CHAPTER SEVEN

Currency and Coercion in the Twenty-First Century

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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, or what this volume terms monetary statecraft—have emphasized the experiences of the twentieth century, and in particular the years 1914–89, the period between World War I 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 statecraft? In particular, has financial globalization—that is, the presence of very large, integrated and influential currency markets—radically circumscribed the capabilities of states to practice monetary diplomacy? This chapter argues that although the consequences of globalized finance are profound, they recast rather than reduce the significance of monetary diplomacy in contemporary international relations. True, the analysis must shift from an almost exclusive focus on state-to-state interactions to one that places much greater emphasis on the relationship between states and markets. But 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.

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1. See for example Paul Einzig, *Behind the Scenes of International Finance* (London: Macmillan, 1931); Charles Kindleberger, "The International Monetary Politics of a Near-Great Power: Two French Episodes, 1926–1936 and 1960–70," *Economic Notes,* no. 1 (1972): 30–44; Jonathan Kirshner, *Currency and Coercion: The Political Economy of International Monetary Power* (Princeton: Princeton University Press, 1995). For a good critique of this literature, see Benjamin Cohen, "Money and Power in World Politics," in *Strange Power: Shaping the Parameters of International Relations and International Political Economy,* ed. Thomas C. Lawton, James N. Rosenau, and Amy C. Verdun, 91–113 (Aldershot, UK: Ashgate, 2000).

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 for the political analysis of monetary relations, one aspect of the intensification of economic exchange—financial globalization—is of paramount concern. To be clear, the analysis that follows does *not* presume that globalization is novel, irreversible, or irresistible. Rather, the point of departure is that it is here now and that it matters.[2] Second, contemporary globalization takes place in a specific political context, that of U.S. preponderance or unipolarity. Space constraints do not permit a lengthy elaboration of its consequences, but 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 chapter proceeds in three parts, with sections that consider how globalization (and also unipolarity) recast the practice of currency manipulation, monetary dependence, and systemic disruption—the three principal instances of money statecraft that I consider in *Currency and Coercion.*[4] For each of these, I use a number of cases from the period since the end of the Cold War to demonstrate that although financial globalization is important in transforming the nature of monetary diplomacy, it does not reduce the significance of monetary power as a feature of world politics. The goals of this chapter are therefore to illustrate the continued role of monetary power and to assess the transformation of monetary statecraft that results from these changes in the global political and financial environment.

Currency Manipulation

Of the three aspects of monetary power mentioned above, 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, in most cases it will certainly be much more challenging for even the most powerful states in the system to successfully engage in the archetypical act of predatory currency manipulation—selling a target's currency on the open market to force depreciation as an act of coercion. The ratio

2. As David M. Andrews has argued, financial globalization (or more specifically, the level of capital mobility) "systematically alters state calculation and behavior." "Capital Mobility and State Autonomy: Towards a Structural Theory of International Monetary Relations," *International Studies Quarterly* 38, no. 2 (1994): 193–218, quotation on 202.

3. On globalization generally, see David Held, Anthony G. McGrew, David Goldblatt, and Jonathan Perraton, *Global Transformations: Politics, Economics and Culture* (Stanford: Stanford University Press, 1999). 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 *Globalization and National Security,* ed. Jonathan Kirshner (forthcoming).

4. I referred to these as types of monetary power in *Currency and Coercion.* Although I retain my original taxonomy, these concepts can be mapped onto the framework outlined by David Andrews (chap. 1 in this volume).

of government reserves to market transactions has diminished considerably (to the disadvantage of states), limiting the ability of governments, 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 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 influence the prospects for successful manipulation.[5] This remains the case, and obviously under globalization the 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, whereas efforts to nudge more robust currencies against the wind of market sentiment will be even less likely than ever to bear fruit. This observation, it should be noted, is consistent with the conclusions drawn by C. Randall Henning (chap. 6 in this volume). But the greater importance of market sentiment and market response, although reducing the vulnerability of some currencies, in fact 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.[6] In addition, there are techniques of predatory manipulation other 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. Realizing these objectives requires measures to sustain 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. For example, these new vulnerabilities will almost 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. In addition, the proliferation of currencies and greater political contestation (especially in weak states) suggest 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 protective and predatory. Indeed, despite the fact that predatory currency manipulation has been relatively rare in history, even this form of "good old-fashioned" currency manipulation has

5. Kirshner, *Currency and Coercion,* 31, 37–38.

6. The International Monetary Fund catalogs 146 separate currencies, with forty-one countries participating in "exchange agreements with no separate legal tender." International Monetary Fund, *Annual Report on Exchange Arrangements and Exchange Restrictions 2003* (Washington D.C.: IMF, 2003), 9–10.

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 conflict were aimed at Saddam Hussein's regime, as Iraq was especially vulnerable to currency manipulation due to an (unintended) consequence of UN sanctions. This, coupled with the vast array of hostile neighbors surrounding Iraq (with the sole 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."[7] Although 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. (As is the practice of many states, Iraq had previously contracted out the production of its currency to foreign firms that specialized in the business.[8])

That the dinar was being counterfeited is beyond doubt; exactly who was behind the operation (or, perhaps, who was not) is less clear. The United States was most often considered to be the chief counterfeiter, under the auspices of the Central Intelligence Agency (CIA) scheme known as "Operation Meseraagh," (the Arabic word for laundry). This was certainly more than plausible; the United States 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.[9] But other reports claimed that separate operations were initiated by Saudi Arabia, Iran, and Israel, to name but a few.

Certainly there was a great deal of counterfeiting going on. Sixty miles south of the Arctic circle in the sleepy Swedish town of Pitea, for example, 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 "Ibrahim S."—was simply in it for the money and planned to pass the notes in European exchange markets. No charges were brought against the representatives of the print-

7. "Iraq Combats Forgery of Its Currency," *Xinhua General News Service,* November 2, 1991.

