Between Collapse and Decline:
The Dissolution of International Monetary Systems in Comparative Historical Perspective

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Abstract

This thesis is concerned with varying rates (i.e. speeds) of system dissolution in the international monetary domain. International monetary systems, such as the gold-dollar system and inter-war order, often suddenly and unexpectedly collapse. Yet other monetary orders, such as the Sterling Area and the long-forgotten Latin Monetary Union, for no less obscure reasons, have declined gradually. The puzzle is why.

I begin by taking seriously the initial conditions that give rise to international monetary systems, for those historical conditions shape the modalities of leadership and political conflicts that drive systems towards particular kinds of ends. In this context, I draw on the classical distinction between spontaneous and negotiated orders. Whereas spontaneous orders emerge around natural processes of trade and financial integration, without any conscious act of creation, negotiated orders emerge through deliberate and directed action. The study breaks with traditional understandings, however, in arguing that the most important legacy of these historical processes is not that spontaneous orders are decentralised while negotiated ones are hierarchical. In fact, all international monetary systems exhibit a strongly hierarchical character. Instead, I highlight, on the one hand, the centrality of collective institutionalised bargaining between integrated national monetary agencies (i.e., treasuries and central bank officials) in negotiated systems and, on the other, the absence of collective institutional bargaining in more atomised spontaneous systems. This structural distinction is the key legacy of the different historical processes of negotiated and spontaneous system formation.

Contrary to conventional wisdom and intuition, I argue that spontaneous systems – plagued by non-association and lacking ready mechanisms of directed adjustment – establish the conditions for slow decline, while negotiated systems – geared to withstand economic and social change through institutionalised collective bargaining and concerted adjustment – establish the conditions for rapid collapse. My framework treats the ultimate unit of analysis as the policy choices made by leaders confronting problems. Specifically, the analysis logically deduces two distinct modalities of leadership that emerge as structural variables interact with political conflicts over preferred policy solutions. I label these modes of action *appropriative* and *exclusory* leadership.

Appropriative leadership involves coopting administrative resources by negotiating with members of monetary institutions to meet problems. Exclusory leadership is geared towards retaining the non-trivial advantages that flow from not having to bargain over the terms of continuation. Under both modalities, leaders exploit their strategic position, distorting information and manipulating costs and benefits to promote their particular interests and goals. Both modalities involve tensions between leadership and membership interests and challenges to systems optimisation. But appropriative and exclusory leadership have different effects; they produce different sorts of political cleavage and maladaptation. Appropriative leadership holds the system against a declining functional fit with its environment, as members chafe under extractive demands. The leader's power to procure assistance will, eventually, be limited. At this point, the negotiated system will shatter, like a piece of glass placed under growing strain. Exclusory leadership, by design and consequence, is less likely to trigger membership resistance. This prolongs the system. However, leaders cannot repeatedly shun collective recalibrations, nor can they endlessly offer selective and differentiated terms of continuation to the members, without paying a price. The practices that sustain the system gradually hollow out, relational ties decay, and interests drift apart until the system fades away.

This novel analytical framework is illustrated through comparative historical analyses of five systems, ranging from the decline of the Latin Monetary Union in the nineteenth century to the faltering progress towards the eurozone in the twenty-first. The studies utilise original archival materials drawn from five countries and more than ten institutions. The empirical findings, guided by the framework, challenge accepted historical understandings and interpretive frames and are thus novel contributions in their own right. The discussion also brings prescient inferences into contemporary debates about the eurozone and US dollar regimes. The argument suggests that policy insiders should rethink their actions. The lesson from history is that opportunistic leadership has repeatedly frustrated more efficient alternatives to the recurring nightmares of disorderly collapse and prolonged decline.

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Abbreviations

ABdF	Archives Historiques de la Banque de France, Paris
AMAE	Archives du Ministère des Affaires Etrangères, Paris
AMdP	Archives de la Monnaie de Paris, Paris
AN	AN Archives Nationales de France, Paris
ANB	Austrian National Bank
Basel Committee	Committee of Central Bank Governors of the G-10
BIS	Bank for International Settlements
BISA	Archives of the Bank for International Settlements
BIS Expert Group	Gold and Foreign Exchange Expert Group of the BIS (known as the "Coombs Committee"
BOE	Archive of the Bank of England
CEA	Committee of Economic Advisors (US)
CIC	Capital Issues Committee
CMT	Capital Mobility Theory
CoG	Committee of Governors of the Central Banks of the Member States of the European Economic Community
CRU	Collective Reserve Unit
DM	Deutschmark
EC	European Communities
ECB	European Central Bank
ECOFIN	Council of Ministers of the European Communities
ECU	European Currency Unit
EEA	Exchange Equalisation Account
EEC	European Economic Community
EFO	Economic and Financial Organisation of the League of Nations
EMCF	The European Monetary Cooperation Fund
EMU	Economic and Monetary Union of the European Union
EMS	European Monetary System
EPU	European Payments Union
ERM	exchange rate mechanism
ESF	Exchange Stabilisation Fund
ESM	European Stability Mechanism
EU	European Union
FRBNY	Federal Reserve Bank of New York
FYBNY	Archive of the Federal Reserve Bank of New York
G-10	Group of Ten
G-10 Deputies	Senior Officials of the Treasury and Finance Ministries of the G-10
HST	Hegemonic Stability Theory
IET	Interest equalisation tax
IGT	Interest Group Theory
ITT	Ideational Transition Theory
LMU	Latin Monetary Union
LON	Archives of the League of Nations, Geneva
LRTO	Longer Term Refinancing Operation
MC	The Monetary Committee of the Member States of the European Economic Community
NARA	National Archives and Records Administration, College Park, Maryland
NET	Network Externality Theory
OCA	Optimal Currency Area Theory
OECD	Organisation for Economic Cooperation and Development

OECD	Organisation for Economic Cooperation and Development Archives, Paris
OEEC	Organisation for Economic Cooperation
OMT	Outright Monetary Transactions
OPEC	Organisation for Oil Exporting Countries
PRO	Public Records Office: The National Archives, Kew, Great Britain
RSA	Rest of Sterling Area
SDR	Special Drawing Right
SMP	Securities Market Programme
SNB	Swiss National Bank
SWAPS network	A network of reciprocal credit line relationship to temporarily swap currencies established around the FRBNY.
SSM	Single Supervisory Mechanism
TTT	Technological Transition Theory
WP3	Working Party No. 3 of the OECD

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PART I

1
Introduction

The collective organisations, institutions and systems that we create and maintain at the expense of enormous shared effort and personal sacrifice are often condemned to suffer regrettable ends. However brilliantly conceived and praiseworthy their achievements in life, they seem almost destined to impose costs in death that all would surely want to avoid. The still-more unpleasant truth is that we are subject to two recurring but opposing nightmares. The first is the spectre of rapid collapse and ensuing chaos, such as was experienced in the downfall of the Soviet Union, the outbreak of the Great War, and the 1929 and 2008 financial crashes. The second is the malady of slow decline and prolonged malaise, as in the degeneration of the Spanish Empire, countless cases of environmental degradation, and the decay of the welfare state. This study labels this observation—that our social labours are often sentenced to massive but diametrically opposed forms of historical inefficiency—the *dissolution puzzle*. In short, why are we recurrently flung on the rocks of rapid collapse and slow decline?

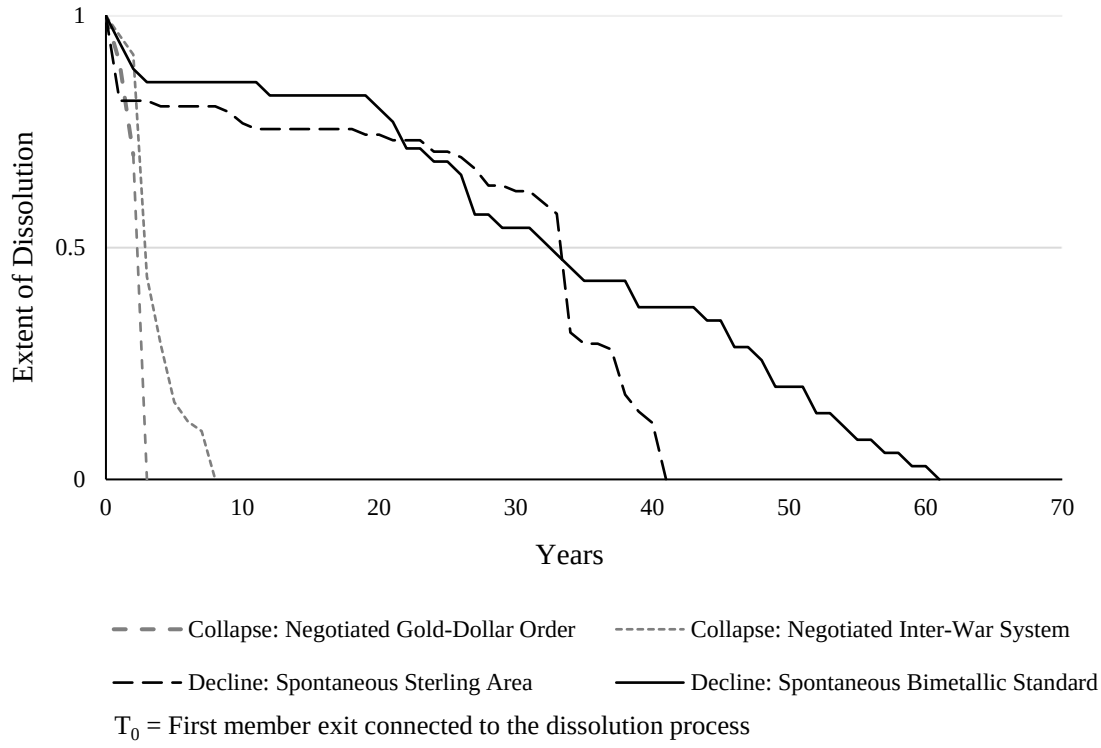
To navigate these hazards, we must understand the winds and tides between them. The contrasting outcomes of rapid collapse and slow decline are therefore ideal candidates for comparative investigation. The theoretical question is: Under what conditions, and through what actor choices and processes, do systems collapse, and when do they decline? How, in short, can we explain varying rates of disintegration?

This thesis attempts to provide a theoretically coherent and empirically grounded answer to this question. In the unity of a single analytical framework, it aims to explain *when* and *why* actors find themselves unable to avert collapse or decline. The study is conducted through comparative and historical autopsies of bygone international monetary systems. The concepts and conjectures, however, are applicable to a wide variety of institutional arrangements and settings.

The subject selected for dissection is important and felicitous. It is important because we live in a state of relative ignorance as to the trajectory of our international monetary arrangements. As might be expected, where ignorance dominates, speculation thrives. The euro and the dollar have been subject to prophecies of collapse and decay. Then, when things carry on as they usually do, we are assured of their robustness without little informed analysis of what has happened in the interim. The euro area is at one moment an optimal currency area and then, almost overnight, it is almost universally considered a mistake. The dollar is doomed to decline only to find insuperable sources of strength. The faith that "political will" explains both continuity and dissolution reveals a certain obliviousness to the deeper factors at hand.

The topic is felicitous, at least from the scholar's point of view, because international monetary systems come and go frequently with recurring variations and patterns. Whatever the proclamations of contemporaries, international monetary systems seldom outlive their founders. This has created a pool of cases for comparative analysis, the most striking irregularity among which is that some systems have vanished little by little over great tracts of time, while others, equally dominant and often better performing, have suddenly and unexpectedly collapsed. The gradual and seemingly ever incomplete move from the bimetallic system, which structured the monetary relations of the post-Medieval world, to the classical gold standard represents the archetypal slow decline. The short and violent collapse of the rouble zone can be found at the other end of the spectrum. Many other cases bunch at the polar extremes, as shown in Figure 1.1 below. This motivates the question behind this study: Why have some international monetary systems blown a fuse, while the lights have dimmed slowly on others?

Figure 1.1. Temporal Structures of Dissolution in Selected International Monetary Systems



Sources: See Appendix I.

Note: In order to simplify, the period of dissolution is taken to start with the first major departure from the system. Additions to the system thereafter were dropped from the data. The number of countries in the system in the year beginning with the first significant exit that led inexorably to dissolution is taken as 100 percent. The dissolution of the bimetallic order is measured through the transition of countries to the gold standard, with Britain excluded because its move from bimetallism occurred far earlier than any other country's.

When faced with the dissolution puzzle, the temptation has been to succumb to Spenglerian themes and untestable speculations about the pathological and irrational tendencies of human nature.[1] However, the finding of repeating temporal variance across historical cases gives reason to believe that it is neither random variations in human will nor exogenous problems that produce different processes of breakdown. It seems that there is something within systems that drives them towards particular kinds of ends that can be subject to systematic analysis and the formulation of explanatory propositions. This thesis is dedicated to discovering the internal logics of varying rates of dissolution through a comparative historical and institutional analysis.

To do so, the study pushes beyond the current state of the art. The picture of institutional development for nearly three decades has been one of equilibria, path dependence and pathologies that are periodically punctuated by exogenous shocks.[2] However, as Guy Peters, Jon Pierre, and Desmond King argued almost a decade ago, if we are to *predict* the occurrence of contrasting modalities of change, such as fast collapse and slow decline, we must analyse the "dynamic political conflict between equilibria".[3] Kathleen Thelen has made a similar point:

> We need to take account of the way in which crisis or turning points can be generated endogenously, including through the working out of the logic of previous switch points. We also need to consider the way in which new problems are conceived and solutions sought are themselves products of the past. . . . This amounts to a call for introducing somewhat more structure at the 'front end' of the analysis of institutional development than most path dependence arguments do [and] . . . somewhat more agency and strategy at the 'back end.'[4]

This thesis is a testament to the fact that better understandings of varying modalities of change can indeed be achieved by connecting "front end" structures with "back end" political agency and strategy. Moreover, the outcomes of collapse and decline are shown to be precisely a function of dynamic conflict and strategy – playing out among the leaders and members of systems as they agree on policy adjustments between equilibria – where the politics is structured by varying initial historical conditions.

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[1] For instance, as esteemed a scholar as Thomas Franck posited, after an exhaustive study of federal system failure, "The principal cause for failure, or partial failure . . . can only be found in the absence of a sufficient political-ideological commitment to the primary concept or value of federation itself" (Franck, 1968, 38).

[2] This pattern of development was first specified in 1984 (see Krasner, 1984). The academy then bifurcated into the so-called three new institutionalisms – rational choice, sociological and historical – each pursuing different questions and theoretical themes for nearly two decades (see Hall and Taylor, 1996). In the early 2000s, scholars proposed moving beyond the limitations of the existing paradigms (see Peters, Pierre and King, 2005; and Thelen, 2003). The most meaningful response to date has sought to integrate insights from all three institutionalisms into USCC theory – using a bounded-rationality assumption and the incentives arising from different sorts of cooperation problems – to understand the conditions under which actors will *use*, *select* between, *change*, and *create* new institutional arrangements (see Jupille, Mattli and Snidal, 2013).

[3] Peters, Pierre and King, 2005, 89.

[4] Thelen, 2003, 213.

1. The Argument in Brief

My argument begins by using the time-honoured distinction between top-down negotiated orders and bottom-up spontaneous ones. Negotiated systems originate in the conscious efforts of leading states to design and impose an order that promotes certain international monetary objectives. The inter-war gold exchange standard, Bretton Woods system, rouble zone and Eurozone provide archetypical examples. Spontaneous systems emerge when actors, responding to more particularistic concerns rather than some negotiated and agreed managerial scheme, nevertheless coalesce around the monetary practices and institutions of leading states. This evolutionary process is found, for example, in the Dutch guilder early modern order, the Latin Union, the pre-1914 gold standard, the Sterling Area, and today's US dollar regime.

The key structural consequence of these two processes of system formation is usually assumed to be that negotiated systems are hierarchical (i.e., centralised) while spontaneous ones are horizontal (i.e., decentralised). However, international monetary orders of *both types* usually exhibit a strongly hierarchical and centralised character, where they are organised around, and effectively led by, politically and economically dominant states. As Benjamin Cohen has noted, "monetary relations have always tended to be distinctly hierarchical, taking the shape of . . . a Currency Pyramid – narrow at the peak where only one or a few states dominate, and increasingly broad below."[5] In light of the pervasive nature of hierarchy, I highlight the alternative legacies of spontaneous and negotiated system formation through a new explanatory typology. This typology identifies systematic variance in the *structural organisation* and *historical foundations* of systems. In this perspective, negotiated and spontaneous systems represent distinct types of international monetary hierarchy.[6]

The *structural organisation* of a system refers to its objective properties as regards the arrangement of and relations between the participant units. In negotiated systems, leaders routinely bargain with members who are collectively organised in specific institutional settings, such as the European Central Bank (ECB) or Organisation for Economic Cooperation and Development (OECD). In spontaneous systems, the members do not routinely engage in collective institutionalised bargaining with the leader but instead separately receive bilateral terms of continuation from the leader. These variations in structural organisation affect members' standing in relation to each other and to the leader. In negotiated systems, the membership is collectively organised and integrated around the bargaining table. By

[5] Cohen, 2006, 50; 1998; and, 2004; also see, Andrews, 2006; and Walters, 2006.

[6] In developing a novel typology of two fundamentally distinct types of international monetary hierarchy and a theory of leadership and system development based on that typology, this study responds to David Lake's claim that "theories of international relations would be improved by explicitly incorporating variations in hierarchy" (Lake, 2003, 304). The endeavour to specify the sources and consequences of different types of international monetary leadership drew inspiration from a number of scholars who have grappled with similar questions (see, in particular, Cohen, 1977; 2004; and, 2009; Strange, 1971; and, 1987; and Helleiner, 2009).

contrast, the members of a spontaneous order are not officially associated with the leader and are not collectively organised. To act together, the members need to overcome collective action problems.[7]

The *historical foundation* of a system captures variations in the temporal orderings and materials that comprise its historical underpinnings. The relevant variables are welded in the historical process of regime formation. In short, the basis of negotiated systems is political, while the basis of spontaneous systems tends to be economic. In negotiated systems, bureaucratic capacity is built from the outset and bureaucratised decision-making forges the action, as national civil servants, in particular treasury and central bank officials, engage in policy coordination from the outset. By contrast, in spontaneous systems, market actors and forces are in the driver's seat, charting courses of action that national monetary authorities only later try to coordinate and direct. As a consequence, the position and power of national monetary authorities – and to the extent that these agents empower them, supranational agents with bureaucratic capacity – varies between the two system types and so do the start-up costs national monetary authorities must pay to build the system. Negotiated orders are expensive, spontaneous orders less so.

The conventional wisdom is that negotiated orders are more stable than spontaneous ones and so less prone to collapse.[8] Oran Young, for instance, in a seminal paper on international regime dynamics, posited that "rapid social change . . . is apt to undermine existing spontaneous orders without creating conditions conducive to the emergence of new orders. By contrast, negotiated orders and even imposed orders usually stand up better in the face of social change."[9] The current study directly challenges this accepted understanding. The counterintuitive argument of this thesis is that spontaneous international monetary systems, hamstrung by a relative lack of mechanisms of collective adjustment, establish the conditions for slow decline, while negotiated monetary orders, endowed with mechanisms of collective recalibration, establish the conditions for rapid collapse.

The argument presupposes two undemanding but important assumptions about human agency: Actors are taken to be boundedly rational and opportunistic. The notion of bounded rationality involves constraints on information processing. In this study, the assumption of bounded rationality means

[7] To draw on the terms of industrial organisation, negotiated systems exhibit high levels of vertical and horizontal integration, while spontaneous systems are less integrated along both dimensions.
[8] It should be noted that scholarship has somewhat neglected the issue of dissolution. This is not to suggest there has been no significant progress in understanding the dynamics of institutions. For example, game theory has helped to reveal where and how cooperation is likely to emerge (see Axelrod, 1984; and Oye, 1986). Scholars added sophisticated tools to understand why actors create institutions and why they take different forms (transaction costs, information asymmetries and enforcement problems, etc.) (see Coase, 2012; Williamson, 1985; and Koremenos, et al, 2003). Economic historians and political scientists then enriched our knowledge of what makes institutions persist (asset specificity, network externalities, path dependency, etc.) (see Arthur, 1989; North, 1990; and Pierson, 2004). By comparison, the explanations of system dissolution remain unsophisticated (see, for example, Diamond, 2005; cf. Tainter, 1988; and Cipolla, 1970). That processes of dissolution differ is often entirely obscured.
[9] Young, 1982, 290.

primarily that actors cannot know all the implications of their actions. The assumption of opportunism combines straightforward self-seeking behaviour with forms of calculated manipulation. A central implication of both assumptions is to restrict the time horizons of agents. The boundedly rational opportunist pursues short-term rewards and discounts long-term effects.[10] Crucially, the study applies these assumptions to the leaders of systems. This innovation challenges the benevolent representation of international monetary leadership in hegemonic stability theory.[11] In that perspective, international monetary leadership is an essentially benign enterprise, where powerful states provide the public good of stability at a disproportionate cost to themselves. I argue that this understanding, though widely accepted, is theoretically misleading and empirically indefensible.[12]

The argument proceeds from these assumptions by positing that the international monetary system is subject to some unspecified deterioration in performance.[13] This performance problem is not so drastic as to wipe the system out immediately. That is, the emerging issue is not something akin to the outbreak of an interstate war, such as the Great War, which arrested the classical gold standard. However, the source of deterioration is sufficiently problematic to prompt the leader to come up with a policy response. The underperformance can come from many places, and the sources may change over time. For instance, international payments imbalances and financial disturbances are constant features of economic life. There are often technical problems incident to the design or internal arrangement of systems that persistently plague their operation and performance. Systems also face political discontent, shifting power relations, transformations in monetary technologies, and ideological challenges that create pressures for adaptation. In addition, there can be exogenous shocks, such as those experienced by the European Monetary System (EMS) following the end of the Cold War.

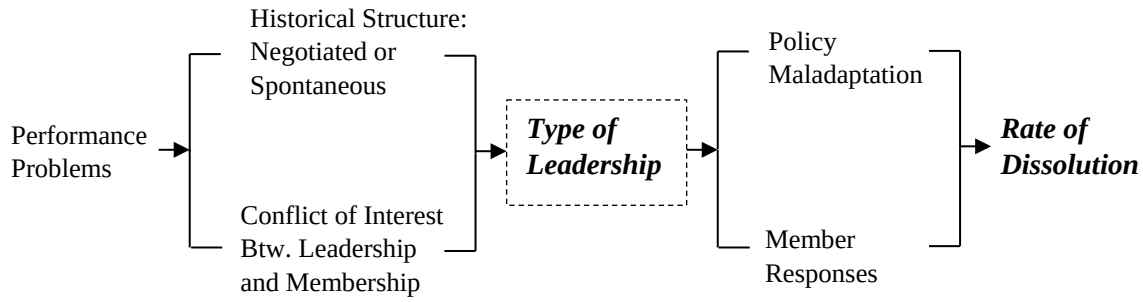
Whatever the source and nature of the problem, the explanatory model assumes a conflict of interest between the leader of the system and its members over the policy solution. The policy adjustments made to manage emergent problems in international monetary affairs are often cloaked in technocratic language, but the stakes are enormous and the process of recalibrating rules and practices highly

[10] In using a bounded-rationality assumption, I follow prospect theory, which sees the status quo as the central carrier of utility in human decision making.
[11] This view has held sway since Charles Kindleberger developed the argument that the Great Depression resulted from a lack of international monetary leadership (Kindleberger, 1973).
[12] In rendering this argument, I draw upon and seek to contribute to the literature on international monetary power (see, for example, Cohen, 1966; Kirshner, 1997; Walter, 1993; and Strange, 1971). It should be recalled that the limits of hegemonic stability theory have long been understood. Duncan Snidal argued some thirty years ago that "the common presumption of recent analyses that hegemony is widely beneficial rests on such special assumptions that it should be rejected" (Snidal, 1985, 614). I find this to be true even in the international monetary arena, where the benevolent interpretation of hegemony continues to be more widely accepted than in other issue areas (see, for example, Lake, 1993; and Walter, 2006).
[13] I abstract a single problem for analytic clarity. However, central to the explanation is that performance problems are endemic. They are "constant causes" that compel leaders to repeatedly search for new compromises with members and to adjust systems (Thelen, 2003, 211, 213).

political.[14] The leaders and members may well agree on the desirability of improved performance but still disagree on their preferred outcome. The selected policy solution will generate winners and losers. The leadership and members will aim to maximise their utility (minimise costs and maximise benefits) under any new arrangements, even if this compromises the utility of the other. To lose out can mean paying high adjustment costs or forgoing some valued benefit under the status quo. If there is no acceptable policy solution – that is, no net gains can be projected from the system's continuation – then the leadership and members will mutually agree to leave the system and take an exit payoff.

This simple context – of a policy problem and distributional conflicts between leader and members – lays the basis for the central theoretical logic of this thesis, which can be summarised as follows: As a comparative matter, the strategies leaders are willing and able to deploy to maximise their utility (under successive policy adaptations to emergent problems) will vary between negotiated and spontaneous systems.[15] The repeated deployment of different modalities of leadership in response to performance problems will create varying sources of system strength and vulnerability. This is because assorted types of leadership induce and sanction *different* member responses and *different* sources of unanticipated policy maladaptation. Thus, as the solutions selected under varying modalities of leadership are entrenched in ongoing institutions and practices, systems develop along alternative paths. These paths represent alternative means of system resilience and diverse kinds of weakness, specifically in discriminating sorts of political and functional cleavages. The production of discriminating types of order and maladaptation under different logics of leadership ultimately drive systems to experience different rates of dissolution.[16] Figure 1.2 represents the argument's structure.

Figure 1.2. The Underlying Structure of the Explanatory Framework



[14] International monetary power is often exercised by externalising or deferring the costs of adjustment needed to achieve an internal and external balance of payments. Benjamin Cohen has called this the "Power to Deflect" and the "Power to Delay". This study complements Cohen's theoretical insights into the macro-foundations of these sources of international monetary power by developing understanding of micro-foundational leadership strategies and behaviours that typically pursue these aims among other goals (see Cohen, 1966; and, 2006).
[15] In other words, the strategic decision calculus for leaders facing problems varies across the two system types.
[16] In specifying the conditions that induce distinct types of international monetary leadership and the dynamic consequences of leadership actions, I address a theoretical gap in hegemonic interpretations of international regimes that "are not always clear about what hegemons actually *do* to promulgate and maintain a given set of rules." And I challenge the associated idea that "structural theories are, by their nature, less useful for understanding processes than for establishing correlations" (Haggard and Simmons, 1987, 512).

How do variations in the *historical foundation* and *structural organisation* of systems shape the policy responses of leaders faced with performance problems? And how do these variations affect the distributional conflicts with members over the chosen solution? Following this framework, I argue that the leader of a negotiated system will be more willing and able to apply strategies to elicit support from members and build concerted artifices and institutions to safeguard its interests and benefits. That is, the leader will secure its power and interests by inducing participant monetary authorities into formal structures of control and technocratic administration in support of the international monetary construct. For the purposes of this thesis, this will be referred to as *appropriative leadership.*

Crucially, confronted with a strategic context in which members are already organised and bargaining over the terms of continuity, the leader has every reason and ready means to win consent and extract assistance in this way. In particular, the leader can procure support from the national monetary authorities around the bargaining table, lifting them out of the islands of their national political contexts, through the endorsement of sub-goal pursuits (in particular, the goal of bureaucratic "autonomy"), special forms of international reciprocity and mutual empowerment, and the development and institutionalisation of commonly held and instrumentally useful beliefs.[17] The monetary officials and authorities appropriated into the defence of the system benefit from an augmentation in their capabilities and autonomy in the domestic arena. They are able to draw on the patronage of the leader and the imperatives of the system to expand their domestic power and authority.

By contrast, the decisive strategic advantage available to leaders operating in a spontaneous system resides in their exclusive control over the terms of continuity and their ability to price-discriminate between the unorganised and divided membership to yield allocative efficiency gains. The notion of price discrimination involves charging members differential amounts to stay within the system. For instance, in return for access to the leader's capital markets, some members might be required to hold all of their reserves in the leader's currency, while others are allowed to diversify their currency reserves. Where new terms of continuity are offered to overcome emergent issues, the leader can maximise its utility by avoiding the bargaining table and instead selectively accommodating different member exit payoffs – in each instance paying only as much as necessary to keep members in the system or let unimportant members drop out. In this context, the leader will maximise its power and interests by pursuing policies that guarantee its continuing monopoly over policy developments. For the purposes of this thesis, this will be referred to as *exclusory leadership.* In order to preserve the huge distributional advantages of a monopoly, the leader must take into account the risk of triggering collective action among members when responding to performance problems. The incentive for members to find a collective voice will increase if the leader looks to increase the level of resource extraction or otherwise

[17] These logics of transactions in repeated collective institutionalised bargaining relations draw upon insights in organisation theory and economic institutionalism (see Arrow, 1964; Barnard, 1938; Boulding, 1956; DiMaggio and Powell, 1983; Simon, 1957; and Williamson, 1975, especially Chapter 8; 1985; and, 1995).

circumscribe the freedom of members. The price of a policy monopoly for the leader is therefore often policy restraint and sometimes inaction.

The historically determined foundations of the system create highly collated ancillary conditions that enable the structural and strategic logics of appropriative and exclusory leadership to yield their full effects. The special sense of responsibility and high initiation costs of negotiated orders compel the bureaucratic activism that characterises appropriative leadership. Put another way, the massive effort expended on creating negotiated structures galvanizes the leader to assertively put things back on track by requisitioning support from the national monetary authorities with whom it struck the initial bargain. Moreover, the dominant place of bureaucratised and technocratic decision-making in negotiated systems allows leaders greater freedom from market and societal interests that would resist the expansion of bureaucratic administrative power, which characterises appropriative demands for control. But the susceptibility of national bureaucrats to unpredictable political influences manifests in commitment problems. The ability of the leading monetary authorities to use discretionary tactics to coordinate markets is therefore constrained, prompting them to embrace new rules and controls when problems emerge.

By contrast, the more marginal position of bureaucratic authorities in spontaneous orders, which have an economic rather than political basis and lower initiation costs, enables officials to rely more on discretion: they face fewer commitment problems and feel less responsibility to put things back on track. The leader thus enjoys the option of price discrimination and other flexible strategies of response. Equally, and by corollary, in spontaneous orders, the ability of public officials to stand apart from private interests that object to added controls encroaching upon the market autonomy is limited, supporting the search for alternative, unobtrusive and backstage means of influence. The traditions of free association that accompany the low initiation costs of spontaneous systems reinforce this exclusory policy calculus by delegitimising efforts to prevent the membership from freely choosing their trade and monetary relationships.

The strategic use of private information supports both modalities of leadership. Generally, leaders systematically misrepresent their willingness and ability to sustain systems. However, structural environments also create different opportunities and incentives that in turn create particular patterns of distortion. In negotiated systems, leaders can *trade* private information in return for individual gain *and* collective control. Importantly, this enables group misrepresentations and distortions. That is, appropriation generates incentives for the co-opted to proselytize on behalf of the interests and aims of the leader and the system. The cumulative effects of sustained group information distortions can result in major functional misalignments. A striking example was found towards the end of the 1980s when European monetary elites collectively claimed that the EMS had developed into a *de facto* monetary

union. In reality, economic trends were diverging, and the system was heading towards a catastrophic failure.

In spontaneous systems, by contrast, leaders *withhold* private information to keep members in the dark about the terms of continuity other members have agreed to. In this way, the inequitable membership terms that result from price discrimination can be maintained. Thus, in the Sterling Area system, the British were careful to insist that their relations with members be treated as analogous to those between a banker and its clients and therefore could not be disclosed.

The modalities of appropriative and exclusory leadership represent the optimum means for leaders to maximise their utility, as successive terms of continuity are agreed with members to resolve emergent performance problems in the contrasting historical and structural settings of negotiated and spontaneous systems, respectively. However, there are endogenous limits to these opportunistic leadership modalities. They cannot be sustained indefinitely. Indeed, the resultant policies are maladaptive because the leadership and membership are not brought into efficient adjustment with each other, and the strategies have the unintended consequence of being suboptimal from a system's perspective. That is, they enhance the objectives of the leadership that controls the transactions, but to the detriment of membership optimisation *and* system rationality. In short, conflicts of interest between leadership interests and global optimisation are taken to be constant and pervasive.

The leader of a faltering negotiated system can maximise its utility by entrenching and engrossing the formal structures and collective administrative controls that defend the international monetary construct. This mode of appropriative action will secure the flow of benefits to the leader and yield collective gains for the participating monetary authorities, but it will also impose costs and produce unintended consequences well before the collapse. The process of appropriative leadership guided by monetary authorities with largely instrumental capacities tends to manifest in technocratic fixes to problems. Such fixes are maladaptive because they leave issues with international power implications unresolved, generating large distributional disjunctures and ongoing points of resentment. The *Economist* captured the maladaptive essence of such fixes in criticising the Bank for International Settlement's (BIS) role in the gold-dollar order:

> The truth is that Basle has become an almost too smoothly working machine. Intricate currency problems have bedevilled the West for at least six years. Some hard choices have to be made. Governments as well as central banks prefer to duck them. So they turn them over to those clever chaps in Basle, and, hey presto, another short term credit is hatched, committing nobody and solving little. It is the financial equivalent of Immaculate Conception.[18]

[18] "Basle's Two Edges", *The Economist*, 18 June 1966, The Economist Historical Archive, 1843–2011. Web. 4 May 2015.

Moreover, although shared gains are available through appropriative leadership, the membership will resist the disproportionate benefits accruing to the leader as they become evident. The propensity for appropriative leadership to induce resistance from those outside the special arrangements organised in the closed institutional bargaining is obvious. However, resistance can come also from the insider monetary authorities, because they cannot be entirely divorced from their national political context or interests. Defending a system led by a dominant foreign power will carry a legitimacy cost for appropriated monetary authorities. And for these collectively organised national monetary authorities, which have a vested interest in the status quo and apparent means to change it through bargaining, exiting from the system is not an obvious substitute to voicing discontent to engender change.

Independently, the asymmetries between appropriated insiders and outsiders, which allow group information distortions to hold the system together against functional problems, are liable to sudden and destabilising exposure. Thus, generally, the longer the leader maintains the system to its advantage through appropriation, the more political cleavages widen as participants chafe under the distribution of costs and benefits and as they become vulnerable to external challenge. Furthermore, as continuity is secured through appropriative leadership, the larger and less sustainable the functional misalignment with the system's long-term considerations becomes. In this context, the appropriative bargains needed to stay the course are harder to reach, and the pressures on the leader and the system increase. Eventually, like glass placed under growing strain, the negotiated system shatters when the limits to further appropriation force the leader to recalibrate its power and interests. The observed outcome is rapid collapse.

In stark contrast, spontaneous systems are much less disposed to member resistance. The reason is simple: The exclusory strategies and price discrimination artifices of leaders, partly by design and partly by unintended consequence, carry a lower prospect of resistance. The escape valve of price discrimination allows the leadership to buy off troublemakers. The incentive for members to oppose the leader is further diminished by the lack of ready means of influence. And defection can take the place of resistance, not least because the leader will refrain from imposing exit barriers that are liable to prompt collective action. This endogenous source of mutual restraint naturally slows the process of dissolution.

Nevertheless, exclusory leadership implicates other costs and unintended sources of maladaptation. The members have no particular loyalty to a leader or system that denies them any say in how policies are developed. Moreover, they have an interest in minimising their exposures to the system by edging out of the malfunctioning status quo without informing the leader, who might then cut off valued benefits. The leader may become aware of these defections and shirking tendencies. However, in calculating that problems are better handled quietly—through bilateral discussions or inaction, as opposed to collective reforms that might result in a costly share-out and/or face insurmountable resistance from entrenched

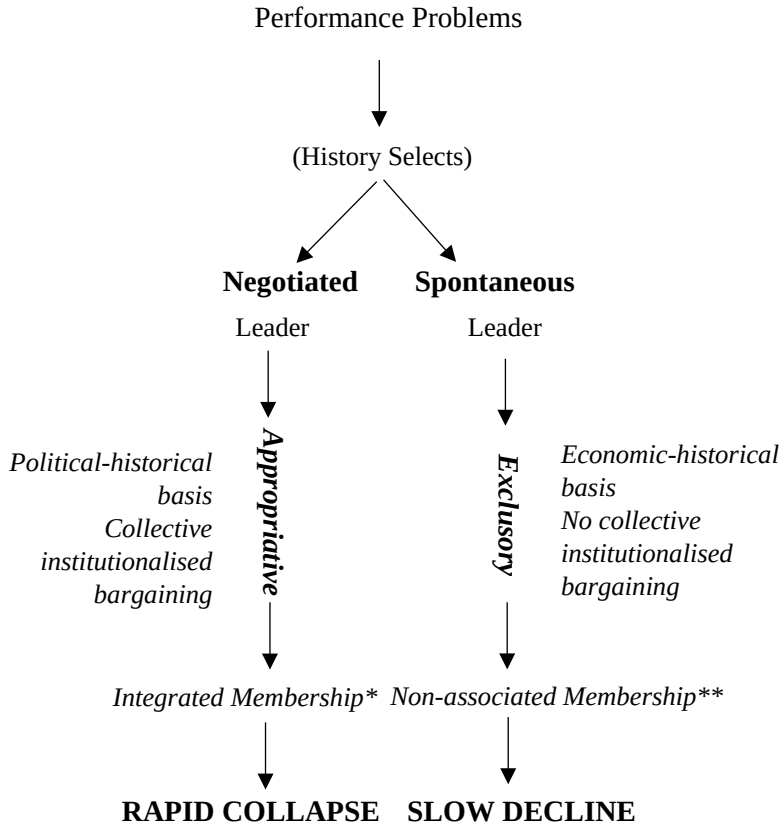
private interests—the leader must accept member shirking and limited policy responses for longer than would be optimal.

The more policy drift and institutional sclerosis are permitted to go on without the activation of counterforces by the leader, the more the system will weaken. The long-term result of failure to update practices is that things fall out of line with functional needs, diminishing the benefits available from continuity. Moreover, the longer the system persists through the differentiated terms of membership that result from price discrimination, the less coherent the system will become. The institutions and practices that sustain the system will be hollowed out by exceptions. As interests drift apart, the prospects of collective remedial action on the scale required to put things back on track will recede further into the background, until, eventually, the whole cannot support its parts. When there are no mutual benefits from continuation left to be extracted, the leader will retire the system. The observed outcome is slow decline.

