensus language in the major post-war monetary and trade regimes and to manage disputes multilaterally. The implication of such US leadership was clear to all, since in playing this multilateral game America often found it had to foster followership by compromising on its initial demands.<sup>71</sup> This also signalled to the followers that America would not overly exploit its enormous power.

The Nixon shocks of the early 1970s represented a clear step away from legitimate leadership based upon persuasion within multilateral institutional frameworks towards hegemonic, often extra-institutional coercion. The acrimony that ensued over economic matters between the major countries reflected this shift. The US blocked international monetary reform efforts in the 1970s and from the 1980s more actively used the IMF and World Bank to promote structural 'reform' in the developing world. In the second half of the 1970s, the US government showed a willingness to exploit as it had never done before the potentialities of the international role of the dollar, during the era of so-called 'benign neglect'. Not-so-subtle threats over 1977-9 to other G-7 countries that the US would encourage further dollar depreciation if they failed to reflate their economies fell clearly into the category of hegemonic

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

70 Benjamin J. Cohen, 2003. 'Global Currency Rivalry: Can the Euro Ever Challenge the Dollar?', *Journal of Common Market Studies*, 41, pp. 575-95.

71 The argument that a commitment to multilateralism helps foster legitimate leadership and a greater inclination to followership by others is different to the mainly efficiency-based arguments concerning the virtues of international regimes in Robert O. Keohane, 1984. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton: Princeton University Press. Nevertheless, Keohane (p. 39) notes the importance of legitimacy in international leadership.

coercion.<sup>72</sup> This threat was credible because of America's sheer economic size and relatively low trade dependence, which meant that other economies lost more from dollar weakness than did the US.

However, the very credibility of the American threat further undermined the legitimacy of its monetary leadership in the eyes of major follower countries. The growing reluctance of Germany and Japan to accede to US pressure in a range of policy areas was a consequence. Perceived American coerciveness boosted Germany's desire to create with its European partners a 'zone of monetary stability' that would deepen the process of political integration in Europe.<sup>73</sup> Moves towards closer monetary and financial cooperation in Asia, although as yet with little effect on the position of the dollar, could in the long run further reduce American monetary power.

To summarize, the power that accrues to monetary leaders changes over time. It is very limited in the initial stages of a leadership bid, when the position of the currency depends upon self-constraint that is transparently embedded in domestic institutions. The leader's power peaks when its currency is successfully entrenched at the top of the currency pyramid. In a third phase, monetary power declines when the leader persists in exploiting its monopoly power and if this encourages the emergence of rival lead currencies. If, as in the British case in the 20<sup>th</sup> century, the institutional foundations of currency leadership are not restored, this is eventually likely to prove fatal to the maintenance of such leadership and to monetary power itself.

## Conclusion

I have argued that monetary leadership requires a relatively (but not excessively) conservative macroeconomic policy from the leader. Many leading theories of international leadership have failed to recognize both this systemic asymmetry and its origins in domestic politics and institutions. The leader's conservative policy needs to be credible, which means firmly embedded in domestic political and institutional arrangements. Fundamental changes in the nature of this domestic institutional framework can eventually undermine the foundations of successful currency leadership, as in Britain after World War I. Particular kinds of domestic institutions, including limited government and pro-creditor legal frameworks, also helped to foster highly developed capital markets, themselves a prerequisite for currency leadership.

The policy credibility of the monetary leader provides incentives on the part of both public sector and private sector actors to follow. Such followership creates substantial potential benefits (power) to the monetary leader, though there are limits on its ability to exploit these 'hegemonically' in practice without undermining the very foundations of its leadership. The extent of these limits will depend upon the degree of asymmetry of financial development in the world economy, the existence of potential rival lead currencies, and the ability of the lead country to use political linkage to ensure its continued leadership.

Does the advent of the euro create a new challenge to the primacy of the dollar that will reduce the ability of the US to exploit its dominant position? Cohen<sup>74</sup> argues the euro does not represent a serious challenge to the position of the dollar. In contrast to the argument made here, Cohen suggests that the monetary conservatism inherent in the constitution of EMU will limit returns on euro assets, reducing the attractiveness of the currency and offsetting the benefits of holding a 'hard' currency. He also argues that the ambiguous division of policy responsibility between the ECB and the Council of Ministers reduces the euro's credibility.

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72 Walter, *World Power*, pp. 216-23.

73 Kenneth Dyson, 1994. *Elusive Union: The Process of Economic and Monetary Union in Europe*. London: Longman, pp. 303-4.

74 Cohen, 'Global Currency Rivalry'.

However, it may be debated how much low long run growth in Europe is due to its monetary constitution and how much it is due to other factors, including inflexible factor and product markets.<sup>75</sup> After all, pre-1914 Britain did not have a pro-growth monetary constitution, and nor did West Germany after 1949, which enjoyed high growth for decades. Even when German growth slowed substantially after 1980, the D-Mark still became the lead currency within Europe. Furthermore, the nature of the US Federal Reserve System is itself not entirely transparent and unambiguous: Faust<sup>76</sup> finds its governance structure ‘bizarre’.

Nevertheless, as Cohen and others suggest, a number of other factors work against the euro, including inertia in international financial markets and low financial integration in Europe. Indeed, until now, in spite of the impressive growth of euro bond markets, there is no evidence yet of a dramatic shift against dollars in favour of euros either in international financial markets or in central bank reserves.<sup>77</sup> As argued above, the relatively underdeveloped nature of financial markets in continental Europe generally compared to those in the US and UK is a major obstacle to European monetary leadership. What Europe still lacks is a truly European, euro-based integrated financial market that can rival those of the US. London’s common law system and transparent, credible monetary and financial regulatory framework provides it with substantial advantages over the rest of Europe in this regard. Even if the UK joins EMU, however, the segmentation of government bond markets in Europe will remain a major constraint upon the euro’s international role for the foreseeable future.

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75 Cohen, ‘Global Currency Rivalry’, p. 585. Later (pp. 587-8), Cohen accepts that non-monetary factors do matter.

76 Faust, ‘Whom Can We Trust to Run the Fed?’.

77 Cohen, ‘Global Currency Rivalry’, p. 580; IMF, 2003. *Annual Report*. Washington, D.C.: IMF, Appendix 1.