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

9. Robert W. Chandler, *War of Ideas: The US Propaganda Campaign in Vietnam* (Boulder: Westview Press, 1981), 117, 123.

ing plant on the grounds that "the prosecution believes they were misled"—suggesting that, had the counterfeiting of the Iraqi dinar truly been in the service of the Kurdish cause, it would have been perfectly legal in Poland.[10]

Whatever the source, the notes were easily smuggled across the Jordanian, Saudi, Turkish, and Iranian borders and contributed to Iraq's monetary disorder, exacerbating an inflation already fueled by the government's excessive recourse 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 was fake. The regime made numerous efforts to address the challenge, including the introduction of a new denomination, the 5-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 counterfeiting was made a capital crime (although this last measure was admittedly less extraordinary in context).[11]

Iraq found itself vulnerable to currency manipulation not only because its currency was so easily forged; there was also the problem of the so-called Swiss dinars—Iraqi currency that had been produced in Europe before the war and was 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 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 market to create instability in the rate of exchange between the two dinars. The government explicitly accused Saudi Arabia and Kuwait of accumulating billions of Swiss dinars, which Iraqi state-run radio described as "time bombs" that could be used to sabotage the economy.[12]

Parry and Thrust: The Iraqi Currency Exchange

Seizing the initiative, on May 3, 1993, Saddam Hussein's government announced a new currency maneuver. Effective immediately, all 25-dinar notes printed before

10. Youssef M. Ibrahim, "Fake-Money Flood Is Aimed at Crippling Iraq's Economy," *New York Times,* May 27, 1992, p. A1; Robert Aaron, "Is the CIA Flooding Iraq with Fake Dinar Bills?" *Toronto Star,* July 18, 1992, p. K4; "Fake Iraqi Cash Claim," *Herald Sun,* March 16, 1992; Kevin McKiernan, "Kurdistan's Season of Hope," *Los Angeles Times Magazine,* August 23, 1992 (which reported that "both the CIA and Iran [are] flooding Iraq with phony bills"); Ireneusz Dudziec, "Iraqi Dinars Forged in Poland," *Polish News Bulletin,* October 5, 1992; Associated Press, "Police: Ring Printed Counterfeit Iraqi Dinars," November 3, 1992.

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

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

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 for local dinars. The border closure was so abrupt that hundreds of travelers were stranded on both sides of the Iraqi-Jordanian border, Iraq's only open international frontier and its sole access to international markets (normally traversed by 1,000–2,000 Iraqis each day).[13]

The emergency measure was initially interpreted as last-gasp defensive maneuver, a "sign of desperation" and "evidence that the economy was crumbling under sanctions."[14] But it very quickly became clear that Hussein's parry was at the same time a powerful thrust, 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. 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.[15]

The Jordanian government appealed to Iraq to allow Jordanians to exchange their canceled notes, or at least to provide some compensation to those who collectively had lost an estimated $250 million. But Baghdad's 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; indeed, if anything, the reverse was true. The use of Iraqi currency in Jordan had been 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. In fact, reports circulated that Baghdad had smuggled huge amounts of Swiss notes

13. David Hirst, "Iraq Closes Border to Rescue Currency: Hundreds of Travellers Stranded on Jordanian Frontier," *Guardian* (London), May 6, 1993.

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

15. Chris Hedges, "Fortunes in Iraqi Bills Gone Overnight," *New York Times,* May 16, 1993; Ed Blanche, Associated Press, "Iraq Invalidates 25-Dinar Banknotes, Closes Borders," May 5, 1993; Reuters, "Jordanians Mock Worthless Iraqi Banknotes," May 6, 1993; Agence France Presse, "Two Die of Heart Attacks over Iraqi Dinar Crisis," 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.

into Jordan and exchanged them for dollars just days before they were declared invalid.[16]

Not surprisingly, the move led to considerable bitterness in Jordan, which had, almost alone, supported Iraq in the Gulf War (providing 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 being an oversight, Baghdad's currency maneuver appears to have been purposely directed, at least in part, 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. In numerous statements and interviews that were widely interpreted as suggesting that perhaps it was time for Saddam to go, the king had been calling for pluralism, democracy, and respect for human rights in Iraq. Baghdad's monetary stab in the back was designed either to serve as a warning to King Hussein or, having assessed that the relationship could not be salvaged, as part of an effort to bring down his regime. (This would also explain why Iraq took the additional measure of halting oil shipments to Jordan during the week the border was closed.[17]) Whatever its motivation, the move brought about a rupture in Jordanian-Iraqi relations as the king, 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.[18]

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 thus repudiating the claim those notes once held on Iraqi goods and services), it also sealed one of its internal borders. 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 hence prohibited from participating in the currency exchange. Because 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.[19]

16. "Jordanian Columnist: Ban the Dinar," *Mideast Mirror,* May 7, 1993; United Press International, "Iraq Shuts Border to Canceled Currency," May 10, 1993; "Amman Stops Iraqi Dinar Dealings, with Jordan Times Questioning the Wisdom of Relying on Iraqi Oil," *Mideast Mirror,* May 10, 1993.

17. "King Hussein Urges End to Saddam's Rule," *Toronto Star,* November 8, 1992, p. B8; Hedges, "Fortunes in Iraqi Bills Gone Overnight"; "Amman Stops Iraqi Dinar Dealings"; United Press International, "Iraq Shuts Border to Canceled Currency."

18. Agence France Presse, "King Hussein Invited to White House in June," May 19, 1993; "King Hussein Says he Cannot Continue Supporting Baghdad," *Mideast Mirror,* May 24, 1993; "Jordan's King Urges Press to Jilt Saddam," *Guardian* (London) May 26, 1993, p. 10; Ruth Sinai (Associated Press), "Jordan's Hussein Calls for Democracy in Iraq," June 22, 1993.