The difficulty in avoiding the dissolution puzzle now comes into view. Appropriative and exclusory leadership strategies and devices enhance the short-term objectives of the opportunistic leaders. They also help to meet performance needs and offer mutual gains to members, but they entrench inequitable distributional outcomes and work to the detriment of the system's long-run efficiency. The outcomes of collapse and decline are not the result of pathologies or irrational human tendencies; they are the product of opportunistic leadership strategies and bounded rationality operating in specific historical contexts.

Having introduced the argument, it is important to emphasise two key scope conditions. First, the study does not accurately capture developmental dynamics in cases where political unification precedes, occurs conterminously with, or interrupts monetary unification or disintegration. That is, the framework applies to systems that can be disaggregated into smaller political units. Thus, for instance, the processes of Swiss and German monetary unification in the nineteenth century are, strictly speaking, outside the scope of the study. Second, the analysis does not theorise the timing of the onset of dissolution nor what comes after collapse or decline. These matters will have to await systematic investigation, and those seeking a crystal ball to hedge the euro will have to look elsewhere. However, those concerned with future probabilities may continue reading. The framework generates plausible hypotheses about the likely manner in which the lights will go out in today's systems. Moreover, at a general level, the analysis expounds logics regarding the operation and performance of systems under different types of leadership that can be seen to apply widely. Within these scope conditions, to reiterate, the thesis of this study is that rapid collapse and slow decline arise from the repeated deployment of varying modalities of leadership induced under specific historical conditions. Figure 1.3 summarises the framework.

Figure 1.3. Summary of Argument



Note: The ***bold italics*** represent the dominant leadership modality the *italics* represent the variables of structural organisation and historical foundation.

* Collectively organised
** Not collectively organised

2. Methodology and Outline

The emphasis in this study on leadership, political conflict and policy developments over time sets certain methodological and presentational priorities. The overall approach is comparative, historical and institutional. These elements are assembled through a research design based on John Stuart Mill's method of agreement and difference, and Charles Tilly's advice to search for the micro-level processes that drive macro-level outcomes.[19]

The analysis starts, as set out above, from an effort to catalogue the universe of cases into sets that represent distinct developmental trajectories. From here, I pursue a "most different systems" design. That is, I specify temporal structures and patterns of dissolution that are most strikingly dissimilar –

[19] Tilly, 1995. On John Stuart Mill's method of agreement and difference see Ragin, 1987, Chapter 3.

collapse and *decline*. For these purposes, I define the process of dissolution as worsening performance and breakdown. That is, reductions in the extent to which systems achieve their objectives in a manner that maintains commitment and ongoing investment from their leaders and stakeholders. The period of dissolution occurs when declining performance, dislocations, member exit, and other losses give rise to further malfeasance, displacements, exits, and losses in a relentless trend toward termination.[20]

The rate of dissolution can be either fast or slow. Fast collapse entails a sudden dissolution trajectory: a rapid breakdown of the relations and institutions that structured state and market practices. This invokes the notion of punctuated equilibria, where systems that have persisted for extended periods are cast aside in moments of crisis.[21] That is, tensions and incongruence between the system and underlying political and economic realities reach a critical juncture, causing a dramatic rupture in the international landscape. Massive exogenous shocks, such as the outbreak of war, can also manifest in rapid termination, as evidenced by the end of the classical gold standard at the onset of World War I. However, this form of termination is outside the scope of this study. Slow decline involves a drawn-out dissolution process. The system weathers and slowly crumbles.

The starting point of dissolution can often be traced to the moment when a significant participant or sub-group separates from the system (formally or informally), begins to meaningfully invest in moving to an alternative system and reduces its investments in the existing order (i.e., moves beyond mere contingency planning), or neglects important aspects of the system.[22] However, these are only indicators of dissolution. The dissolution process can involve long historical developments, fine-grained reductions in performance, and gradual processes that suddenly accelerate in particular periods, which must be grappled with through careful historical analysis. As a comparative matter, the pertinent question is whether there are significant differences in the power and interests of the two kinds of supporting systems and their relative capacities to persist, and associated strategic interactions among states, which can be seen to yield predictable developmental effects, producing different recurring temporal structures of dissolution.

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[20] The definition stresses that the process of dissolution does not directly correspond to the point at which the stability of a system, defined as its endogenous capacity to achieve equilibrium, is first compromised. This has important theoretical implications. It demonstrates why it is essential to pay close attention to the period of stability – or relative stability – prior to dissolution and to the system patterns and relations and policy trajectory then pertaining. This follows from suggestions about how social revolutions might be better understood (Goldstone, 2003, 78). Duncan Snidal and Lora Anne Viola provide a useful and related conceptual discussion of institutional stability and change (see Snidal and Viola, 2007; also see, Grief, 2006).

[21] Krasner, 1984. This historical pattern of stability punctuated by moments of crisis is dominant in rational-choice, historical, and sociological institutionalism. Whatever the perspective, change invariably comes from an exogenous source, be it a sudden shock, imported script or interpretative frame. This is widely recognised as problematic, especially when the object is to explain varying modalities of endogenous institutional change (see Thelen and Mahoney, 2010, 4–10; Greif and Laitin, 2004, 633; Bates, et al., 1998, 8; DiMaggio and Powell, 1983; and Fligstein, 1996). The framework developed in this study moves past this long-standing impasse by conceptualising and theorising endogenous logics of rapid and gradual change.

[22] Hirschman, 1970.

In order to find these systematic differences, the study draws out the key structural features that distinguish cases of collapse and decline through the typology of negotiated and spontaneous orders. The typology lays the groundwork for the explanatory framework introduced above and developed in Chapter 2. This framework provides a simple yet highly plausible basis for understanding the variance in rates of dissolution found between cases – a variance that comes about through the divergent logics and consequences of the two modalities of leadership. The substance of the framework, also in Chapter 2, is in the identification of a limited number of interrelated causal mechanisms (that is, modes of leadership, membership responses and maladaptive developments) whose presence or absence is anticipated according to the *structural organisation* and *historical foundations* of a system. These can be expected, by their presence or absence, to have a significant impact in driving systems along paths towards particular ends. The framework operates on the proposition that leadership actions occur with sufficient frequency and systematically differentiated effects to drive big structures and major historical events in predictable ways.

The empirical analysis is guided by this theoretical precept: It uncovers the micro-foundations of individual leadership behaviour, the main stimuli dominant actors attend to, and the leadership behaviours these provocations and inducements generate. This thesis also pays particular attention to distributional outcomes and intertemporal developmental processes. The empirical analysis in Chapters 3–7 achieves this through the application of systematic process analysis and the intensive use of original archival data.[23] The case studies are organised around the operation of the central causal mechanisms anticipated by the framework, rather than as complete histories, although they are generally chronological accounts. The presentation also focuses on repeated strategic interactions and distributional trends that unfold over time rather than on static outcomes and conditions. The case selection process was similarly concerned primarily with a desire to test the general framework of causal relations. The fact that cases cluster at extremes of collapse and decline helped to simplify this selection process. It is important to note that the cases exhibit a large degree of random variation. Furthermore, although their precise technical features and degrees of integration vary, the selected systems also share an important common control factor in being either fixed, but adjustable, or fixed-exchange-rate systems.

Chapter 8, the penultimate chapter, reflects on the significance of this study and its contribution to the analysis of international monetary systems past and present. I highlight the particular importance of conceptualising leaders as opportunistic rather than benevolent, together with the theoretical challenges of studying international monetary system transition. The aim is to emphasize the value of understanding international monetary systems as dynamically led phenomena that inevitably confront new dilemmas of governance as environmental conditions change and internal tensions arise. The close

[23] This approach is closely associated with the tools of "pattern matching" and "process tracing" (see Hall, 2003, 391; George and Bennett, 2005; and George and Mckeown, 1985).

attention given to how solutions to emergent problems are skewed by the power and interests of leaders, and are then consolidated into ongoing institutions and practices, reveals the manner in which distinct distributional relations in developmental patterns are entrenched in actual historical cases. The key point is that this perspective turns the focus onto the process and practice of international monetary governance and leadership. Yet, with the partial exception of Europe, there is a paucity of such analysis today, and our dominant understanding of leadership is deeply flawed.

I conclude with Chapter 9 by bringing the study together and exploring its contemporary implications for the US dollar. These reflections highlight the central contribution of this study by challenging the conventional wisdom that the dollar will remain a cornerstone of American power provided the US retains an internationalist and cooperative stance in international monetary relations. To the contrary, my expectation is that, because the dollar is a spontaneous order under which US policymakers hold a monopoly, its future will turn on opportunistic governance and anti-internationalism, as the US stalls its power from weakening by strategically avoiding collective resistance and by discriminating among the diffusely arranged members of the dollar regime.

3. Summary of the Cases

I test the framework through five comparative historical studies, selected from a subset of the larger historical universe. The negotiated orders covered are the post-war gold-dollar system that imploded between 1968 and 1973, the inter-war gold-exchange standard that collapsed around 1931, and European monetary integration since 1970, with its fitful progress from the Snake (1972–74) to the EMS (1979–1993) and eventually the launch of the European Union's Economic and Monetary Union (EMU) in 1999. The spontaneous system case studies are the Sterling Area, which disintegrated between 1949 and 1975, and the Latin Monetary Union (LMU) which began fading away in the 1870s and was finally terminated in 1929. The selected cases vary according to the historical process of emergence and the temporal structures of decline. They provide a powerful validation of my argument that negotiated orders collapse while spontaneous orders transition slowly into history. The studies make intensive use of original archival materials in order to understand how these exchange systems operated and gave way. Each study, which I now introduce, offers original discoveries and revises understandings of critical events and historical junctures.

The collapse of the gold-dollar system has long been a source of intrigue. Paul Volcker, writing decades after Nixon closed the gold-window, conceded his surprise at the rapid end of the negotiated post-war international monetary order: "With the world enjoying the sort of economic expansion that it had never before experienced, why was there so little sense of commitment to an international monetary system associated with that performance?"[24] This regretful reflection from a key US Treasury actor speaks to

[24] Volcker and Gyohten, 1992, 29.

the enormous inefficiencies imposed by the collapse of the 1970s. This study includes unprecedented analyses of original archival materials from the core negotiated fora of the gold-dollar order, including Working Party 3 (WP3) of the OECD, the BIS, the Group of Ten Deputies meetings, and the preparations made within national central banks and treasuries. By applying my analytical framework to these materials, I seek to explain the shocking and costly collapse of the gold-dollar system.

The gold-dollar system started to run into difficulties in the late 1950s, but the US was determined to maintain the benefits of cheap financing for its deficits and to avoid the costs of domestic adjustment. Emphasising the opportunity structure of negotiated relations, Chapter 3 investigates the appropriative leadership devices the US instituted to maintain the system, including multilateral surveillance, joint operations in exchange and gold markets, currency swaps, and platforms for information exchange. These institutional props and devices have been memorialised as examples of constructive cooperation. However, a closer analysis guided by the framework shows that the appropriative schemes were opportunistic, failed to deal with the real distributional disjunctures in the system, and made no sense assuming a desire to maintain the system in the long term. In fact, archival materials reveal that these defects were known to contemporary insiders. To take just one example of the opportunistic logics, the BIS warned in 1963 that, "The 'gold pool' arrangements, together with the inhibitions that exist about buying gold in New York, constitute an acceptance of the de facto partial inconvertibility of the dollar. It is hard to see how this can be a permanent state of affairs; the function of the pool, therefore, is to provide breathing space during which steps can be taken that will make its existence no longer necessary."[25] My analysis also exposes how currency swaps and information exchanges in WP3 of the OECD facilitated systematic information distortions in order to hold the system on an increasingly maladaptive trajectory against a changing world.

The technocratic fixes and group information distortions generated gains for the US and Group of Ten (G-10) country central banks and treasuries at the bargaining table, but they also entailed tangible social and economic costs well before the system's end. The manner in which the terms of continuation protected rents for the US produced resistance. From the early 1960s, European participants started to chafe, as long negotiations over the creation of special drawing rights and French gold conversions illustrate. The Nixon administration's decision to turn away from cooperation as bargains became harder to reach is well known and usually attributed to the combative nature of its leading personalities. However, I show how the aggressive strategy of "benign neglect" in fact pushed the logic of appropriative leadership to its ultimate conclusion. The US adopted a more oppressive way of dealing with participants because the props and devices that had formerly coordinated state and market

[25] Gilbert, Draft Memorandum, "The Cooperation of Central Banks in the Gold Market". [Undated], BISA, DEA 14, f38.

behaviour started to fail. At this point, the US destroyed its own creation rather than assume the costs of sustaining the system on an alternative set of terms.

To locate the failure of the gold-dollar system in the breakdown of a hegemonic bargain is nothing new. But my claim is not that the existing accounts are entirely wrong; rather, they have not been properly specified. A complete account must explain how and why dissolution occurred in the manner that it did. The existing explanations rooted in ad hoc changes in US interests or exogenous market pressures do not meet this standard. In fact, US interests did not suddenly change: as appropriative instruments failed, so a more coercive calculation supplanted the previous modality of action. The observation that markets became ungovernable also leaves out the source of that ungovernability: the policies and means of continuation were maladaptive. This study, above all, challenges the teleological economic history of the system. The perception of inevitable failure due to technical problems – whether located in the nth-currency problem, the Triffin dilemma, or increasingly mobile capital – has obscured the individual-level processes and mechanisms that brought about aggregate-level collapse. It was people, mostly based in Washington, who determined the fate of the gold-dollar system. We need to understand the choices they made. The logic and consequence of appropriative leadership in negotiated systems provides this perspective. In so doing, it offers a response to Volcker's confusion when faced with the crash of a system that was providing unprecedented prosperity among close allies.

The second case of collapse, presented in Chapter 4, is that of the inter-war gold exchange standard. The event, marked by Britain's departure from gold in 1931, is perhaps the most studied single decision in economic history. The application of the framework to the reconstruction and operation of the inter-war gold exchange standard puts this momentous event into a new explanatory context. It reveals key similarities with other negotiated systems, including the gold-dollar order and the EMS, and compelling differences from spontaneous orders destined to meet different ends.

The international economic conferences held after the Great War, in Brussels (1920) and Genoa (1922), set out the essential parameters of the inter-war gold exchange standard. Construction (1920–1924) and consolidation (1924–1928) proceeded in the context of competition among the leading financial powers of the UK, France and the US, and against the background of the enormous problem of German reparations and inter-allied debts. Underlining the distributional struggles was Britain's push to establish European countries on a gold exchange standard (a hybrid between a sterling fiat and gold metallic standard) that would restore British financial power and influence. Using original archival data from central banks and treasury departments, I show how Britain was able to return to gold after 1919 through appropriative devices and to use these means of influence to entrench its monetary position in Central and Eastern Europe.

The focus of the analysis is on the League of Nations' stabilisation schemes, the Dawes Plan, and the terms of incorporation into the Bank of England's family of central banks. The case study demonstrates

how, through these collectively administered stabilisation programmes, the UK procured resources for the defence of the system. The common instrument in this strategy was the establishment and reorganisation of independent central banks instituted on a sterling exchange standard basis, which was made a condition for accessing London's capital markets. Again, there were mutual gains in these appropriative schemes for member monetary authorities. As Montague Norman, the governor of the Bank of England, poignantly noted, "A [foreign] Central Bank [could] acquire by external help . . . a certain freedom or independence within, and perhaps without, its own State."[26] However, the result was the widespread surrender of administrative independence in the countries concerned. To be sure, British leadership revived international lending and brought the gold exchange standard into being, but it embedded in its ostensibly constructive structures of cooperation continuing distributional conflicts. The US and France consistently resisted British designs to extend the reach of sterling, putting limits on the resources Britain could procure to defend the system. Moreover, the appropriative arrangements bred resistance in vanquished powers, not least because these arrangements limited monetary independence. The system was thus instituted and sustained between 1921 and 1928 in a manner that built predictable vulnerabilities. William Adams Brown, Jr., beautifully captured the logics and consequences of appropriative leadership and technocratic fixes when he observed that the system was left in a state of "conflict and a lack of balance . . . alleviated by a series of powerful, but impoverished and opportunistic, cooperative expedients to hold the system together."[27]

With similar implications, group information distortions also became bound up in the patterns of repeated institutionalised bargaining between small groups of monetary experts. United formulas promising solutions for the system's problems were delivered in one conference after another. Yet the resultant contracts never came close to reconciling the competing interests at hand. They delivered ever more technocratic fixes and group misrepresentations. Indeed, as Gustav Cassel complained, every successful effort at diplomacy left the world duped: "The economic problems of Europe are realities that cannot be removed from the world by a certain skill in verbal manipulation."[28] The reality, now well recognised, was that over time the distribution of gold was increasingly manipulated, and patterns of credit were distorted to sustain a fundamentally unbalanced economic structure. The year of 1928 saw obvious cracks emerge in the façade. Unresolved war debts, domestic coalitions committed to fundamental change, and enormous distributional tensions came to the fore between 1929 and 1931. The failure to rescue Germany and Austria in 1931 revealed that room for further bridging mechanisms and appropriation had disappeared. As the limits of appropriation were reached, the costs of continuation recoiled violently on the UK. The huge administrative power that had been so crucial in

[26] Norman to J.P. Morgan, 19 November 1926, BOE, G307, file 27.
[27] Brown, 1940, 779.
[28] Castell, "The Position of the Reparation Question", Translation from Svenska Dagbladet, 23 July 1923, BEA OV32 101.

building the system was turned against it. Without the prospect of continuing assistance, the UK pulled the plug and resorted to economic nationalism.

My central insight as regards these events is that the collapse of the gold exchange standard can be logically traced to the conditions of its origination: specifically, the manner in which the negotiated structure was instituted and secured in the 1920s under British leadership. This locates the collapse in neither the changed external conditions of the inter-war world nor technical design failure, but rather in the internal logics of the system's origination and directed development. To be sure, the extension of the political franchise and the rise of organised labour movements made the operation of the gold exchange standard more difficult than that of its pre-1914 counterpart. However, we must also explain how and why the post–World War I system adjusted to these challenges in a way that led to a catastrophic end. The analysis of appropriative leadership provides such insight. The study explains how tensions were absorbed and internalised in the stabilisation programs that brought the system into being, compounding and reinforcing inequitable and maladaptive trends. We gain new and deeper historical perspective by observing the build-up of latent maladaptive pressures and resistance to British leadership, which led to the dramatic rupture of 1931. Without such a perspective, it is difficult to understand why the pre-1914 gold standard and post-1918 order responded so differently to policy stresses and conflicts. By putting front and centre the most fundamental structural difference between the classical and inter-war gold-standard regimes – that one was bottom-up and spontaneous while the other was a top-down and negotiated order – the study breaks important new ground.

The stubborn resistance to dissolution and resulting slow decline of the Sterling Area, the third case study, have long vexed commentators. Existing explanations resort to the obstinate character of the British foreign investor or the "Commonwealth myth" shared by the nation's political class in order to explain a seemingly irrational British commitment to the decaying order. Analysts similarly judge the independent and Commonwealth members of the British-based system as dupes, thrall to a foolish sense of loyalty to their old imperial master. In Chapter 5 I provide a more plausible and coherent account of the system's slow dissolution and why other systems, such as the Latin Union, declined at comparable rates with the conjecture that the grudging and costly decline was a function of the system's spontaneous origins. I rely on the Bank of England and Treasury archives to build an almost day-to-day picture of the exclusory calculations made by UK administrators trying to cope with the pressures of faltering monetary arrangements.

The Sterling Area emerged in 1931 as an unplanned remnant of Britain's nineteenth-century economic hegemony. The system went through substantial changes during the war, but it remained without any means of collective control or management as it began to face difficulties in the late 1940s. The framework helps to reveal that at the heart of the distributional conflict over the terms of continuity was British officials' desire to retain a monopoly on policymaking. But officials faced difficulties solving

problems because it was "too much to expect that [participants] will be content to see the sterling exchange rate and sterling reserves manipulated without any voice in the policy with regard to sterling."[29] Leslie Rowan, writing in 1954 from Whitehall, put it thus: "What is at stake here is that in future the reserve policy, and therefore sterling, will not be run by the UK but will be run by some sort of Sterling Area body."[30] In order to retain exclusive control over policy and the benefits it offered in terms of avoiding collective bargaining and enabling price discrimination, the British exercised policy restraint and carefully withheld information on the terms of membership. The result was that no mechanisms for collective control were imposed on the most persistent sources of weakness in the system. In particular, the sterling balances problem, and the practice of reserve diversification called out as a threat to the system as early as 1952, would be managed by the British on a country-by-country and month-by-month basis. This helped Britain avoid a costly share-out that members would have demanded if they had been given the chance to come together around a bargaining table or in some other way overcome their collective action problems.

However, as this study's framework would predict, the great irony of the Sterling Area in decline was that as long as the initiative rested with the UK, no decisive action could be taken to arrest the decay of the order, for risk of jeopardising that very power of initiative. The inability to take positive actions resulted in widespread dysfunction—from policy drift and institutional sclerosis—forcing the UK to pay a higher and higher price for the continuation of the system. Particular strain came from massive capital outflows that were part of the economic base of the system. Due to powerful groups in the City, as well as the status of capital flows as the most valued membership benefit for participant nations, the UK could not diminish, still less shut off, this drain. The maladapted consequence was that the UK retained near complete openness vis-à-vis the Sterling Area while imposing heavy restrictions against the rest of the world. By the late 1960s, British officials recognised that this failure to update practices and impose constraints produced an economically "unsound" system.[31]

Yet the modality of exclusory leadership and restraint gave the members of the Sterling Area good reason to stay with the UK and muted the prospect of a direct attack on the system. And by withholding information on the unequal terms of membership and their own weakening position, the British further helped the system to endure. This is an especially striking finding, as the members of the Sterling Area were publicly committed to destroying the vestiges of British imperialism. However, as the analytical framework predicts, participants also stood to gain from surreptitiously edging out of the order through policies of trade and monetary diversification. In order to retain the benefits of membership, they defected indirectly; that is, they refused to tighten or update existing relationships with the UK and

[29] Bolton, "Comments on Sir Leslie Rowan's Memorandum: 'Problems Facing the Sterling Area and System'", 19 November 1955, BE OV44/30.
[30] Rowan, "Problems Facing the Sterling Area and System", 3 November 1955, BE OV44/30.
[31] Treasury/Bank, "Future of the Sterling Area", 25 January 1968, BE OV44/116.

accumulated independent reserves and other resources in a manner contrary to established practices. Again, the UK tolerated these practices of defection because its monopoly provided compensatory short-term gains and an impression of strength. However, the implication was that the system became less coherent. The analysis reveals how and why the lifeblood was drained from the Sterling Area through a combination of tolerated non-compliance and failure to grapple with problems.

The most important contribution of the analysis is to show why, at each policy turn, UK officials calculated that their best course of action was to maintain their monopoly over policy. In the extended drama of the decline—and across policy issues including sterling balances, trade and monetary diversification, decaying exchange controls, discovered departures and latent indiscretions, and the unstoppable tide of draining capital—exclusory calculations dominated British actions. The Sterling Area was not condemned to a slow and inefficient end because officials could not give up on the habits of imperialism. Nor, for that matter, did the members of the system suffer from some kind of pathological loyalty to their old imperial master. The Sterling Area was subject to the tyranny of calculated exclusory leadership, the distributional rewards that accrued with policy constraint, and the historical motors of gradual defection and policy drift that hollowed out the system.

Chapter 6 develops a second case study of slow decline through an investigation of the Latin Monetary Union. "The Latin Union is doomed to existence in its present condition for an indefinite period" Chicago economist Henry Parker Willis wrote in 1901. "Although doctrinaire statements concerning the advisability of dissolving the union are frequently made, both in and out of the legislative bodies, they are quite without significance."[32] Some 27 years later, though, it was all over. Still, why was its demise so inefficient, prolonged and difficult? The analysis finds the spontaneous origins of the LMU to have played a crucial role in structuring the relations between France and other members that made for a slow dissolution despite massive changes in the international monetary landscape.

Marc Flandreau asserts, "The Latin Union can be seen as the largely accidental result of deeper economic forces at work within the international system."[33] The key driver was the relatively early industrialisation of France, which produced domestic savings that served as a foundation for the internationalisation of the franc and the development of the Parisian capital market. The Napoleonic model of French monetary stability in bimetallism provided another important pull factor, particularly since tying domestic monetary systems to the franc was seen as important for attracting French capital. The result was a wide "franc zone" in Central and Southern Europe that spontaneously came into the orbit of the franc and instituted the Napoleonic monetary standard. The formalisation of the LMU in an 1865 treaty with Italy, Belgium, and Switzerland reflected these spontaneous origins with its minimalist agreement to manage subsidiary coins. The key driver was an exclusory calculation by French officials

[32] Willis, 1901, 267.
[33] Flandreau, 2000, 42.

who feared that the Latin Union would infringe upon their established privileges. The most important of these voices came from the Bank of France. The traditions of free association that had developed with the low initiation costs of the franc zone also contributed to the relative lack of positive obligations placed on states. The ironic result was that the 1865 convention failed to provide for strong retaliatory measures against member countries that might over-issue debased coinage at the expense of France, which had to redeem it at an overvaluation. These periodic devaluations created problems in domestic and international circulation across the LMU.

Almost from the outset, the French suffered the same difficulties as the British in attempting to shore up weakening economic ties without resorting to coercive controls that could prompt members to form a united front. The Second Empire was forced to assume a growing share of the costs of sustaining the status quo even before 1870. The effort to impose limitations on Italian borrowing in Paris in 1866 strikingly highlights France's invidious position under the LMU convention. The move precipitated a retaliatory debasement of the lira from which France incurred costs because it shared a common monetary unit. To the frustration of many in France, this *de facto* Italian exit from the system was tolerated rather than punished. This was partly due to the fact that France did not want to see members permanently leave the system so early in its life. The authorities also sought to avoid a concerted push for the gold standard by the members of the Union. French policy restraint was sufficient to prevent Union members finding a common voice or otherwise departing into relations with the UK. However, because it was impossible to introduce direct control over the behaviour of free riders without creating collective administrative architecture, which the French would not countenance, the system faced recurring and further destabilising difficulties.

France's limited ability to control members while keeping its domestic freedom of action produced internal resistance to the Latin Union's extension to other nations in the franc zone. The only country to join the original four was Greece, in 1867. However, in order to retain the prestige and commercial benefits of a wide franc zone in Europe, France entered into a series of bilateral arrangements that partially extended the benefits of the Union to countries such as Austria-Hungary and Spain. Other countries were never admitted to any of the benefits of the Union, but the possibility of entrance was kept open on the condition that they continued to retain monetary and financial relations with France. This represented a subtle form of price discrimination where the un-associated members of the wider franc zone were granted differing and unequal monetary relationships with France to maximise the leader's gains and control over the Latin Union. In order to sustain this practice, French officials were careful to withhold information on the discriminatory terms of membership.

After 1870, LMU members began to look for ways to limit their exposure to the status quo by pursuing strategies of trade and monetary diversification with the UK and Germany. These moves of partial defection weakened the Latin Union. France's failure to take firmer remedial action can be attributed

to the short-term rewards to policy restraint and accommodation that characterise exclusory leadership in spontaneous structures. The absence of member resistance enabled the Union to live through drastic changes associated with the printing of paper money based on the bimetallic currency, the Franco-Prussian war, the retirement of the bimetallic system, and the adoption of the international gold standard. However, no positive action was taken to restore the system. As my framework would predict, this inaction partly reflects French authorities' inability to challenge the vested interests of the *haute banque*, which valued the opportunities for bimetallic arbitrage that the economic base of the Union allowed. When policy steps were taken, officials updated existing practices on a purely defensive basis; reform was not designed to proactively bring the order in line with changed economic and political conditions. In other words, in marked contrast with the leadership of twentieth-century European monetary integration, French authorities pursued measures that mitigated the costs of the changing external environment instead of affirming and reinforcing the unification project. The incremental policy developments that gradually moved the Union to a limping gold standard in 1878 provide a case in point.

The system continued to slowly break apart under this exclusory logic through the 1870s and 1880s. Amid policy drift and increasing institutional sclerosis, France sustained inconveniences and costs associated with an increasingly maladapted set of arrangements that were still vulnerable to free riding and exploitation by weaker powers. In the final decades of the nineteenth century, tiny South European powers wreaked havoc on their powerful northern neighbour. Greece was the worst offender. The drachma was persistently debased in violation of the system's rules while avoiding any effective sanction. France's persistently conciliatory response is baffling without an appreciation of the internal logics of the system. The status quo gave France monopolistic influence that it did not want to risk by pushing the Southern powers out of the system or into collective actions with other members agitating for a clean move to the gold standard. Moreover, the economic base of the Latin Union limited the options available to the French authorities. Above all, through its application of exclusory leadership practices, France benefited from continued monetary hegemony over as large an area of Europe as possible. However, the long-term consequence was that the Union never fulfilled the promise of being a common currency and exchange-rate regime but instead remained a mere coinage agreement.

Again, the explanatory framework of this study sheds new light on this history. The persistence and slow demise of the Latin Union has been attributed to Napoleon's political ambitions and the French desire to irrationally sustain bimetallism after 1870. The continued dominance of this explanation, despite its direct contradiction by France's essentially passive manipulations, suggests something is amiss. My analysis helps to reconcile fact and theory by showing that the conventional wisdom is mistaken. The slow decay of the Union was not the product of the Second Empire and Third Republic attempting to assertively hold the decaying system together against political or economic change. On the contrary, the persistence of the Latin Union is best explained by the sources of power and influence

available to the French monetary authorities in a spontaneous structure. In order to retain gains from its monopolistic control over the spontaneous monetary association based on the franc and bimetallism, France was steered towards policy restraint and price discrimination. This stance came at a high price in the long run. In the final analysis, Willis was correct to observe, "It could not be doubted by anyone possessed of political insight that the action of France had been too tardy and hesitating."[34] However, as with the British case above, this stance was not due to a lack of insight, at least not in the sense that Willis asserts. France benefited from the continuity of the system through exclusory logics, but the system itself was subject to the tyranny of everyday decisions skewed by a calculus that provided short-term gains but did not force updated practices onto others. It became clear over the long run that, by prioritizing the short-term gains enabled by its policy monopoly, French authorities condemned the Latin Union to a slow and painful death, the memories of which were so scarring that Europe would wait almost a century before attempting monetary unification again.

The final case study, in Chapter 7, takes up the history of European monetary unification in the twentieth century. I assess the punctuated and difficult path towards the EMU through the Snake and the EMS in order to make sense of problems currently facing the Eurozone. The Snake provides an interesting study of a negotiated system in which relations of appropriation never stabilised into any kind of order due to international disturbances and divisions among potential leaders. The result was that the members of the system remained rooted to national priorities and were never appropriated into the defence of the order. Nevertheless, important developmental features, as this study's analytical framework anticipate, did take root. For instance, the Snake was based on technocratic fixes that covered over a distributional conflict between the French "economist" and German "monetarist" visions for European integration. In addition, the Commission, which assumed a leadership role in the system, extended the status quo against worsening functional performance in an effort to move the integration project forward. The analysis also highlights the most important legacy of the Snake system in the establishment of a European monetary elite deeply committed to the realisation of monetary union and in the rise of Germany to a dominant position in European monetary affairs.

These two legacies formed the touchstones of the EMS. The development of the EMS provides striking analogies with the gold-dollar system, helping to validate the utility of the framework. Reflecting German interests, the EMS was more substantively similar to the Snake than its architects would like to admit. Like the Snake, EMS was a fixed but adjustable exchange-rate order organised around a European unit of account. The objective of the members, in particular the French and Italians, was to make the EMS a more symmetrical system than the Snake had been. However, under logics of appropriation, the technical details were tilted in favour of Germany. In the words of Karl Otto Pöhl, "The Bundesbank turned the original concept [of the EMS] on its head by making the strongest currency

[34] Willis, 1901, 168.

the yardstick for the system."[35] As time passed, the monetary authorities of member states were increasingly appropriated into this structure. In the process, they saw enormous increases in their power and authority. Specifically, following a change in French policy towards the "franc fort" in 1983, the EMS and German patronage provided an external constraint for member states pursuing competitive deflationary policies. However, as the explanatory framework predicts, Germany was the most significant winner from the negotiated trades. The Bundesbank was free to set its interest rate in light of domestic economic conditions and international competitiveness, while the other states in the system set interest rates with a view to retaining stable exchange rates with each other. Germany also had the ultimate power to force devaluation on countries by not offering them short-term financing support.

The system continued to mature under logics of appropriative leadership, with Germany careful to protect its special prerogatives and position. By the mid-1980s, although the system was superficially in a state of reasonable political and economic equilibrium, tensions had developed under the surface. In particular, France and Italy had begun to argue that the intervention obligations of the EMS should be made more symmetrical and the collective support mechanisms for deficit countries more generous. However, as the framework expects, the EMS underwent only marginal technical adjustments, such as those enacted in the 1987 Basle/Nyborg Agreement. The failure of these technocratic fixes to recalibrate the fundamental distributional payoffs of the system eventually caused the French to drop their long-standing objection to the empowerment of supranational institutions in the pursuit of full-EMU. In the words of the British Chancellor of the Exchequer, Nigel Lawson, "It was the way in which Pöhl openly revelled in his role, via the EMS, of the ruler of Europe's monetary affairs and arbiter of its density . . . that the French . . . found so intolerable that they were prepared to sacrifice their own national independence in order to see the Bundesbank abolished."[36]

With the publication of the Delors Report in 1989, the stage was set for the next period of monetary integration. However, this was exactly the moment when growing functional divergences and political cleavages were beginning to undermine the operation of the EMS. Deeply committed to the realisation of the EMU, policymakers collectively suppressed and distorted information about these problems. In a series of prescient trends, the capital flowing to South European countries was read as a response to long-term improvements in prospects. In truth, this capital was hazardously exploiting short-term interest-rate differentials. Inflation rates grew apart after years of nominal convergence, but authorities saw only temporary blips. The absence of any fundamental structural convergence in labour markets and productivity was deemed unimportant or ignored. Still more remarkably from the advantage of hindsight, officials believed the lack of parity changes led to immutable exchange rates and the emergence of a *de facto* currency union.

[35] Pöhl's speech in St. Paul's Church, Frankfurt, on 27 August 1991 (quoted in Marsh, 1992, 233).
[36] Lawson, 1992, 662–663.

The shocks of German unification and a depreciating dollar exposed this gross collective image distortion and the functional disjuncture between the system and political and economic realities. Rapidly diverging member interests, which were already limiting further appropriation, splintered still further. After 1990, successful member resistance to Germany's aim of selective devaluations showed that the limits of appropriation had been reached. The events of Black Wednesday in 1992, when Italy and the UK were driven from the system, demonstrated the limits to German support for the EMS. The appropriated managers of the system continued to protest its sustainability because they did not want to jeopardise the final stages of the path to the EMU. However, in the context of a non-cooperative standoff between France and Germany and an increasingly coercive stance in Frankfurt and Berlin that seemingly aimed to purge the system of uncommitted weak currency members, the fate of the system was clear. As with the gold-dollar system before it, when the limits of appropriation forced a choice between the system and the interests of its most powerful state, the leader put its interests first.

But, in contrast to the leaders of other negotiated systems I have discussed, the European monetary elite held on, narrowly avoiding collapse. Indeed, they exploited the failure of the EMS as a reason to demand deeper integration. The unusual circumstances of German unification deserve much of the credit for preserving the EMU. However, even among the technocrats removed from the high politics, officials who had paid high entry costs, the argument was familiar: the problems with the system were largely technical and resulted from unfortunate external events. The issues with the design of the EMS, to the extent that they were relevant, could be resolved in a swift move to full monetary integration. In particular, the technocrats' almost bizarrely paradoxical assertion was that the only way to remove the political constraints that prevented unlimited support being available for the EMS's exchange parities was to remove the parities themselves. My framework offers a challenging critique of this conventional narrative. I argue that the problems afflicting the EMS were structural, political and predictable. The lessons of history, if they had been heeded in time, would have been prescient.

By linking the chequered history of European monetary integration with the conditions of its origins, the analytical framework opens a gateway onto the events leading to the recent Eurozone crisis and the institutions and practices evolved to manage it. However great the political will to sustain the single currency might be, the political conflicts endogenous to its development cannot be wished away. Indeed, the removal of exchange-rate flexibility through the single currency, along with further institutional and political centralisation in the ECB enhancing the capacity of elites to hold political and economic pressures at bay, have not changed the fact that the EMU comprises distinct political units engaged in distributional conflicts over policy solutions. The governance of the EMU is not *sui generis* but is rather an order led by Germany and supported by the appropriation of technocratic powers across its subordinate member states. A historically informed analysis in theoretical recognition of this reality suggests that recent palliative reforms may well make for even larger functional disjunctures and even

more explosive political divides in the future. Chapter 7 concludes with the prediction that the Eurozone will collapse if it continues along its present path.

4. Summary

All social systems are subject to dissolution. Yet our understanding of this fundamental component of social life remains curiously unsophisticated. The political and economic theories that have ostensibly explained deterioration have in fact attempted to identify what makes some economies grow while others stagnate, rather than consider degeneration as a general phenomenon.[37] The proposition that open systems thrive whereas closed regimes fester offers no obvious way to understand the process of dissolution itself.[38] When carefully considered, existing theories offer little more than intriguing fragments. The conventional wisdom that organisation is the essence of system survival is also often misleading, as I will show.

The chapters that follow demonstrate that there is a logic as to why we are sometimes caught in the paralysis of decay and why, at other times, apparently robust systems and institutional structures suddenly collapse amid regret and recrimination. The variation in rates of dissolution can be connected and made intelligible through a simple analytical framework that puts opportunistic leadership and system maladaptation at its centre.

[37] This is true even of Mancur Olson's magisterial book *The Rise and Decline of Nations*. His application of the logic of collective action provides a powerful analysis of how social hierarchies and rigidities impede innovation and drive processes of maladaptation, but it explains the relative decline of nations rather than the process of dissolution (Olson, 1982).

[38] James Robinson and Daron Acemoğlu most recently made this argument (Robinson and Acemoğlu, 2012).

2

Explaining Variation in Rates of Dissolution

International monetary systems always decline and fall. Indeed, whatever the initial expectations, they seldom even survive their founders. Yet, we understand little about what consigns them to history: how and why do they falter in the ways that they do? Is it possible to distinguish distinctive modes and patterns of degeneration? If so, is there some unifying logic that might explain these pathways to death? What can this tell us about the sources of resilience and vulnerability in different systems? Might such knowledge help us predict the fate of present-day systems? This chapter develops an explanatory framework to answer these questions.