19. This technique was used with great effectiveness by the central government in Nigeria during its civil war with Biafra in 1968. See Kirshner, *Currency and Coercion,* 102–6.

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 UN that this "new economic war against Kurdistan" threatened the region with "economic devastation." By one estimate, one-third of the region's wealth "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.[20]

The Kurdish leadership faced multiple dilemmas. For 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 the Kurds 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."[21]

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 formally requested 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 toward 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; after all, inflation in Turkey was galloping along at 60 percent and the Turkish currency was no model of stability.[22]

Ultimately, inertia carried the day, and the Iraqi Kurds carried on with the Swiss

20. Agence France Presse, "Iraqi Kurds Seek Ways of Countering Baghdad's Monetary Moves," May 6, 1993; Hugh Pope, "Saddam's Dinar Ploy Bankrupts Kurds," *Independent* (London), May 15, 1993; Clare Pointon, "Banned Dinars Send Kurds Economy into a Tailspin: Leaders Need Western Backing to Continue to Use Currency," *Guardian* (London), May 10, 1993; Agence France Presse "Iraq Dinar Kurds."

21. Pointon, "Banned Dinars"; John Murray Brown, "Kurds Seek Access to Turkish Lira," *Financial Times,* May 28, 1993, p. 6; Agence France Presse, "Iraq Claims Triumph"; "Ankara Divided over Kurdish Request for Circulation of Turkish Lira in Northern Iraq," *Mideast Mirror,* May 18, 1993.

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

dinar because the creation of a Kurdish currency remained too politically explosive while local currencies such as the Iranian riyal and the Turkish lira struggled with their own weaknesses and instability. The Swiss option was never satisfactory, however, especially because the notes diminished through wear and tear could not be replaced, creating a constant monetary shortage. In 2002, as an "emergency interim measure," the Kurdish authorities reintroduced stores of Swiss-printed 1-dinar notes that had long been retired; also U.S. dollars were used to buy up Swiss notes still in the hands of Turkish and Iranian merchants. Meanwhile, there remained the constant fear that Saddam Hussein (or, for that matter, the Iranians or the Syrians, as some rumors held) might dump the massive stores of Swiss notes he had held since the note exchange in an effort to cripple the Kurdish economy. The Iraqi government, on the other hand, periodically insisted 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 when the United States 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" circulating in the rest of the country.

Currency Manipulation under Globalization

As illustrated by these events, 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 this aspect of monetary statecraft.

First, as suggested by the Gulf cases, it seems likely that predatory currency manipulation will be even less viable than it was previously against currencies that are widely traded and widely held but perhaps even more viable against less commonly held and traded currencies (of which there are now more than ever before)—especially where markets are thin and incomplete. According to the Bank for International Settlements, trade in five currencies accounts for 85 percent of all foreign-exchange transactions; adding the next five brings the total to 92.55 percent.[23] That leaves the vast majority of the world's currencies susceptible to predatory manipulation.

Second, more subtly and more important, globalization will recast the ways in which currency manipulation is most commonly practiced. After all, predatory manipulation is only one part of the currency manipulation story and, perhaps, the part of the story that is the least affected by the need to shift from a state-to-state to a state-system perspective. With this shift, as many surveys of international finance

23. The next fifteen currencies share about 4 percent of the market, which means that the top twenty-five currencies account for 96.6 percent of all currency trades. The rest of the world's currencies account for the remaining 3.4 percent, with the largest individual share in this group accounting for one-twentieth of 1 percent. Bank for International Settlements, *Triennial Central Bank Survey: Foreign Exchange and Derivatives Market Activity in 2001* (Basel: Bank for International Settlements, 2002), 9; Bank for International Settlements, "Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2001: Preliminary Global Data," (press release) October 9, 2001, 6.

under globalization make clear, the system as a whole is more crisis prone and there is more, rather than less, politically consequential currency instability.[24] Under such conditions, the 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 in exchange for such help) as well as protective manipulation (the positive side of the same coin) proliferate in this context. The United States in particular is well placed to use its resources or to wield its enormous influence in international institutions, either to help out—or to fail to help out—those in distress. This will be a continuing, and likely even expanding, source of influence.

Monetary Dependence

The politics of international monetary arrangements centered around one currency are also transposed, not mitigated, by the consequences of unipolarity and globalization. Ironically, the relative increase in U.S. power generally since the end of the Cold War 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 United States, western Europe, and Japan.[25] The source of this emerging conflict is often misattributed; it is not that U.S. hegemony at the center of a stable Cold War alliance system allowed the United States, in particular, to disregard concerns for "relative gains." The pursuit of relative gains is not a function of anarchy—in fact, the pursuit of relative gains 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.[26] Rather, during the Cold War shared concerns for secu-

24. See, for example, Barry J. Eichengreen, *Financial Crises: And What to Do about Them* (Oxford: Oxford University Press, 2002); John Eatwell and Lance Taylor, *Global Finance at Risk: The Case for International Regulation* (New York: The New Press, 2000); Alexandre Lamfalussy, *Financial Crises in Emerging Markets: An Essay on Financial Globalisation and Fragility* (New Haven: Yale University Press, 2000).

25. Fred C. Bergsten, "America's Two Front Economic Conflict," *Foreign Affairs* 80, no. 2 (March–April 2001): 16–27.

26. The collective bargaining agreement of the National Basketball Association, for example, sets player's salaries at 48.04 percent of basketball-related income (BRI). But see, in contrast, Joanne S. Gowa, "Bipolarity, Multipolarity and Free Trade," *American Political Science Review* 83, no. 4 (December 1989):

rity 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 rein in behavior, economic conflicts will become more uninhibited. Not only will this 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.