The challenge is to manage the diversity of the exchange rate systems under consideration so that how they operated, and subsequently failed, can be analysed. That is, to find "a way of looking at or interpreting or organizing the evidence that will reveal superficially disconnected and diverse phenomena to be manifestations of a more fundamental and relatively simple structure."[39] The framework achieves this by setting up an explanatory typology, which distinguishes between two types of system: negotiated and spontaneous orders. The typology is used to draw out the main structural and political variations arising from the differing historical processes. The analysis focuses on a simple yet puzzling difference between these systems: negotiated systems regularly collapse, while spontaneous ones tend to decline slowly.

The framework developed in this chapter explains this counterintuitive irregularity as the product of a dynamic process whereby system leaders, responding to chronic performance problems and to conflicts between themselves and members over policy solutions, drive systems towards particular ends. Specifically, the repeated deployment of distinctive "appropriative" and "exclusory" modalities of leadership, induced and sanctioned by the varying historical and structural conditions of negotiated and spontaneous orders, manifest in 'syndromic' system developments (i.e. developments that exhibit predictable strengths and weaknesses). The endogenous limits to the differing types of leadership, which prevent the continuation of the system along the established path of development, ultimately explain the variation in rates of dissolution. In presenting this framework, the chapter addresses an important gap in received theories, which focus on variables such as the technical constitution of systems, ideas, and exogenous shocks, that are rarely determinative in explaining varying modalities of historical transition. It also makes the case for a new understanding of international monetary leadership

[39] Friedman, 1953, 33.

that is concerned with power and opportunism, rather than the benevolent production of stability in the interests of the global public good.[40]

The chapter is organised in three parts. The first introduces the explanatory typology that distinguishes between negotiated and spontaneous orders. The explanatory framework is then developed in section two. The final section concludes.

1. The Explanatory Typology

International monetary systems bridge the gap between domestic monetary structures and relations, and the cross-border exchange of goods and services.[41] They are driven by the functional need among sovereigns, traders, investors and publics for some order through which to conduct transactions. To recall Mundell's classic definition, these systems are "an aggregation of diverse entities united by regular interaction according to some form of control."[42] This definition is broad, it includes: formal and informal systems; global and regional ones; currency areas in the form of both blocs and target zones; monetary unions; commodity-based systems; and even the so-called "non-system" of today. The only requirement is that a degree of multilateral order exists in the monetary relations between political and economic units, which is capable of supporting the basic elementary goal of facilitating the international exchange of goods and services. This order may take the form of institutions, stable relationships and patterns of interaction and authority.

There are more ways to characterise international monetary systems than there are historical cases. The reason is that the intricate details of systems differ across an almost infinite range of dimensions. There are two basic ways to bring order to this diversity. The first is to specify the monetary policy choices available to states in systems, usually focusing on the exchange rate regime (peg, band, managed float, etc.), the nature of reserve assets and the degree of international capital mobility permitted.[43] This approach sets the basic standard for macro-economic studies.[44] It leads to a focus on the technical construction of different systems, the internal consistency of the various dimensions highlighted and the implications for economic efficiency and other performance characteristics. There is nothing wrong with such economic taxonomies per se, but neither is there anything straightforward or uncontroversial about them.[45] Alternative catalogues are possible that pay greater attention to the historical and political structures behind systems.[46] Following in this second tradition, the taxonomy that underpins this study begins with two simple but fundamental questions:

[40] Chapter 8 provides a discussion of the theoretical contributions of the framework.
[41] Cohen, 1977.
[42] Mundell, 1972, 92.
[43] Cooper, 1975.
[44] International Monetary Fund, 2004.
[45] Reinhart and Rogoff, 2004.
[46] Cohen, 1977; and Strange, 1971.

1. *Under what conditions did the system originate?* Who were the key actors? What forms of cooperation did they engage in? Where was the locus of action?
2. *What structural, and in particular political, consequences can be expected to follow from these origins?*[47]

These questions move away from the technical constitution of systems to investigate how they are structured at a more basic level. This takes seriously the fact that different kinds of agents have built and sustained monetary orders, changing the internal properties of systems. It also stresses how systems exhibit different objective properties at a structural level, that is, how actors stand in relation to each other. These fundamental features represent the structural framework or historical setting in which the systems develop and operate, whatever the complex mechanisms, modes of interaction and particular policy choices that are attendant upon them.[48]

The typology that underpins this study distinguishes two fundamental structures, or international monetary system types, based on whether they emerged though a "negotiated" settlement or "spontaneously". The distinction between spontaneous and induced systems, sometimes referred to as centralised and decentralised cooperation, has its origins in the specialisation of the social sciences. Indeed, the conception of a spontaneous order was developed by Carl Menger in the 1870s in an effort to detail the emergence of exclusively "economic phenomena." Such phenomena, of which, for Menger, money itself was the ultimate example, were "the unintended result of social development." [49] They arise through "the economic interest of individuals … without any agreement, without legislative compulsion, even without any consideration to the public interest …"[50] Friedrich Hayek described the price mechanism as "one of those formations which man has learned to use … after he stumbled on it without understanding it."[51] Chester Barnard, in the 1930s, gave perhaps the clearest specification of the notion of negotiated systems that arise from "that kind of cooperation among men that is conscious, deliberate and purposeful."[52] The two forms of cooperation are alternatives, as Hayek wrote in condemnation of centralised planning and in defence of free-market economies: "We have in effect [through planning] undertaken to dispense with the forces which produced unforeseen results and to replace the impersonal and anonymous mechanism of the market by collective and 'conscious' direction of all social forces to deliberately chosen goals."[53]

[47] Susan Strange began her magisterial study, *Sterling and British Policy: A Political Study of an International Currency in Decline*, by posing very similar questions (Strange, 1971, 1).
[48] Robert Mundell makes a similar separation between what he calls monetary orders and monetary systems (Mundell, 1972, 92).
[49] Menger, 1963, 147.
[50] Menger, 1963, 154.
[51] Hayek, 1945, 528.
[52] Barnard, 1938, 4.
[53] Hayek, 1945, 24.

It has long been recognised as important that international monetary systems, like many social phenomena, can emerge spontaneously or be induced through deliberate negotiations.[54] Negotiated systems are cases in which a limited number of national bureaucratic authorities, treasuries and central banks, often exercising the authority of heads of state, design particular exchange rate mechanisms. Such systems are a product of conscious political engineering orientated around a particular schema. Spontaneous systems, by contrast, are cases where a large number of (predominantly non-public) actors embedded in market relations coalesce around authority structures and practices that perpetuate international monetary orders. Market participants and forces are often at the helm, charting their own courses of action around dominant trading currencies and patterns of finance, making waves that political authorities seek to ride and negotiate, but do not create.[55]

This typological distinction facilitates the classification of a wide variety of international monetary regimes past and present, as Table 2.1 suggests. It is immediately apparent that there is no automatic correlation between the cells of the taxonomy and the features of systems in technical economic terms. There are exchange rate regimes in all manner of varieties in every cell and the reserve assets and degrees of capital mobility also vary. This demonstrates that the present taxonomy draws out different aspects than those catalogues which capture the technical particularities of systems.

Table 2.1. Selected Examples of Negotiated and Spontaneous International Monetary Systems

Negotiated	**Spontaneous**
Rouble zone (1947–1993)	Latin City States (gold florin) (1250-1533)
Gold-dollar System (1955–1973)	Dutch Guilder (1550-1800)
European Monetary System (1979–1993)	Latin Monetary Union (1865–1927)
Inter-war Gold Standard (1919–1936)	Scandinavian Monetary Union (1873–1931)
East African Currency Area (1966–1977)	Sterling Area (1931–1978)
European Snake (1969–1979)	Dollarization in Latin America (1900–)
The Tripartite Agreement (1936–1944)	Bimetallic Standard (1800–1881)
Franc zone (1964–)	Classical Gold Standard (1881–1913)
Eurozone (1969–)	Floating ‘Non-System’/USD Regime (1975–)

The creation of the rouble zone provides an archetypal example of a negotiated system. Beginning in 1947, through a series of reforms, Soviet authorities ripped up the traditional West-leaning patterns of trade in the Eastern Bloc and imposed a new monetary order from the top-down based on a mono-bank structure.[56] The gold-dollar system, whose origins lie in the congregation of delegates from forty-four nations in 1944 at Bretton Woods, New Hampshire, with the declared objective of crafting a “new world

[54] Gallarotti, 1995; Flandreau, et al., 2010; and Strange, 1971.
[55] This conceptualisation of spontaneous orders draws especially on Giulio Gallarotti’s study of the emergence of the classical gold standard and Marc Flandreau’s study of the Latin Union (Gallarotti, 1995; and Flandreau, 2000).
[56] Lewin, 1994; and Johnson, 2000, Chapter 1.

economic order", is another model case of a negotiated system.[57] The birth of the post-war monetary system was described by one leading commentator as a "political miracle."[58] The inter-war gold exchange standard is another example of political demand operating in the aftermath of a major conflict. When the automatic restoration of the classical gold standard failed to occur, and desperate economic conditions prevailed across Europe, the task of manufacturing a return to the gold standard was assumed in earnest by British monetary officials. Finally, the path towards EMU, as Luigi Zingales succinctly put it, was pursued "mostly for political reasons."[59]

After the Byzantine Empire, the Florentine florin, struck from 1252 to 1533, provides perhaps the first example of a spontaneous monetary order emerging around a dominant trading centre. In the fourteenth century, some one hundred and fifty European states and local coin issuing authorities made their own copies of the florin. The Sterling Area offers an example of a more contemporary spontaneous system. Before 1931 there was already a bloc based on private and official exchanges made in pounds. After the UK went off gold, the British government policy sought to "gradually build up world confidence in sterling, which, by degrees, [was] bringing one country after another into line, without any compulsion."[60] The result was that, in the words of one commentator, "the binding material of the group was economic and financial rather than political…"[61] The Latin Union was similarly structured by economic forces, specifically in the trade and financial integration of Europe that gathered pace in the 1850s and 1860s.[62] As Marc Flandreau has put it, "unlike its modern counterpart, the Latin Union involved much less 'politics' than has been often believed."[63] Although a century divides them, the classical gold standard and the so-called 'non-system' of today are two further examples. The classical gold standard, in the words of Charles Kindleberger, "developed more or less unconsciously."[64] As Giulio Gallarotti has put it, the process of emergence was a "fundamentally additive" one, where "intergovernmental cooperation was not a principal factor in influencing either the origin or stability of the regime."[65] The system retained "stability without a pact", through market-based relations, and dependencies configured one or a few economic hubs.[66] The non-system of today is similarly a residual spontaneous regime orientated around the US dollar that emerged from the failure to find a negotiated basis for a new order in the 1970s.[67]

[57] Gardner, 1969; and Van Dormal, 1978.
[58] Gardner, 1985, 21.
[59] Luigi Zingales "The Fate of the Euro." Speech given at the Becker Friedman Institute for Economic Research, Chicago, March 2014.
[60] Drummond, 1981, 19.
[61] Crick, 1948, 3.
[62] Flandreau, 2000.
[63] Flandreau, 2000, 43.
[64] Kindleberger, 1988, 134.
[65] Gallarotti, 1995, 19.
[66] Flandreau, et al., 1998.
[67] Solomon, 1982.

The typology used in this thesis makes two important breaks with traditional depictions of spontaneous and negotiated orders. First, in keeping with the original distinction between economic markets and political hierarchies, the tendency has been to view spontaneous systems as horizontal and negotiated ones as hierarchical.[68] However, the historical record suggests that this distinction is misleading. To be sure, negotiated systems are usually organised by leading states. Here hierarchies are more readily accepted. But, in reality, spontaneous systems are also hierarchical. Indeed, they are seldom, if ever, horizontal.[69] The error has been to conflate a diffuse process, in which actors autonomously orientate themselves around particular rules and practices in response to particularistic concerns, with a diffuse power distribution. In fact, spontaneous systems usually emerge around a leading pole or economic hegemon. Currency leadership often provides the material and ideational pull which draws other actors into a discernible order.[70]

Second, the typology places less emphasis on the degree of constitutionalisation than is sometimes thought relevant when comparing international monetary regimes.[71] To be sure, the initial designs for negotiated systems are often instantiated in international treaties, while spontaneous systems usually operate without any treaty basis or codification. However, negotiated systems seldom operate according to the rules initially agreed. Equally, spontaneous systems can be supported by international treaties without these treaties playing a huge role in developments. The role that legal frameworks play in influencing the operation and performance of systems is often undermined by the very fact of asymmetry which is so central to the current analysis. As Richard Cooper has noted:

> [T]he world economy is very asymmetric in its functioning. For technical reasons, it is both likely and desirable that one or a few currencies will emerge with special status in market transactions. Even when this fact is fully known and acceptable, it cannot always be formally acknowledged and sanctified in treaties, in part for reasons of status […] There thus emerges a discrepancy between what governments say in formal negotiations and what they do, or are willing happily to accept, in day-to-day operations – a discrepancy between their stated preferences and their revealed preferences.[72]

Given that the hierarchical versus horizontal distinction is misleading while the degree of constitutionalisation is often of little practical importance, what pertinent consequences do follow from

[68] Giulio Gallarotti is notable for conflating spontaneity with decentralisation in his study of the gold standard (Gallarotti, 1995). In an even more obfuscatory assumption, some scholars have associated spontaneous orders with "no conflict situations", where no politics exists, or "free for all" situations, where no order exists (see Stein, 1983; and Cooper, 1987).
[69] The potential exception is the classical gold standard that some argue was centred on a number of economic hubs. However, others strongly assert that Britain was unquestionably at the centre. For contrasting views (see Walter, 1993; and Eichengreen, 1989).
[70] The role of hegemony and currency leadership in shaping the geography of international monetary affairs is well developed (see, in particular, Cohen, 1997).
[71] Cooper, 1975; and Flandreau, et al., 2003.
[72] Cooper, 1975, 63.

the alternatives of either negotiated or spontaneous emergence? The typology developed in this study draws out two key points of variation. First, the system-types develop through distinct historical processes, temporal orderings and binding materials. This gives negotiated and spontaneous systems varying *historical foundations*. In short, spontaneous systems have an economic foundation while negotiated systems have a political foundation. More precisely, in negotiated systems, state monetary authorities, treasuries and central banks, and the national civil servants that represent them, assume a central position from the outset and incur large up-front costs creating the system. In spontaneous systems, by contrast, market actors and forces are in the driver's seat, while state monetary authorities, central bankers and monetary experts from treasuries arrive later; as a result they assume a more marginalised position. They also incur lower initiation costs. Thus, the process and sequencing by which a system acquires its historical basis are key factors in shaping the following attributes: the initiation costs of the system; the common practices and materials by which the system is supported; how states and markets stand in relation to one another; and the consequent ability of leading monetary authorities to pursue certain courses of action.

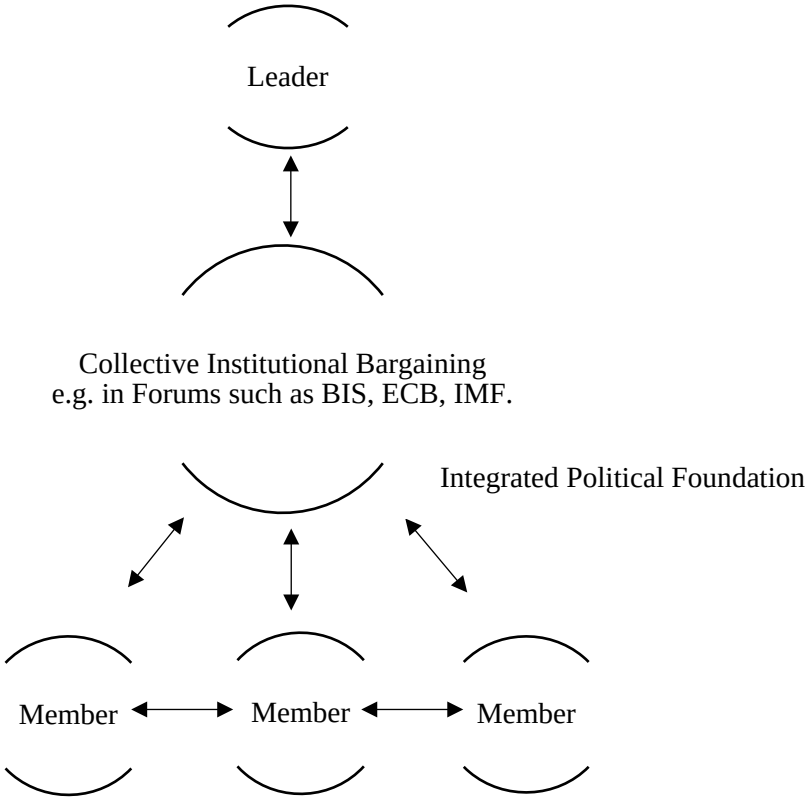
Second, the *structural organisation* or arrangement of the systems will vary. In negotiated systems, the treasuries and central banks of the leading and participant states will be vertically and horizontally integrated through their engagement in persistent collective institutionalised bargaining. The membership will be collectively organised within these settings. For instance, in the gold-dollar system, an integrated group of officials from the US met with Japanese and West European national civil servants and monetary officials on a repeated basis, in specific institutional settings, to organise common responses to problems facing the system. The settings included WP3 of the OECD, the BIS, the International Monetary Fund (IMF), and the G-10 Deputies.

In spontaneous systems, the atomised and diffuse process of system formation means that the treasuries and central banks of participant states will be unassociated, not just vertically vis-à-vis the leader but also horizontally amongst themselves. The leadership and membership will not routinely bargain with each other over the terms of continuity, the members will not be collectively organised, and there will be few, if any, institutional forums in which to facilitate concerted cooperation. The consequence is that the leader assumes exclusive responsibility for most of the effective policymaking for the system. For instance, in the Latin Union, as Luca Einaudi put it, "[d]ue to the lack of common institutions, the French Ministry of Foreign Affairs became in fact the coordination institution of the Union. It hosted all the conferences, received communications for all the members, summarized the various options, dealt with candidates, negotiated controversial agreements, and dispatched circular replies to the whole Union."[73]

[73] Einaudi, 2001, 51.

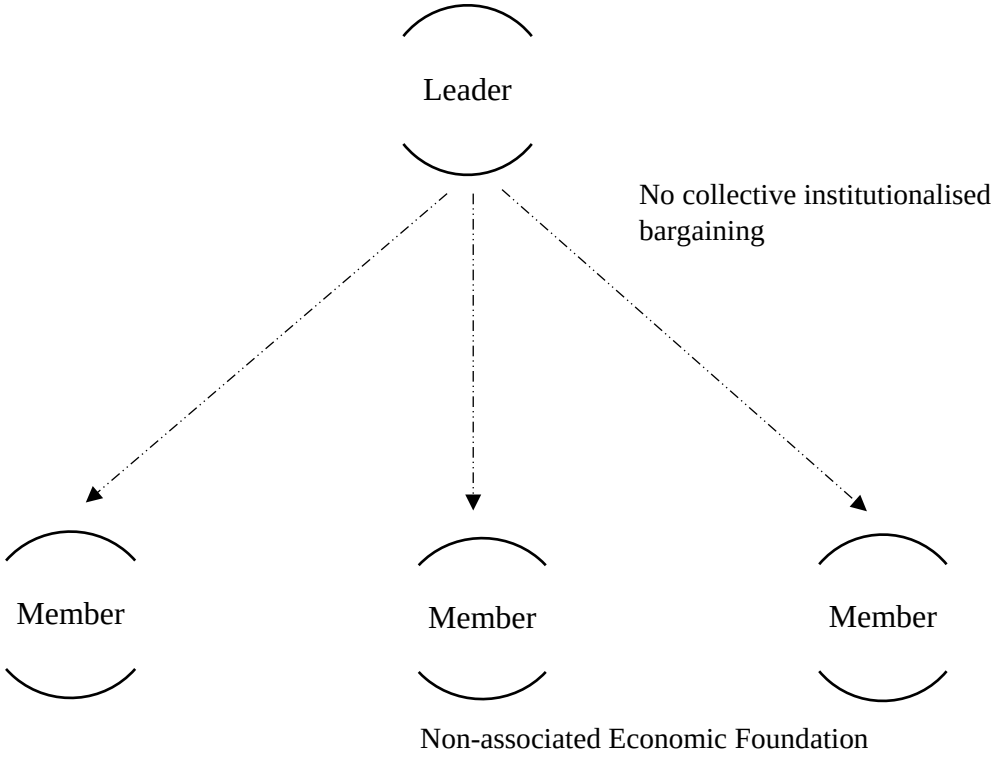
In summary, modern international monetary systems can be defined as hierarchical aggregations of diverse entities united by regular interactions guided by the monetary authorities of leading states.[74] The participating entities (i.e. members) include the treasuries and central banks of other states and other market participants, such as private capital and labour market organisations. These systems have emerged through one of two distinct historical processes, either as the "negotiated" product of induced cooperation or as the "spontaneous" result of actors coalescing around an economic pole. These varying conditions of emergence will shape the historical constitution, or character-forming structural foundations, of systems. Specifically, history drives two dimensions of variance. First, systems emerged with different *historical foundations*, having political or economic roots. Through alternative temporal orderings and historical processes, there is variation in the relative centrality and power of national treasury and central bank monetary authorities vis-à-vis market actors and forces, and so in the paths available to monetary officials. Second, the *structural organisation* of systems differs according to the degree of vertical and horizontal integration and the related presence or absence of repeated collective institutionalised bargaining. Figures 2.1 and 2.2 summarise the two structures.

Figure 2.1. Negotiated International Monetary System



[74] This adapts Robert Mundell's classic definition (Mundell, 1972, 92).

Figure 2.2. Spontaneous International Monetary System



2. The Explanatory Framework

The explanatory framework developed in this section is grounded in the assumptions of institutionalism. Political and economic agents are taken to be boundedly rational and situated in complex and uncertain environments. While subject to cognitive constraints, in general actors weigh and link the costs and benefits of their actions to expected outcomes. More precisely, they try to maximise utility (or value) in the sense that prospect theory would assert. That is, they think about expected gains and losses primarily in terms of status quo endowments and changes to them.[75] They pursue their goals in a strategic and interdependent situation: one in which the best course of action depends on what others do.[76] The framework also assumes that actors are opportunistic. They will combine "self-seeking with guile."[77] This behavioural assumption means actors can manipulate information and other resources for self-serving ends. The concept of bounded rationality, as applied in this study, means principally that actors cannot know the full consequences of their decisions, and that the status quo will cast a dark

[75] Markowitz, 1952; and Tversky and Kahneman, 1979; 1981; and, 1991.
[76] Schelling, 1980.
[77] Williamson, 1975, 26.

shadow over decision makers. The boundedly rational opportunist will heavily discount the long-term implications of decisions.

From these assumptions, consider a hierarchically ordered international monetary system comprised of a leader and members, each represented by national monetary authorities. This system will also have private market participants. The leader is defined simply as the dominant state in the system; the one with the most economic and monetary power, strategically placed at the apex of the system's hierarchy – a point to which the other members of the system look for leadership. The hierarchical structure of relations and the material capacities of the leading state will cause it to have the most power and incentive to sponsor and implement initiatives that adapt the system to emergent cooperation problems. This definition acknowledges the ability of dominant states to define the 'rules of the game' and to make critical contributions to resolving collective action problems.[78] Generally, the leader is able to delineate the ends of system, develop institutions and policies adapted to these ends, and see to it that the members adjust such that those objectives become a part of the system.[79] For simplicity, the framework assumes homogenous interests within the leader and members, although not between them. That is, the various sub-state interests, such as the distinct preferences of the central bank and the treasury officials, are taken to be aggregated in the international setting.

The analysis begins with an unspecified deterioration in performance.[80] At issue is the policy response of the leader. Although there are potential shared gains from some new policy that facilitates the continuation of the system, there is an assumed distributional conflict between the leader and members over this policy response.[81] For some policy of continuation to be enacted, the net exit payoffs for the participants in the system must be less than the net payoffs from the policy solution. Thus, in conformity with basic rational choice theory, continuation depends upon making people better off. However, the payoffs from continuity will still produce winners and losers. This follows Krasner's famous observation that institutional arrangements and policies are "necessary to resolve coordination

[78] Mattli, 1999; and Keohane, 1984. Chapter 8 elaborates on why the behavioural assumptions of opportunism and bounded rationality nevertheless cause the definition of leadership in this study to differ markedly in its substantive application from traditional conceptions of hegemonic leadership.
[79] This dynamic conception of leadership is derived from Philip Selznick (see Selznick, 1957, 57; and 1949). The importance of the social relations of hierarchy in processes of leadership and social change draws upon studies of employment and other structured economic relations. These studies consistently recognise that agents at the top of hierarchies have greater influence over processes of institutional change than the agents who sit at the bottom of hierarchies (see Offe and Wiesenthal, 1986; and Hall, 2010, 209). For useful discussions of the role of hierarchy in international monetary affairs (see Andrews 2006a; and, 2006b; Cohen, 1997; and, 2006; and Walters, 2006).
[80] This approach follows Albert Hirschman's theoretical starting point in *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Hirschman, 1970, 4).
[81] In this construction, in game theoretic terms, the relationship between the leadership and the membership is represented as being akin to a "battle of the sexes game". That is, both leaders and members want to find a solution to the problem, but they disagree over what that solution should look like.

problems.… Without [these arrangements] all parties would [be] worse off. There are, however, many points along the Pareto frontier."[82]

As already noted, the *structural organisation* and *historical foundations* of systems are established at their inception, and they differ between spontaneous and negotiated orders. It is within such differing contexts that the performance problems will emerge. First, consider the effects of variance in structural organisation: In a negotiated system, the leader will bargain over the policy response with an organised membership in specific institutional settings. The parties retain the ability to exit should the negotiation break down. By contrast, in spontaneous orders, the leader will, usually implicitly, stipulate the terms of continuation and the members will adapt autonomously to these. Crucially, there will be no collective institutionalised bargaining between the leader and members. Second, consider the effects of variance in the historical foundations of systems: Recall that in negotiated orders, national monetary authorities design the system and assume a central position within it from the outset. In spontaneous systems, market-based relations and actors establish certain patterns of action first. The following sections elaborate on how these factors combine to vary the dominant modality of leadership across negotiated and spontaneous systems.

Holding all else equal, leaders can extract more benefits from continuity in spontaneous systems than in negotiated ones, because they will not have to bargain with members over policies, or divide the surplus gains from continuity. Moreover, the unorganised membership provides an opportunity for the leader to engage in price discrimination practices, charging different amounts to members for their continued support, which will yield allocative efficiency savings. Thus, the leader of a spontaneous order has good reason to retain its exclusive control over policy developments. By contrast, in negotiated orders, leaders will have to share out the benefits of continuation at the bargaining table. However, unlike in spontaneous systems, the leader does not need to guard against the possibility that members will overcome their collective action problems when developing policy responses, because it is a positive attribute of a negotiated system that the membership is already organised and bargaining. There follows the central insight of the framework, that although leaders can dictate policies and discriminate between members in spontaneous orders, they will be more willing and able to appropriate administrative resources from members when performance problems emerge in negotiated systems. The leader that is engaged in institutionalised bargaining with a collectively organised membership can readily procure support from those around the bargaining table, lifting member monetary authorities out of their national political contexts and into the defence of the system. The means of appropriation include the endorsement of sub-goal pursuits (in particular, the goals of monetary authorities to increase their own autonomy and administrative capacities), special forms of reciprocity and mutual empowerment, and the development of common ideas and beliefs. Thus, across negotiated and

[82] Krasner, 1991, 337.

spontaneous systems, leaders respond to performance problems through two distinct modalities of action. These modalities are referred to in this study as “appropriative” and “exclusory” logics.

The link between these leadership modalities and different temporal structures of dissolution comes from the varying member and system responses that arise endogenously under them. In negotiated systems, the appropriation of the administrative capacities of members is likely to manifest in resistance and protest. By contrast, exclusory leadership is designed to avoid inducing collective action on the part of members. This naturally lessens the probability of resistance. Trouble spots can be bought off, some members can be allowed to drop out, and policies that might induce resistance can be withheld. This will naturally slow the process of dissolution. However, the members will owe no loyalty to a system in which they have no say. As a result, the members will seek to diminish their exposure to the decaying core through defection. The manner in which functional misalignments accrue will also vary according to which leadership modality is in operation. Under appropriative logics, the negotiated order will be prevented from responding to changing functional demands by technocratic fixes and group information distortions that hold the status quo in place. On the other hand, the spontaneous order, responding to the logics of exclusory leadership, stands condemned to suffer from institutional sclerosis and reduced coherence; the basis of common interests will be hollowed out through discrimination and policy drift. Differing modalities of leadership drive systems towards differing ends. Under appropriative leadership, functional disjunctures and political cleavages put limits on the possibilities for further appropriation. Eventually, the leader will either have to assume the burdens of continuation or pull down the monetary temple. In the latter case, the outcome is rapid collapse. The spontaneous system, by contrast, will be potholed with exceptions and will experience functional decay, and in the absence of remedial actions and updated practices the outcome will be slow decline.

The following subsections walk through the main explanatory factors in more detail. For reasons of analytic precision, the various elements and social processes are unbundled and discussed independently. The logics of appropriative and exclusory leadership are analysed first. The discussion elaborates on the foundational and structural drivers of the two modalities of action, before turning to the path dependent logics that support their repeated deployment. Next, the unintended defective consequences of the two modalities of leadership, in political cleavages, policy maladaptation, and information and image distortions, are discussed. This presentation allows for clear argumentation regarding the causal mechanisms and pathways that lead to particular outcomes. However, as discussed in the third subsection, in reality the factors coincide and interact in a dynamic and constitutive fashion. Under constraints set by the distinct ways in which they originated, and through the repeated deployment of distinct leadership modalities, systems are driven along different historical and developmental trajectories towards the aggregate level outcome of contrasting rates of dissolution.

2.1. The Logics of Appropriative and Exclusory Leadership

a. Historical Foundations of Leadership Modalities

Negotiated and spontaneous orders emerge through historical processes of distinct kinds, each following a predictably regular sequence of events, temporal durations and materials of instantiation. These contrasting historical foundations are causally connected to the emergence of either appropriative or exclusory leadership. One point of contrast is that the initiation costs of negotiated systems are higher than the initiation costs of spontaneous systems. As a consequence, the onset of problems is likely to induce higher levels of policy activism from national monetary authorities in negotiated orders than in spontaneous ones. There is another point of contrast, in the temporal sequence, whereby national monetary authorities join a system either before or after market based actors. Specifically, national monetary authorities arrive first and thus occupy the centre of negotiated systems, while in spontaneous orders they arrive later and are thus constrained to operate around the centrally established market-based players. The leaders of international monetary orders have incentives and capabilities that vary in accordance with the possibilities and constraints created by the investments made in creating a system, and by the timing of their arrival. This section elaborates on how these points of variation support the development of appropriative and exclusory leadership.

i. *Initiation costs*

The large initiation costs involved in establishing negotiated systems increase the incentive for leaders to resort to appropriation. The start-up investments made in designing, negotiating and implementing the system increase the payoffs from further investments in the established monetary construct.[83] Two particular mechanisms are worthy of mention. First, failure shortly after creation can be rendered politically 'unthinkable'. This will encourage the leader to procure assistance and organise collective defences for the system. The investments made by members in negotiations will also make them susceptible to co-optation. Second, the longer the designers of the system, or their protégés, remain around the negotiating table, the stronger the tendencies towards appropriation will be. With personal and institutional reputations at stake, such individuals will be reluctant to admit that the initial design was defective. Paul Volker recalled the missionary zeal finance officials had when supporting the gold dollar system: "A few of them had personally participated, at least at the margins, at the Bretton Woods conference and saw themselves as disciples of the founders, who would keep their vision intact."[84] This special sense of collective responsibility for the system drives the high levels of policy initiative and activism that are constitutive features of appropriative leadership.[85]

[83] This is a basic expectation of the literature on increasing returns (see Arthur, 1994; and North, 1990).
[84] Volker and Gyohten, 1992, 2.
[85] Hirschman, 1970, 94.

In contrast, the slow and incremental emergence of spontaneous orders, in the absence of conscious construction, lowers initiation costs. The order is not forged by short-term and deliberate political and economic investments, but by longer acting and deeper historical processes. Those who find themselves in a system via 'historical accident' rather than volition typically attach less special significance to it. This absence of personal and institutional responsibility tempers fervent activism in response to underperformance. The context thus induces and supports what this study calls exclusory tactics.

ii. *Control needs and capacities*

The historically determined positioning of national monetary authorities in the foundation of a system will also shape responses of leaders to policy problems. The central positioning of national monetary authorities in negotiated systems, and the more marginal position they assume in spontaneous systems, determines the availability of certain courses of action.[86] The bureaucratised decision-making that characterises negotiated orders means that leading monetary authorities stand relatively apart from markets. In spontaneous systems, the monetary agencies of the leading state are in a less central and relatively less autonomous position vis-à-vis the markets.[87] This matters because the best course of action for leaders depends upon the market control needs to which they must respond. These differing needs either induce appropriative leadership, and disincentivise exclusory leadership, or vice versa.

In negotiated orders, leading monetary authorities have an incentive to turn to rules rather than discretion in times of crisis, because they face acute time inconsistency and commitment problems.[88] Because large and centrally-positioned bureaucratic monetary authorities are subject to unpredictable political demands, and able to implement their policies in the face of market resistance, it will be difficult for them to convince the markets that they will honour commitments in the absence of binding rules. To be sure, domestic institutional arrangements and traditions are often more important determinants of credible commitments than rules agreed to on an international level.[89] Nevertheless, generally, policy rigidity is more of a tactical and technical necessity in a negotiated system than in a spontaneous one. The fit with logics of appropriation is clear: the leading authorities need to stabilise expectations and minimise external sources of uncertainty that might undermine their control.

By contrast, the market control needs of monetary authorities are lower in spontaneous orders. This is because their more marginal position relaxes the time inconsistency and commitment problems they face. Their resource dependency makes it less likely that they will make major changes in policy. They

[86] The observation that the control needs of leaders vary in different institutional structures is derived from the varieties of capitalism literature (Hall and Soskice, 2001, 45-50).
[87] The role of national and supranational bureaucratic agency in regime development was emphasised by Ernst Haas in his classic study of European integration (Haas, 1968).
[88] This section draws on the economics literature on time inconsistency and the central insight that given the opportunity and having the capacity to "re-optimise" monetary policy at a later date, governments will commonly do so, often in way that are inflationary and detrimental to total output (see Kyland and Prescott, 1977; and Barro and Gordon, 1983).
[89] North and Weingast, 1989.

are constrained by their relative weakness. However, seemingly paradoxically, this increases the scope for the flexible responses and contingent commitments that characterise exclusory leadership. These policies of adjustment are more feasible because the markets can discipline the monetary authorities if they go too far.[90] The finding by Arthur Bloomfield of regular rule breaches under the gold standard shows this is true even in fixed exchange rate regimes, where the discretion of monetary policy is otherwise more constrained.[91]

As the variance in market control needs itself implies, the capacity of leaders to stand apart from societal interests and impose their preferences differs between the two systems very consistently.[92] The vested market interests that form the base of spontaneous systems can serve as a major constraint on certain remedial policies for leaders. This acts as a stronger limitation on policies of appropriation than is to be found in negotiated orders. Of course, in negotiated orders, private sector actors will still defend their interests. However, the resort to technocratic fixes, rules and the expansion of bureaucratic capacity that typifies the process of appropriation is easier where national monetary authorities are able to stand apart from the market practices that constitute the order. Thus, for instance, in the negotiated gold-dollar order, the US was able to introduce an exchange equalisation tax and impose other limits on capital outflows, whereas the British were unable and unwilling to introduce similar policies in the spontaneous Sterling Area, where market practices and banking relationships comprised the foundations of the system.[93]

iii. *Historical foundations, leadership, and system development*

The differing initiation costs and market control needs of national monetary authorities, which follow from the differing historical foundations of negotiated and spontaneous systems, determine the incentives and the capacities of leaders to pursue strategies of either appropriation or exclusion. The negotiated system has a developmental trajectory that is heavily dependent on state intervention from the outset and prone to becoming increasingly so over time. Negotiated systems are disposed to the logics of "planning" that Hayek identified: "The increasing veneration for the state, the admiration of power, and of bigness for bigness' sake, the enthusiasm for "organization" of everything".[94] In spontaneous orders, the foundational logics produce a different policy track. The bureaucratic authority of the state will be less of an expanding presence in the system, because it will arrive later and be constrained by the private market-based interests defending their autonomous and pre-established sphere of operation. This does not necessarily mean superior leadership, as these vested private interests

[90] Ellickson, 1991; and Ostrom, 1990.
[91] Bloomfield, 1959.
[92] Katzenstein, 1985; and Krasner, 1984.
[93] Indeed, when it was suggested to British officials in one meeting of WP3 of the OECD that they might pursue similar techniques to the Americans to help equilibrate the Sterling Area, the proposal was dismissed with the observation that such devices were "unsuitable" because the Sterling Area had a "different basis of loyalty" (Caincross, "WP3 OECD Record of Meeting' held in July 1966", OECD/CPE/WP3, 23).
[94] Hayek, 1946, 200.

can skew the policies in a maladaptive way, such as was the case with the City of London's influence over the Sterling Area or the *haute banque's* defence of bimetallism in the Latin Union.[95]

b. Organisational Structure and Leadership Modalities

The second factor explaining the different forms of leadership in negotiated and spontaneous systems is organisational structure. In negotiated systems the leader's national monetary authorities engage in institutionalised bargaining with collectively organised national monetary authorities from member states. By contrast, in spontaneous systems, in the absence of collective institutionalised bargaining, the leading monetary authorities will have a monopoly over policy developments, and the member monetary authorities will not even necessarily be directly associated with each other. How does the presence or absence of collective institutionalised bargaining, and the relational arrangement of members, cause the strategic behaviour of leaders to differ? The proposition developed here is that this structural distinction changes the strategic means through which the leader can manipulate costs and benefits to maximise its utility as successive grounds for continuity are transacted. Therefore different decision calculations produce either appropriative or exclusory leadership.

In responding to a performance problem, how can the opportunistic leader secure terms of continuation that apportion costs and benefits to its advantage? The nature of the underlying structure has a direct bearing on this. In negotiated systems, the leader will have to share the benefits of continuation with the membership in a bargaining process. Members will receive more of the benefits from continuity than in a spontaneous setting, not only because they are organised, but also because they have influence by virtue of their 'seat at the table'. However, collective institutionalised bargaining is not just a constraint on the leader; it also creates an opportunity for appropriation. The leader can procure support from members to help defend its international monetary construct. The position of national monetary authorities in concerted institutionalised settings provides a readymade pool of power that can help secure the system if correctly directed.