Globalization will contribute further to this tendency by providing incentives for states to create, join, and support regional currency organizations. Again, this is more readily seen by shifting the focus from state-to-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. For these reasons among others, states will look to regional shelters from those monetary storms. For many states, ceding 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 behavior that has not changed as a function of either unipolarity or globalization is the efforts by states to extend their influence by situating themselves at the center of a regional monetary order. It remains difficult to quantify the benefits that states enjoy from such monetary leadership because the most important of these accrue from changes in perceived interests rather than from the exercise of overt coercion. This argument, which derives from Albert Hirschman's classic book *National Power and the Structure of Foreign Trade,*[27] is underappreciated in the literature on international relations. Hirschman was concerned with the political consequences of asymmetric economic relationships, and *National Power* illustrates this with a study of German trade strategy in the interwar period. Hirschman demonstrates, both theoretically and empirically, how asymmetric trade relationships can accrue political benefits to the larger state. For example, although trade between a large state and a small one can account for a very large percentage of the total commerce of the latter, it may represent only a fraction of the large partner's total trade. This asymmetry provides an imposing coercive lever because any interruption in the relationship will cause much greater distress in the small state than it will 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.[28] But there is much

1245–56; Joseph M. Grieco, "Understanding the Problem of International Cooperation: The Limits of Neoliberal Institutionalism and the Future of Realist Theory," in *Neorealism and Neoliberalism: The Contemporary Debate,* ed. David Baldwin, 301–38 (New York: Columbia University Press, 1993).

27. Albert Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley: University of California Press, 1980).

28. See, for example, Stephen D. Krasner, "State Power and the Structure of International Trade," *World Politics* 28, no. 3 (1976): 317–43.

more to Hirschman's *National Power* than a story about coercion; there is also an important argument about influence.[29] Hirschman does develop the mechanics of the former more fully and systematically, but he also illustrates the crucial significance of the latter.[30] In practice, this less visible mechanism is the more common—and the 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 it is most significant in asymmetric relations, in which 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 perceives 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. Participation in the agreement will, by definition, strengthen those who benefit from it relative to those who do not, but these effects are likely to be magnified in the smaller state. Consequently, as the external relationship is sustained, the reshuffling of power, interests, and incentives among firms, sectors, and political coalitions in the small state will increasingly reflect these new realities. 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 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."[31]

Although *National Power,* of course, focuses on trade relations, parallel arguments hold for currency arrangements as well.[32] It is 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 center of an international currency nexus that will be attractive to at least some potential participants.[33] The significance of this sort of structural power is addressed by Eric Helleiner (chap. 4 in this volume) and discussed by David Andrews (chap. 1 in this volume) under the rubric of micro-level aspects of monetary power.

The larger point is that both globalization and unipolarity create additional incentives for states capable of considering some form of monetary leadership. Globalization presents risks of 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

29. Rawi Abdelal and Jonathan Kirshner, "Strategy, Economic Relations, and the Definition of National Interests," *Security Studies* 9, no. 1–2 (autumn 1999–winter 2000): 119–56.

30. Hirschman, *National Power,* 18, 28, 29, 34, 37.

31. Ibid., 29.

32. See Kirshner, *Currency and Coercion,* 115–69.

33. Note that the pursuit of this objective—political influence—can inhibit the practice of overt coercion. See Kirshner, *Currency and Coercion,* 168–69, 244; Scott Cooper (chap. 8 in this volume).

nature of the agreement, opportunities for coordination that can enhance the collective policy autonomy of the group as a whole. Unipolarity not only reflects the absence of a common threat (which would inhibit discord); it also leads to the inclination, however subtle, to lean against or at least mitigate U.S. influence—yielding two additional incentives for states to seek politically countervailing monetary arrangements. Thus, the stage is set for an increase in competition for monetary influence and for the coalescing of new monetary relationships. To be clear, this need not imply economic closure, draconian discrimination, or continuous economic warfare between competing centers 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.

Competition for Monetary Influence in Asia

Japan's efforts (especially since the Asian financial crisis) to exert regional monetary influence, and the fierce opposition of both the United States and China to those efforts, reflect the high stakes involved in the struggle for monetary influence.[34] Since the late 1980s, Japan harbored aspirations to a greater leadership role in international monetary affairs to enhance its international influence and 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 that argued that an internationalized yen might insulate Japan from the increasingly crisis-prone system; moreover, there was broad dissatisfaction with the response of the International Monetary Fund (IMF) (and by implication, the United States) to the Asian financial crisis. Whereas 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 IMF, however, would en-

34. C. Randall Henning (chap. 6 in this volume) also addresses this case, but focuses less on its geopolitical dimensions than does the analysis here.

35. On Japan's increasing assertiveness in the late 1980s, see Eric Helleiner, "Japan and the Changing Global Financial Order," *International Journal* 47, no. 2 (spring 1992): 434–37.

36. Kiichi Miyazawa (Japanese minister of finance), "Towards a New Financial Architecture," speech delivered at the Foreign Correspondents Club of Japan, December 15, 1998, http://www.mof.go.jp/english/if/e1e057.htm; Eisuke Sakakibara (Japanese vice minister of finance), "Reform of the International Financial Architecture," speech delivered at the Symposium on Building the Financial System of the Twenty-First Century, Kyoto, Japan, June 25, 1999, http://www.mof.go.jp/english/if/if004.htm; Haruhiko Kuroda (Japanese vice minister of finance), "Information Technology, Globalization, and International Financial Architecture," speech delivered at Foreign Correspondents Club of Japan, June 15,

tertain the notion that the crisis had an important international component or that perhaps some regulation of short-term capital flows was in order.[37]

The crisis thus reinvigorated dormant discussions in Japan about whether the time had come to promote the internationalization of the yen more aggressively. Although Japan was interested in claiming a greater leadership role in the region, viewing the behavior of the United States and the IMF as "a direct challenge to their country's economic and ideological interests,"[38] 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."[39]

The most celebrated (and ill-fated) outcome of Japan's new assertiveness was Tokyo's proposal, floated in summer 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 loans to Asian states facing financial crisis without the types of conditions associated with IMF assistance.[40]

Leaders in both Tokyo and Washington understood that the stakes in 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 United States to be "caught by surprise" by the plan, which only heightened tensions—as one account stated simply, "American officials were enraged."[41] In the end, the original AMF proposal never got very far, mostly due to "heated" and "vehement" U.S. opposition,[42] although other factors played a role as well—including the strong op-

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2000, http://www.mof.go.jp/english/if/if018.htm. See also Michael Green, *Japan's Reluctant Realism: Foreign Policy Challenges in an Era of Uncertain Power* (New York: Palgrave, 2001), 259–60; Christopher Hughes, "Japanese Policy and the East Asian Crisis: Abject Defeat or Quiet Victory?" *Review of International Political Economy* 7, no. 2 (summer 2000): 241, 242.

37. Jonathan Kirshner, "Explaining Choices about Money: Disentangling Power, Ideas and Conflict," in *Monetary Orders: Ambiguous Economics, Ubiquitous Politics,* ed. Jonathan Kirshner, 270–79 (Ithaca: Cornell University Press, 2003).

38. Saori Katada, "Japan and Asian Monetary Regionalization: Cultivating a New Regional Leadership Role after the Asian Financial Crisis," *Geopolitics* 7, no. 1 (summer 2002): 86.

39. William Grimes, "Internationalization of the Yen and the New Politics of Monetary Insulation," in *Monetary Orders: Ambiguous Economics, Ubiquitous Politics,* ed. Jonathan Kirshner (Ithaca: Cornell University Press, 2003), 173, 181 (second quotation, emphasis in original), 185 (first quotation). See also Paul Bowles, "Asia's Post-Crisis Regionalism: Bringing the State Back In, Keeping the (United) States Out," *Review of International Political Economy* 9, no. 2 (summer 2002): 231, 248.

40. Eric Altbach, "The Asian Monetary Fund Proposal: A Case Study of Japanese Regional Leadership," Japan Economic Institute Report no. 47, December 19, 1997; Fred Bergsten, "Reviving the Asian Monetary Fund," *International Economics Policy Briefs* 98, no. 8 (1998).

41. Green, *Japan's Reluctant Realism,* 230–31, 245 (first quotation), 248; Paul Blustein, *The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF* (New York: Public Affairs, 2001), 165–66 (second quotation).

42. Altbach, "Asian Monetary Fund Proposal," 2, 10. See also Eric Helleiner, "Still an Extraordinary Power, but for How Much Longer? The United States in World Finance," in *Strange Power: Shaping the Parameters of International Relations and International Political Economy,* ed. Thomas C. Lawton, James N. Rosenau, and Amy C. Verdun, 229–48 (Aldershot: Ashgate, 2000), quotation on 236; Philip Lipscy,

position of China. Like Washington, Beijing 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.[43]

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 center 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 modest and bowed to political realities; they were coordinated with both the United States and the IMF. But they reflected the underlying motivations that contributed to the original AMF proposal: a push for a greater international role for the yen in the wake of the instabilities reflected by the Asian financial crisis and, at the same time, an attempt to counter the influence of the United States and the IMF in Asia. In other words, they reflected Japan's reactions to globalization and unipolarity.[44]

The continuing divergence between Japan and the United States on questions of monetary order was reflected in their dramatically different responses to Malaysia's September 1998 decision to impose capital controls in response to the Asian financial crisis.[45] While officials from the United States and the IMF heaped scathing criticism on the Malaysian government, Japan fully supported the measure. In December, Japanese Finance Minister Kiichi Miyazawa stated publicly that in some cases it was appropriate to reintroduce or "maintain market friendly controls," and

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"Japan's Asian Monetary Fund Proposal," *Stanford Journal of East Asian Affairs* 3, no. 1 (spring 2003): 93; Christopher Johnstone, "Paradigms Lost: Japan's Asia Policy in a Time of Growing Chinese Power," *Contemporary Southeast Asia* 21, no. 3 (December 1999): 377.

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

44. Saori N. Katada, "Determining Factors in Japan's Cooperation and Non-Cooperation with the United States: The Case of Asian Financial Crisis Management, 1997–1999," in *Japanese Foreign Policy in Asia and the Pacific: Domestic Interests, American Pressure, and Regional Integration,* ed. Akitoshi Miyashita and Yoichiro Sato (New York: Palgrave, 2001), 155–74. 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 (161, 162, 169). See also Hughes, "Japanese Policy," 245–47; Bowles, "Asia's Post-Crisis Regionalism," 239, 240; Lipscy, "Japan's Asian Monetary Fund Proposal"; Council on Foreign Exchange and Other Transactions, "Internationalization of the Yen for the 21st Century," April 20, 1999, http://www.mof.go.jp/english/if/e1b064a.htm. On the Chiang Mai initiative, see C. Randall Henning, "East Asian Financial Cooperation," Policy Analyses in International Economics no. 68, Institute for International Economics, Washington, D.C., 2002; Hennings (chap. 6 in this volume).

45. On this episode, see Rawi Abdelal and Laura Alfaro, "Malaysia: Capital and Control," case no. N9-702-040, Harvard Business School, March 14, 2002; Prema-chandra Athukoralge, *Crisis and Recovery in Malaysia: The Role of Capital Controls* (Cheltenham, UK: Edward Elgar, 2001); Mark Beeson, "Mahathir and the Markets: Globalization and the Pursuit of Economic Autonomy in Malaysia," *Pacific Affairs* 73, no. 3 (2000): 335–51.