The means of appropriation are numerous. The most important is the support for sub-group goals of the national monetary authorities in member states. The leader, and the system, can help the member monetary authorities to augment their capacities and increase their autonomy in the domestic arena.[96] For instance, the leader can offer special financing arrangements to loyal members, or simply rhetorical support. The price charged for this external endorsement is reciprocal support. This mutual empowerment of leading and member national monetary authorities can be sufficient to mute concerns about the inequitable payoffs from continuation. Member monetary authorities may even accept terms

[95] Strange, 1971; Schenk, 1994; and Flandreau, 2001.

[96] As scholars of public administration have shown, autonomy is a "proximate goal" for all regulators, including national monetary authorities, because "whatever else they desire," autonomy is "necessary to achieve it" (Carpenter, 2001, 374-75, n.16). Crucially, "autonomy determines the degree to which it is costly to acquire and use [bureaucratic] resources" (Wilson, 1989, 195).

of continuity that run contrary to national interests. For instance, in the gold-dollar system, the US co-opted central banks in Western Europe to hold dollar reserves that far exceeded the self-imposed limits that were considered prudent. In return, the US provided those authorities with access to special financing arrangements, such as Federal Reserve swaps, that helped them defend their exchange parities.

Invariably, appropriation occurs with the active participation of the national monetary authorities in member states. Credibility can be imported from the monetary hegemon without collective institutionalised bargaining. However, the structure of social relations in collective bargaining institutions provides a powerful resource for appropriation. The sites of collective bargaining pool technocratic authority in a focal location that can be used as a coordinating device. The fact that monetary authorities face common political pressures, and shared collective and private objectives such as political autonomy and market control, also makes appropriation easier. Closed institutionalised bargaining also makes it hard to distinguish appropriation from constructive cooperation. The shared professional norms of central bankers and monetary experts provide another cloak for the subgroup endeavours and reciprocal exchanges. Common participation in closed forums and repeated face-to-face interactions further facilitates the development of common ideas and beliefs, which, while empowering member monetary authorities, also eases their enlistment into the construct that disproportionately benefits the leader.

The same incentives and opportunities do not arise in spontaneous orders. All else being equal, in such an order, leaders are better off because members are not organised and do not routinely bargain collectively with them. In this situation, leaders can retain the entire surplus from continuation over and above the members' exit payoff. Furthermore, across all systems, members will differ in the value they attach to the system. In a collective institutionalised bargaining setting with integrated members, the leader cannot easily exploit this variation. But where the members of the system are not collectively organised and there is no collective bargaining, the prospects for price discrimination increase. The leader can provide different terms of membership to the fragmented national monetary authorities according to the individual value they accord to the system. For the leader, this will yield allocative efficiency gains. For instance, the leader can allow members it wants to keep to diversify their reserves or give them privileged access to its markets, while members of lower value to the system can be required to hold all of their assets in the leader's currency or face more restrictive terms of access to the leader's capital markets.

The central strategic calculation that leads to exclusory leadership is that in order to retain these advantages of monopolistic control, leaders need to reduce the probability of collective organisation. The probability that the diffusely arranged membership will overcome their collective action problems

is determined by factors within the leader's control.[97] The leader will be disposed to policy restraint, as activism increases the likelihood that the member monetary authorities will organise and demand a say in developments. In particular, the leader will leave open the possibility of exit and allow certain members to drop out because, as Albert Hirschman noted, "the presence of the exit option can sharply reduce the probability that the voice option will be taken up widely and effectively."[98] To avoid collective organisation the leader may also take no action when problems emerge, for fear of triggering a collective response that would result in a costly share-out. "What does not happen" in decision-making matters: systems develop not only because of positive actions, but also because of those issues that are avoided or consciously excluded from the agenda.[99]

To summarise, appropriation enables the leader to maximise its utility through continuation by co-opting authorities in member countries into the concerted defence of the system. The structure of collective institutionalised bargaining and integrated membership increases the incentives and opportunities for leaders to pursue this strategy. By contrast, exclusory strategies defend the leader's interests by keeping the membership divided, not only so the costs of collective bargaining can be avoided, but also so the allocative gains of price discrimination can be reaped.

c. The Logics of Two International Monetary Leadership-Types

The foregoing analysis delineated the central dimensions of difference between negotiated and spontaneous orders that have a direct impact on the responses of leaders when performance problems emerge and solutions are sought. Table 2.2 below summarises the factors and mechanisms through which the two modalities of appropriative and exclusory leadership emerge. In short, because of systematic variations in initiation costs, system formation, and organisational structures, leaders can maximise their utility through the deployment of alternative strategies and devices.

The various logics are closely interrelated and highly correlated: one or other leadership modality emerges as an increasing number of the historical conditions for it are satisfied. Exclusory and appropriative leadership represent modalities of action induced by collections of associated conditions, such that the failure of a given case to strongly satisfy one of the conditions in a 'package' does not necessarily mean that the more favoured modality of leadership will not arise. Moreover, the framework explains the dominant modalities of leadership: the type of leadership that will be repeatedly deployed in response to emergent problems. These are the modalities of action that leaders have the strongest

[97] Hirschman, 1970, 92; and Gehlbach, 2006, 398.
[98] Hirschman, 1970, 76.
[99] There are various definitions of non-decision making. However, the classic definition provided by Peter Bachrach and Morton Baratz is that non-decision making involves "the practice of limiting the scope of actual decision making to safe issues by manipulating the dominant community values, myths and political institutions and procedures" (Bachrach and Baratz 1963, 632). The same authors' revision to this definition reads as "a decision that results in suppression or thwarting of a latent challenge to the values or interests of the decision maker' (Bachrach and Baratz, 1970, 44). The notable point for the present study is that the strategic calculation that drives non-decision making is almost always concerned with retaining control over issues.

incentives and the greatest capacities to pursue under particular historical and structural conditions. There may be instances of price discrimination in negotiated systems or examples of collective bargaining in spontaneous ones. However, system-incongruent leadership actions are less likely and will be infrequent, because they are costlier strategies for leaders. Indeed, they run against the key sources of power and interest.

Table 2.2. The Logics of Appropriative and Exclusory Leadership

System Type:	Negotiated	Spontaneous
Historical Foundations:		
Initiation costs:	High	Low
	High levels of policy activism and initiative.	*Reduced levels of policy activism and initiative.*
Sequencing and materials:	National monetary authorities arrive first establishing a "political base"	Market actors and forces arrive first establishing an "economic base"
	Incentive to resort to rules rather than discretion arising from high control needs. Capacity to impose rules arising from ability to stand apart from economic interests.	*Incentive to resort to discretion rather than rules arising from low control needs. Capacity to impose rules limited by inability to stand apart from economic interests.*
Structural Organisation:		
Strategic calculus:	Collective institutionalised bargaining and vertical and horizontal integration	No collective institutionalised bargaining and vertical and horizontal disassociation
	"Co-opt support": *Induces special forms of reciprocity, the endorsement of sub-goal pursuits, the development of common beliefs, and other sources of mutual empowerment, as new terms of continuation are transacted.*	*"Safe policy monopoly":* *Induces policy restraint, non-decisions, price discrimination, and other devices compatible with reducing the probability of collective bargaining, as new terms of continuation are transacted.*
Leadership Modality:	Appropriative	Exclusory

Note: The *italics* summarise the leadership and policy responses to the onset of performance problems.

There is naturally a degree of coevolution between the historical processes, the embedding of the structural forms, and the modalities of leadership. The deployment of exclusory price discrimination tactics will drive the disaggregation of member interests, making it harder for them to overcome their collective action problems. By contrast, the deployment of appropriation increases the likelihood that the locus of power and decision will converge on specific forums of collective institutional bargaining.

This coevolution implies that at the micro-foundational level there are powerful path dependent logics at work. That is, appropriative and exclusory leadership are each self-reinforcing and broadly incompatible. Different historical structures encourage particular modalities of leadership, which result in specific types of investment, which then further embed those structures, and so on. The developmental trajectories forged by the distinct original conditions and the two modalities of leadership become difficult to reverse as the relative benefits of continuing with a particular mode of action are high, while the option of switching to the alternative mode is almost entirely precluded.[100] Thus, a leader that increases its capacity for appropriation, for instance by establishing collective supranational authorities, diminishes its capacity to exclude national monetary authorities from decision-making. Equally, a leader that has persistently excluded other national monetary authorities from influencing policy developments will have less of a chance of mobilising collective actions when difficulties emerge. The reason the theory cannot be reduced to one of pure path dependence is that the modalities of action are self-limiting. As will be elaborated below, specific forms of maladaptation and political resistance emerge endogenously to limit the continued deployment of the two modalities of action and so undermine continued development along a particular policy track.

The combination of bounded rationality and opportunism drives path dependence. Leaders are opportunistically satisficing, not optimising, when pursuing appropriation and exclusory tactics. They are not looking all the way down the decision tree.[101] Quite to the contrary, leaders are systematically discounting the long-term implications of their actions, rather than bringing the system into more efficient adjustment with underlying political and economic realities. This applies also to members. The national monetary authorities in negotiated systems are seduced by short-term gains into relations of appropriation. In particular, they discount the long-term implications of sustained asymmetry and of subordination to a dominant foreign power. In the case of spontaneous orders, in failing to mobilize collectively, the members stand to be exploited through price discrimination. However, they can pursue relative gains vis-à-vis each other and avoid the short-term costs of collective mobilisation. As already noted, the self-liming defects of appropriation and exclusion will accumulate and, eventually, change the cost and benefit calculations of leaders and members. There are predictable defects or costs to transactions guided by appropriation and exclusion that eventually limit the power of leaders to maintain systems through each strategy. It is to these limits that the framework can now turn.

2.2. The Defective Consequences of Appropriative and Exclusory Leadership

a. The Political Cleavages

Albert Hirschman famously asked: when firms enter into decline and product standards slip, under what conditions will consumers *exit* the market, rather than *voicing* their discontent in the hope of

[100] Hacker, 2002, 54; and Pierson, 2004, 20-48.
[101] Jupille, Mattli and Snidal, 2013.

engendering a change on the part of the firm's management, and vice versa?[102] This section draws upon several of Hirschman's insights to argue that differing member responses from national monetary authorities, namely, *resistance* and *defection*, that are analogous to *voice* and *exit*, can be expected to arise endogenously under appropriative and exclusory leadership respectively.[103] To reiterate, under appropriative leadership, the dominant response of members will be *resistance*, while under exclusory leadership it will be *defection*. These different member responses contribute towards varying rates of dissolution.

Leadership through appropriation is liable to produce resistance, not simply because resource extraction and barriers to exit tend to increase over time under appropriation, but also because the legitimacy of national monetary authorities is rendered vulnerable by their collaboration with and subordination to the interests of the leader. It is necessary to distinguish between internal and external factors that prompt members towards resistance. As the exorbitant privileges of the leader become clear, external coalitional groups will form to protest the structure. These agents, outside the system of appropriation and losing in distributional terms, will organise to make further appropriation for member monetary authorities more difficult. Such external coalitions may emerge from within states or civil society. The growth of the international lobby for floating exchange rates from the early 1960s provides an example of an outsider coalition in the gold dollar system. This lobby made it more difficult for the Bundesbank to make trades with the Federal Reserve to support the gold dollar system. The non-monetary executive agencies and legislative branches of government, that is, parts of the state that do not participate in the actual day-to-day administration of the system and so do not benefit directly from appropriation, are also candidates for the articulation of resistance.

Perhaps more surprisingly, resistance will come also from national monetary authorities who are insiders to the bargaining structure. These authorities can never act entirely independently of the domestic political contexts in which they are embedded, and the national interests they are supposed to represent. It follows that they will not be entirely comfortable about their subordination through appropriation or its inequitable payoffs. West European monetary authorities, for instance, protested against the distribution of costs and benefits under the gold-dollar system, even as they grew in power through appropriative trades with US monetary authorities that advanced their sub-group goals. The context of collective institutionalised bargaining further lends itself to the development of insider resistance. The organised and integrated membership will be able to identify common interests around inequitable payoffs and coordinate common responses to them. In addition, the fact that national monetary authorities are engaged in bargaining, enjoy special privileges from appropriation, and are heavily invested in the status quo, generates an incentive to voice discontent, rather than simply

[102] Hirschman, 1970, 5.
[103] The language of resistance and defection is used rather than voice and exit because it better captures the relevant behaviours observed in case studies.

defecting when problems emerge. The members may threaten exit to extract bargaining power, as the French and Italians sometimes did in the EMS, but will usually do this privately and seldom carry out the threat.[104]

Under exclusory leadership, different membership responses arise. Exclusory leadership tactics are intended to avoid collective resistance, and they do render it less likely. Instead, therefore, the dominant response of members to exclusory leadership is defection. Through the process of defection actors gradually stop following the practices that are constitutive of the system, often without any formal agreement to do so.[105] As already noted, the exclusory leader will consciously leave the exit option open to members while passing on special benefits to those members it has a particular interest in retaining. The result is that the leader can let members drop out in the order of their increasing relative importance to the system, while the option of price discrimination provides a further safety valve to relieve pressures arising from restive participants. In other words, the probability of resistance is diminished because the exit option – full or partial – substitutes for protest. The study of the Sterling Area provides a compelling demonstration of this strategic context in action. Members that were particularly committed to leaving the system, like Burma and Egypt, were allowed to drop out with a minimum of resistance from the UK, primarily because officials in London were desperate to avoid wider unrest.

The other driver of defection is that member national monetary authorities will have a limited degree of loyalty to a leader that gives them little or no say in matters. They will have few means of influence, not just because they will need to overcome collective action problems to exert significant influence, but also because they will need to create points of access to the policymaking of the leader that are not already established. A related factor is that the dissociated relations among members will generate uncertainty about payoffs; members are often not fully aware of the extent of their exploitation, especially given the informational monopoly held by the leader. Moreover, the parallel sets of relationships pit members against each other. This frustrates the identification of common interests around which protests might be voiced. Yet, at the same time, the members will know that the leader could unilaterally cut them off from valued benefits. In this context, as the system falters, the best course of action for members will be to limit their exposure to the decaying centre, while retaining whatever benefits are still available. Thus, gradual and often silent defections, which involve edging out of the status quo, are a more viable strategy than open protest. The gradual processes of reserve and trade diversification that underpinned the dissolution of both the Sterling Area and Latin Union provide examples of calculated defection.

[104] This follows Albert Hirschman's observation that, "the effectiveness of the voice mechanism [i.e. bargaining power] is strengthened by the possibility [or value] of exit" (Hirschman, 1970, 83).
[105] Hall, 2010, 218; Thelen, 2004; and Thelen and Kume, 1999.

The emergence of resistance and defection under appropriation and exclusion respectively provides an important part of the explanation of varying rates of dissolution. The formation of resistance will increase the degree of politicisation around the system. The rising tide of restive pressures will, eventually, put limits on further appropriation and the addition of further supports for the status quo. As it becomes more difficult to coordinate states and markets, these rising costs will present the leader with a major decision over whether to continue to prop up the system or allow it to collapse. The process of defection is a slower motor of history. The leader is able to sustain its power as the mainspring of a spontaneous system by permitting limited departures. However, the unintended consequence of defection is that the system disintegrates as common practices and interests fall apart.

b. The Sources of Policy Maladaptation

International monetary systems seldom respond straightforwardly to changing functional demands. From a comparative perspective, the question is whether differing sources of policy maladaptation can be expected to afflict particular systems. This section demonstrates that appropriative and exclusory leadership systems are subject to alternative sources of policy dysfunction. Specifically, negotiated orders are disposed towards *technocratic fixes*, where new institutions and devices are devised to prop up systems – and established channels of benefits – in the face of changing functional demands, whereas spontaneous orders are disposed towards institutional *sclerosis* and policy drift as practices are not updated to meet emerging functional needs.

Logics of appropriation tilt the capacities of national monetary authorities towards maintaining established channels of benefits as functional demands change and as successive terms of continuity are organised. In collective institutional bargaining between monetary authorities, instrumental issues that do not have consequences for the fundamental distribution of power within the system can be resolved more easily than those that do. The reason is that the central domestic sources of power available to monetary authorities are technocratic and instrumental, but they lack political authority. Moreover, the leader will usually not want beneficial status quo payoffs to be disturbed unless the outcome is to further entrench its advantages. The path of policy development is therefore typified by the development of a series of limited technocratic fixes.[106]

Technocratic fixes enable leading authorities to mitigate problems and extend the system, while sustaining or entrenching the established distribution of power and authority. For example, the EMS saw a number of technical changes instituted through the 1980s, but the fundamental asymmetries of German dominance persisted. Jaqueline Best observed, as the "Bretton Woods system struggled through an escalating series of monetary crises, state and global policymakers chose a similar path of technical

[106] Fitz Machlup has called these "compensatory corrections" (Machlup, 1965, 65). In the words of David Andrews, these are "policies designed to reduce the immediate demand for policy change without engaging in real adjustment – in other words, without effecting a marginal reallocation of resources" (Andrews, 2006, 100).

expediency, opting for limited reforms."[107] The resort to technocratic fixes tends to result in the expansion of the administrative architecture around the system and a proliferation of new means and devices of market intervention. These technical devices empower national monetary officials, but they leave the system skewed towards the interests of the leader. Technocratic fixes do not bring the system into political equilibrium or a sustainable balance.

Exclusory leadership is subject to a different form of policy maladaptation. The repeated avoidance of concerted remedial actions and the propensity towards restraint will result in policy drift and inaction.[108] The inability of national monetary authorities to stand apart from the market based actors at the foundation of the system and impose their preferences upon them will reinforce status quo biases. In addition, the relative absence of resistance may deny the leader an important source of information regarding the functional needs of the system, not least as regards the actual commitment of members to the system. In the long term, the leader is unlikely to take the coercive actions necessary to bring practices in line with changing functional demands. In other words, the system will be disposed to institutional sclerosis.

The maladaptive effect of exclusory policies is that leaders and members become less sensitive to whole-part relations, and interests drift apart. Eventually, the point is reached when the sum of the participants' interests does not correspond to a clear collective interest that can support the system. At this point, the system risks becoming so incoherent and unworkable that nobody stands to benefit from it. The case studies reveal how the aversion of French and British policymakers to remedial responses that would have reinforced the LMU and Sterling Area gradually undermined and then reversed the patterns of integration that had brought the systems into being. In the final days of these systems, the common interests and practices holding them together were so weakened that they could be retired almost without anyone noticing the difference.

The differing forms of policy maladaptation under appropriative and exclusory leadership help to explain varying rates of decline. The increasingly wide distributional inequities that are supported by technocratic fixes under appropriative leadership will in the long-run confound the leader's ability to find further technocratic solutions to problems. The result, when this limit is reached, is the sudden intrusion of politics and discontent. This often manifests in non-cooperative standoffs between participant monetary authorities that precipitate collapse. Equally, the decay that results from institutional sclerosis and policy drift will hollow out the foundations of spontaneous systems. These gradual processes manifest in decline.

[107] Best, 2004, 383.
[108] This notion of policy drift is drawn from Jacob Hacker. (see Hacker, 2002; and, 2004).

c. Information and Image Distortions

The selective distribution and disclosure of information is an important tactic for leaders as they respond to performance problems. Three specific conjectures are central to the explanatory framework proposed here. First, generally, leaders are incentivised to withhold private information on any deterioration that puts in doubt their commitment or capacity to support the system. Second, in negotiated orders, the leader can *trade* private information in return for collective and individual control. Third, by contrast, in spontaneous systems, leaders have cause to *withhold* private information on the terms of membership in order to facilitate price discrimination. These antithetical patterns of positive trading and negative withholding of information support the modalities of appropriative and exclusory leadership respectively. They also produce specific patterns of bias that distinguish the two systems. These biases limit the scope for continuation under each particular modality of leadership and, ultimately, contribute to their particular rates of dissolution. This subsection discusses each conjecture about information in turn.

Leaders tend to overstate their willingness and capacity to continue the system because they want to minimise uncertainty and the prospect of members defecting. The prestige and power that flows from international monetary leadership makes it difficult to abandon. This particular bias is not affected by whether transactions are organised around appropriation or exclusion. The slight qualification to this is that in a negotiated system the leader may be able to leverage its bargaining power by suggesting that its commitment is wavering, in order to gain a larger share of the surplus from continuation. The same incentive does not exist in spontaneous orders where the leader in effect holds all the bargaining power anyway. That is, the leader of a spontaneous order cannot improve its position by suggesting any faltering in its commitment. However, generally, the benefits of disclosing information about an impairment in the leader's commitment or capacity to sustain the system will be outweighed by the benefits available from overstating its ability to do so.

The implication of this generalised distortion is profound. It suggests that leaders will almost always distort information in a manner that promotes extensions of institutions and practices beyond what might be optimal. The distortions are also harmful to the interests of members that would push for alternative arrangements, or make individual adjustments, if they had complete and accurate information on the leader's actual preferences and power. The leader may also be harmed to the extent that the persistent reassertion of its ability to keep things going produces cognitive dissonance between its self-believed and actual capacity and willingness to sustain the status quo. As Kenneth Arrow notes: "It is easier to understand and accept information congruent with previous beliefs than to overcome cognitive dissonance."[109] Therefore, once information distortions have begun to be incorporated into

[109] Arrow, 1974, 75.

the maladaptive workings of the system, information confirming the stability of the system will receive a better reception than information suggesting weakness.

The differing arrangements of negotiated and spontaneous orders also generate differing sources of bias. The integration of the leader and members, and the internalisation of private information exchange within collective bargaining forums tends to divert those forums into patterns of communication bias that defend the goals of the leader and appropriated members.[110] The leader can increase the impact of its representations through the greater frequency of statements to a concentrated, proximate and identifiable audience. The members too can overstate the robustness of their position in order to promote particularistic goals or sustain the rents flowing to them from appropriation. Co-opted national monetary authorities attain private benefits, specifically the supply of privileged private information, in return for endorsing misrepresentations to interested outsiders. The technocratic expertise of the monetary authorities at the bargaining table provides authority that enhances the impact of these collective misrepresentations. Ten central bankers insisting that a system is moving in the right direction is a more powerful coordination device than just one doing so.

The risk is that forums become places where the suitability and resilience of the status quo is constantly affirmed, rather than places where substantive adjustments are made to solve problems. Furthermore, the isolated and closed nature of bargaining forums increases the propensity for a common filter to be placed on external stimuli, favouring data that affirms the collective actions of the group and disregarding contradictory data. This filter will bond the group and increase its capacity to overcome collective action constraints, but can easily result in gross collective image distortions.[111] This pattern of bias is present in the various mechanisms of appropriation, including the endorsement of sub-group goals and special forms of internal reciprocity. The wider effect of these distortive informational trades is the diversion of the bargaining forums towards concerted misrepresentations, where insiders share in and present images that have little in common with objective realities, but which help to sustain the system in the immediate term.

The case studies developed in the subsequent chapters reveal the severe extent to which negotiated systems have been subject to these patterns of bias in perception and representation. In the next chapter, the meetings of WP3 of the OECD in the gold-dollar system provide a remarkable illustration of chronic information distortions. Through the 1960s, participants in this tight group routinely provided each other with erroneous economic forecasts that secured international approval of national balance of payments packages that were supposed to bring the system into equilibrium. The distortions built a picture of the whole system moving towards a better payments equilibrium when the opposite was true.

[110] This section draws implicitly upon Kenneth Boulding's theory of internal images and their creation and revision through repeated social interactions and Herbert Simon's study of information process in closed organisations (see Boulding, 1956; and 1966; Simon, 1956, [2013]; and 1981).
[111] Boulding, 1966, 8; and Williamson, 1975, 122.

The US in particular lurched from one failed adjustment package to another. In the process, essential adjustment measures were endlessly deferred and steps that eroded the rules of the order were legitimated. Participants even came to believe in the image of stability that they were publicly propagating. Gabriel Ferras of the BIS wrote to the G-10 Deputies in 1965 to complain. "The fact is," he warned, "that we have serious problems right now and I am convinced that there is considerable risk in letting them slide while we indulge in this leisurely contingency planning."[112] The close reading of discussions in the League of Nations Gold Delegation in the 1920s and those of the European Committee of Central Bank Governors on the path to EMU reveal strikingly similar patterns of distortion. These many and varied forums became instruments of group misrepresentation that maintained the status quo in spite of changing external pressures, thereby undermining the adaptive usefulness of the forums to their systems in the long-term.

The context in which information distortions arise in spontaneous orders is different. Leaders and members have incentives to withhold private information rather than collectively distort it. This bias in representations is intrinsic to exclusory leadership and price discrimination. For the leader, if persistence is to be achieved through price discrimination, the sensitive terms of continuity agreed with particular members must be kept confidential. Equally, keeping their own (differentiated) terms of continuation confidential is compatible with the interests of the disunited members hoping to maximise their individual gains. Moreover, to support the distortions, the leader can disburse extensive rewards to members on condition of silence. The non-associated relations of the membership are deepened by these patterns of withheld information. The result of such selective disclosures over time is to deepen the structural separation between members and to frustrate the possibility of integration and collective action. By way of contrast, withholding information on discriminatory terms of membership in integrated negotiated systems is far more costly and less sustainable for the leader.

There is compelling evidence of this pattern of withholding private information in spontaneous systems. The diffuse arrangement of members in the Sterling Area made it possible for virtually every member to participate in the system on different terms. This state of affairs was sustained by Britain's insistence that it could not disclose sensitive financial data about banking relationships with other members. Equally, the members who were operating on special terms did not disclose these to other members, as they sought to maximise their individual gains. This pattern helped to maximise British gains as bespoke terms of continuity were agreed with members depending upon their importance to the system. However, the ties that bound the Sterling Area together progressively weakened as suspicion regarding discriminatory treatment spread. The same patterns of withholding information are found in the LMU case, where members remained inside the system on radically different terms. This protected France

[112] Ferras to Eimmenger, Undated, BISA FER 7 7.18(10) A34 10.

from the dangers of collective resistance, but it made organising useful collective adaptations more difficult.

To summarise, information distortions and selective disclosures support both appropriative and exclusory modalities of leadership. There is also a general tendency for leaders to bias information in support of extensions of the status quo. However, the precise sources and impact of the distortions will vary. In negotiated systems, the leader and members will trade distorted information, individually and collectively, in order to defend the system. In spontaneous orders, the withholding of private information will help to support the practice of price discrimination by keeping members at arms-length from one another and ignorant about the differentiated terms of membership.

The nature of these information and image distortions can be linked to rates of decline. The gross collective distortions that tend to warp negotiated systems are liable to sudden exposures that rapidly undermine the credibility of the national monetary authorities and central bargaining forums. The result is to dramatically disrupt the ability of the leader to coordinate state and market behaviours through the established structures and institutions of appropriation. In contrast, the fragmented distribution of information that results from its withholding in spontaneous orders fuels ever greater degrees of disassociation between the members and between the leader and the members. Gradually, the exclusory leader will undermine the common bonds and interests that support the system.

2.3. Leadership Logics, Limits, and Rates of Dissolution

The foregoing analysis has elaborated on the endogenous limits of appropriation and exclusion. The several maladaptive mechanisms that operate under each respective modality of leadership are highly correlated amongst themselves, and operate in dynamic ensembles. Thus, the resistance that appropriation induces makes technocratic fixes more difficult and forces leaders and appropriated groups into larger image distortions. Equally, the defections that emerge in response to exclusion weaken the basis for collective remedial actions and widen the constraints imposed by the tendency to withhold private information. The broad effect of these defects is to drive systems towards varying rates of dissolution.

In a negotiated system, the resistance and political cleavages left in place by technocratic fixes, and the other major dysfunctions caused by group image distortions, will build pressures that eventually limit appropriation. The burdens of continuation, without the support of continued appropriation to coordinate state and market behaviours, will weigh heavily upon the leading state. At some tipping point, the cost-benefit analysis of the leader will radically alter. Unless the leader finds some way to increase the extraction or assumes the growing burdens, the system will collapse at this juncture, sometimes following a short period when coercion supplants appropriation. In a spontaneous system, by contrast, the repeated deployment of exclusory tactics that induce defections, institutional sclerosis, policy drift, and fragmented information, will undermine the common interests and practices that

sustain the system. Slow decline will ensue, and eventually, the whole will not be able to support its parts, and it will become impossible to rationalise sustaining the system. At this point, the leader will retire the system. Table 2.3 summarises the endogenous limits of appropriative and exclusory leadership.

Importantly, the limits that differing member responses and functional maladaptations place upon appropriation and exclusion do not emerge immediately. On the contrary, they build up over time, until, eventually, a threshold is reached where the dominant modality of leadership is no longer viable. It is again important to note that this model assumes actors which are characterised by bounded rationality and opportunism. The leadership may be aware of some of the potential risks and downsides of appropriation and exclusion. However, often, the defects that limit appropriation and exclusion are unintended downstream consequences of opportunistic actions taken by leaders, with limited decision-making capabilities, following established routines that (for a while, at least) secure satisfactory rents from the solutions to prior problems.

Table 2.3. The Consequences of Appropriative and Exclusory Leadership and Rates of Dissolution

Leadership Modality/ 'Defect'	Appropriative	Exclusory
Political cleavage		
	Member Resistance	Member Defection
	Member resistance places increasing limits on appropriation until a critical juncture is reached.	*Member defection undermines the practices constitutive of the system.*
Policy maladaptation		
	Technocratic fixes	Sclerosis and policy drift
	Short-term holding devices that do not address the underlying political and economic disequilibria.	*Common practices and institutions are not updated to meet changing functional needs.*
Image and information distortions		
	Distortive trades and collective misrepresentations	Withholding and fragmentation of information
	Large collective image distortions made for group purposes that are liable to sudden exposure.	*Withholding private information on varying terms of membership weakens coherence.*
Rate of Dissolution:	Fast (collapse)	Slow (decline)

3. Conclusion

International monetary systems rarely last more than a couple of generations and few are fondly remembered. Here the obvious similarities end. Among the most striking differences between them is that they are consigned to history in a plethora of ways. However, a regularity to these differences can be discerned in the distinction between fast and slow rates of dissolution. The huge variations in the rates of dissolution of monetary systems derive from a simple logic. The central claim of this thesis is that the way systems dissolve is determined by the way they came into being, through negotiated or spontaneous cooperation, and by the modalities of leadership that develop according to these initial conditions.

The explanation can be summarised as follows: the unit of investigation is the response of leaders when facing performance problems and distributional conflicts with members of a system over the terms of its continuity. The dominant strategies pursued by leaders consolidate particular kinds of solutions into ongoing institutions and practices. In this model, leaders are assumed to be opportunistic and boundedly rational utility maximisers. They are concerned primarily with self- rather than system-serving considerations. As a comparative matter, negotiated and spontaneous orders represent alternative kinds of international monetary hierarchy, having distinct forms of *structural organisation*, defined in terms of how national monetary authorities stand in relation to each other, and distinct *historical foundations*, because they have roots in either political or economic processes, which determine the paths available to policymakers. Specifically, in negotiated systems, national monetary authorities from the leading and member states are: 1) in a central position from the outset; 2) vertically and horizontally integrated; and 3) engaged in repeated collective institutionalised bargaining. By contrast, in spontaneous systems, national monetary authorities from the leading and member states are: 1) marginalised from the outset by the market-based agents; 2) vertically and horizontally unassociated due to the atomised and diffuse process of formation; and 3) not engaged in collective institutionalised bargaining, meaning the leader has exclusive control over the terms of continuity. Under these distinct historical conditions, leaders can be expected to have alternative sources of power and interest, and differing opportunities to secure their position through continuity. In response, a distinct modality of leadership emerges in each system-type.

In negotiated systems, *appropriative leadership* guides the successive transactions and adaptations that secure the persistence of the system. In spontaneous systems, *exclusory leadership* is the dominant modality of action. Appropriative leadership involves procuring administrative and technocratic resources through collective institutionalised bargaining to resolve problems, whereas exclusory leadership is geared towards retaining the non-trivial monopoly advantages that flow from not having to bargain over the terms of continuation. Under both modalities of action, leaders exploit their strategic position, distorting information and manipulating costs and benefits, to promote their particular interests

and goals. Moreover, each leadership modality has 'syndrome' characteristics, that is, particular strengths and weaknesses.[113] Even as they underpin the repeated transactions that secure continuity, these characteristics create varying political cleavages and sources of informational and policy maladaptation. The practices of appropriation induce technocratic fixes and group image distortions that sustain the system in spite of resistance and maladaptation. The negotiated system is therefore held together, notwithstanding growing dysfunctions and discontent, until the limits are reached and the leader must conclude that the costs of continuation exceed the benefits. On the other hand, the practices of exclusory leadership induce policy drift and fragmented information, which facilitate defection. The spontaneous system will be slowly hollowed out until it can no longer support its parts, and it will be impossible to rationalise sustaining the system. The following chapters illustrate this framework with historical cases.

[113] This draws on Oliver Williamson's argument that markets and hierarchies exhibit 'syndromic' characteristics (Williamson, 1975, 115).

PART II

3

The Collapse of the Gold-Dollar System

Individual agency in the long struggle for the gold-dollar system has come to seem less significant in hindsight, due to a retrospective perception that the system was doomed to failure by its technical defects.[114] Yet this history was in fact very dramatic. US policymakers shuttled between the capitals of the Western world, launching one initiative after another and establishing an amazing array of new institutional props and devices. This chapter will argue that these bargains hold the key to explaining the system's rapid collapse.[115] Using the analytical framework laid out in the opening chapters of this study, it will show that the system's integrated bargaining structure and political foundations set US officials on an appropriative course. In order to sustain an established channel of benefits derived from leadership, the US Treasury and Federal Reserve engaged in side-dealings and sub-goal pursuits with affiliated monetary authorities, too often at the expense of necessary recalibrations to the overall system. Technocratic fixes and group information distortions repeatedly sacrificed necessary adjustments at the altar of the US's payoffs and those of national monetary authorities in Europe and Japan. However, the costs imposed on subordinate actors provoked their resistance well before the collapse. The pressure of their resistance constrained the path of appropriation and, ultimately, pushed the US to reassess its interests and redirect its power, bringing the system to a dramatic end.

This argument is based on an unprecedented analysis of the three collective institutional bargaining forums of the gold-dollar system: the G-10 Deputies, WP3 of the OECD, and the Gold and Foreign Exchange Experts' Group of the Bank of International Settlements ("Expert Group" of the BIS). In these settings, the US cajoled and manipulated Western Europe and Japan into prolonging the gold-dollar system. The level of activism among US monetary officials was high because they had invested a vast amount to establish the gold-dollar system. Moreover, they recognised that by selectively disclosing private information and doling out special dispensations and punishments, it would be possible to hold the system together in spite of worsening performance. The means employed to sustain the system included, among other things: multilateral surveillance, joint operations in exchange and gold markets, currency swaps, inter-governmental credits, interlocking exchange controls, and special drawing rights (SDRs). The terms of continuation enabled the US to reap seigniorage gains and avoid

[114] This is true whether accounts focus on the system's economic structure (Bordo and Eichengreen, 1993; Eichengreen, 1993; 1996; and, 2000; and Williamson, 1977); the changing domestic economic situation in the US (Eichengreen, 2000; and Willett, 1980); the changing political position of the US in the word (Gilpin, 1983; Gowa, 1983; and Keohane and Nye, 1977); or an expansion of private capital flows and other environmental changes (Helleiner, 1994).

[115] This challenges the received wisdom, found across a range of studies, that these bargains were examples of constructive cooperation (Bordo and Eichengreen, 1993; Eichengreen, 1993; and Williamson, 1977). For the personal memoirs and recollections that support this positive historical perspective see Coombs, 1976; Mikesell, 1994; Roosa, 1967; Solomon, 1977; and Volcker and Gyohten, 1992.

domestic adjustment costs. An internal report put it thus: "The available financing for our deficits has permitted the United States to carry out heavy overseas military expenditure and to undertake other foreign commitments, and to retain substantial flexibility in domestic economic policy." [116] Yet the appropriative schemes that the US created to support the system were opportunistic and constrained by the bounded rationality of their creators. They led, over time, to a maladaptive layering of debt, almost as much "fairy money" as real, burdensome commitments to keep supporting the gold price, exchange parities that stretched credulity, and, ultimately, backlash and resistance from member countries.

As had been the case with the appropriative monetary relations of the 1920s that will be discussed in the next chapter, and congruently with this study's explanatory framework, the benefits of continuation through appropriation were shared with co-opted European partners. Indeed, the appropriative schemes and US patronage vastly augmented the power and resources of national monetary officials in their domestic contexts. The large market control needs of the powerful monetary officials inclined them to willingly accept international administrative supports and external patronage to extend their powers of intervention. However, participants were never truly comfortable with the payoffs under the appropriative schemes. They knew that short-term gains were being made at the expense of long-term performance, and that the schemes were steadily reinforcing the lack of symmetrical pressure on the US balance of payments. In short, members were very conscious that they were repeatedly surrendering to the imperatives of the centre. In particular, European central banks were pushed to take in ever more uncovered dollars under the threat that gold convertibility would be suspended if they did not.[117] They were also forced to impose restrictive policies on the markets, against their better instincts that: "The object of current international economic policy [should be] to attempt to eliminate these controls [and to] object against further controls."[118] Thus, as would be predicted by the framework, the terms of continuation entrenched US advantages, but they were maladaptive and produced widening political cleavages. Specifically, the hand of the state in the system extended the status quo in spite of changing environmental conditions, and the policy trajectory induced growing resistance among both insiders and outsiders.

In 1965, after several years of silent chafing, France broke ranks and publicly challenged America's leadership. However, the US was unwilling to change course. As a result, the national monetary authorities in the appropriated core, still committed to supporting the system, became increasingly vulnerable to rebellious domestic coalitions. The governor of the Bank of Italy remarked in 1968 that, "while his bank was still in control of the Italian situation, it might not be for much longer, since politicians were moving into the monetary policy field."[119] The markets also tired of being hoodwinked

[116] Gowa, 1983, 63; also quoted in James, 1996, 211.
[117] Bergstein, 1996, 267, fn. 42 and 43.
[118] Ossola, "OECD WP3 Record of Meeting held in May 1961", OECD/CPE/WP3, 6.
[119] Macdonald, "Gold and foreign exchange markets, meeting of the Governors and the US undersecretary of Treasury, Hotel Euler", 11 December 1967, BISA 7.18(16) – Papers R.T.P. Hall, box HAL 2, f01.

by group information distortions and grew unstable. The capacity of the US authorities to procure the necessary support to maintain the status quo was increasingly cast into doubt. In the increasingly politicised and unstable economic climate, all sides bargained harder. As a result, new swaps arrangements and extensions to the Gold Pool became harder to procure. The schemes supporting the system became increasingly maladapted. In the words of one insider: "From 1965 things started to happen that reduced monetary collaboration … almost to a façade."[120] Faced with the rising costs, but significantly *without* an actual run on the dollar by participants, the US pushed the monetary authorities of Europe and Japan into more costly and coercive deals. Eventually, when no more support could be extracted to avoid economic adjustment, in August 1971, the US exercised its ultimate power play, embargoing gold and undermining the entire gold-dollar edifice.

The above narrative implies an important theoretical argument. Most international relations theories locate the failure of the gold-dollar system in the breakdown of a hegemonic bargain.[121] This bargain allowed the US to finance its hegemony on cheap credit provided by continental Europe and Japan, who received, in return, reserves to support their growth. The standard argument is that as the power asymmetries between the US and the rest declined, and the economic imbalances between the creditors and debtor grew, both sides found cause to recalibrate the deal. However, when reform proved elusive, the most powerful player in the game abandoned the system. It is not that this theory is wrong, but rather that it is underspecified. To be sure, shifting costs and benefits led the actors to recalibrate their strategies, and undid the hegemonic bargain. However, this account is ad hoc and lacks micro-foundations. The individual-level leadership calculations and system developments that brought about the aggregate level outcomes of collapse are absent. US interests did not change in some ad hoc way, rather the leader's calculation of the best means to project its power shifted, when the endogenous limits of appropriation were reached. A complete account of the collapse must explain the process leading to this outcome. The explanation must tell us why the US led the system as it did, and with what implications. The logic and consequences of appropriative leadership in negotiated systems provide such an explanation.

Economic historians, as opposed to scholars of international relations, focus on problems of adjustment, liquidity and confidence.[122] These problems are common to all monetary systems, but cannot be easily solved in a gold-dollar system for reasons intrinsic to its structure. The standard argument, in brief, is that the adjustment mechanism between major economies failed because the gold-dollar price was rendered immutable by the 'nth currency problem'. The 'nth currency problem' required the US to allow its exchange rate to function passively as the net of all the other exchange rates, because any change in the gold-dollar parity would alter all the rates in the system, unleashing unknowable economic

[120] Guindey, 1977, 37.
[121] Gilpin, 1983; Gowa, 1983; Keohane and Nye, 1977; and Soloman, 1977, 212.
[122] Bordo, 1993; and Eichengreen, 1993; and, 2008.

distortions and retaliatory actions. This meant the dollar was perpetually overvalued and the system became hooked on its deficits.[123] This deficit addiction was acute because the other sources of liquidity (gold and International Monetary Fund credits), could not be readily increased. The claims on the US gold stock soon outstripped the available reserves, but monetary traditions in respect of the gold composition of reserves were slower to change. It followed that, absent new sources of liquidity, the deficits would have to be curtailed, creating a deflationary bias in the system, or confidence in the gold-pledge would founder. This unsolved conundrum - coined the Triffin Dilemma - caused the system to sink at its golden anchor.[124] In short, according to this standard narrative, policy failures caused the collapse. However, if the economic problems were genuinely insoluble, then it seems unreasonable to blame policy decisions for the collapse, because there could be no conceivable alternative policy that might have ensured a better outcome. Moreover, the economic historians' account ignores the fact that the collapse occurred at a time when national monetary authorities were in the middle of a painstaking analysis of precisely these problems. Their narrative also obscures the massive web of domestic and international controls spun with the apparent object of containing these problems. A fully specified explanation must give a reason for why these policies failed to deal with the structural weaknesses of the system. The application of this study's explanatory framework helps to do this by exploring the policies' distributional implications and maladaptive trajectory.

The chapter is organised as follows. Section 1 traces the emergence of the negotiated system. Sections 2, 3, 4 and 5 investigate the politics of four US led schemes of appropriation negotiated with affiliated monetary authorities between 1960 and 1968: the Gold Pool; WP3 multilateral surveillance; the Federal Reserve Bank of New York (FRBNY) swaps network; and SDRs. The particular focus is on the distributional implications and maladaptive downstream consequences of these schemes. The penultimate section analyses the end-game of the system between 1968 and 1971. The final section concludes.

1. The Making of the Gold-Dollar Order, 1945-1963

The gold-dollar system was a negotiated international monetary order, built within the framework established at Bretton Woods. US officials led a ruling oligarchy of states that collectively met the problems that emerged in the system. This section sketches the origins of the system, and the production of the political historical foundation and integrated organisational structure, that formed the conditions for the system's eventual collapse.

[123] This was because US deficits financed the disequilibria not resolved via adjustment. There is much debate about whether the main issue was liquidity or adjustment at the time and subsequently, but in important ways the problems were intimately related.
[124] Triffin, 1961.

The set of countries that bargained over the shape of the gold-dollar system became known as the G-10, and included the US, UK, France, Germany, Japan, Canada, Italy, Belgium-Luxembourg, the Netherlands, Sweden and Switzerland (confusingly, there were actually eleven political units in the G-10). The basic economic properties of the system, enshrined in the regulation and practice to which they subscribed, were as follows: National currencies were convertible for current transactions at fixed exchange rates. The parity structure was based on the US pledge to convert dollars into gold at a fixed price. Monetary authorities retained reserves to maintain rates through ordinary balance-of-payments fluctuations. The composition of reserves was strictly discretionary, but gold and US dollar assets dominated.[125] International credit facilities were made available to help countries whose reserves were not sufficient to manage balance-of-payments problems without harsh deflationary measures or external controls. The members of the system committed themselves to institutionalised cooperation. They agreed to coordinate national policies and to remove the basic causes of imbalances. The use of capital controls and financial restrictions were accepted as legitimate means to seek internal and external balance, but for both practical and theoretical reasons there was a reasonable degree of consensus that the world should work towards their removal under conditions of convertibility. In cases of fundamental disequilibrium, exchange rates could be adjusted, but this required international agreement to avoid competitive devaluations.

The IMF's founding articles provided much of this basic constitutional framework. However, the Fund had a marginal role in active management of the system, which centred instead on the US, negotiating with the G-10 finance ministries and central banks.[126] The collective bargaining was organised around three institutions: WP3 of the OECD, based in Paris, France; the BIS, founded in Basel, Switzerland; and the nomadic grouping of G-10 Deputies. The membership of these bodies, in personal and institutional terms, overlapped tightly. They comprised bureaucratic officials, rather than politicians, from the national treasury departments and central banks of a small number of industrialised countries who had arrived first to manage the gold-dollar order. They shared the view that they were the most responsible and capable individuals in international monetary matters. They orchestrated the defence of the system, negotiated over the terms of its extension, and arranged studies into its long-term future.

The integrated organisational structure took shape at the time of the Kennedy Administration, but its building blocks were formed much earlier. The institutional and intellectual connections between the US Treasury and Federal Reserve and the other treasuries and central bank agencies at the political base of the system can be traced to the inter-war years.[127] In the aftermath of the Second World War, the US and Western Europe moved slowly away from bilateralism and administrative controls and toward the

[125] Bank of England, "World Holdings of Gold and US Dollars", 13 April 1962, BOE. EID 10/15, 1275/3; also see, Parsons, "Gold versus Dollars", 14 December 1962, BOE EID 10/15, 1275/3.
[126] Rasminskey, 1972, 40.
[127] Clavin, 2013; Pauly, 2003; and Nurske, 1944.

Bretton Woods vision. In the process, things deviated from the original design of the Bretton Woods vision, in particular as the US dollar came to dominate monetary relations.[128] Nevertheless, over a 15 year period, monetary diplomacy and domestic reforms rebuilt shattered economies, overcame entrenched balance of payments disequilibria, and restored convertibility. The gold-dollar system thus came into existence on 27 December 1958, after a massive amount of political capital had already been invested in it, when key European countries declared their currencies convertible for current transactions.[129]

The pre-convertibility era saw the dollar eclipse sterling as the key currency in the international monetary system. The size and financial weight of the US fuelled this rise, leading to a growing demand for dollars, both for private use (as a unit of account, medium of exchange and store of value), and for official use (as a reserve asset and means of intervention). The demand for dollars was met through private and official capital outflows from the US that produced payments deficits beginning in 1950.[130] The financing of these deficits rested on confidence in the convertibility of the dollar: the pledge to maintain the free convertibility of dollars into gold at the fixed parity set by Act of Congress in 1934 at a value of $35 an ounce. This pledge was the fulcrum of the fixed exchange rates network and the bedrock of the international financial and payments mechanism. However, certitude in the pledge was vulnerable. At the turn of the 1960s, the US deficit could not be entirely covered by US gold stocks. This weakness first emerged in the October 1960 "gold rush" and it subsequently became the most frequent source of adaptive pressure on the system. This weakness also formed the core distributional point of contention between the US and members in the gold-dollar system. To the extent that the US could induce participants into holding more dollars than was optimal from their perspective, it could reap seigniorage from financing its deficits at low cost, and other returns from the use of dollars in international trade and finance. As Fred Bergstein explained: "The real gain to the United States from that build-up of foreign dollars […] was the avoidance of the costs of adjustment measures which would otherwise have had to be taken".[131] The participant states wanted the US to make those adjustments in order to reduce the threat of imported inflation and to take the pressure off their currencies.

As the explanatory framework of this study would predict, the high initiation costs associated with building the gold-dollar order, and the national and supranational bureaucratic capacity at its historical foundation, caused US officials to turn to bureaucratic activism and collaboration when problems first emerged in the early 1960s. Douglas Dillion, Secretary of the US Treasury between 1961 and 1965, had calculated even before taking office that "one thing was perfectly obvious and that was that we had to create and carry out a new and different policy for the United States - a policy of close cooperation

[128] Bordo, 1993, 41-48.
[129] Bordo, 2003, 47-49.
[130] The overall balance of payments was "in deficit (on a liquidity basis) every year since 1950 with one exception in 1957", because of the Suez crisis (Bordo, 2003, 47-49).
[131] Bergstein, 1996, 273.

with all the other industrialized countries which had convertible currencies."[132] The collective institutionalised bargaining structures that emerged from this US policy were put together between late 1960 and early 1963 through closed discussions with officials from major industrialised countries. The product was an organisational structure that would define the contours of international monetary diplomacy for the decade to come.

The first step on this path was taken in December 1960 when the US FRBNY attended a BIS meeting in Basel. From this point on, the "Basel club" became a crucial decision making forum in the system.[133] In the words of Guido Carli, governor of the Bank of Italy: "The BIS [behaved] like a national organisation ... like a single unit. It was a true example of supranationality."[134] The operations of the Basel club were guided by the deputy governors and directors of national central banks in charge of operating exchange market interventions. These were persons holding formidable power over domestic market operations. They stepped into the international domain through a report penned for the BIS governors in May 1961. The report addressed bank cooperation to deal with capital movements, the Euro-dollar market, joint central bank exchange market intervention, credit facilities to cushion short-term flows, a review of gold market operations, information exchanges through the BIS, and reform of the Fund.[135] The report's central recommendation was to "forge ahead with inter-central bank arrangements."[136]

Following this mantra, the experts began to operate various joint operations in gold and foreign exchange markets from March 1961. Reflecting on these two years later, Charles Coombs (FRBNY), Johannes Tüngler (Bundesbank), and Max Iklé (Swiss National Bank (SNB)) noted that "in the process of almost daily consultation with one another" they ended up "thinking along more or less similar lines" that short-term credits, swaps, joint international exchange, and gold market interventions based on domestic "market and institutional realities" should become "permanent features of the system."[137] They considered that with these supports, the system was essentially fit for purpose, expecting new challenges to "differ only in degree but not in essential nature" from the problems they had already been dealing with.[138] Together with Roy Bridge (Bank of England) and Julien Koszul (Bank of France), these

[132] Douglas Dillon and Robert Roosa, "Recorded Interview by Dixon Donnelley", 25 January 1965, John F. Kennedy Library Oral History Program, 9.
[133] Interestingly, one of the reasons France was persuaded to work within the BIS was because it could thereby ensure it retained a voice in decision making whereas it viewed the IMF as an organisation that served only the interests of the US and UK (see Monnet, 2013).
[134] Bank of International Settlements, 1980, 112.
[135] Bank of International Settlements, "Report of the Ad Hoc Committee of Central Bank Technicians", May 1961, BOE OV44/34 1521/2.
[136] Bank of England, "Record of Meeting of Central Bank Governs at Basle on 8th May 1961", 9 May 1961, BOE OV44/34 1521/2.
[137] Coombs, "Memo: Conversations among C. A. Coombs, M. Iklé, E. Randalli and J. Tüngler in New York and Basle December 1962 – January 1963", February 1963, BOE OV44/34 1521/2.
[138] There could in this view be "no effective alternative but to rely upon a further development of mutual credit facilities among major trading nations to cope with the inevitable swings in their payments accounts" (Coombs,

individuals formed the BIS Gold and Foreign Exchange Experts' Group (Expert Group), informally known as the "Coombs' Committee".[139]

WP3 of the OECD formed the second institutional centre of collective bargaining. WP3 was another product of the US decision to collaborate in order to secure the system. Its membership comprised top ranking officials from finance ministries and central banks and high-level representatives of the IMF and BIS.[140] WP3 met up to nine times a year for two- or three-day meetings. The central concern of WP3 was the adjustment process, which meant that discussions reached deep into sensitive areas of domestic policymaking. The attitude of mind among the finance officials in the committee was recalled by Paul Volcker, then an official at the US Treasury: "The participants saw themselves as carrying a very special and important, if arcane, responsibility to protect the stability of the international monetary system. Like high priests, or perhaps stateless princes, they were schooled in arts with which few were familiar, arts that required both a certain amount of secrecy and a high degree of mutual confidence. A few of them had personally participated, at least at the margins, at the Bretton Woods conference and saw themselves as disciples of the founders, who would keep their vision intact."[141]

The final institution constituting the concerted bargaining centre of the system, alongside the Expert Group and WP3, was the G-10 Deputies committee. At a dinner held in connection with the WP3 meeting in July 1963, the US proposed the idea that the members should each seek authorisation from their respective political masters to form a new group to commence work on the reform of the system.[142] This led to the formation of the G-10 Deputies committee whose membership aligned exactly with WP3 because it was "an existing group for which there would have to be no defence made as to why its membership was chosen."[143] The G-10 Deputies assumed a focal position in the debate on reforming the system, delegating work-streams to WP3, the BIS, the Fund and ad hoc groupings, including the powerful Ossola and Esteva committees.

To summarise, between 1961 and 1963, policy activism on the part of US monetary authorities, responding to the desire to put the gold-dollar order back on track following its high initiation costs, established the working foundations of a negotiated international monetary order. The governance structure is plotted in Figure 3.1. There were no objective membership criteria, but the institutions and

"Memo: Conversations among C. A. Coombs, M. Iklé, E. Randalli and J. Tüngler in New York and Basle December 1962 – January 1963", February 1963, BOE OV44/34 1521/2).

[139] The Expert Group included all G-10 countries by 1964 (Koszul, Note, 'Reunion des Experts de l'Or', 4 July 1964, BFA, Souns-fonds Reparations et Banqe des Reglements Internationaux 14892000303194 – Collaboration entre les Banques Centrales, 1960-1966).

[140] Japan, the Fund and BIS first joined the WP in July 1964.

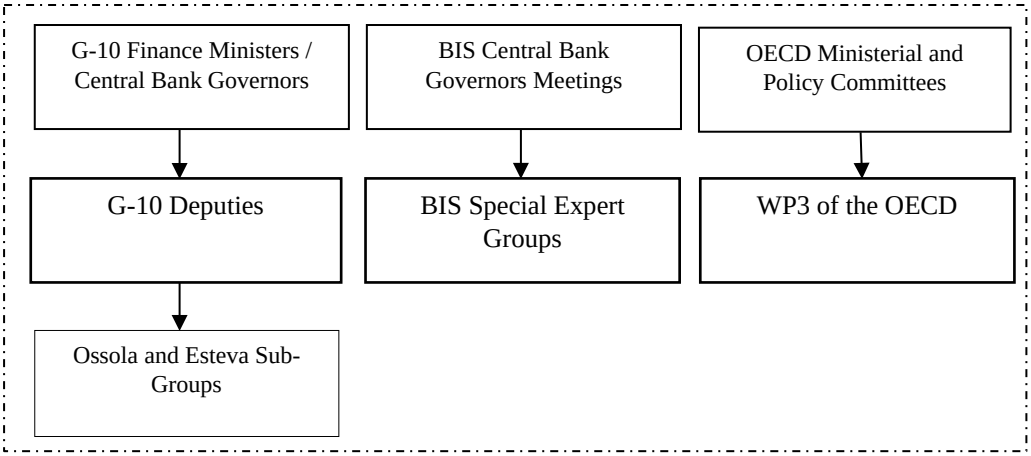
[141] Volcker and Gyohten, 1992, 2.

[142] The actual impetus for the creation of the G-10 Deputies came from negotiations around the general agreement to borrow (GAB). The GAB, agreed in side-dealings at the annual Fund meeting in Vienna in October 1961, saw the resources of the Fund increased, but control over the additional borrowing transferred to the G-10, which importantly included Japan, paving the way for its inclusion in the OECD.

[143] Douglas Dillon, "Oral History Interview", 18 August, 1964, JFK#5, 08/04/1964.

persons at the centre were not accidental. This structure was consciously designed by the US to integrate a small number of public officials into the gold-dollar system. A small set of concerted and restricted international institutions would make an ongoing study of the gold-dollar system, to diagnose problems and oversee their solution. The political foundation brought together persons with direct responsibility for national policies and day-to-day market operations. They became the actual operators and guardians of the system. They possessed not only specialist expertise and privileged domestic and international positions, but also a powerful interest in negotiating rules and devices in a manner consistent with the organisational and institutional advantage of their national monetary authorities. The organisational structure and historical foundations necessary for leadership through appropriation were thus established.

Figure 3.1. The Negotiated Governance Structure of the Gold-Dollar System



2. The Gold Pool, 1960 to 1968

The Gold Pool, established under the auspices of the BIS in November 1961, was an agreement between the Bank of England, FRBNY and certain European central banks to cooperate to stabilise the London gold market and to take pressure off the US gold reserves. In the context of this study, the Gold Pool represents a classic example of a technocratic fix designed to ease the constraints of the gold-dollar system on the US, by ameliorating the growing mismatch between dollar and gold reserves and by weakening the link between gold and the adjustment mechanism.[144] In line with this study's explanatory framework, the analysis describes how this opportunistic bargain was made through special forms of reciprocity and mutual self-empowerment between the US and member national monetary authorities.

[144] Gilbert to McDonald and Dealtry, Memorandum, "The Cooperation of Central Banks in the Gold Market", 19 November 1963, BISA, Basel, DEA 14, f38. The gold-dollar system needed order in the private international gold markets. This order was initially defended by the IMF. However, the Fund's regulatory structure weakened as gold markets grew up outside its control and eventually gave way when the Bank of England deregulated the London market in 1954. The restoration of this market linked the parallel gold and foreign exchange markets in London and created a latent vulnerability in the system (see, Bott, 2013, 110-112; and Strange, 1977, 68-71).

The section further demonstrates how the Gold Pool evolved in an increasingly maladaptive fashion from the perspective of the overall system. Finally, the discussion reveals how the extension of the scheme was, eventually, limited by resistant participants.

a. The Background and Organisation of the Gold Pool

The price of gold served as a barometer for confidence in the dollar and in the system.[145] When the private gold price rose above the official gold price ($35 an ounce) an arbitrage opportunity was created for central banks willing to sell gold and replace it at the US Assay Office and for private gold and foreign exchange dealers willing to exploit the price differentials between the linked gold and currency markets. In October 1960 speculation over the anticipated return of a Democratic President saw the private gold price leap to above $40 an ounce. The system was perceptibly shaken. After a rescue mission conducted with the Bank of England, the US authorities felt it imperative to establish "some cooperative scheme in which other central banks participated."[146]

The US established the detailed workings of the Gold Pool in negotiations between 1960 and 1962. Each member of the scheme committed a certain amount of gold to the Pool, with the US presenting 50% of the resources, and the Bank of England sold it when the price of gold in London rose above the inward shipping parity from New York (i.e. the cost of buying it in New York and shipping it to London).[147] The establishment of this selling consortium was coupled with a self-denying ordinance, which required members of the Gold Pool to desist from purchasing private gold for their own account for the duration of the scheme. This effectively limited the freedom of action of the participant states, and depressed the price of gold by subordinating public to private demand. In January 1962, a buying syndicate was discussed so that the London market was not left to private demand or subject to competitive official purchases when the price dropped below $35.08.[148] The aim was to siphon gold into official reserves and especially to help the US return to the market as a buyer. The experiment was agreed by the central bank governors in their Basel meeting of 12 March 1962.[149] The buying syndicate distributed its purchases in the same proportion as the liabilities under the sales consortium meaning the US gained the lion's share of the benefits. The Gold Pool was never committed to paper in a legalistic way and was run on a rolling basis for the same basic reason: informality avoided the more stringent examinations that come with public visibility and oversight. The central banks were anxious

[145] Coombs, 1976, 14.
[146] Stevens to Coombs, 16 October 1961, BOE 44/35. For a detailed discussion on the origins of the Gold Pool see Toniolo, 2005, 369-381.
[147] Bank of International Settlements, "Proposed Arrangements for Co-ordinated Gold Purchases by Central Banks on the London Gold Market, Report of the Experts Meeting at the Bank for International Settlements, Basle, 9th-11 February 1962", BOE. EID 10/15, 1275/3.
[148] Hayes to Guidney, 1 February 1962, BISA, Basel, DEA 14, f38; and Telex Washington to Foreign Office, "Gold" 4 January 1962, BOE. EID 10/15, 1275/3
[149] Bridge to Parsons, "Syndicate for Gold Purchases on the London Market", 14 March 1962, BOE C43/233.

about fettering their operational freedoms, adverse signalling to the markets, and being caught in an arrangement that would be hard to disengage from.[150]

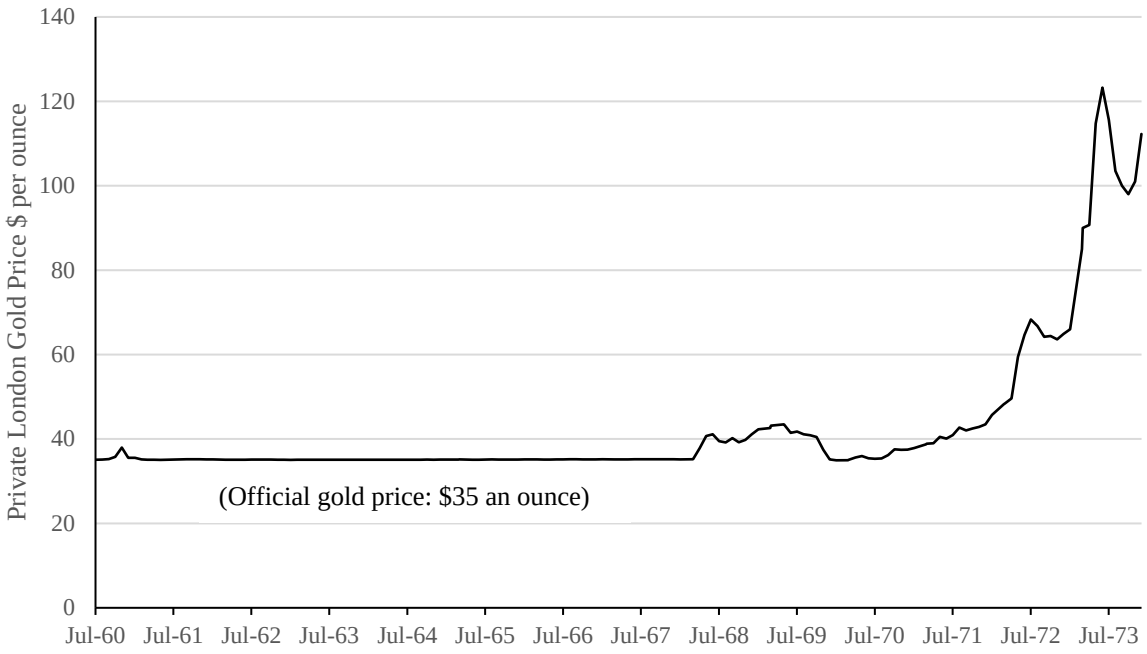
The buying and selling strategy for the Pool was decided by the Expert Group while day-to-day operational tactics and decisions were left to the Bank of England as their agent in London. The Expert Group would submit major changes in the Gold Pool operations to the BIS governors. The sales consortium and buying syndicate were technically separate entities, although this separation was blurred in practice when the Gold Pool agreed to retain a reserve of funds for resale when market circumstances dictated.[151] From this point onwards, the buying syndicate operated continuously with a retained surplus of $50 million.[152] The sales consortium, on the other hand, which began with a committed ceiling of $270 million, required authorisation to sell on a case-by-case basis from the BIS. The sales consortium was established on an understanding that sales would only be made in response to a "sudden and heavy speculative attack which could be attributed to a specific incident such as the Berlin crisis."[153] This "Berlin test" was intended to prevent the Gold Pool from being activated for routine demands on US gold reserves attributable to the US balance of payments deficit or a general confidence movement against the dollar.

The first five years of Gold Pool operation were championed as a success in public. As Figure 4.2 shows, the official and private gold prices were kept in close alignment. The Gold Pool allowed the US to save its gold reserves and even helped channel new gold supplies into its reserves. The Europeans, uneasy about the size and composition of their reserves (i.e. the growing ratio of dollars to gold), were able to reduce the immediate exchange risk of holding uncovered dollars through a stronger guarantee that the US would not be forced off gold. The scheme became a major source of prestige for the central banks, and the BIS, as information about its existence became public.[154] The Expert Group reviewing the first year's operation felt the experience "would seem to have justified the action which the governors decided to take."[155] The BIS secretariat was similarly positive, stating that the Pool "showed by acting jointly the principal central banks have the power and resources to keep the market under control."[156] In 1964 the Bank of England *Quarterly Bulletin* stated that "there is little doubt that the

[150] The Bank of England ensured that the plan "was hemmed in with plenty of ifs and buts and would not involve any final commitment to leap too far into the dark" (Bridge to Parsons, "Proposed Cooperative Scheme for Certain Central Banks to Share in the Costs of Controlling the London Gold Price", Undated, BOE C20/3 - Bridge Papers, 1960-1962).
[151] This was proposed and agreed formally in the July 1962 Meeting of Experts (Bank of England, "Anglo-American Discussions", 7 May 1962, BOE C43/233).
[152] This was initially $40 million but later increased.
[153] Bank of England, "Draft Submission to the Chancellor on the US Proposal about Gold", 3 November 1961. BOE. C43/233 1965/3, 2.
[154] "A Good Start", *The Economist* (London, England), Saturday, January 12, 1963; p. 133; Issue 6229; "Squaring the Circle". *The Economist* (London, England), Saturday, February 9, 1963; p. 525; Issue 6233.
[155] Bank of International Settlements, "Coordinated Gold Purchases: Report of Group of Experts on the Experiences of the Past Year", September 1964, BISA, DEA 14, f38.
[156] Bank of England, Draft Memorandum, "The Cooperation of Central Banks in the Gold Market", [Undated. Probably late 1963 or early 1964], BISA, DEA 14, f38.

knowledge that central banks were working together in the gold, as well as in the exchange, markets has helped to maintain public confidence in the international monetary structure."[157]

Figure 3.2. The Private London Gold Price (monthly average), 1960 to 1973



Source: Data provided by the BISA.

b. Buy-in through Special Reciprocity and Mutual Empowerment

Despite its initial success, the scheme was received with great scepticism by insiders. First and foremost, they knew that the plan would run into resource constraints. The slowdown in increasing gold supplies from the crucial South African mines and the growth in private demand for gold that turned against the viability of the scheme in 1966 was foreseen by experts as early as 1962.[158] Furthermore, the participants knew the scheme was maladaptive from a systems perspective. In this regard, the BIS spelled out the limitations of the scheme in 1963: "[T]he "gold pool" arrangements, together with the inhibitions that exist about buying gold in New York, constitute an acceptance of the de facto partial inconvertibility of the dollar. It is hard to see how this can be a permanent state of affairs; the function of the pool, therefore, is to provide breathing space during which steps can be taken that will make its existence no longer necessary."[159] In other words, the early success depended on benign market

[157] Bank of England, *Quarterly Bulletin*, vol. 4, 1 (March) 1964, 20-21.
[158] Indeed, industry estimates were even more conservative than those of public officials (Bank of International Settlements, "The Prospects for a Growth in Gold Reserves", (confidential), 3 December 1963, BISA, 17.18(12) – Papers Michael Dealtry, box DEA14, f01; G10).
[159] Bank of England, Draft Memorandum, "The Cooperation of Central Banks in the Gold Market", [Undated: presumably 1963], BISA, DEA 14, f38.

conditions and merely illustrates how hard it can be to distinguish maladaptive agreements from constructive cooperation.

The private reservations arose primarily because the scheme broke the mechanical link between gold reserves and the balance of payments adjustments that should operate in a gold exchange standard.[160] The Bank of France wrote to the BIS in 1961 to express strong reservations about the program, because of the asymmetric implications of the arrangement.[161] The issue was that through the Gold Pool the US was able to save – or even acquire – gold despite a persistent payments deficit. This enabled the US monetary authorities to avoid tightening the liquidity of the banking system despite a deficit and thus they circumvented the classical rules of the system. The BIS also had related concerns. To quote from the same report: "We have long argued in favour of market forces and are now asked to participate in a scheme which aims at putting these on one side, so that the inconvenience of certain financial policies can be avoided. This may be justifiable in the short term but in the longer term it could be disastrous, not least of all for the US."[162]

The pursuit of this kind of transaction by leading monetary authorities is exactly as the explanatory framework of this study would predict. In the face of the instability affecting the system in 1960, the US did a deal that advanced its short-term utility. In this regard, the Gold Pool not only entrenched gains that were asymmetric between nations, but it also provided domestic benefits for US monetary officials. In particular, the Gold Pool tightened the US Treasury and FRBNY's grip on domestic developments. The need to support the London market in October 1960 had invited unwelcome scrutiny. The most "awkward Congressmen might be silenced if they could be told that a secret cooperative scheme was in operation and that it was not only American gold which was being fed to hoarders."[163] The Gold Pool also offered the prospect of recovering some ground. The scheme was designed to ensure a slow and steady the attrition in the US gold stocks arising from its deficit and also to this end to enable the FRBNY to buy gold. Gaining this control over the "reserve tap" could avoid "concentrated heavy withdrawals of gold [that] might stimulate action at the political or monetary level."[164]

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[160] Sir Lee to Hubback for the Chancellor, "US/European Gold Pool", 7 November 1961, PRO, T 312/312. Bridge reported from Basel in 1962 that "a number of the others were not particularly enamoured by the American scheme" (Bridge, Note for the Record, "The American Gold Scheme' Experts' meeting and report", 2 May 1962, BOE. C43/233, 1965/3.

[161] Brunet and Calvet wrote: "Dans l'état actuel des choses, je ne vois pas qu'un progréss sincére puisse être enregistré en matière de discipline monétaire international à la faveur des propositions des Etats-Unis canalisées par les Anglais" (Brunet and Calvet to Guindey, Note, Undated [Presumably 1961], ABF 1489299803).

[162] Gilbert to McDonald and Dealtry, Memorandum, "The Cooperation of Central Banks in the Gold Market", 19 November 1963, BISA, Basel, DEA 14, f38.

[163] Bridge to Parsons, "Proposed Cooperative Scheme for Certain Central Banks to Share in the Costs of Controlling the London Gold Price" BOE. C20/3 - Bridge Papers, 1960-1962.

[164] Gilbert, "The Reserves, Conversations with F.R.B. of N.Y.", 16 January 1963, BISA 7.18(23) – Papers Milton Gilbert, GILB 3.

A particularly interesting question is why the Gold Pool was selected by members? For sure, the alternatives would have been difficult to coordinate and often involved technical issues at least as great as the Gold Pool's.[165] Moreover, the boundedly rational members could not perfectly foresee all the problems of the scheme. The UK Treasury cautioned for instance that: "We cannot be sure what we may be letting ourselves in for."[166] However, the bounds of rationality in crisis decision-making provide an incomplete explanation. To understand the scheme, it is instead necessary to look to the private motives of the national monetary authorities that signed up to the deal.

The answer to the puzzle of member participation, in short, was that the scheme came with special benefits. The participating central banks had a financial interest in the continuance of a low gold price.[167] The buying syndicate was highly valuable to the integrated members because it shared the gold surplus without competition between them. The participating banks were able to extract a better price by acting together.[168] The US also agreed to underwrite, finance and refinance undistributed coordinated purchases.[169] The scheme further enabled members to benefit from a special supply-side link between the Bank of England and the South African Reserve Bank. It was a priority of the US that South African gold, to the extent that it was not used to smooth the price, would be made available for consortium purchases.[170] The BIS also soaked up new supplies, particularly from Canada and Russia. In the first quarter of 1964 all but 19 tons of an estimated 289 tons in Russian sales were taken in by the Pool.[171] For the years 1963 and 1964, the Gold Pool was able to distribute nearly $1.3 billion worth of gold to its members.

In the self-denying ordinance and its extension to all gold markets, members, including the BIS, were granted a waiver on the ¼% commission of 8¾ cents normally charged when buying gold at the US Assay Office. The FRBNY was able to discriminate in terms of who it afforded the cancellation of the ¼% commission. This was an inherently political innovation instituted despite technical objections, with distortive price implications for the market.[172] The waiver acted as an incentive to stay in the scheme and the US authorities could offer it to countries provided they exercised certain disciplines.[173]

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[165] The Bank of Italy Annual Report in 1964 contemplated some of the alternatives (BISA Papers Antonio d'Aroma, 718(10) ARO 5).
[166] Sir Lee to Hubback for the Chancellor, "US/European Gold Pool", 7 November 1961, PRO, T 312/312.
[167] Bank of England, Memorandum, "Proposed Cooperative Scheme for Central Banks to Share the Costs of Controlling the London Gold Market", 11 October 1961, BOE. EID 10/15, 1275/3.
[168] Gilbert to McDonald and Dealtry, Memorandum, "The Cooperation of Central Banks in the Gold Market", 19 November 1963, BISA, Basle, DEA 14, f38.
[169] Bank of International Settlements, Experts Report, "Proposed Arrangements for Co-ordinated Gold Purchases by Central Banks on the London Market, Report of the Experts Meeting at the Bank of International Settlements, 9th – 11th February 1962", Para 3(b), BOE. EID 10/15, 1275/3.
[170] Lee and Parsons to Stevens and Allen, "Gold", 4 January 1962, BOE C43/233 1965/3.
[171] Note from Lee and Parsons to Stevens and Allen, S.F.B., "Gold", 3 April 1965, BOE C43/233 1965/3.
[172] Gilbert, "Proposed Cooperative Scheme for Central Banks to Share the Costs of Controlling the London Gold Market", 11 October 1961, BISA 7.18(23) – Papers Milton Gilbert, GILB 3.
[173] Bank of England, "Note of Meeting US Treasury, Anglo-US Discussions", 8 March 1962, US Treasury Washington, BOE. EID 10/15, 1275/3.

These disciplines were particularly tight: they had to offer the US a right of first refusal when acting as sellers of gold and were required to refrain from buying in London whatever the price.[174]

As the explanatory framework would anticipate, the Gold Pool was an appropriative transaction, designed to help US monetary authorities address a problem in the functioning of the system, and thereby to ward off political pressures that would have placed a burden of adjustment upon the leader. Although national monetary authorities were co-opted into the arrangement, it is important to note that the unequal payoffs under the scheme induced resistance from the outset. Indeed, while participating, France never stopped privately protesting against central aspects of the scheme. In particular, France objected to the fact that the system came to operate on a permanent rather than temporary basis. Furthermore, France objected to the distribution of gold in accordance with liabilities to the Pool, rather than according to the balance of payments positions of its members, and the retention of gold surpluses within the Pool. The reason for this resistance was that this arrangement benefited the US, especially at the expense Switzerland, France and Germany. The French also especially disliked the absence of strict rules for the scheme, because they feared the US authorities would use this flexibility to skew things even further in their favour.[175] This turned out to be a more than legitimate concern.

c. The Skewing of the Scheme towards US Interests and Maladaptation

The opaque operation of the Gold Pool made it susceptible to maladaptation. Indeed, exemplifying what this study's framework calls 'internal reciprocity', members habitually did each other special favours, shifting around gold and financing arrangements, primarily to "cook" their balance of payments statistics.[176] This kind of reciprocity was insidious from the perspective of the system as a whole. The most important early effect of internal reciprocity was the removal of the "Berlin test" commitment. The high bar that had been set for this crisis proviso was needed to maintain the usual balance of payments disciplines on the US.[177] Coombs was explicit, in negotiating the deal, that the aim of the US authorities "was not to avoid discipline [or] avoid gold losses but to temper them."[178] However, in July 1962, the central bank governors in Basel delegated the power of decision to activate the sales consortium to the FRBNY, to be exercised "as a matter of conscience" and subject only to collective

[174] Bank of International Settlements, "Meeting 7 July 1963", (handwritten notes), BISA Basel, 7.18(16) – Papers R.T.P Hall box HAL 2.
[175] Broadly, the Bank of France wanted the disbursements to respond to normal balance of payments pressures. (Bank of France, "Mode de répartition entre les pays membres de l'or acheté par le gold consortium", 16 Septembre 1964, ABF 1467200501/73 ; also see, Bank of France, "Historique sommaire du gold consortium", Juin 1962, ABF 1467200501/73).
[176] Bridge to the Governor, Deputy Governor, Parson and Stevens, 'Notes on a Visit to the Federal Reserve Bank of New York 3rd/6th January 1964', BOE C43/233, 1965/3. For instance, the Bank of England and FRBNY would alternate in financing the scheme. To give one other example, the FRBNY refinanced undistributed purchases made by the buying syndicate, which would otherwise result in lost interest for the UK Exchange Equalisation Account, by offering three month gold-dollar swaps to the Bank of England (Telephone Conversation with Coombs on 23 September, BOE. EID 10/15, 1275/3).
[177] Bridge, "Gold Operations – Basle 8th July", BOE. EID 10/15, 1275/3.
[178] Bridge, "Coombs", April 1962, BOE, Roy Bridge Papers 1960-1962, C/203 172/687/2.

appraisal after the fact.[179] It was further agreed that the selling syndicate could be activated if gold losses continued at a level which would be "embarrassing to have to cover through published losses to the American gold stock."[180] The activation of gold sales in the summer of 1962 to meet an ebbing of confidence in the US dollar was the first instance of this maladaptation in practice.[181] More than ever, the scheme was now geared towards helping the US avoid the costs of adjustment.