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 as well as from other parts of Asia.[46] 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 currencies, 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 the incumbency advantages enjoyed by the dollar will delay this development, it is solely a matter of time; and some developments suggest that the euro may be gaining firmer footing, such as reports that some Asian central banks may increase their euro-denominated holdings.[47]

Others, such as Benjamin Cohen, remain skeptical 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 "world's currency"; for example, there is an anti-growth bias in management of the euro, rendering euro-denominated assets less attractive. Furthermore, as Kathleen McNamara and Sophie Meunier have noted, the formation of the euro left the currency without a clear political representation on the world stage—a "single voice" for the euro in the international arena. Cohen also points out that exchange-rate movements tell 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 favor the dollar.[48]

The politics of monetary dependence will remain important regardless of how

46. Rudi Dornbusch, "Malaysia: Was It Different?" *NBER Working Paper* no. 8325 *National Bureau of Economic Research, Washington, D.C.*, June 2001, 1; Miyazawa, "New Financial Architecture," 3; Katada, "Japan and Asian Monetary Regionalization," 87 (quotation), 97; Abdelal and Alfaro, "Malaysia," 12.

47. Fred Bergsten, "The Euro versus the Dollar: Will There Be a Struggle for Dominance?" paper presented at the meeting of the American Economic Association, January 4, 2002; Mingqi Xu, "The Impact of the Euro on the International Stability: A Chinese Perspective," in *The Euro as a Stabilizer in the International Economic System*, ed. Robert Mundell and Armand Clesse (Boston: Kluwer Academic Publishers, 2000), 266. The IMF has also revised upward its estimate of the share of euros in foreign-exchange reserves; see International Monetary Fund, *Revised IMF Annual Report Data on Official Foreign Exchange Reserves* (Washington, D.C.: IMF, 2002).

48. Benjamin J. Cohen, "Global Currency Rivalry: Can the Euro Ever Challenge the Dollar?" *Journal of Common Market Studies* 41, no. 4 (2003): 575–95; Kathleen McNamara and Sophie Meunier, "Between National Sovereignty and International Power: What External Voice for the Euro?" *International Affairs* 78, no. 4 (2002): 850.

this competition plays out; however, a perspective that privileges the role of power in explaining monetary relations yields different predictions than do standard analyses. Rather than an incremental process, as suggested by both the euro-optimists and euro-pessimists already mentioned,[49] 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 the capital market deregulation associated with financial globalization is that the attractiveness of the dollar as an international asset—one of the pillars that supports the currency's dominance—may prove to be a double-edged sword. The United States has been empowered (relative to other states) by the process of financial globalization, yet at the same time it has become more vulnerable to financial crisis than at any time since World War II. In particular, the oceans of dollars held abroad—over $1 trillion—could serve as fuel to a fire started by a relatively moderate financial crisis involving the United States.

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 both inflation and the exchange rate. These flags will loom large if a moderate-size financial disturbance involving the United States takes place. At the same time, unipolarity has contributed to both U.S. unilateralism and to wariness of U.S. power in ways that create political space between the United States and many other parts of the world.[50] Should the dollar buckle, instead of a rush to preserve the status quo there might be a more subtle movement to recast the monetary order to the detriment of the United States.

Whether or not this dollar doomsday scenario occurs, what is of greater significance for present purposes is the explicit recognition 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."[51] States do and will continue to 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 in conjunction with the politics of unipolarity create additional incentives for this behavior. As Martin Feldstein has argued, there is "no doubt" that the real rationale for Economic and Monetary Union (EMU) is "political, not economic," as the aggregation of European resources provides some insulation from global instability while potentially providing an essential element of any political counterweight to the United States. This may become increasingly important if the divergent foreign pol-

49. See, for example, Benjamin J. Cohen, *The Future of Money* (Princeton: Princeton University Press, 2004), especially chap. 3.

50. Robert Jervis, "Understanding the Bush Doctrine," *Political Science Quarterly* 118, no. 3 (fall 2003): 365–88.

51. Hubert Zimmermann, "Ever Challenging the Buck? The Euro and the Question of Power in International Monetary Governance" (unpublished manuscript), Cornell University, 2003.

icy visions of the European Union and the United States create increasingly greater political space between the two entities.[52]

European monetary politics are also illustrative of a more general point. Regardless of the level of globalization, the geography of money—which 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; the economic costs and benefits offer little guide. Similarly, choices about dollarization in Latin America will also be made primarily in response to political factors because 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, hence, unlikely unless it becomes seen as necessary as a defensive move against an increasingly assertive euro or in the wake of a sudden realignment of the global monetary order.[53]

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 formal participants in EMU, twenty-nine countries have abandoned their own legal tender in favor of foreign currencies; another forty-two have fixed-peg arrangements against a single currency. These relationships create vulnerabilities that could conceivably be exploited by the monetary leaders in exceptional circumstances. In 1988, for example, the United States capitalized on Panama's use of the U.S. dollar as its legal tender, turning the Panamanian reliance on the greenback into an important economic weapon during the confrontation between the United States with the Manuel Noriega regime.[54] As previously discussed, however, the principal effect of such arrangements will be first to shape and then to reinforce political preferences in the weaker partners of these asymmetric relationships.

Systemic Disruption

Systemic disruption—threats to destabilize the system, in almost all cases in order to extort political side payments—also remains an important feature of international

52. Martin Feldstein, "The EMU and International Conflict," *Foreign Affairs* 76, no. 6 (November–December 1997): 60–73, quotations on 60, 72, 73; see also McNamara and Meunier, "Between National Sovereignty and International Power," 849; Cohen, "Global Currency Rivalry." On the possibility of emerging rifts between the United States and Europe, see Charles Kupchan, *The End of the American Era: US Foreign Policy and the Geopolitics of the Twenty-first Century* (New York: Knopf, 2002).