The problems intensified as the defence of the inward shipping parity became a goal in itself. The rigged defence of this parity had been expressly resisted at the outset of the Pool, because speculators thrive on one-way bets.[182] However, for the managers of the Pool, letting the price of gold in London rise above the inward parity was easier said than done, especially as confidence thinned. This became clear when, in early 1965, the market began to move against the Gold Pool, as tensions built in Vietnam, China returned to the market, and a banking crisis hit Hong Kong. Bridge tested the market several times, but found it impossible to reverse the upward trend in the price of gold in London. In the end, he committed to hold the price at $35.18, for fear that letting it go higher would only fuel demand. The Pool was committing 12 tons of gold a day until the pressures subsided.[183] The major strategic shift was formalised in March 1965 when the Basel governors agreed that a price ceiling of $35.20 (the inward shipping price) should be defended and the selling consortium activated automatically when the surplus of the buying syndicate was exhausted.[184] The Gold Pool thus transitioned from a device designed to defend the dollar against specific and exogenous shocks, to an endogenous and continuing part of the system predicated on the rigged defence of the inward shipping parity.

The difficulties in 1965 brought to the fore the rumbling disagreement about how to manage the undisbursed surplus. Coombs, Bridge and Tüngler pressed for the surplus to be retained rather than disbursed in accordance with what was initially agreed. André (Bank of Belgium), disagreed with this and added that not to have a fixed rule "was a little like playing roulette" with the market.[185] This conflict threw the whole scheme into question. Furthermore, given the locked-in commitment to intervention in the markets, it also became necessary to consider ways to dampen speculative forces. The members discussed more tightly regulating banks and other market participants and making a statement to the market. However, the only real proposal on the table was more aggressive and visible selling.[186]

[179] Bridge, "Gold Operations – Basle 8th July", BOE. EID 10/15, 1275/3.
[180] Bridge, "Central Banks Gold Pool 18th July 1962", BOE. EID 10/15, 1275/3.
[181] Bridge, "Gold Operations – Basle 8th July", BOE. EID 10/15, 1275/3.
[182] Bridge, "Central Banks Gold Pool' 18th July 1962", BOE. EID 10/15, 1275/3.
[183] Parsons, "WPE of the OECD Record of Meeting, March 1965, 14", OECD/CPE/WP3, 3.
[184] Sangster to Parsons, "The Basle Gold Sales Consortium", 10 March 1965, BOE. EID 10/15, 1275/3.
[185] Dealtry, "Meeting of Experts', 6/iii/65", (handwritten note), BISA DEA 20 FO 50.
[186] Dealtry, "Meeting of Experts', 6/iii/65", (handwritten note), BISA DEA 20 FO 50.

This manifestly limited option should have prompted deeper questions. However, the fortunes of the Gold Pool improved later in 1965 and the respite was enough to stall reforms. This respite was short-lived. The picture worsened again through 1966 due to an absence of Russian sales, and South Africa trying to build up its own reserves.[187] Bridge and Coombs offered technical reasons to suggest that these adverse changes would not last and at the same time pressed for an additional commitment of resources, arguing that "on an objective assessment the gold pool seems to have worked well so far and to have achieved its objectives[, so] if the resources still available under the original commitment should become exhausted, support for the market should not cease but continue."[188] They conveniently forgot the lessons of early 1965 and contended that "the existence of the Gold Pool ... has had a stabilising and tranquilising effect upon world opinion and has enabled the London free market price to be kept within a range of $35.03 to $35.20 for over five years."[189]

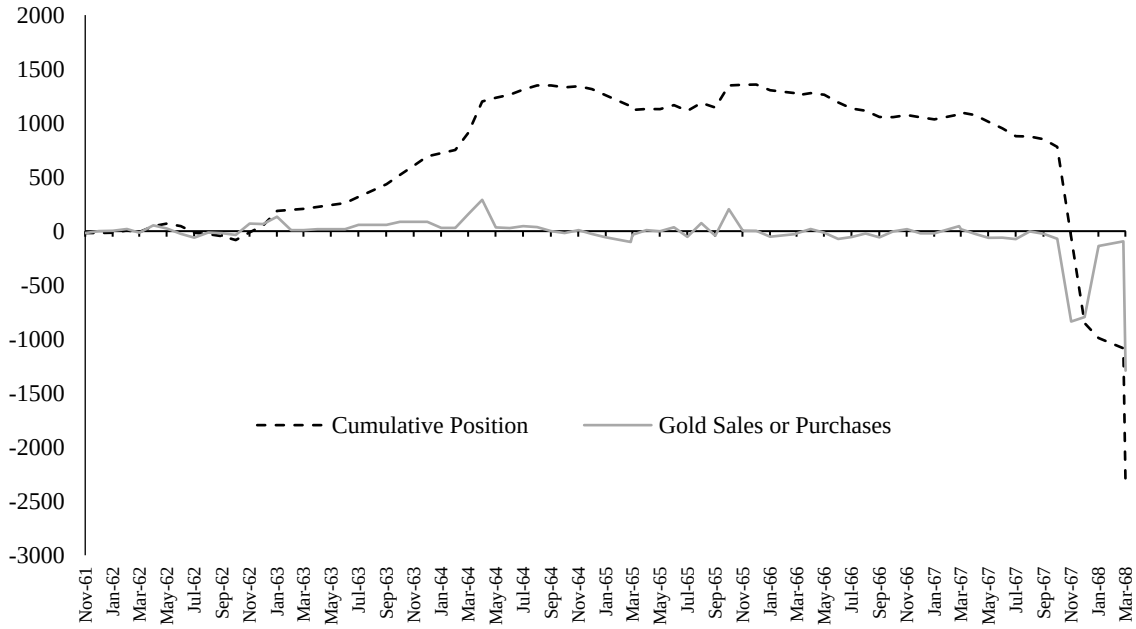
The Gold Pool ceiling was increased for the first time by $50 million at the meeting in Basel on 4 September 1966.[190] Coombs had sought a larger figure, with more room for flexibility, but "the governors did not want to make an open ended commitment."[191] The financial repression of domestic gold markets was also ramped up and efforts made to limit the increasing diversion of South African gold to Zurich.[192] The BIS, for instance, was required to enter a formal agreement with the Bank of England to prevent its activities in Toronto and Zurich from fuelling instability.[193] The group also closed ranks to keep outsiders in the dark about the losses being incurred.[194] Thus, as anticipated, the appropriated core began to engage in the collective suppression of information to sustain the status quo.

The anticipated market turnaround did not materialise. On the contrary, the drain on the Pool acquired a chronic character as Figure 3.3 reveals. The Pool was persistently making more sales than purchases meaning the cumulative position progressively weakened. The Bank of England chose not to publish in its *March Bulletin* its usual summary of the preceding year, something the *Financial Times* noted as being "conspicuous by its absence."[195] The deficit increased to $282 million in May 1967 and a new ceiling of $370 million was organised. This caused the first country to exit from the scheme. The Bank of France warned that it could only agree to participate up until the end of July 1967.[196] The outbreak of the Six-Day War on 5 June 1967 forced the ceiling to be raised again to $420 million. The extension

[187] W.P.C. "Gold Pool", 6 August 1966, BOE. EID 10/15, 1275/3.
[188] Bank of England, "The Gold Pool", 11 August 1966, BOE. EID 10/15, 1275/3.
[189] Bank of England, "The Gold Pool", 11 August 1966, BOE. EID 10/15, 1275/3. Coombs wrote to Bridge arguing that the final version of this document should be redrafted to stress that there was a "very real possibility' of the fortunes of the Gold Pool reversing rather than a 'possibility'" (Coombs to Bridge, 14 August 1966, BOE. EID 10/15, 1275/3.
[190] Bank of England, Note, "Gold Pool", 8 September 1966, BOE. EID 10/15, 1275/3.
[191] Dealtry, "Meeting of Experts", September 1965 (handwritten note), BISA DEA 20 FO 50.
[192] Coombs, 1976, 158.
[193] Stevens to Hubback, 11 May 1966, BOE C43/233/1965/3.
[194] Parsons, 'Gold Pool', 21 November 1967, BOE. EID 10/15, 1275/3.
[195] "How Vulnerable is the Bankers' Gold Pool?" *Financial Times*, 27 April 1967.
[196] Note "Pool d'OR", 29 May 1967, BISA DEA 20 FO 50.

was agreed without French participation, and they privately withdrew soon after. The US took on the French share, increasing its stake to 59 percent, and pledged to assume further responsibilities in the event of further withdrawals.

Figure 3.3. The Gold Pool Cumulative Position and Purchases and Sales of Gold, 1961 to 1968



Source: Data provided by the BISA.

Note: $ millions.

The participant resistance to the scheme increased with each deficit. The question of whether to continue came up again in an emergency meeting of the Expert Group on 9 June 1967. The division was predictable. The US, UK and Germany wanted to continue. Tüngler argued that the most important thing was that "the public should be convinced that the Pool [was] working smoothly and unanimously." He appealed for larger resources in order "to hold the line." Coombs also pushed for continuation, claiming all that was important was "that the central banks stood united, the amount committed did not matter." The French, Swiss and the Belgians protested. Van de Brock (Dutch National Bank) put the basic anxiety thus: "Do we expect a permanent deficit in the Pool?" André doubted the rationale for the scheme given that the answer was in the affirmative. Bridge responded simply: "What would the practical alternative be?" Théron and Iklé felt the crisis must be seen through, but that afterwards things would have to be reassessed.[197]

[197] Hall, "Meeting 10 June 1967", (handwritten notes), BISA 7.18(16) – Papers R.T.P. Hall, box HAL 2, f01.

However, the concerns were not readdressed when things had calmed down.[198] Instead, the limit was raised at the end of July to $470 million and with increasing frequency over the coming months. [199] With the deficit standing at $670 million on 11 November, having seen eight extensions of $50 million and one of $100 million since June, Coombs and Bridge continued to pin their hopes on an improbable upturn in the market comprising large new supplies and less demand.[200] Moreover, Coombs and Bridge vigorously dismissed the possibility of a division in the official and private markets, and in late 1967 they maintained, against all evidence, that "the best hope for reducing speculative demand for gold lies with aggressiveness rather than defensiveness in selling it."[201] This stance is not easily explained as a matter of objective calculation. However, in line with the expectations of the explanatory framework of this study, the negotiated structure had acquired a special significance for its designers and managers. They had committed themselves in advance to the the scheme, and were therefore prepared to extend it far past its rational cut-off point, in the hope that a change in external conditions might somehow save the arrangement.

Matters reached a new low with the devaluation of the pound on 18 November 1967. The next day the news leaked that France had not been in the scheme since June.[202] By the end of the week, the ceiling stood at $1,370 million. Coombs, Bridge, Iklé, Tüngler and McDonald tried to find a solution. They agreed to clamp down on speculators by controlling credit-financed purchases, screening demand, and endeavouring to limit sales exclusively to commercial requirements. However, to impose these constraints through legislation with sufficient speed would be impossible. This left only moral suasion and depended on Swiss and British compliance to make the London and Zurich markets transparent.[203] The governors had serious doubts about whether these measures would work, even with full cooperation, and so commissioned a report into dividing the market into official and private transactions. However, Coombs and Bridge managed to kick this report into the long grass by saying it had become superfluous to requirements in the New Year, with President Johnson's announcement of a new balance of payments package.[204]

Thus, the Gold Pool staggered into 1968. The ceiling still crept up in January and February. The market was on tenterhooks and political pressures increased. It was left to Senator Jacob Javits to deal the knockout blow in a speech calling for an end to the Gold Pool on 28 February. The wave of speculation

[198] Hall, "Reunion, July 1967", (handwritten notes), BISA 7.18(16) – Papers R.T.P. Hall, box HAL 2, f01.
[199] One remarkable feature of these increases in the UK case is the complete absence of any Treasury oversight. There is no direct correspondence in this period other than simple telexes where Roy Bridge would report on the changes in the Pool to the UK Treasury. The notifications were neither acknowledged nor acted upon.
[200] Hall, "Gold Meeting', 11 November 1967", (handwritten notes), BISA 7.18(16) – Papers R.T.P. Hall, box HAL 2, f01.
[201] Bridge, "The Gold Pool and the London Gold Market", 6 December 1967, BOE C43/233.
[202] "France Dodges Gold Pool Boost", *The Times*, 21 November 1967; "The deterioration in the international monetary system causes unease among the gold pool", *Le Monde*, 21 November 1967.
[203] D.H.M. "Gold", 3 January 1968, BISA 7.18(12) - Papers Michael Dealtry, DEA 20.
[204] D.H.M. "Gold", 3 January 1968, BISA 7.18(12) - Papers Michael Dealtry, DEA 20.

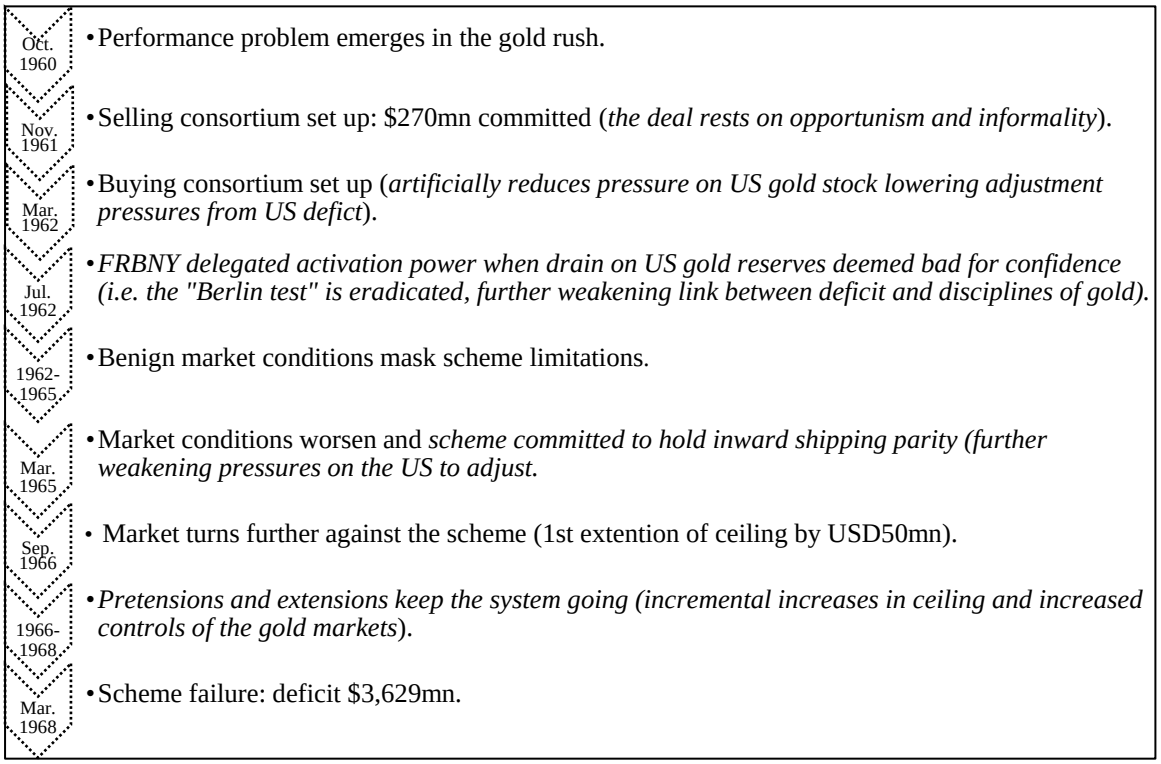
that followed cost over $1 billion. The governors met in Basel on 9-11 March and issued a statement of continued support. However, this final reprieve proved totally ineffectual. The Gold Pool was no longer able to influence the market. On 14 March 1968, the US Treasury called time on the scheme. The operational deficit stood at $3,692 million. The London gold market was closed and Air Force One dispatched to pay the debts and collect the European members who were completely "in the dark about what was going to happen."[205] The decision taken in Washington was to introduce the Two Tier Agreement. The official gold stock would no longer be supplied to the market, but only distributed within the gold club, and the private market would be free to find its own price. Governor O'Brien recorded this move on a slip of paper as "an act of faith."[206]

d. The Gold Pool as a Technocratic Fix

The explanatory framework of this study anticipates that, upon the onset of a performance problem, the leaders in a negotiated system will be disposed to high levels of policy activism. Furthermore, they are expected to opportunistically use the structure of relations, created by repeated bargaining and a political base, to draw on the concerted instrumental capacities of national monetary authorities to defend their interests. The Gold Pool was the product of exactly this appropriative calculus and modality of action. The moment pressures on the gold-dollar system emerged in October 1960, the US set out to acquire the support of the world's most powerful central banks and engage them in a collaborative effort to stabilise the gold market. This scheme, however, was not one calibrated towards preserving the system for the good of the all the members. On the contrary, it was designed to defend, and even enhance, the flow of benefits to the US. In particular, the scheme was organised to avoid the adjustment pressures that would normally be incurred with gold losses. In this regard, the scheme of continuation was skewed to enable the US to avoid the normal rules of the gold-dollar regime. The participating monetary authorities repressed anxieties about the long-term implications of this reality for no less opportunistic reasons. They achieved sub-group goals and received other special privileges through participation. However, as the explanatory framework emphasises, the consequence of such a technocratic fix was that the Gold Pool, a scheme usually praised as being a powerful example of constructive cooperation, set the system upon a profoundly maladaptive trajectory. The situation worsened as internal adaptations to the initial contract progressively lessened the constraints on the deployment of the syndicate. Figure 3.4 summarises the steps down this maladaptive pathway. In the end, the scheme was endogenously limited by its own maladaptation, and by participants that resented the asymmetric character of the deal. However, this was not before the Gold Pool had facilitated a decade of political and economic disequilibria that progressively deepened and widened the disjuncture between the leader and members of the gold-dollar system.

[205] UK Treasury, "The London Gold Pool", 1975, Para 113. PRO T 312/312.
[206] O'Brian, "Handwritten note on draft of Communique", March 16 1968, Secret, BOE OV 53/38.

Figure 3.4. The Maladaptive Development of the Gold Pool



Note: The points of policy maladaptation are in *italics*.

3. WP3, Information Distortions and the US Deficit, 1960 – 1968

The analytical framework put forward by this thesis assumes that in institutionalised bargaining forums, such as WP3 of the OECD, which is analysed in this section, leaders can actively trade and distort private information in return for collective control and distributional gains. In the process, the negotiated structure can become embroiled in systematic patterns of informational bias, and group image distortions can develop. For a time, in this way, leaders can maintain the status quo, and the channel of benefits it provides to them, in the face of pressures for change. However, bargaining forums thereby risk being diverted from their intended function as places where meaningful policy recalibrations are discussed. Instead, they may become locations where misrepresentations of information are made for the leader's individual purposes, and for those of the group. The usefulness of the bargaining forums will thus be undermined, both for adapting policy and for coordinating meaningful information. This section carefully traces how this pattern of development afflicted WP3 of the OECD and what the implications were for the gold-dollar system.

a. Background: WP3 and its Functions

WP3 was formally tasked to "analyse the effect on international payments of monetary, fiscal and other policy measures, and . . . consult together on policy measures, both national and international [that

might] promote a better balance of payments equilibrium."[207] The cooperation problem the group faced was daunting. In addition to the customary dilemmas in reconciling domestic and external objectives, there existed deeply held differences in philosophical outlook regarding the appropriate use of key policy instruments (especially monetary policy), which were worsened by conceptual and empirical uncertainties about the world. The traditional view is that WP3 was rendered ineffectual by this "absence of a common intellectual framework" and had only a modest effect.[208]

However, to understand the significance of WP3 in helping the US hold the gold-dollar system together in spite of its declining performance, it is important to separate its stated purpose from its actual operation. In the words of one official, as shared in a private meeting: "The object of consultations would not be to prevent countries from doing what they wished to improve their own economic situation but to give the impression that any decisions taken had been taken in concert."[209] WP3 did not coordinate internal or external adjustments. In fact, the group consciously avoided taking concrete policy decisions and making political recommendations, although it did become adept at suggesting sensitive policy changes on behalf of national authorities.[210] Moreover, the search for payments equilibrium was never a determining objective of the committee, but one among several means designed to maintain confidence in the dollar. To this end, the committee brought together the bureaucratic core of the system. In this capacity, WP3's actual role was to endorse US plans and to keep oppositional forces at bay. The external perception of a dispassionate technocratic grouping comprised of "the best working economists in the world [engaged in] discussion at a commensurately high level … exchanging ideas backed by a remarkable frankness" was the key to its power and influence.

The group provided four specific appropriative functions. First, WP3 members would share private information on their balance of payments objectives and programs such that they got to know, or believed that they got to know, why particular policies were adopted. In consideration of this privilege, they refrained from publicly questioning one another's plans. Second, WP3 ensured that all members were on-message to help coordinate friendly external reactions in the markets and political constituencies. That is, they gave the impression that unilateral actions were joined-up and gave collective assurances regarding the health of the system. Third, the information shared in discussions and its connection to the committee's expertise and credibility was used to make policy preferences more persuasive to domestic audiences. The members used WP3 to help determine the terms on which

[207] OECD WP3, "The Balance of Payments Adjustment Process, A Report by Working Party No. 3 of the Economic Policy Committee of the Organization for Economic Cooperation and Development", Paris: OECD, August 1966, 8.
[208] James 1996, 184; Russell 1973; and Strange 1976, 149.
[209] Hay, "WP3 of OEEC Record of the Meeting held on May 1961", OECD/CPE/WP3, 3.
[210] Dow, "WP3 OECD Record of Meeting June 1964', OECD/CPE/WP3, 2"; Lennep, "WP3 OECD Record of Meeting held in July 1965", OECD/CPE/WP3, 14.

national policies were debated and priorities set. Fourth, through the affirmation of insiders and the dismissal of outsiders, the members built conformity and commitment to each other.

A careful analysis of 55 WP3 meetings between 1961 and 1968 reveals that the information presented in WP3 was subject to bias of a constant nature. This was most significant in relation to US balance of payments forecasts, where US monetary officials gave reports that reassured members and sought collective legitimacy for proposed actions. The US disclosed only what they wanted participants to hear, which was essentially whatever was necessary to retain their confidence and support. The presentations were focused on justifying actions and deflecting attention from failings, rather than seeking solutions or policy changes. Furthermore, to push their domestic agenda, the US participants reported their preferred interpretation of the international mood when returning from meetings. The goal was to calm the private financial community, whatever the objective facts of the situation, and to keep politicians at bay. The US also influenced the group to close ranks, and encouraged the members to share in self-justificatory interpretations of events.

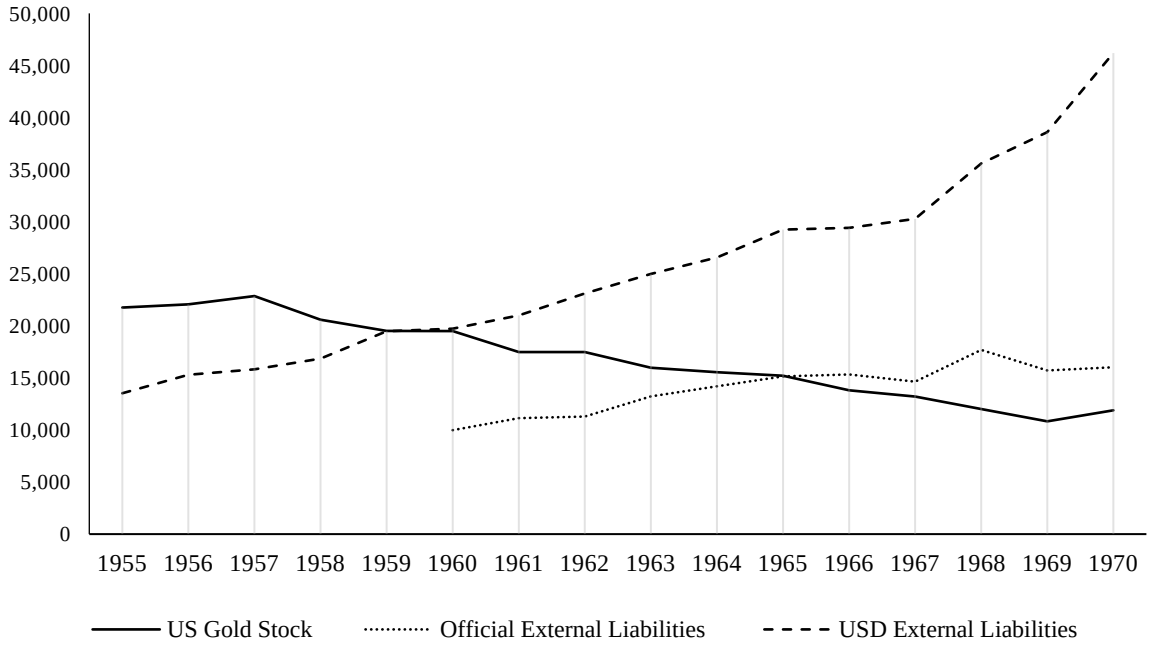
The resulting rhythm of the meetings was regular, as was the list of attendees. The US routinely provided erroneous economic forecasts, optimistic political assessments and requests for special dispensations, after which the US balance of payments plans, without exception, received endorsement. This was not because the members were easily duped, or even down to the difficulties of dissenting in small groups. The WP was designed to facilitate reciprocity and collective self-justification. The endorsement of defective projects and the legitimation of deviance simply followed. Criticism from within the committee was neutered and disapproval from outside tempered. The individual distortions built a picture of the US and the whole system moving towards a better equilibrium, when the opposite was usually true. The politicking and distortion also shifted attention away from the fundamental causes of global imbalances in the relative competitive power of Europe and the US, and away from the actual processes of economic adjustment in all its gritty distributional reality, towards areas where there was great scope for obfuscation. Things were so adrift by 1967 that WP3 had to commence a forlorn study into what the balance of payments aims of its members actually were, and whether these could actually be reconciled. This was too little too late. The necessary recalibrations had been endlessly deferred, discussions bogged down in technical details, and measures that eroded the foundations of the gold-dollar order legitimated.

b. WP3 and US Balance of Payments Packages

The US deficit was the most persistent feature on the international monetary landscape in the 1960s. The Report of the President's Task Force on Foreign Economic Policy in 1964 identified the underlying dilemma: In the first half of the 1960s, the US had to navigate between an external deficit and sluggish domestic performance; and between an international commitment to maintaining an open capital market and a domestic commitment to full employment. The system hinged upon this dilemma. The external

liabilities of the US climbed past its available gold-stock from 1960 onwards, as shown in Figure 3.5. However, until now, the role of WP3 in shaping the response to this malignant problem has been ignored. Through repeated distortions of information, US authorities retained the buy-in of foreign creditors and kept domestic interests at bay while stalling constructive actions. The fate of the dollar determined the whole pattern of world payments, so the refusal to acquiesce to pressures for adjustment in this way maintained the trajectory toward collapse.

Figure 3.5. US External Liabilities and US Gold Stock, 1960 to 1970



Source: Banking and Monetary Statistics 1941-1970. Washington D.C. Board of Governors of the Federal Reserve System. September 1976, Tables 14.1 and 15.1

Note: $ millions.

The US's leading economist warned a week prior to the October 1961 WP3 meeting that: "We must bear in mind that in the next one to three years the balance almost inevitably will worsen because our domestic recovery will cause imports to increase faster than exports."[211] Nevertheless, WP3 was greeted by a delegation that wanted to "achieve a reasonable equilibrium by 1963 … without a change in the gold price or the imposition of restrictions" and asked delegates to opine on how best to get there.[212] The US projected improvements in its competitiveness through structural changes in its labour markets, and positive moves on its external accounts through a tempering of capital outflows and an export drive,

[211] Triffin, "Summary Minutes of Meeting of the Interdepartmental Committee of Under Secretaries on Foreign Economic Policy", Washington, Department of State, E Files: Lot 65 D 68, Interdepartmental Committee of Under Secretaries on Foreign Economic Policy, Balance of Payments. Official Use Only.
[212] Roosa, "WP3 OECD Record of Meeting held in October 1961", OECD/CPE/WP3, 1.

all aided by a growing sensitivity of policymakers to external problems. In other words, the US reconciled the trade-off between growth and external balance through positive forecasts. WP3 endorsed the US target and the measures taken. The Chairman felt that "there were good reasons to believe the US would achieve external equilibrium in a reasonable time."[213] The group offered to "cover the deficits in the meantime … if necessary by artificial means … to prevent deterioration of confidence in the private financial community."[214] The trend for the next decade was thus established.

The group approval was important because it assisted in maintaining official confidence in the dollar: "The financing of the US external deficit by central banks could continue only as long as these countries were convinced that all necessary steps had been taken to correct the US deficit."[215] WP3 also helped the US Treasury to institute its 1961 balance of payments program against staunch domestic resistance. In particular, the US Treasury faced the Council of Economic Advisers (CEA) who wanted a fundamental change in approach, with a new international treaty, rather than continuing "on a secret, day-to-day, piecemeal and ad hoc basis."[216] The CEA seemed to have a strong case.[217] However, the US Treasury held a trump card in its ability to define what "will not be accepted by our European friends and [what] cannot be accepted by them if the dollar is to maintain its position as the world's reserve currency".[218]

By the middle of 1962, the US forecasts started to look hugely optimistic, especially as predictions on wages and capital outflows were found wanting.[219] The Europeans pleaded with the US to alter its monetary and fiscal policy mix in order to raise interest rates. In a classic deflective manoeuvre, the US authorities pointed to the "vast implications and ramifications of a shift"[220] and sought to persuade (with the use of charts and historical comparisons) that "the effort to sustain short term rates [had been] largely determined by international considerations,"[221] while holding out the possibility of a raise in interest rates once things had moved on the fiscal front.[222] The US thus deferred action; it also turned the spotlight onto its partners, calling for "broad questions … to be raised in connection with European capital markets."[223]

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[213] Lennep, "WP3 OECD Record of Meeting held in December 1961", OECD/CPE/WP3, 6.
[214] Emminger, "WP3 OECD Recording of Meeting held in December 1961", OECD/CPE/WP3, 8.
[215] Lennep, "WP3 OECD 'Record of Meeting' held in February 1963", OECD/CPE/WP3, 18.
[216] Chairman of the Council of Economic Advisers (Heller) to President Kennedy, Memorandum, "Why we need an interim international monetary agreement", Kennedy Library, National Security Files, Kaysen Series, Balance of Payments, International Monetary Agreement, 8/62. No classification marking.
[217] President Kennedy to Secretary of the Treasury Dillon and the Under Secretary of State (Ball) Kennedy Library, Memorandum, President's Office Files, Treasury, 8/62. Confidential; Limited Distribution.
[218] Secretary of the Treasury Dillon to President Kennedy, Memorandum, Kennedy Library, Dillon Papers, Memos to President, 2/63-3/63. Secret.
[219] Emminger, "WP3 Record of Meeting held in July 1963", OECD/CPE/WP3, 4.
[220] Roosa, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 18.
[221] Daane, "WP3 OECD Record of Meeting held in December 1962", OECD/CPE/WP3, 1.
[222] Fowler, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 19.
[223] Down, "WP3 OECD Record of Meeting held in November 1962", OECD/CPE/WP3, 2.

Entering 1963, the US was in the now familiar position of having to seek group buy-in for a new package, stressing that there was "no failure in diagnosis of the problem, nor in its treatment, and the trend toward improvement continues."[224] Far from convinced, the Europeans pressed for more active policies - some new path forward was needed. The US authorities had long been unequivocal that they "could not take direct action to keep foreign borrowings out of [its] market, because any move of this sort would frighten holders of short-term dollars."[225] However, reflecting the ability of monetary authorities in negotiated orders to stand relatively apart from private interests, Robert Roosa, Treasury Undersecretary for Monetary Affairs during the Kennedy administration, was preparing the ground for the interest equalisation tax (IET). The IET was designed to mimic the effect of higher US interest rates by increasing the cost of foreign loans in New York by 1% without actually raising interest rates in weak domestic conditions. This proposal was bound to have ramifications in a world committed to reducing exchange controls and dependent on US capital.

Nevertheless, in September 1963, WP3 legitimated the IET, together with a controversial Canadian exemption and Japanese carve out. The US authorities secured this endorsement by stressing the temporary and emergency nature of the measure. They also predicted a drastic $1 billion improvement in the capital account, amounting to an elimination of half of the 1962-level foreign issues.[226] This international approval was crucial to the domestic passage of the IET. The private financial community had received the tax as a first move toward exchange controls, likely to do "more harm than good to the international monetary order", and they pledged resistance in Congress.[227] They argued that the measure risked retaliation in the form of currency wars akin to the 1930s. WP3 made it possible to reassure that this sort of beggar-thy-neighbour response was improbable. Furthermore, WP3 helped to override doubts expressed by prominent individuals. Hay anxiously predicted "a deplorable effect on the exchange market."[228] However, WP3 delegates were "confident and assured" the measure would work.[229] Sharing a one-sided impression of the tax, WP3 legitimated a major limitation on the private international use of the dollar, as a substitute for a more fundamental adjustment that would have been more costly to the US.

The first half of 1964 brought a US export boom and a sense of real optimism.[230] However, it soon transpired that the IET was being avoided, and corporates were pouring money out of the US.[231] A third payments package in almost as many years was necessary in 1965. The plan extended and tightened all

[224] Roosa, "WP3 OECD Record of Meeting held in February 1963", OECD/CPE/WP3, 4.
[225] Roosa, "WP3 OECD Record of Meeting held in July 1962", OECD/CPE/WP3, 15.
[226] Roosa, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 1.
[227] Hearings before the Committee on Ways and Means of the House of Representatives, 88th Congress, 1st session on H.R. 8000, 159, 1963 (henceforth IET Hearings).
[228] Hay, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 8.
[229] Emminger, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 7.
[230] Young, "WP3 OECD Record of Meeting held in June 1964", OECD/CPE/WP3, 2 and 4.
[231] Young, "WP3 OECD Record of Meetings held in October 1964", OECD/CPE/WP3, 12.

the existing measures and introduced a new program of moral suasion to induce companies to voluntarily limit direct investment and bank and non-bank lending abroad.[232] The *Economist* reported on complaints of "external dollar pools," "investment currency premiums," and "effectively frozen dollar balances."[233] This seemed to be a price worth paying however, as the possibility of equilibrium appeared on the horizon.[234] However, the BIS struck a note of caution in late 1965 warning of a "basic deterioration" in the US position such that the "authorities might be fooling themselves a little."[235] Contrary to what all members had apparently hoped, the impact of Vietnam would not be "temporary" or "contained."[236] The US authorities tried to maintain that it "was still serious about its [payments] problem,"[237] but it was increasingly clear that they believed a "balance of payments equilibrium was an impossible goal in view of the US's military obligations [and] therefore a deficit of indeterminate size would have to be accepted."[238]

The charade was to continue into 1967. The now annual US balance of payments package proposed an extension of the IET, and a broadening of the scope and tightening of the requirements of the voluntary programs. This set of policies could "only hope to buy time."[239] The final lurch of the merry-go-round came in 1968. The US was facing more grim figures and the drastic possibility of having to impose border taxes and other direct controls, rather than restraints, on the external account. The balance of payments problem received yet another study. The measures contemplated went further than ever, proposing to directly limit the internal convertibility of the dollar and running against the spirit of the OECD Codes of Liberalisation by discriminating in favour of Canada, Japan and the UK and against continental Europe.[240] The US insisted that it had "no other choice" when it presented its ideas in Paris.[241]

In a clear display of the way that appropriation binds officials to leaders and systems, WP3 endorsed a plan that, if "regarded as permanent … would entail a sacrifice of a great part of the philosophy to which OECD countries subscribed – ending the freedom of the movement of men and goods."[242] Yet, the Managing Director of the BIS, Gabriel Ferras, called the move out for what it was, "an unsavoury …

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[232] Paper Prepared for the Cabinet Committee on Balance of Payments, 'Balance of Payments Prospects and Policies', Washington, December 9, 1964 Source: Kennedy Library, Herter Papers, Balance of Payments, January 29, 1963 thru April 24, 1965, Box 6. Limited Official Use
[233] "A New Plan for Gold", *The Economist*, April 23 1966.
[234] Lennep, "WP3 OECD Record of Meeting held in March 1966", OECD/CPE/WP3, 13.
[235] Gilbert, "WP3 OECD Record of Meeting held in November 1965", OECD/CPE/WP3, 7.
[236] Kessler, "WP3 OECD Record of Meeting held in July 1966", OECD/CPE/WP3, 23.
[237] Deming, "WP3 OECD Record of Meeting held in May 1966", OECD/CPE/WP3, 15.
[238] Strycker, "WP3 OECD Record of Meeting held in September 1966", OECD/CPE/WP3, 9.
[239] Treasury Fowler to President Johnson Washington, Memorandum, May 10, 1966. Balance of Payments—1966 Johnson Library, National Security File, Subject File, Balance of Payments, Vol. 3 [1 of 2], Box 2. Secret.
[240] Telegram From the President's Special Assistant (Califano) to President Johnson in Thailand, Memoradum, Washington, December 22, 1967, 1649Z Johnson Library, National Security File, Subject File, 1968 Balance of Payments Programs, Cables [2 of 2], Box 4. Secret.
[241] Dillon, "WP3 OECD Record of Meeting held in January 1968", OECD/CPE/WP3, 3.
[242] Ossola, 'WP3 OECD Record of Meeting' held in January 1968", OECD/CPE/WP3, 14.

backward step [reflective of an] increasing tendency to move towards measures of direct control of a more restrictive nature."[243] The market's reaction was violent and brought with it political pressures. There developed in Congress an "almost anarchic willingness to pull the temple down."[244] The CEA asked: "Is all this worth doing just to preserve the gold-dollar link?"[245] This marked a change in the utility of WP3 as an informational prop for securing the confidence of the world's largest debtors and creditors in each other and in the system.

c. WP3 and the Maladaptive Development of the System

The costs for the system that came with the information distortion in WP3 were wide-ranging. Four particular developments were especially important. First, the group misled outsiders through its external presentations, and created an unreal image of stability. For instance, by constantly rationalising deferring the costs of adjustment through information distortions, politicians and "public opinion [became] less balance of payments minded."[246] This made reform harder as many "seemed too satisfied with present trends."[247] The BIS notably warned that WP3 "had fooled not only the public but also the ministers."[248]

Second, in selectively filtering incoming information, the group indulged in self-serving interpretations of events. For instance, as pressure mounted, the behaviour of the financial markets was portrayed as being "perfectly ridiculous" such that the "authorities had long ceased to take seriously the various rumours circulating in these markets." [249] By 1966, increasing numbers of people, professors, journalists and others were arguing that there was an imminent danger to the international monetary system. However, these views were slow to penetrate the sanctum of WP3. In November 1966, for instance, the French representatives insisted that they "did not see how they could find themselves facing a crisis."[250] At the same meeting, Sir Denis Rickett of the British Treasury asserted that "no one around the table thought they were faced by an imminent crisis."[251] The effect, again, was to underestimate the

[243] Ferras, "WP3 OECD Record of Meeting held in January 1968", OECD/CPE/WP3, 32.
[244] "Administration's Balance-of-Payments Proposals", Hearings before the Committee on Ways and Means, House of Representatives, Ninetieth Congress, Second Session on Administration's Balance-of-Payments Proposals 1, 2 and 3 Washington, US Govt. Print. Off.
[245] Telegram from the President's Special Assistant (Califano) to President Johnson in Thailand, Washington, December 22, 1967, 1649Z Johnson Library, National Security File, Subject File, 1968 Balance of Payments Programs, Cables [2 of 2], Box 4. Secret.
[246] Ossola, "WP3 OECD Record of Meeting held in July 1966", OECD/CPE/WP3, 27.
[247] Emminger, "WP3 OECD Record of Meeting held in November 1965", OECD/CPE/WP3, 18.
[248] Gilbert, "WP3 OECD Record of Meeting held in July 1967", OECD/CPE/WP3, 14.
[249] Emminger, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 17. This contrasts sharply with early meetings where investors' decisions were represented as being guided by "fundamental economic conditions in different countries" and "speculative movements [as being] the result of basic imbalances" (see Strycker, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 5; Emminger, "WP3 OECD Record of Meeting held in September 1963", OECD/CPE/WP3, 8.
[250] Perouse, "WP3 OECD Record of Meeting held in November 1966", OECD/CPE/WP3, 2.
[251] Rickett, "WP3 OECD Record of Meeting held in November 1966", OECD/CPE/WP3, 4.

vulnerabilities facing the system and to make functional policy adjustments less likely, but this time among insiders.