53. Marco del Negro, Alejandro Hernandez-Delgado, Owen Humpage, and Elizabeth Huybens, "Introduction: Context, Issues and Contributions," *Journal of Money, Credit and Banking* 33, no. 2 (May 2001): 310–11; Jurgen Schuldt, "Latin American Official Dollarization: Political Economy Aspects," in *The Dollarization Debate,* ed. Dominick Salvatore, James Dean, and Thomas Willett 238–65 (Oxford: Oxford University Press, 2003); Cohen, *Global Currency Rivalry,* in which he argues that "political considerations will be decisive" (236). See also Rawi Abdelal, *National Purpose in the World Economy: Post-Soviet States in Comparative Perspective* (Ithaca: Cornell University Press, 2001).

54. International Monetary Fund, *Annual Report,* 9. On Panama, see Kirshner, *Currency and Coercion,* 159–64.

relations.[55] 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 Thomas Schelling's analyses of the manipulation of risk.[56] The state-to-state version of this fable focuses on the occupants of the boat and the explicit negotiations among them—one state rocking the boat, the other protesting (or pretending not to care). In the state-system fable, by contrast, rather than overtly rocking, one state—the state with the power to set the boat's course—intentionally steers the craft toward stormy waters.

Still a story about the manipulation of risk and still risky business, this maneuver changes the underlying setting in a way that privileges the most powerful. Thus, strategic disruption under globalization is transformed from an instrument of economic coercion allowing second-tier powers to take on those at the top into an instrument of the powerful, whereby those mighty enough to alter the very the rules of the game do so in a way that the benefits the strong at the expense of the weak. In short, strategic disruption from below is replaced by strategic disruption from above.

Awareness of this type of structural power can help explain U.S. efforts to render illegitimate any forms of international capital control and, likewise, its efforts to promote complete and comprehensive domestic financial liberalization abroad in the absence of evidence to support the proposition 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 United States, given the hegemonic position of the U.S. economy. Despite the vulnerabilities previously discussed, the United States 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 a "flight to quality," with capital seeking refuge on perceived islands of relative stability such as the United States. Further, as the home of powerful private financial actors and with rich and deeply institutionalized domestic financial markets, the United States is especially well situated to thrive competitively in a world of deregulated international markets. For these reasons, the United States can afford to adopt a position of benign neglect in many cases of financial crises around the globe. Most pointedly, when crises do occur, given its resources and influence in international institutions such as the IMF, the United States can set conditions for those who seek help.[58] The resulting influence is clearly seen in the case

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

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

57. See Kirshner, "Explaining Choices about Money," especially 270–71.

58. On the international politics that sustain a system of economic instability, see Mark Blyth, "The Political Power of Financial Ideas: Transparency, Risk, and Distribution in Global Finance," in *Monetary Orders: Ambiguous Economics, Ubiquitous Politics,* ed. Jonathan Kirshner (Ithaca: Cornell University Press, 2003), especially 239, 256. Great power indifference is characterized as "benign neglect" in Graham Bird and Ramkishen S. Rajan, "The Evolving Asian Financial Architecture," Princeton Essays in International Economics no. 26, Princeton University, Princeton, N.J., 2002, 7.

of IMF policy toward South Korea in the wake of the east Asian financial crisis, as the next section describes.

International Instability and Korean Domestic Reforms

When the Asian financial crisis reached South Korea in the closing months of 1997, Seoul 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 was obviously related to the financial crisis, with provisions concerning the restructuring, prudential regulation, and transparency of the banking and financial sector. But the IMF insisted on a second set of reforms—including the elimination of ceilings on foreign holdings of bonds and equities, abolition of restrictions on foreign ownership of land, the dismantling of trade barriers and acceleration of capital account liberalization, and reduced restrictions on corporate borrowing abroad—that were just as clearly unrelated to the risk of financial crisis.[60]

The economic merits of this second set of measures have since come under criticism from many sources, including some mainstream ones. 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."[61] 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." This being the case, 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. Feldstein therefore 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.[62]

59. Uk Heo, "South Korea: Democratization, Financial Crisis, and the Decline of the Developmental State," in *The Political Economy of International Financial Crises: Interest Groups, Ideologies, and Institutions,* ed. Shale Horowitz and Uk Heo, 151–64 (London: Rowman and Littlefield, 2001); Kiseok Hong and Jong-Wha Lee, "Korea: Returning to Sustainable Growth?" in *The Asian Financial Crisis: Lessons for a Resilient Asia,* ed. Wing Thye Woo, Jeffrey D. Sachs, and Klaus Schwab, 203–25 (Cambridge, Mass.: MIT Press, 2000).

60. Chol-Hwan Chon (governor, Bank of Korea) and Kyu-Sung Lee (minister of Finance and Economy), "Letter of Intent of the Government of Korea," May 2, 1998, http://www.imf.org.external/np/loi/050298.htm. See also Ajai Chopra, Kenneth Kang, Merai Karasulu, Hong Liang, Henry Ma, and Anthony Richards, "From Crisis to Recovery in Korea: Strategy, Achievements, and Lessons," International Monetary Fund Working Paper WP/01/154, IMF, Washington, D.C., 2001, 55–56.

61. W. Max Corden, "The World Financial Crisis: Are the IMF Prescriptions Right?" in *The Political Economy of International Financial Crises: Interest Groups, Ideologies, and Institutions,* ed. Shale Horowitz and Uk Heo (London: Rowman and Littlefield, 2001), 59. Although offering a thoughtful and balanced assessment of the IMF's performance during the crisis, Corden reports "surprise" and even "amaze[ment]" at many of the provisions required by the letter of intent.

62. Martin Feldstein, "Refocusing the IMF," *Foreign Affairs* 77, no. 2 (March–April 1998): 24, 27, 31, 32. See also Jeffrey Sachs, "Fixing the IMF Remedy," *The Banker* (February 1998), 16–18; Ha-Joon

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 United States. For example, South Korea had always restricted foreign direct investment (FDI) and had also protected its financial service sector from foreign competition; the United States had been pushing for some time on these matters without success. U.S. export interests had likewise been pressing for greater access to the Korean market, another requirement of the IMF agreement. In sum, the measures required by Korea's letter of intent, as Robert Gilpin concludes, "included specific items that the United States had long demanded of Asian governments, and that the latter had rejected." Joseph Stiglitz states it more bluntly: the U.S. imposition of requirements from its trade agenda had little to do with the crisis and "was simply part of a crude power play."[63]

There are few observers in Asia (or elsewhere, for that matter) who do not see the IMF as an agent of U.S. influence; they regard bowing down to U.S. demands that the Korean market be opened as a quid pro quo for IMF assistance. The required structural reforms, according to Feldstein, touched on areas that were "among the most politically sensitive" in Korea.[64] Notably, U.S. government officials have not offered much that would contradict this perspective. It is widely understood that it was the United States 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 done more to promote America's trade and investment agenda in East Asia than 30 years of bilateral trade 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.[65]

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 United States and these efforts have been of profound importance.

Chang, Hong Jae Park, and Chul Gyue Yoo, "Interpreting the Korean Crisis: Financial Liberalization, Industrial Policy and Corporate Governance," *Cambridge Journal of Economics* 22, no. 6 (1998): 739.

63. Joseph Stiglitz, "Failure of the Fund: Rethinking the IMF Response," *Harvard International Review* 32, no. 2 (summer 2001): 18; Robert Gilpin, *The Challenge of Global Capitalism: The World Economy in the 21st Century* (Princeton: Princeton University Press, 2000), 157, 159.

64. Feldstein, "Refocusing the IMF," 25. See also Donald Kirk, *Korean Crisis: Unraveling of the Miracle in the IMF Era* (New York: Palgrave, 1999), 35 (where he refers to "egregious imperialistic meddling"), 36–38, 43, 46; John Mathews, "Fashioning a New Korean Model Out of the Crisis: The Rebuilding of Institutional Capabilities," *Cambridge Journal of Economics* 22, no. 6 (1998): 752. Stiglitz, "Failure of the Fund," reports that the IMF is perceived to be "dominated by the political interests of the U.S. Treasury," (17); see also Marcus Noland, "Japan and the International Institutions," paper presented at Macquarie University, Sydney, Australia, July 6–7, 2000, 8, 19.

65. David Hale, "Dodging the Bullet—This Time: The Asian Crisis and US Economic Growth during 1998," *Brookings Review* 16, no. 3 (summer 1998): 24, Summers's quotation on 26; *International Herald Tribune,* January 14, 1998 ("battering ram").

As U.S. Deputy Treasury Secretary Summers stated plainly, "financial liberalization, both domestically and internationally, is a critical part of the US agenda."[66] Encouraged by an ideological commitment to capital deregulation, the promotion of financial globalization is also a policy that serves U.S. geopolitical preferences. In the public assessment of Alan Greenspan, the Asian crisis offers evidence that "market capitalism, as practiced in the West, especially in the United States, is the superior model."[67] Although many in the United States have held this view for a long time, the end of the Cold War and U.S. preponderance have provided the opportunity to act on this belief. During the bipolar confrontation with the Soviet Union, the United States 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.[68] 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 theater of monetary statecraft will shift from disruption to dependence. In this scenario, the United States and other monetary leaders will make efforts to cultivate influence with followers and will pursue more subtle, economically generous strategies, á la Hirschman, of entrapment—and thus be more cautious with naked monetary coercion. Until that time, however, a monetary power perspective expects the United States to continue to promote global financial liberalization and to take political advantage of those financial crises that do occur, following a strategy, á la Schelling, of parlaying that riskier environment that enhances U.S. interests relative to those of other states.

Conclusion

As suggested here, the politics of U.S.–boat rocking is most transparent when it is understood that the economic merits of complete financial globalization are ambiguous. That is, although capital mobility is generally economically efficient, the balance of evidence suggests that the optimal level of controls on the international movement of capital is greater than zero. Thus, the vehement reaction of U.S. officials to the Malaysian controls, declaring that "it would be a catastrophe" if other countries followed suit, makes little sense if the analysis is limited to economic costs and benefits.[69] The political benefits of financial globalization, on the other hand,

66. Quoted in Devesh Kapur, "The IMF: A Cure or a Curse," *Foreign Policy* 111 (summer 1998): 114–29.

67. Alan Greenspan, "The Current Asian Crisis," testimony before the Subcommittee on Foreign Operations of the Committee on Appropriations, U.S. Senate, Washington, D.C., March 3, 1998.

68. Bruce Cumings, "The Asian Crisis, Democracy, and the End of 'Late' Development," in *The Politics of the Asian Economic Crisis,* ed. T. J. Pempel, 17–44 (Ithaca: Cornell University Press, 1999), quotations on 18, 41.

69. Lawrence Summers, quoted in Abdelal and Alfaro, "Malaysia," 11. Other leading figures had similarly disproportionate responses to the Malaysian experiment; Michel Camdessus called the controls

are more certain: the United States on balance has much to gain and bears a disproportionately small share of the resulting risks.

Power in international politics is always relative; a system characterized by greater risk of financial crisis does in some ways leave the United States more vulnerable, but compared to other states its power is enhanced. With relatively less vulnerability and the best prospects for practicing strategic disruption—manipulating the risks of crisis as well as the nature of agreements to contain them—the international political power of the United States is enhanced by 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.

"dangerous and even harmful," as reported in Robert Wade, "The Asian Crisis and the Global Economy: Causes, Consequences, and Cure," *Current History* (November 1998): 368. Alan Greenspan, in pointed testimony, quickly (and erroneously, at least 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, "International Economic and Financial Systems," testimony before the Committee on Banking and Financial Services, U.S. House of Representatives, Washington, D.C., September 16, 1998.