Third, the information distortions in WP3 persistently legitimated increasing government intervention in the system. Nowhere was this clearer than in the realm of exchange controls. These were progressively tightened by national authorities using WP3 endorsement as the means of justification to domestic audiences. This policy trend occurred despite the fact that WP3 was ostensibly committed to the removal of controls.[252] The usual bias towards putting power into their own hands easily explains this contradiction between the stated and revealed preferences of the managing authorities. Their need for control also increased their propensity to seek new powers and tighter rules. In the process, WP3 acted to increase the size of the state in the system. This is exactly the way that the explanatory framework would lead one to expect a negotiated system to develop.

Finally, the WP3 became increasingly distracted from the analysis of basic balances. Having started out by identifying the fundamental causes of imbalances and looking to improve US export competitiveness and productivity, the central economic causes of the overvaluation of the dollar faded from discussions. To be sure, identifying the elusive "fundamental disequilibrium" required for a Fund sanctioned change in parities proved difficult throughout the history of the system. Yet, references to the adjustment process became oddly rare amongst the committee. One member even had cause to remark on his "surprise that the [WP3 report to the G-10] dealt so little with exchange rate adjustments."[253] The answer to his question lies in the fact that WP3 was being deployed for very different purposes.

Generally then, as this study's framework would predict, WP3 became almost perfectly maladapted, as it was bound up in repeated information distortions facilitated by its common membership and integrated structure of relations. WP3 came to have almost nothing to do with balance of payments adjustments or any other kind of functional policy change, but rather had everything to do with offering informational support to colleagues deemed to be engaged in a common struggle. The fact that there was not an equitable relationship between the US and the other members, as shown through the endorsement of manifestly flawed adjustment plans, was unimportant to the process of internal reciprocity and mutual gain that supported the exchanges. However, it mattered greatly to the end result. The information traded and represented by WP3 enabled the US to consistently avoid or lessen balance of payments pressures and, in doing so, it supported a widening disjuncture between the system and underlying political and economic realities. The cumulative effect over many years of the repeated

[252] Within WP3 Rinaldo Ossola (Italy), Dennis Rickett (UK), Emile van Lennep (Netherlands), Rolf Gocht (Germany), Michael Hay (Canada), Robert Roosa (US), and others, all spoke out unequivocally against controls in the May 1961 meeting.
[253] Perouse, "WP3 OECD Record of Meeting held in December 1966", OECD/CPE/WP3, 3. The report being referred to was, WP3, OECD, "The Balance of Payments Adjustment Process, a Report by Working Party No. 3 of the Economic Policy Committee", Paris, August 1966.

manipulation of information exchanges was to entirely undermine the utility of WP3 from the perspective of the overall system.

4. Further Examples of Appropriation: Swaps and SDRs 1960 - 1968

The explanatory framework of this study predicts that leaders pursuing appropriative modalities of action will draw upon the instrumental powers of the other parties around the bargaining table when problems emerge, in order to retain established rents and avoid painful adjustment costs. It also predicts that, eventually, this leadership behaviour will incite resistance. Section 2 showed how these logics applied to the Gold Pool. The Federal Reserve swaps network and SDRs, that developed under the same drive by the US to avoid costs of adjustment, by means of appropriation, provide further evidence of these logics.

The revaluation of the mark and guilder in March 1961 rocked the gold-dollar system. In the aftermath, the US Treasury began acting through the Exchange Stabilisation Fund (ESF) administered by the FRBNY to intervene in the foreign exchange market to take the pressure off Swiss francs and deutschmark for the first time in the post-war period, specifically to reduce their premia against the dollar and so stall speculative capital flows to these countries.[254] The success of these operations encouraged US officials to establish *Reciprocal Currency Arrangements* (the swaps network) between the FRBNY and 11 (subsequently increasing to 14) central banks and the BIS, as a permanent structure of support for the dollar. The network was advocated for not only by the FRBNY but also by other central banks as they sought through exchanges of internal reciprocity and mutual self-empowerment to put in "[their] own hands as much freedom of action as [they] could."[255]

The network aided the US in the defence of the dollar, by co-opting national monetary authorities into arrangements that were politically and economically expedient rather than functional. The network grew in size and complexity, as it was extended to cover fundamental payments disequilibria in the system. The special forms of reciprocity between monetary authorities committed to the gold-dollar order fuelled maladaptive trades. However, arrangements that persistently put power into the hands of monetary authorities, while being heavily skewed towards the interests of the US, could not hope to pass without criticism indefinitely. Increasingly, finance ministries began to complain that their liabilities were unclear under the network. By the mid-1960s, European finance officials had become so concerned that they started to look for ways to retire much of the network.[256] In the late 1960s, doubts even began to develop in the US. For instance, in early 1968, Bill Martin, the Chairman of the Federal Reserve, reported "considerable resistance."[257] According to another US Treasury officialthere was a

[254] Federal Reserve Bulletin 48 1138 (September 1962).
[255] Bridge, Note for the Record, "Telephone Conversation with Coombs (F.R.B.) on 23 September 1963", 24 September 1964, BOE C43/233.
[256] "WP3 OECD Record of Meeting held in November 1966", OECD/CPE/WP3.
[257] Martin to the Chancellor, 19 April 1968. BOE OV44/130.

growing "attitude against a roll-over on swaps."[258] The political limits to appropriation were thus being reached at exactly the time that the ability of the swaps to coordinate markets was being constrained by their persistent application to maladaptive ends.

If swaps provided a hidden means to avoid adjustment, the debate over the creation of a new reserve unit, known as Special Drawing Rights (SDRs), designed to ease the pressures within the gold-dollar system, brought the distributional conflicts into the open. Indeed, the striking difference between SDRs and the other supports for the dollar was that they involved deep and open conflict. The reason was that the issue of SDRs had the potential to impact upon the distribution of power within the G-10, and upon the traditional practices of central banks. Because of this, those at the meeting in Stockholm in 1968 felt that the SDRs deal was of historic significance. Chairman Martin of the Federal Reserve noted that the feeling was that "the end of an era was at hand, and that it would now be seen whether it was possible to demonetize gold at the margin and to make it a supplementary rather than a central element in the system of international payments."[259] However, in the end, the expectation that SDRs would radically alter the system was mistaken. The reason – consistent with the explanatory framework of this study – was that SDRs were yet another technocratic fix, infused with a deep bias towards perpetuating the status quo.

The SDRs were non-transferable either directly or indirectly (i.e. through an agent); the instrument could not serve for intervention purposes; and it had no material or paper backing. Although there was no creditor limit, the terms of initiation were also limiting in the extreme. The reason was simple: nobody, least of all the US, was truly prepared to invent a new international currency that might be controlled by someone else.[260] Indeed, according to the G-10 Deputies, "the term "reserve unit" was provided for reasons of public presentation." [261] Rinaldo Ossola of the Italian central bank was clear that "I have never considered this unit international money ... international money is solely gold ... so I feel inclined to regard this as a drawing right."[262] Much earlier, Milton Gilbert, at the BIS secretariat, had tried, and failed, to make the G-10 Deputies face up to their responsibilities: "When we – well, I don't mean we I mean YOU really and particularly the central banks … approach the fact that this

[258] D.A.A. to Fenton and Morse, 30 April 1968. BOE OV44/130.
[259] FOMC, "Memorandum of Discussion: A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, April 2, 1968, at 9:30 a.m.", Federal Reserve Board Archive.
[260] Bank of International Settlements, G10 Deputies, "Three questions about reserve units", Basel, 28 February 1966, p.1 BISA, 7(18) 10 – Papers Gabriel Ferras, box FER7, f.A34, f10.
[261] G-10 Deputies Group, "Summary of Views expressed by Ministers and Governors at their meeting at Lancaster House", London 17-18 July 1967, 20 September 1967, BISA G-10-14 ,X/DEP/ 134/.
[262] Ossola, "Verbatim Record of Meeting, Group of Ten, Informal Record of the Discussions of the deputies of the Group of Ten meeting in the International Monetary Fund", Washington, 30 November 1966. BISA G-10-14 X/DEP/ 134/.

[scheme] means that there's going to be a de-emphasis of gold, that it really means some profound changes in the system … there's an immediate tendency to back away from it."[263]

5. The Collapse, 1968-1971

The analysis so far has revealed how the US, through appropriative leadership, held the gold-dollar system on a trajectory that was advantageous to its own short-term interests, but maladaptive from a broader perspective. Through the repeated deployment of information distortions and co-optive devices, US officials deferred any need for meaningful adjustment at the centre. The discussion has also shown that the limits to appropriation were being reached by the end of the 1960s. The Gold Pool had been suspended in the Two Tier Agreement. WP3 was becoming increasingly irrelevant, even as a means to hoodwink markets and politicians, as nobody truly believed the US was serious about addressing its payments problem. New swaps arrangements were running into political resistance. Moreover, despite much furore, SDRs represented little more than another international credit facility. The present section addresses how political tensions, and pressures to adapt to the changing external environment, which had both intensified over a decade of appropriation, finally shattered the system between 1968 and 1971. Two issues combined to precipitate the collapse. First, there was a shift in Europe, where resistance finally broke the appropriative institutions that had previously sustained US dominance. Second, the markets ceased to respond to the instruments of coordination formed around appropriation. These issues drove the US to reassess its interests, redeploy its power, and to close the gold window.

In every European country, by the late 1960s, subordination to US interests had incited major opposition. There was a deep reservoir of political resentment against the actions of national monetary authorities. After 1967, the German Länder were indignant about jurisdictional losses, and felt that the German Federal officials unreasonably wanted powers of *totalsteuerung* (total intervention).[264] In France, financial officials had already incurred the wrath of the Élysée Palace for trying to temper the conflicts arising from gold conversions. Even in the UK, where, after devaluation, the authorities had to resort to mandatory controls and sanctions, the sense was that, absent some meaningful change in US policy, the limits to the gold-dollar order were being approached.[265]

The lobby for floating exchange rates also started to put huge pressure on the national monetary authorities. The first country to feel the effects was Germany, where the Council of Experts for the Assessment of Overall Economic Developments called for a more flexible exchange rate regime as early as 1964.[266] In November 1966, the German Otmar Emminger, vice president of the Bundesbank,

[263] Gilbert, "Verbatim Record of Meeting, Group of Ten, Informal Record of the Discussions of the deputies of the Group of Ten meeting in the International Monetary Fund", Washington, 30 November 1966. BISA G-10-14 ,X/DEP/ 134/.
[264] Roeper, 1979.
[265] Hancock, "Note of a meeting", 27 August 1969', BISA, G10D7 3AA/4.
[266] Emminger, 1977, 15.

and chairman of the G-10 Deputies, reported that: "They would have to find an answer to the growing support for flexible exchange rates. So far the German authorities had successfully defended the thesis that the right solution was through better international cooperation. But … they would have to discuss the exchange rate and gold price issues in some forum or another … more and more people were saying that fixed exchange rates were not appropriate for countries which try to seriously maintain internal stability in an inflationary world."[267] Yet it was only in January 1970 that central banks met to actually discuss more flexibility in exchange rates and representatives left rueing "a not particularly satisfactory two days."[268] The thesis that the solution to domestic problems should be entrusted to national monetary authorities working in international concert had by this time lost almost all of its political capital.

This external resistance produced new intergovernmental coalitions, formed outside the integrated structure of relations that supported US appropriation and system management. The first step in this direction occurred in December 1966, when the UK Chancellor Callaghan set out to make "those responsible for monetary policies in the leading countries … understand how their policies affected others."[269] This was a direct challenge to the independence of monetary authorities that acted with regard to the system rather than national priorities. Similar political forces undermined the November 1968 Bonn summit. The French and German central bank governors, in conjunction with a small number of finance officials, had agreed prior to the meeting upon a realignment of the franc and the mark to support the system. However, German government resistance undermined the plan. Lest the new climate for monetary officials be overlooked, the Bundestag attacked the Central Bank Council for having "stabbed its own government in the back."[270] The entire Bonn meeting was clouded by "an undercurrent of "Ministers versus Governors" feeling."[271] Under these limits, European national monetary authorities could not do appropriative deals. Robert Russell captured the central consequence: "As policy decisions were elevated to the level of heads of government and became publicly debated in legislatures, the resources which trans-governmental coalitions [organised around the BIS and OECD] could mobilize to influence policy decisions became less and less decisive for the outcomes."[272]

The growing inability to secure concerted actions fuelled speculation in the markets. The system experienced repeated speculative attacks between 1967 and 1969, before the conclusive turn of events in 1971. In this period, from 1967 onward, the market convulsions took on a system-wide character and the interludes of stability shortened. The volatility was channelled primarily through the Eurodollar market. This offshore market for US dollars had expanded rapidly in the early 1960s. The reality was

[267] OECD, "WP3 OECD Record of Meeting held in January 1966," OECD/CPE/WP3, 13.
[268] Bank of England, "Meeting on Exchange Rate Flexibility", Basel, 12-13 January 1970, BOE, OV4/110.
[269] Record of Meeting Johnson Library, Bator Papers, Chequers Trip, Box 8. Secret. No drafting information appears on the source text.
[270] Emminger, 1977, 147.
[271] Morse to O'Brien/Parson, "Bonn meeting: 20-22 November", 25 November 1968; O'Brian, "Bonn meeting: 20-22 November", (handwritten annotation), 26 November 1968, BOE OV44/130.
[272] Russel, 1973, 464.

that "neither the central banks nor even the commercial banks [had] a truly comprehensive view of the nature of the transactions passing through the market."[273] Moreover, years of neglecting the issue meant that, by the end of the 1960s, the market had grown to a massive $50 billion, creating an enormous, opaque and unregulated speculative overhang. The central banks increasingly found they lacked the resources to repel attacks. In crises, the Bank of England reported, "there was little scope for manoeuvre; finesse had no place and [authorities] became locked into defensive positions."[274] As a result, the markets "became a sort of disorderly casino with the odds rigged in favour of the gamblers instead of the house."[275] They forced realignments in three major currencies (sterling, the franc and the mark), temporary floats in Canada and Germany, and the massive tightening of controls across the board. The BIS described the period of 1967-68 as the "most disturbed since 1949."[276]

Under pressure from the markets and restive partners, the US opted not for accommodation or a collective response, but instead to replace appropriation with coercion. For the US, this did not really represent a change of course, however, for it had never subordinated its national interests to the system or its members. Rather, the US stopped trying to bring its partners along with it by means of the positive inducements that characterise appropriation. In the words of Harold James, the US chose to "push to its logical and ultimate limit the role of the US as a reserve centre."[277] This meant "the adoption of a more bullying and brutal way of dealing with international issues."[278] The resulting policy was called "benign neglect" or "malign neglect". The intent was to "free [US] policy from constraints imposed by the weakness in the financial system."[279] The specific objective was to force uncovered dollars onto European countries in amounts that compelled them to make exchange adjustments. John Connally, the Secretary of the Treasury under President Nixon, summed up the approach in declaring that: "The dollar may be our currency but it is your problem!"[280]

The policy of benign neglect destroyed the institutions and relations of appropriation that rested on mutual gain. Policymakers desperately sought to argue that the system was still valid in 1970.[281] However, in truth, the concerted action upon which the system depended had been undermined. Emminger conceded in a confidential memorandum that "indispensable adjustment measures (e.g. the pound devaluation, two-tier gold market, US tax measures, German and French measures of November

[273] Coombs, "Notes for Talk on "Euro-dollar Market" at ABA Monetary Conference at Princeton Inn," March 18 1966, BSIA 7.18(10) FER.8 A35A2.
[274] Cook and Bull, 1967, "Draft Report on History of Sterling Crisis", (handwritten drafting points by Roy Bridge), BOE C20/6 687/5, 121, 107.
[275] Coombs 1976, 211.
[276] Bank of International Settlements, Annual Report 1969, BIS Annual Reports 1931 to 1996, BISA.
[277] James, 1996, 210.
[278] James, 1996, 212.
[279] Gowa, 1983, 63.
[280] James, 1996, 210.
[281] Ossola, Group of Ten, "Informal Record of Meeting of Deputies G10 Deputies", Paris, 23 April 1920, BISA G10D 14, Restricted x/DEP/.

1968) [were] forced on unwilling countries by major international crises."[282] The BIS observed that different countries' monetary policies were being applied "forcefully" in opposing directions.[283] Coombs reported that traders all over the world were sensing "a total breakdown in policy coordination between the US and its trading partners" and exploiting the opportunities this created.[284] The instruments of market and political coordination and control were failing internationally and domestically.[285]

The renewed exchange instability in 1971 exposed how vulnerable the system had become. In May 1971, the German government overruled the Bundesbank and unilaterally floated the mark. As Harold James puts it: "Germany abandoned the multilateral approach, because it transparently failed to produce any change in US policy or any substantial coordination in Europe, and went on an isolated course."[286] The Netherlands followed Germany, and Belgium was forced to separate the rates on its official and unregulated markets. Meanwhile, the US administration did nothing to tighten monetary policy or take the pressure off Europe or Japan. On the contrary, the US upped the pressure on the members by threatening to adjust military security relationships. The final crisis came with Nixon's decision to close the gold window on August 15, 1971. At the same time, the US embargoed gold, and imposed a price and wage freeze and an import tax of 10-15%. The G-10 Deputies meetings held on 17 August and 3-4 September 1971 were conducted with a sense of powerlessness amongst the members.[287] They desperately sought to impress upon the US that their actions had "put in jeopardy the fought-for achievements in multilateral trade and payments."[288] Yet, Paul Volcker did not seem to care, responding simply that the US was "aware of the problem that our decision provokes."[289] The Rubicon had been crossed. President Nixon wrote to Prime Minister Heath to say as much: "So much of my own concern in the period since last August 15 has been directed toward establishing the point that we need to go beyond a simple patching up of the Bretton Woods system."[290] The gold-dollar order was finished.

6. Conclusion

US monetary leadership exercised in the framework of the 1946 Bretton Woods accord had delivered the most "remarkable price stability [and] the most rapid growth of any monetary regime."[291] Still,

[282] Emminger, "Some remarks on possible reform in the exchange-rate system", Bundesbank, 9 January 1969, BOE OV 53/40.
[283] Bank of International Settlements, "Forty-Second Annual Report", Basel, 12 June 1972, 25.
[284] Coombs 1976, 214.
[285] "Up goes the Mark?" *The Economist*, 8 May 1971.
[286] James, 1996, 215.
[287] Ossola conceded that "most of the relevant matters were not in our sphere of competence" (see Ossola, Group of Ten, "Informal Record of Meeting of Deputies 1970", BISA G0D 1, Restricted x/DEP/).
[288] Emminger, "Group of Ten: Informal Record of Meeting of Deputies on 3 September 1971," September 1971, BISA G10D 14, Restricted x/DEP/.
[289] James, 1996, 221.
[290] Washington National Records Centre, Department of the Treasury, Files of Under Secretary Volcker: FRC 56 79 15, UK British Float. Confidential.
[291] Bordo, 1993, 5-28.

neither this unparalleled economic performance, nor the multiple layers of governance built around the system, could save the post-war monetary order from collapse. This supports the consensus view that the outcome was preordained and would have come about sooner but for constructive US leadership and cooperation.[292] The individuals defending the order may have made some regrettable mistakes, but these were almost unavoidable given the flaws in the system and the extraordinary complexity of the problems faced.[293] This chapter has questioned this comfortable consensus. To the contrary, it has been argued that the logic and consequences of US leadership drove the system to collapse. The gold-dollar system was a negotiated one, with an integrated organisational structure and a political foundation. These properties enabled and induced appropriative leadership, which, in turn, ultimately gave rise to maladaptation and membership resistance.

The Gold Pool, WP3, swaps and SDRs, although unique in their particulars, were all concerted bureaucratic schemes, organised through institutions of collective bargaining, that were designed to keep the gold-dollar system on track without imposing costly domestic adjustments on the US or otherwise compromising the dominant status of the dollar. They were created by officials that had invested a huge amount in the gold-dollar order and were deeply committed to its success. However, the schemes came to look and operate as they did because the opportunistic and boundedly rational actors that created them consistently opted for short-term and particularistic gains, at the expense of the system's overall optimisation. The schemes represented technocratic fixes and informational devices that put power into the hands of national monetary authorities, but did nothing to equilibrate the underlying political and economic disjunctures in the system. As they developed through repeated transactions, each scheme suffered from an expansionary bias and a tendency to become ever more diverted from functional ends. The social and economic costs of securing the persistence of the system through relations of appropriation were felt well before the US strategy turned to benign neglect. Member states had long chafed under a thickening web of constraints and administrative devices that disproportionately benefited the US. However, rather than paying the costs of adjustment, the US became locked into diverting ever more resources to the devices that sustained their power and influence. Eventually, maladaptations and political cleavages limited the coordinating capacities of the various institutional props and supports, and anyone's ability to extend them. When faced with the costs of continuation without the support of appropriation, after a short period of more coercive leadership, the US pulled the gold-dollar temple down.

The argument that has been put forward in this chapter is important in theoretical and historical terms. The standard history of the gold-dollar system suffers from the biased assumption that all the system's problems were technical. To be sure, the technical problems were real. However, it has been forgotten

[292] See the various references in footnote 2 above.
[293] Eichengreen, 1996, 121; James, 1996; Solomon, 1982, 187; and Toniolo, 2003, 357.

that it was people, mostly in Washington, operating within a particular determining historical structure, who decided how these technical problems would be met. For these individuals, appropriation offered a ‘satisfactory’ pathway to solving performance problems without compromising the advantages of leadership. However, by persistently opting for solutions that were not optimal for members, still less for the system as a whole, the leadership ensured that the gold-dollar system was bound to reach a tipping point, when its mounting defects would block continuation along the established path. This argument uniquely puts the collapse of the gold-dollar system in comparative and historical perspective. As will be seen in the next chapter, appropriative policies had been tried before, for comparable reasons, and with similarly dramatic consequences.

4

The Collapse of the Inter-War Gold Exchange Standard

In 1932, still reeling from the collapse of the gold exchange standard, Montagu Norman, governor of the Bank of England, wrote to Per Jacobsson, at the BIS, to downplay his own role in the calamity: "I am now accused for having gone back to the gold standard. It was probably a mistake. […] It is easy to see afterwards. But a great deal of what has happened in the meantime was not necessary but depended on policy."[294] To a degree, this chapter agrees with Norman: much depended on policy. But this does not exonerate him, since it was policies of appropriation, by which Norman and other British officials led the system, that drove it to catastrophic collapse. The British leadership's actions were a response to the strategic incentives and opportunities created by a politically founded negotiated order, which rested upon ongoing collective institutional bargaining.

A gold exchange standard is a system under which the monetary use of gold is economised by some currencies, which *are not* themselves based on the gold standard, but are instead kept at a par with other currencies that *are*.[295] The decision to institute the gold exchange standard discussed in this chapter was formally agreed in post-war international monetary conferences held in Brussels (1920) and Genoa (1922). The plan for the gold exchange standard, designed in Whitehall, was intended to restore London's financial dominance after the First World War. However, members of the system disagreed over whether it should lead on to a full gold standard or towards a fiat order. In its efforts to defend the pound, Britain became increasingly committed to the latter vision. Resistance came from the US and France, whose superior gold reserves, and interests in the dollar and franc respectively, caused them to champion the pre-1914 gold standard orthodoxies.[296]

The gold exchange standard developed through dozens of international conferences and expert committees attended by national monetary authorities. These gave the system a political foundation in a network of formal contracts and institutions of collective bargaining. The Reparations Commission, and the Economic and Financial Organisation of the League of Nations (EFO), became central milieux in which delegates collected information and took decisions. The participants were keen to brand their activities as "financial" and "apolitical", but the highly centralised bargaining structure had clear political implications. Writing candidly to Benjamin Strong, his counterpart at the Federal Reserve, Norman explained that the object was "to attain a political end under a commercial cloak": to get

[294] Moggridge, 1972, 14.
[295] In this case, the central banks that were working on the basis of an exchange standard could redeem notes with gold, or in the currency of any country on the gold standard, at par.
[296] Rueff, 1964.

countries "round a table, and cooperating with one another" in constructing the international monetary order.[297]

The members of the system were incorporated into it through currency stabilisation programs. These schemes, often administered through the League of Nations, provided the finance and technocratic guidance that enabled countries to return to gold. The first scheme was rolled out for Austria in 1922, and similar ones followed for Hungary, Greece, Bulgaria, and Danzig; the Dawes Plan for Germany was similar, albeit not sponsored by the League. The schemes took a common form under British design: currencies were stabilised on a gold exchange standard basis; independent central banks were established, provided with working capital from London and New York, and endowed with capacities to exercise new techniques of management in exchange market operations and capital controls; and the central banks and governments were placed under the supervision of external controllers with wide-ranging powers.

In creating the order, the Bank of England championed central bank cooperation. In addition to his friendship with Strong, Norman cultivated associations with the Bank of France, the Reichsbank, and, among others, the central banks of Austria, Belgium, Italy, Poland, Scandinavia, Hungary, Greece, and the Netherlands. Formally, this cooperation was directed towards the public good of stabilising the international value of gold by regulating credit. However, in the process of guiding concerted action on interest rates and gold demands, the Bank of England procured resources to assist in its return to gold. Through a network of exchange stabilisation agreements, Threadneedle Street attained wide discretionary powers to intervene in the gold and exchange markets as an agent for European central banks. Writing to the Vice President of the Reichsbank, Norman revealed his expectation of special international reciprocity from partners: "The return of this country to the gold standard […] is a step towards international stability […] I should like, therefore, to think that so far as the Reichsbank can, from time to time, assist us, either by action in one direction or refraining from action in another, I may rely with confidence upon your cooperation."[298]

By appropriating support through stabilisation schemes and the central banking network, Britain was able to swiftly return to gold in 1925.[299] In 1929, Norman boasted this had "enabled London to restore its position as a great international finance centre [and had] re-established sterling as the favourite medium of international commerce and finance."[300] The member countries also received political and economic benefits from appropriation, most obviously via access to financial resources and foreign

[297] Norman to Strong, 6 March 1922, BOE OV31/5.
[298] Norman to Kauffmann, 21 April 1925, BOE OV34/115.
[299] Infamously, this return at the pre-war parity left sterling as much as 10 percent overvalued. However, this was only acknowledged as problematic later. Of course, John Maynard Keynes famously expressed grave reservations about the return to gold at the pre-war parity in 1925, but he was side-lined (see Moggridge, 1972, 94-97).
[300] Norman, "Some Notes on the Return to the Gold Standard", 29 April 1929, BOE OV9/264.

capital markets. Furthermore, financial officials in the member countries were thereby empowered to resist pressure from domestic forces that wanted to abandon financial orthodoxy.[301] Such mutual gains, available through appropriation, are consistent with the explanatory framework of this thesis. Norman articulated the advantages to member monetary authorities in a letter written in 1926: "A [foreign] central bank [could] acquire by external assistance […] a certain freedom or independence within, and perhaps without, its own state."[302]

Appropriation empowered member monetary authorities through special forms of reciprocity. It also consolidated a nexus of domestic and international bureaucratic interests around the gold exchange standard project and the ideas supporting it. However, appropriation also generated costs well before the eventual collapse of the system. The bargains struck to build the system demanded the surrender of nations' administrative independence. This provoked domestic resentments against the control of national economic resources by external creditors. Newly established central banks were vulnerable to the criticism that they were sacrificing national interests, especially those of the native worker, to the foreign banker. The Entente (the US and France), with whom it was also necessary for Britain to compromise, put further limits on appropriation. They were never prepared to entirely subordinate their interests to British designs. Indeed, when the US returned to the international scene in 1924, it used the Dawes Plan to thwart Britain's intentions to place Germany firmly on a sterling standard. Equally, following the stabilisation of the franc in 1926, Paris rarely missed an opportunity to channel financial capital and influence away from London.

In accordance with the explanatory framework put forward in this study, discontent grew because, although technocratic fixes were devised through collective bargaining, nothing was done to resolve those issues which had consequences for the balance of power between members of the system, such as reparations, inter-allied debts, and the position of gold. Each subsequent 'fix', by failing to unify the different competing interests, merely widened the political disjunctures. Worse still, because of the opportunistic and boundedly rational basis upon which decisions were made, many policies had the unforeseen effect of tying countries to the gold standard on problematic terms. The Dawes Plan's statutes for the Reichsbank and Transfer Protection Clause are stand-out examples of policy maladaptation. Under these provisions, as Thomas Ferguson and Peter Temin later noted, the Reichsbank could not act as a central bank for its domestic constituents.[303] The straitjacket administered by the League had similar implications for its patients.[304] The policy maladaptation had hugely

[301] The Bank of England drafted letters setting out codes of practice that were intended to reinforce the hand of the foreign central banks in the domestic arena (see Norman to Bradbury, 11 January 1924, BOE OV34/117; and Bank of England, Memorandum, 29 September 1925, BOE OV34/117).
[302] Norman to J.P. Morgan, 19 November 1926, BOE, G307, file 27.
[303] Ferguson and Temin, 2001.
[304] For instance, a drafting suggestion in the Austrian stabilisation, that the government should be able to make policy suggestions to the central bank regarding the currency, on the basis of "public interest", was removed by

significant unforeseen consequences for the functioning of the system. Member countries were left dependent on foreign credit, and had no technical or political room to manoeuvre when it stopped flowing.[305]

The explanatory framework put forward in this thesis posits that institutions of collective bargaining are liable to be diverted from their functional ends by distorted information traded within them. Confirming this conjecture, the stabilisation packages administered through the Reparations Commission and EFO were subject to massive assessment biases and misrepresentations. The high entry costs paid to bring countries back onto gold reinforced the normal propensity to supress negative information and extend the status quo of institutions and practices. This was disastrous for the international credit structure, because it delayed the correction of financial imbalances until far worse conditions prevailed. The EFO Gold Delegation, belatedly established in 1929 to investigate the position of gold in the international monetary system, failed to achieve any policy recalibrations and fell victim to logics of obfuscation and extension.[306]

When global growth slowed in 1928, cracks in the system's façade widened. The British argued for an extension of the exchange standard to address a shortage and misdistribution of gold in the system. The US and France pushed back. Unable to procure further support, Britain was left trying to lead the system "while standing on tiptoe."[307] In the decisive year of 1931, the limits to continuation of the system through appropriation were reached. As the system broke down, Europe scrambled for London's gold, Germany was engulfed by the anti-Young Plan backlash, America pulled up the drawbridge with the Hawley-Smoot tariff, the German-Austrian customs union was vetoed, Credit-Anstalt was let go, and France tried in vain to force the pre-1914 orthodoxies on the system. This caused Britain to recalibrate its position. The May and Macmillan reports pulled the plug on those still committed to gold in London. Following the British decision on Monday, 21 September 1931, to come off gold, the system collapsed. One country after another saw domestic coalitions, who had been excluded from the system, undermine the influence of financial authorities and classical orthodoxies.[308]

The explanatory framework put forward here challenges two competing accounts of the collapse of the gold exchange standard, which mainly isolate international causes.[309] The first is that the gold exchange standard was disposed to collapse, because it imposed "golden fetters" on its adherents and tended to transmit economic shocks. That is, the system demanded fiscal policy constraints and the uncontested

British officials, who dominated the League of Nations (Bank of England, Memorandum, "Austria", Undated [Presumably early 1923], BOE OV 28/53).

[305] Holtfreich, 1990.

[306] Clavin, 2013, 63.

[307] Crowther, 1948, 310.

[308] Gourevitch, 1984; Weir and Skocpol, 1985; and Berman, 1998.

[309] The opposing camp sees the failure of the system as originating domestically within the US, before spreading abroad (see Bernanke 2000; and Friedman and Schwartz, 1963).

authority of an independent central bank to protect the exchange, and it forced deflation on countries.[310] The absence of international cooperation, which was needed to compensate for the constraints imposed on prices by unionised labour and democratisation, plays a central part in this explanation.[311] The second alternative account is that the inter-war system suffered from a lack of leadership, because Britain was unable and the US unwilling to provide it. Charles Kindleberger summarised the case in his assertion that for a liberal monetary order to survive there has to be "one stabiliser".[312]

This chapter advances a revisionist perspective, challenging both established narratives. The assertion here is that both the substance of British leadership (rather than its supposed absence), and the specific quality of concerted actions (rather than a supposed failure to act concertedly), drove the system to collapse in 1931. To reiterate, the gold exchange standard was a negotiated construct of British design; whose strengths and vulnerabilities can be understood through the concept of appropriative leadership. The deflationary policies and breakdown of cooperation after 1928 were the result of, and reactions to, a decade of appropriative leadership and the conditions that it had produced. As well as drawing attention to a set of determinants of collapse that are ignored in the established accounts, this analysis helps explain the radically different performances of the classical gold standard and its post-1918 counterpart. Interestingly, the two systems were quite similar in terms of their technical constitutions. To be sure, environmental conditions had changed. However, the more obvious difference between them is the opposing processes by which each system developed. The classical gold standard emerged as a spontaneous order while the gold exchange standard took a negotiated form. As a result, the two systems represent fundamentally different types of monetary hierarchy that were led in different ways, and evolved down different tracks.

The chapter proceeds as follows: Section 1 discusses the post-war International Economic Conferences. Section 2 studies the stabilisation schemes and central banking network that instituted the system. Section 3 analyses the information distortions that supported the stabilisation schemes. Section 4 highlights the limits to appropriation in the Gold Delegation. Section 5 connects the collapse of 1931 back to the development of the system. Finally, Section 6 concludes.

1. The Post-war Economic Conferences

The League of Nations reported in 1920 that: "Everywhere currency and exchange disorder is hampering trade and retarding reconstruction. In some countries it is a prime factor amongst those which are causing a breakdown of the economic and social system."[313] To contemporaries, the restoration of the pre-1914 gold standard appeared to be the only path back to order. The US had retreated into

[310] Temin, 1989; and Eichengreen, 1992.
[311] Eichengreen, 1994.
[312] Kindleberger, 1973, 305.
[313] League of Nations, 1920a, xi.

isolation and France had descended into economic turmoil, so London was "the centre to which the world was looking for financial leadership."[314] This section discusses how Sir Ralph Hawtrey and Otto Niemeyer at the Treasury, and Norman at the Bank of England, among others, used the strategic advantages of leadership to lay the political foundations of a new international monetary order that advanced British interests.

The Cunliffe Committee set the parameters of British monetary thinking from August 1918.[315] The central points were: the desirability of the gold standard, because of the automaticity of its adjustment mechanism; the special position and responsibility of the Bank of England in managing that system internationally; and the need to continue the Bank Act of 1844 and its basic requirement that there remain a fixed one-to-one link between changes in gold reserves and Bank of England note issues.[316] From the outset, the return to gold was thought vital to restoring London to the centre of world trade and finance, and to returning the Bank of England to its position as manager of the system. By linking the currency strength of sterling to gold flows and the control of credit, provided the discount rate was set by the Bank, the central bank would regain its dominance in the monetary sphere.[317] Furthermore, faced with depression and stagnation at home, Britain needed to minimise the costs of the return to gold. The gold exchange standard offered an expedient means to achieve this, because it would increase demand for sterling as a reserve and trading currency. In theory, this would lift the pound back to its pre-war parity – $4.86 – and restore financial hegemony abroad and prosperity at home. [318]

The British brought this agenda into the international arena at the Brussels conference, held under the auspices of the League of Nations in September 1920 and attended by 86 delegates of 39 nations, largely from central banks and treasuries. Though acting in the capacity of 'experts,' rather than state representatives, national monetary authorities collectively agreed that: deficits had to be reduced; international lending needed to be restored; and the gold standard should be instituted. The British also made an effort to infuse the political accord with more particular lines of conduct and principle, of which three shall now be highlighted.[319] First, they placed a new emphasis on the importance of relative prices, and especially the need for US prices to rise, because the British Treasury saw this as vital to avoiding UK deflation.[320] Second, Lord Cullen, representing the UK, got the sub-committee on

[314] Clarke, 1967, 34.
[315] Cunliffe Committee, "The Interim Report of the Committee on Currency and the Foreign Exchanges," 18 August 1918, PRO T 208/17.
[316] Much has been made of the fact that the pre-1914 gold standard did not actually operate with anything like this kind of automaticity, nor did central banks generally follow the so-called rules of the game (see Hawtrey, 1927, [1948]; Sayers, 1936; and Bloomfield, 1957).
[317] Clay, 1957, 292-193.
[318] Niemeyer, Memorandum, "The Return to Gold", Undated [Presumably 1923], PRO T 176/5 Part 1.
[319] Bank of England, Memorandum, "The Brussels Conference", Undated [Presumably 1920], BOE C40/1034.
[320] Niemeyer, "The Return to Gold", Undated [Presumably 1923], PRO T 176/5 Part 1; Hawtrey, Memorandum, "The Export of Gold to America", 5 March 1923, PRO T 176/5 Part 1; Hawtrey, Memorandum, "Monetary Policy", 31 October 1923, PRO T 176/5 Part 1. This emphasis was, in part, achieved through Gustav Cassel's "Memorandum on the World's Monetary Problems" that took the US repeatedly to task on the issue. The

currency and exchanges to affirm the view that stability would depend on the institution of independent central banks and a return to gold on an exchange standard basis.[321] The conference endorsed the related view that where there was no central bank, one should be created, independent of government, and if foreign capital was given for its establishment, some international control might legitimately be applied to oversee its operations.[322] Third, the principle of ongoing technocratic cooperation was enshrined in the recommendation to establish a "provisional committee of bankers and business men to give effect to certain decisions of the conference."[323]

Emerging in response to this call for ongoing cooperation among financial officials, the EFO became a focal point for concerted action. The EFO, supported through a permanent secretariat in Geneva, was the League agency that administrated the first stabilisation loans contracted on behalf of Eastern and Central European countries. The Economic and Financial Committees of the EFO, established in 1923, became crucial forums for collective bargaining. British officials dominated the EFO bureaucracy.[324] The leading figures were: Niemeyer, chairman of the Financial Committee; Hawtrey, an active member of both the Finance and Economic Committees; and Sir Henry Strakosch, a naturalised South African, who was an influential staffer in Geneva and the unofficial representative of the Bank of England. Behind the scenes, Norman was "an important though unofficial member."[325] Norman linked the EFO to the central banking community, and to private financial markets in London. The EFO could not afford "a clash between the Committee and the central banks" or to risk "the support which the Bank of England has always given the Committee."[326]

Another political foundation stone was established as the Bank of England began building up relationships with foreign central banks.[327] In 1921, Norman reached an understanding with the Federal Reserve, the text of which included a "manifesto" outlining four principles of central banking: independence from national governments; separation from commercial banks; supervision over commercial banking; and cooperation between central banks. Central bank cooperation was defined as "the confidential interchange of information and opinion", and the mutual extension of exclusive

memorandum had a major impact on the thinking at the conference and was later published as 'The World's Monetary Problems' (Cassel, 1921). Patricia Clavin notes the importance of the memorandum, but does not link it to the complementary thinking inside the UK Treasury or British interests (Clavin 2013, 21).

[321] Cullen, "On Currency and the Exchanges, Speech Made to Brussels Conference", 29 September 1920, BOE C40/1034. League of Nations, Final Report, "International Financial Committee, Report on Currency and Exchanges", 7 October 1920, BOE C40/1034.

[322] League of Nations, 1920b, 13.

[323] League of Nations, 1945, 37. This British influence is recognised in several studies of the League and in Henry Clay's biography of Montague Norman (Walters, 1952; and Clay, 1957). However, as Patricia Clavin notes, the full extent of British influence in Geneva has yet to be fully explored (Clavin 2013, 21).

[324] Strong to Norman, 18 February 1922, BOE OV31/5.

[325] Clay, 1957, 181. This view was widely held by contemporaries (see, for example, Einzig, 1932).

[326] Niemeyer, Memorandum, 31 January 1928, BOE OV9/331.

[327] In fact, as early as May 1917, the Federal Reserve and Bank of England had agreed to buy and hold each other's bills, earmark and set aside gold for each other, and exchange information on credit and financial conditions with each other.

banking facilities, "without undue regard to profit," such as "the custody of gold, monies and securities and the discount of approved bills of exchange."[328] Through the 1920s, Norman worked tirelessly to realise this vision.[329] As a result, national monetary authorities were brought into the centre of the system from the outset.

The next international monetary conference was held in Genoa. The historical record has downplayed the importance of this 1922 gathering, largely because reparations and inter-allied debts were not on the table.[330] However, crucially, the proposal submitted by the British to the Financial Commission to institute a gold exchange standard based on sterling, and working through a network of autonomous central banks, received official European and unofficial US endorsement there.[331] In support of this end, the Financial Commission agreed to a series of resolutions, which formed "a currency code".[332] The code's central objects were: "the limitation of the issue of paper currency, the fixing of a parity with gold, the economizing on the use of gold, and the co-ordination of credit policy designed to prevent fluctuations in the commodity value of gold."[333] The code also included a repetition of the call that "in countries where there is no central bank of issue one should be established."[334]

The innovative feature of this agenda was to call for central banks to economise on the monetary demand for gold (i.e. to limit actual transfers of gold from one country to another), by "maintaining reserves in the form of foreign balances", through means "such as the gold exchange standard, or an international clearing system", and to stabilise prices, including the international gold price, through the coordination of credit policies.[335] In addition, there were recommendations to eliminate internal circulation of gold coin, to concentrate gold reserves at central banks, and to permit domestic residents to acquire coin and bullion for export only with public authority.[336] These policies formed the core of the gold exchange standard. The implication was that not every country's currency would be convertible into gold. Instead, the gold link would be retained through open gold markets in a limited number of countries, while other countries' currencies would be convertible into the currencies of those countries.

[328] For full text, see Sayers 1976, Appendices, 74-75.
[329] In correspondence with Strong, Norman explained that his objective was what he called relations of "matrimony". By this, Norman meant "exclusive" relationships between the central banks (see Norman to Strong, 13 April 1922, BOE OV31/5; Norman to Strong, 16 November 1921, BOE OV31/5; Norman to Strong, 16 November 1921, BOE OV31/5; and Norman to Strong, 13 April 1922, BOE OV31/5).
[330] Eichengreen, 1985.
[331] Norman to Strong, 23 February 1922, BOE OV31/5.
[332] Mills, 1922.
[333] Mills, 1922, 155.
[334] Report of the Second Commission (Finance), Papers Relating to International Economic Conference, Genoa, April-May 1922, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London, 61, Resolution 2.
[335] Resolution 9. Report of the Second Commission (Finance), Papers Relating to International Economic Conference, Genoa, April-May 1922, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London, 61.
[336] Hawtrey, Memorandum, 4 February 1923, PRO T 176/5 Part 1.

As to deciding which nations would be on the gold standard, British officials had in mind Britain and the US, and perhaps a few others.[337]

The means of instituting the gold exchange standard were specified in detail. The institutionalisation of collective bargaining was agreed in the following terms: "the practice of continuous co-operation among central banks of issue, or banks regulating credit policy in the several countries."[338] This was necessary to coordinate demands for gold in order to smooth internal price changes, which would otherwise be subject to greater volatility resulting from the "simultaneous and competitive efforts of a number of countries to secure metallic reserves."[339] It was contemplated that this effort to stabilise exchanges and prices would be achieved not through definite rules, but rather through the institutionalisation of collaboration between central banks. The condition of membership in the system would be the maintenance of the national currency unit at the prescribed value. Failure to keep to this policy would result in the suspension of the right to hold reserve balances (i.e. sterling and dollar balances).[340]

The core of the British plan was to depress the demand for gold and stabilise its purchasing power. Self-interest drove this objective. Any rise in the gold value of the dollar, decline in American prices, or move by European countries to use stabilisation funds or deflation to restock their gold reserves, would make restoring sterling to its pre-1914 parity harder, because the demands for gold would come via London and so weaken the strength of sterling.[341] The restoration of the gold standard, from the British standpoint, had to maximise the strength of the pound in order to minimise the cost of returning to gold in terms of domestic adjustment. British officials wanted to avoid having to deflate UK prices. They wanted to shift the burdens of adjustment onto the US and Europe.[342] The plan offered to bring sterling back to parity without raising the bank rate, which had already caused great unease among manufacturers.[343] At the same time, the continuing fluctuation in exchanges had raised concerns in the City.[344] In this context, it was felt important to achieve stabilisation quickly, even if that involved artificial devices.[345]

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[337] Hawtrey, Memorandum, 4 February 1923, PRO T 176/5 Part 1.
[338] Report of the Second Commission (Finance), Papers Relating to International Economic Conference, Genoa, April-May 1922, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London, 60, Resolution 3.
[339] Report of the Second Commission (Finance), Papers Relating to International Economic Conference, Genoa, April-May 1922, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London, 61, Resolution 9.
[340] Hawtrey, Memorandum, "Details of the Proposed Currency Convention", Undated [Presumably 1920], PRO T 176/5 Part 1.
[341] Clarke, 1967, 34-35.
[342] Norton, Memorandum, "The Proposed Raising of the Bank Rate in the Near Future", June 1924, PRO T 176/5 Part 2.
[343] Hugent to Norman, 9 July 1924, PRO T 176/5 Part 2.
[344] Hawtrey, Memorandum, "Sterling and Gold", 4 July 1924, PRO T 176/5 Part 2.
[345] Hawtrey, Memorandum, 4 February 1923, PRO T 176/5 Part 1.

The Genoa proposals were coloured throughout by British power and interests, and set the stage for the appropriation that was to follow: "Norman pursued one variant or another of the Genoa proposals throughout most of the rest of the 1920s. Time and again he sought means by which to manage gold flows so that the movement of the metal might be made to support, or at least not interfere with, the aims of British monetary policy."[346] Unsurprisingly, the US and French reaction to the Genoa plans was ambivalent.[347] In correspondence with Norman over the summer of 1922, Strong expressed concerns that the use of credit policies to manage the value of currencies in relation to gold might create a conflict with domestic stability: "The appearance of an attempt by cooperation between central banks and reserve banks to regulate credit so as to maintain the international value of currencies at equality and to prevent undue fluctuations in the purchasing power of gold has had, ever since I read these paragraphs, an ominous sound to me." [348] With the dollar at a premium, the Federal Reserve might have needed to expand credit in order to bring down the gold value of the dollar, even if the domestic economy was suffering inflationary pressures.[349] However, Strong did not oppose the gold exchange standard until ongoing British appropriation drove him to this point.[350] Given the need to open up export markets, the US priority was stabilisation as such, rather than its precise terms. Moreover, Strong was comfortable with the idea of key currencies, providing one was the dollar, believing that it would be safe to put the currencies of weaker powers on the exchange standard. The French also gave a qualified endorsement to the Genoa plan as a "temporary measure demanded by the present state of Europe."[351] However, France cautioned against any permanent break in the direct link between the global money supply and gold. Moreover, France knew that the greatest beneficiaries of the system would be the UK and US.[352] Yet these concerns were muted by expediency. The asymmetric distribution of costs and benefits under the gold exchange standard, which would ultimately drive France to resist the system, would only fully crystallise later.

The Genoa Resolutions called for a meeting of representatives of central banks.[353] This conference never materialised; it was first deferred, then dragged into the reparations issue, and finally overtaken by events.[354] This partly explains why "the principle of having regard to the value of gold in regulating credit [was] never embodied in [some] 'rules of the game.'"[355] However, perhaps more importantly,

[346] Clarke, 1967, 36.
[347] Clarke, 1967, 36-37.
[348] Strong to Norman, 14 July 1922, BOE G35/8.
[349] Strong to Norman, 14 July 1922, BOE G35/8.
[350] Strong to Norman, 14 July 1922, BOE G35/8. In fact, the Federal Reserve gave private, if not official endorsement, to most of the program
[351] Mills, 1922, 157.
[352] Kooker, 1976.
[353] Report of the Second Commission (Finance), Papers Relating to International Economic Conference, Genoa, April-May 1922, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London, 60, BOE OV9/382, Resolution 3.
[354] Eichengreen, 1985, 152.
[355] Hawtrey, Memorandum, "The Gold Standard and the 'Rules of the Game'", 17 October 1931, PRO T 188/28.

there was a preference for ongoing flexible cooperation between central bankers, as opposed to a formal convention to guide their interactions, because flexible cooperation made it easier to mediate the power relations between the countries that had adopted the gold exchange standard, and at the same time, to avoid political oversight.[356] Thus, the entire artifice of central bank cooperation was a technocratic fix. This device provided a means for resolving short-term problems, but it did not establish a firm political equilibrium, because central bankers feared that an open debate over rules would give politicians a pretext to move into the monetary arena.

In summary, historical accounts have understated the importance of the post-war international financial conferences. In reality, a negotiated international monetary order, with a political basis and integrated organisational structure, established in permanent forums for collective bargaining, was instituted at enormous cost and effort. The economic world was stabilised around a gold exchange standard, through ongoing cooperation among central banks and other international agencies, operating under British leadership and guidance. Each subsequent element of the inter-war order was built within and reinforced this integrated organisational structure and political pattern of action.[357] To put it in the conceptual terms set out in this study, the historical foundations and structural properties of the system were constituted to enable leadership through appropriation. The British would opportunistically exploit this possibility. Sterling was lifted back to its pre-war parity over the next three years through a series of appropriative trades. As Emile Moreau, the governor of the Bank of France, would later write: "England having been the first European country to re-establish a stable and secure money had used that advantage to establish a basis for putting Europe under a veritable financial domination."[358] Section 2 takes up this history.

2. Stabilisation Programs and Appropriative Leadership

In the 1920s, monetary instability was the key problem. One theoretical conjecture of this study is that in a negotiated system, when there is a dispute between leaders and members over policy solutions, the leader will control the shape of transactions through appropriation, in order to procure resources to defend its monetary construct and maximise utility for itself. We should therefore expect an analysis of the historical records to show Britain guiding the terms of stabilisation in a manner that augmented the capacities of the international administration to defend the system, but which skewed international and domestic artifices towards its own particular priorities. Such a policy would have provided gains for other participating national monetary authorities, but also provoked resistance from them downstream.

[356] Hawtrey, Memorandum, "The Gold Standard and the "Rules of the Game'", 17 October 1931, PRO T 188/28.
[357] For example, the Dawes Committee was "convinced that some kind of coordinated policy with continuous expert administration in regard to the exchange, lies at the root of the reparation problem and is essential to any practicable scheme in obtaining the maximum sums from Germany for the benefit of the Allies" (Reports of the Expert Committees appointed by the Reparations Commission, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London 1924, BOE OV9/382).
[358] Moreau, 1954, Lundi 6 Février 1928, 488.

This section finds that this was precisely what happened when the vision for the gold exchange standard was realised.

The British used two methods to bring countries into the system. Wherever possible, they placed countries under the EFO Financial Committee in Geneva. In the case of Germany, a comparable structure of control was set up through the Dawes Plan. Where countries could avoid foreign controls, the British used the central banking network to achieve their aims. The degree to which British interests were achieved varied between the different stabilisation schemes. Nevertheless, logics of appropriation were generalised across all of them. As part of the process, European currencies were reconstituted on a gold exchange standard basis. The monetary institutions in member countries, especially newly formed central banks, gained British patronage and financial support. However, because the process of appropriation produced inequitable payoffs, seeds of discontent were sowed. Almost from the outset, resistance began to build up, not only from countries targeted for incorporation into the system, but also from the Entente. In general, the later a country was stabilised, the more resistance diluted British influence there, and the more compromised and maladapted the resulting institutional arrangements became.

a. Appropriation through External Controls

The British choice of the League as an instrument of external monetary policy was presented as motivated by concerns for political neutrality and economic efficiency.[359] However, the League was effectively controlled by London. The British government used Geneva to appropriate support and extend the reach of sterling. The price countries paid for assistance from the League was that they had to establish national institutions geared towards defending the gold exchange standard project. Through this appropriative process, national administrative capacities were subordinated to the interests of Britain and other external creditors. The first stabilisation program, in Austria, which provided the model for subsequent programs, clearly illustrates these dynamics.

i. *Moving into Austria*

Austria, a small state carrying the costs of a defeated Empire, faced political and financial collapse after the war. The British looked to Austria as a bridgehead to restore economic order more widely, by first "reinstating it in an area which more than any other area of the world suffers from the destruction of the former economic organization."[360] The choice of Austria for the "grand experiment" of stabilisation was not purely functional, however.[361] One simple reason was that British banks were owed huge amounts by Austria that might never be recovered if the krone was not stabilised, so Britain had a

[359] Niemeyer, 'League Relations with US', 22 February 1928, OV9/187.
[360] Bank of England, 'Austria Stabilization', [Undated, Presumably 1920], BOE OV28/52.
[361] For general discussions of the Austrian stabilisation see: de Bordes, 1924; Marcus, 2010; and Wessels, 2007.

financial interest. A more strategic reason was that France had a competing vision for Central Europe that London wanted to outmanoeuvre.

The dispute between Britain and France turned on the fact that the British insisted that "the basis of control of Austria [should] be economic rather than political."[362] Stabilisation, according to London, should be "a policy of pure international finance."[363] The French financial attaché in London, M. Joseph Avenol, expressed the French desire that the Entente should "permanently control the political and economic situation in Austria and the adjoining countries."[364] France's main concern was to prevent Austrian reunification with Germany, but it also wanted to maximise its influence over commercial relations in Central Europe. These differences were really about influence, rather than a significant distinction between "political" and "financial stabilisation". Nevertheless, they led to technical problems in the 1921 League stabilisation scheme, particularly regarding wartime liens, guarantees, and changing the domiciles of the Landersbank and Anglo-Oesterreichische Bank. [365] In the end, "the delay […] and the poison of politics" caused progress to slow.[366]

With Austria continuing to face chronic depreciation and potential collapse,[367] the issue was handed again to the League Financial Committee in the spring of 1922. The Bank of England renewed its efforts to organise a consortium of private lenders in New York and London. The terms precedent to the first League sponsored international stabilisation loan were worked out between the Bank of England, League experts and private banking houses in the following months.[368] The League insisted that the credits should come with external controls. The Bank of England stipulated that the loan and new central bank would have to be "parts of one whole" that must be "dealt with simultaneously and together."[369] The private lenders demanded the removal of all wartime liens and some governmental guarantee.[370] French demands for political control were accommodated through a burgeoning structure of external controls. The separate conditions that laid the basis for the second League stabilisation scheme and the

[362] Bank of England, Note for Governor, "Financing Austria", 3 June 1921, BOE OV 28/52; and Norman to Vissering, 4 June 1921, BOE OV 28/52.
[363] Norman to Balfour, 15 July 1921, BOE OV 28/52.
[364] Bank of England, "Austria", 6 July 1921, BOE OV 28/52.
[365] J.P. Morgan & Co. New York to Morgan, Grenfell & Col. London, 16 June 1921, BOE 28/53. Norman to Strong, 6 March 1922, BOE OV31/5; Strong to Norman, 9 June 1921, BOE OV 28/52. Bank of England, "Outline of the General Scheme for the Financial and Economic Reconstruction of Austria with Special Reference to the Party Played by the Bank of England", Undated [Presumably 1923], BOE OV 28/52.
[365] Balfour to Eric, 19 July 1921, BOE OV 28/52.
[366] Balfour to Eric, 19 July 1921, BOE OV 28/52.
[367] Bank of England, "Outline of the General Scheme for the Financial and Economic Reconstruction of Austria with Special Reference to the Part Played by the Bank of England", Undated [Presumably 1923], BOE OV 28/52.
[368] The key individuals were: Norman at the Old Lady; Spencer Smith in Geneva; G.W. Young in Vienna, working as a representative of the British Treasury at the Anglo-Austrian bank; Morgan & Co.; the Anglo-Austrian Bank; and Austria, initially represented informally by Sir William Goode, the Chairman of the Austrian Section of the Reparations Commission.
[369] Norman to Spencer, 3 April 1922, BOE OV28/52.
[370] Bank of England, Copy, "Resolution of the US Congress House Ways and Means Committee", 15 March 1922, OV28/53 BOE; and Young to Spencer Smith, 17 June 1922, BOE OV 28/53.

related Geneva Protocols were signed on 4 October 1922. The Protocols agreed by Britain, France, Italy, Czecho-Slovakia and Austria provided for the suspension of all wartime liens, and an external loan backed by foreign government guarantees, that was secured on national assets. In return for the loan, massive budgetary austerity and fiscal retrenchment was demanded of Austria.

ii. *The appropriative price of stabilisation*

Britain used the League to help itself gain control over the Austrian economy.[371] Under the terms of stabilisation, Austria would be subject to "wide and autocratic" economic control under a Commissioner-General, seated in Vienna, nominated by the League. The post's powers of oversight were enormous. The Commissioner-General, in providing external control, had to sanction all operations of the loans; would oversee all accounting operations of the government and central bank; had the right to perform on-the-spot investigations; and could demand any information deemed necessary to verify the position of national finances and/or loan payments.[372] A Trustee was assigned to receive the revenues allocated for the service of the loan. Furthermore, in a concession to France, and to secure Italian support, a Committee of Control was established to represent the government guarantors of the loan.[373]

The scheme involved a massive monetary reorganisation in Austria. The most important institutional change was the creation of a new Austrian National Bank (ANB), to which the government would surrender all rights to issue paper currency and to negotiate or conclude loans. The Austrian krone was reconstituted by the ANB, which was given complete independence from the national government, through having a board elected by its shareholders (domestic and foreign banks) and the formal exclusion of government officials from management.[374] The operations of the ANB were only allowed to be commercial. No government department or municipals would have access to the central bank resources without paying in gold or securities to the exchange value of the notes received. The ANB took over responsibility for the notes that were already in circulation. The notes were to have metallic cover, which was to be increased in stages from 20% to 33½%. Thus, the central bank was established on a sterling exchange standard basis.

The announcement of the plan stabilised the krone in November 1922, and foreign finance began to flow. Following this, the ANB was immediately brought into the British-led network of central bank

[371] From the outset, British officials believed that the League "might play a very important part in the whole action, especially in regard to carrying on negotiations with the government and imposing the necessary conditions that have to be fulfilled by the Austrian government" (Bank of England, "Austria Stabilization", [Undated, Presumably 1920] BOE OV28/52).
[372] Bank of England, "Reply of the Financial Committee to the Questions Referred by the Austrian Sub-Committee of the Council", Undated [Presumably October 1922], BOE OV 28/53.
[373] The Committee of Control had extraordinary reach. For details, see League of Nations, "Supplement to the Monthly Summary of the League of Nations, The Financial Reconstruction of Austria", October 1922, BOE OV9/382.
[374] The government was given the right to oversee the central bank but only to the extent that its statutes were obeyed. (see Bank of England, Memorandum, "Austria", Undated, BOE OV 28/53).

coordination. Although the British were unable to appoint a foreign ANB governor as they had wished, a permanent foreign *Conseiller* (or Advisor) with enormous powers was made a condition of the external loan. Schnyder Von Wartensee, a Swiss national, provided this permanent foreign presence inside the ANB from March 1923.[375] Furthermore, as the loan was floated in London, the Bank of England entered into a stabilisation agreement with the ANB.[376] Spencer Smith was dispatched to Vienna to agree terms in May 1923, and the head of the ANB's Exchange Department visited London in June.[377] The agreement gave the Bank of England discretionary powers to buy and sell krones for sterling, to stabilise the Austrian exchange.[378] The two central banks opened accounts with each other to facilitate the transactions. However, it took a little longer for the Austrian bank to submit entirely to the demanding level of cooperation that Norman sought, namely, concerted action on discount rates and gold management.[379]

iii. *Extending the Austrian model*

The Austrian stabilisation provided a model for the League programs agreed for Hungary, Danzig, Greece, Bulgaria and Estonia. These countries were all in a similar position of having no realistic prospect of access to international markets other than through Geneva. The monetary basis of stabilisation varied between pure sterling, sterling exchange, and dollar exchange standards, depending largely on the degree of US capital involvement in the loans.[380] Moreover, as shown in Table 4.1, the means of external control varied. But the logics of appropriation were constant. Above all, the schemes were crafted to move the locus of decision and authority regarding currency matters away from politicians in the target countries, and into structures that the British could influence and control.

[375] Marcus, 2010, 148.
[376] Norman to Reisch, 25 April 1924, BOE OV 28/53.
[377] Norman to Reisch, 25 April 1924, BOE OV 28/53.
[378] Bank of England, "Arrangements Concluded Whereby the Bank of England will Act on Behalf of the National Bank of Austria with a View to the Stabilisation of the Austrian Exchange", April 1924, BOE OV 28/53.
[379] Norman wrote to Schacht to complain in early 1925 that he had "wished from the very beginning to cooperate with Dr. Reisch [but] had been quite unsuccessful […] there has been no cooperation or understanding." The situation changed in April 1925 when, in order to obtain further London credits, the principles of cooperation were conceded "without reservation" (Norman to Schacht, April 1925, BOE OV 34/73).
[380] Bank of England, "Financial Reconstruction", 4 February 1928, BOE OV9/379. Greece and Danzig went directly onto a gold exchange value basis owing to greater US participation.

Table 4.1. The League of Nations Stabilisations in 1920s, Scope and Controls

Country / Year(s) of action	Issues	Forms of Control
Austria (1922)	Bank, Budget (including detailed restructuring plans).	Committee of Control: Controller: Zimmerman (Dutch), plus two staff; Advisors: Wartensee (Swiss), Van Cyn (Dutch) Kay (English). Loan Trustees appointed by League: Jay, Wallenburg, Janssen.
Hungary (1924)	Bank, Budget (limits but no detailed plans).	Committee of Control: Controller: Jeremiah Smith (American), plus two staff; Advisor: Siepmann (English). Loan Trustees: Strakosch, Riancini, Ter Meulen.
Greece (1924, 1928)	Refugees, bank, budget.	International Financial Commission (dating from 1890s). Refugee Commission: American, and one foreign member. Advisor: Englishman.
Danzig (1924, 1925, 1927)	Bank, municipal loan, state loan.	No Controller or Advisor. Only Trustee on municipal and state loan: Ter Meulen.
Bulgaria (1926)	Refugee loan.	Control on loan only through Refugee Commissioner: Charron (French). Trustee: Lawrence of Glyn Mills.
Estonia (1926)	Bank only.	Advisor: Williamson (English). Trustees: Jenson, Biancini and Wallenburg.

Source: Bank of England, "Financial Reconstruction", 4 February 1928, BOE OV9/379.

iv. *Resistance to Geneva*

This thesis' framework explains that leadership through appropriation will generate resistance. In the League stabilisation process, political cleavages formed around the vanquished powers, and the US and France. The onerous terms of the loans and the external control structure undermined the legitimacy of the schemes within their target countries. In Austria, for instance, the *Neues Wiener Tagblatt* charged that "what is now being laid upon the shoulders of the inhabitants of Austria surpasses all surmises that we have made in patriotic good faith."[381] This resistance grew over time and led to the early termination of external control in 1926, well before the League's experts thought appropriate, and against British wishes.[382] Although less well-known, no less important for the system were the limits placed on appropriation by the Entente. Moreau, at the Bank of France, was scathing of how Britain exercised financial domination through the League of Nations: "The remedies prescribed always involve the installation in the central bank of a foreign supervisor who is British or designated by the Bank of England, and the deposit of a part of the reserve of the central bank at the Bank of England, which

[381] As quoted in Bank of England, "Report for the Week 14-21 October 1922", BOE OV9/379.
[382] Strakosch to Schwarzwald, 13 October 1925, PRO, T 160 65, 2073, 029, 1; and Niemeyer to Schwarzwald, 14 October 1925, PRO, T 160 65, 2073, 029, 1; also see, Marcus, 2010, 226-248.

serves both to support the pound and to fortify British influence. […] England is thus completely or partially entrenched in Austria, Hungary, Belgium, Norway and Italy. She is in the process of entrenching herself in Greece and Portugal. She seeks to get a foothold in Yugoslavia and fights us cunningly in Rumania."[383]

The use of Geneva as a channel for organising financial assistance was first seriously challenged by France in relation to the Polish stabilisation of 1927. The Polish zloty was stabilised briefly after 1924, but the government stopped defending its value in 1925. In 1926, a mission was led by Kemmerer, a Princeton economist, to study the issue. The plan that followed was elaborated between US experts and French officials. Parisian and American financiers underpinned the deal.[384] The League and the British were bypassed in the process. The benefit for Poland was that the degree of external control was less onerous than that of the League schemes. For Britain, this initiative by the US and France presented a dilemma. Britain needed to provide financial support in order to secure some position for sterling in the restoration of the zloty, but without Geneva they could not control the foundations of the stabilisation scheme or ensure the same degree of control over the central bank.[385] In the end, the zloty was reconstituted on a gold exchange standard basis. However, under French and US influence, the stabilisation demanded an extremely high 75% gold to fiduciary reserves ratio, and a high minimum reserve requirement of 40% of notes in issue.

The same pattern emerged in Romania.[386] It was rumoured that the French directed a Romanian central bank official back to his country, rather than allowing him to meet with officials in London.[387] Whatever the truth, the spirit of cooperation in the Entente was being tested, not least because Strong was backing France's recalcitrance. Strong wrote to the deputy governor of the Bank of England to explain, revealing much about the sources of resistance to British appropriation: "For some years past it has been more than current comment in Europe, both in political and banking circles, that Governor Norman desired to establish some sort of dictatorship over the central banks of Europe and that I was collaborating with him in such a program".[388] Had the Federal Reserve supported Norman in pressing the Romanians to turn to the League, Strong continued, "it would have been complete confirmation in the minds of the French, whether justly so or not, that these surmises as to his intention and my own were correct."[389]

The Bank of England recognised in 1928 that "the field of future League activity […] is now being encroached upon by the policy of the French."[390] The costs of leading the system increased because the

[383] Moreau, 1954, Lundi 6 Février 1928, 488.
[384] For a collection of the documents relating to the Polish stabilisation see Dullis, 1928.
[385] Bank of England, "Poland: Conclusions Reached in a Conversation at Calais on Sunday", 3 April 1927, BOE OV9/379.
[386] Meyer, 1970, 100-137.
[387] Bank of England, "Financial Reconstruction", 4 February 1928, BOE OV9/379.
[388] Strong to Stewart, 6 June 1928, Papers of Benjamin Strong, Federal Reserve Bank of New York.
[389] Strong to Stewart, 6 June 1928, Papers of Benjamin Strong, Federal Reserve Bank of New York.
[390] Bank of England, 'Financial Reconstruction', 4 February 1928, BOE OV9/379.

exchange standard was being limited by the American and French preference for gold standard orthodoxies. The Bank of England noted this effect: "However desirable a reduction in the fashionable figure of the gold reserve may be, it is exceedingly difficult to see much hope in that direction. On the contrary, many of the recent Bank statutes (Germany, Belgium, Poland) have made the position more difficult, not merely by stereotyping a minimum cover of 40%, but also by stipulating for unduly large proportions of that cover in actual gold."[391]

The British concerns about the effects that higher reserve ratios would have upon the position of the Bank of England soon became reality. The new central banks quickly became large purchasers of gold in London, Poland being the single largest in 1927.[392] This generated adverse comment from the Bank of England.[393] However, the deputy governor of the Bank of Poland retorted that the central bank was only purchasing as much as was necessary to meet its statutory needs, that this was a condition of its securing stabilisation funds, and that it had gone to New York where possible.[394] Pressures on the UK continued to rise over 1929 as collective restraints on demands for gold from London broke down. The Eastern European central banks even accumulated gold in excess of their statutory needs.[395] Thus, as per the explanatory framework of this study, resistance began to limit the continuation of appropriative policy. As a consequence, it became more costly for Britain to manage the system. The next section explores similar dynamics of appropriation and resistance in relation to the German stabilisation of 1924.

b. The Dawes Plan: Technocratic Fixes and Maladaptation

The integration of Germany into the gold exchange standard began only after the disastrous occupation of the Ruhr and total collapse of the mark in 1923. The period of stabilisation ran from the government order of 13 October 1923 to issue the rentenmark, to the coming into force of the new law reconstructing the Reichsbank, and the issue of reichsmarks supported by gold exchange cover on 11 October 1924, in accordance with the Dawes Plan.[396] This section does not offer a complete history of this period, but focuses on how this study's theoretical framework can help to interpret certain technical features of the stabilisation process. Taking a fresh look at the stabilisation of the mark reveals the logics and consequences of appropriation. These manifested themselves in flawed compromise solutions and technocratic fixes, which would have enormous unintended implications for the subsequent functioning of the system, as the Dawes Plan led to widening political and functional cleavages.

[391] Bank of England, Memorandum, 30 December 1927,
[392] Smith, 1936, 160.
[393] Smith 1936, 160.
[394] "Difficulties of the Gold Market", *Polish Economist*, February, 1928, 83.
[395] Smith, 1936, 160.
[396] Ferguson, 1995, 398.

i. *The background in the Gold Bank*

Stabilisation of the German currency began with the establishment of the Gold Bank in 1924. The plan was originally proposed by Schacht to Norman, before Schacht even took office in the Reichsbank, on New Year's Day 1924. The primary aims were to side-line separatist movements in the Ruhr, and to thwart a French plan that was being concocted in collaboration with German industrialists for a new central bank in the Rhineland.[397] Schacht recognised that he had to establish a means to revive German trade, through the creation of a medium of transferable exchange that was centralised but independent of Germany's chaotic public finances and internal circulation.[398] Britain identified the Gold Bank as a means of drawing Germany into sterling's sphere of influence.[399] Indeed, it was seen as an opportunity to give a lift to sterling, as against the dollar, which was proving popular in Germany as a means of trade finance.[400] The ancillary benefit of undercutting French ambitions in the Rhineland was also important to London.[401]

When Norman wrote to Vissering about the monetary reconstruction of Germany, he gave candid expression to Britain's particular interests that were normally skirted around in official correspondence: "I submit that the notes should be issued on a sterling basis (as the only practical alternative) rather than gold and be repayable outside Germany: they would be less likely to be horded and the Gold Bank would be free from dependence on America. I am aware, of course, that sterling is now depreciated in terms of gold: but it remains the basis on which European exchanges are operated and I am most strongly of the opinion that because Europe obtains no financial assistance or cooperation from America, Europe should no further attach herself to the basis which for the present America controls."[402] Britain successfully secured this objective. Upon incorporation, the Gold Bank's capital was paid up largely in sterling, its reserves were kept in gold and sterling, and it had the power to issue notes for sterling. The scheme could have been used to bind the mark to sterling.[403] When the Gold Bank opened on 7 April 1924, the *Times* incisively noted that it was "making its debut under a misnomer, since sterling is not synonymous with gold."[404]

However, Britain was halted in its tracks before the Gold Bank could bring the mark under sterling's wing, because the Dawes Committee refused to endorse the Gold Bank. There were rival policy interests

[397] Schacht, 1955, 194-200.
[398] On domestic conditions in Germany see Ferguson, 1995.
[399] The British agenda is starkly revealed in edits to a memorandum, prepared by Vissering, the President of the Dutch central bank, which circulated in the Bank of England in December of 1923, regarding any new monetary authority in Germany. (Vissering, "Monetary Reconstruction of Germany", (Bank of England edits), January 1924, BOE OV34/117.
[400] Bank of England, Memorandum, 19 January 1924, BOE OV34/117.
[401] Schacht, 1955, 202.
[402] Norman to Vissering, 14 January 1924, BOE OV34/117. There were other occasions when Norman put down in writing the particular nature of British interests in the sterling exchange standard. See, for instance, Norman to Clegg, 10 January 1924, BOE OV 34/117, and Norman to Clegg, 9 February 1924, BOE OV34/117.
[403] Bank of England, 'Memorandum', 19 January 1924, BOE OV34/117.
[404] "German Financial Reform, The New Discount Bank", *The Times*, 8 April 1924.

behind this blockage. The Belgian and French governments were determined to link the German central bank to the payment of reparations.[405] For the Americans, a sterling-based central bank was contrary to their interests in a gold and dollar standard. However, because of the stakes involved, British officials were prepared to go ahead even without Paris.[406] In the end, face was saved when the Dawes Committee accepted the Gold Bank on the provisos that it would be absorbed by the Reichsbank following stabilisation, and that a limit would be placed on the Gold Bank notes of issue, meaning it could not pre-emptively take the place of the new bank of issue that would be needed to stabilise the mark. The key points surrounding the stabilisation of the mark would thus be left in the hands of the Dawes Committee.

ii. *Sterling, the dollar, the fixes and the Dawes Plan*

The Dawes Committee was an American initiative, although it had British support. Its objectives were to find a resolution to the reparations problem and a peaceful end to the occupation of the Ruhr. This demanded the stabilisation of the mark to halt the depreciation of assets, and the restoration of the German internal and external credit system.[407] The struggle in the Dawes Committee over the constitution of the German central bank and banking law of 1924 represents a crossroads in the development of the inter-war monetary system. The policy conflict between the British and the Americans over the basis of the inter-war monetary system was thus unmasked. The terms of its resolution, in technocratic fixes, would be crucial to the subsequent development of the system.

A Reichsbank based on gold could fast become an expensive drain on London's gold reserves.[408] Thus, in Paris, the British lobbied for a sterling standard or, failing that, a gold exchange standard basis for the mark with a large portion of foreign exchange as reserves. In this, they found allies in some European countries, less because they liked the British plans than because they objected to the German central bank being founded on a stronger gold basis than their own.[409] The French also recognised that the need to hold the mark at parity with gold could obstruct the transfers necessary for the payments of reparations.[410] The Americans, on the other hand, wanted a gold basis: because they could better afford the gold losses; because they believed this would be necessary to instil confidence in the new mark, given the recent history of inflation; and because this would promote the dollar.[411] If the mark was at a

[405] Norman to Strong, 30 January 1924, BOE OV34/117.
[406] Norman to Strong, 30 January 1924, BOE G35/8.
[407] Reports of the Expert Committees appointed by the Reparations Commission, Presented to Parliament by Command of His Majesty, His Majesty's Stationary Office, London 1924.
[408] Bank of England, "Memorandum for Mr. Dawes, Legal Reserve Requirements for Proposed New German Bank of Issue, General Principles that Determine the Percentage of Reserves Needed", 1 March 1924, BOE OV34/120.
[409] Bank of England, "Memorandum for Mr. Dawes, Legal Reserve Requirements for Proposed New German Bank of Issue, General Principles that Determine the Percentage of Reserves Needed", 1 March 1924, BOE OV34/120.
[410] Harvey, Memorandum, 1 March 1924, BOE OV34/120.
[411] Harvey, Memorandum, 1 March 1924, BOE OV34/120.

par with gold, it would be in the interests of Germany to borrow as many dollars as possible, since dollars were not at a discount with gold, rather than face the potential losses associated with borrowing in sterling that was set to appreciate. Given that the stabilisation credits would be lent largely in dollars, the Americans saw little reason to compromise on this point, and felt little pressure to do so.[412]

The eventual agreement in Paris reflected the American preference. In an opportunistic trade, Norman withdrew his insistence that the new central bank be put "squarely on a sterling basis" upon an offer from Strong to allow some inflation in American prices that would help Britain back to gold.[413] Even though the country was not on a de jure gold basis, the constitution of the Reichsbank provided for 40% gold cover up to a specified circulation limit, and then 100% gold cover above that limit.[414] Thus, technically, the Bank was on a gold exchange basis, but with a relatively high gold reserve ratio. Tight constraints were also placed on the operations of the Reichsbank. The amount that could be lent to the government was limited and the government had to clear its debt with the Reichsbank each year. In addition, the Reichsbank was only allowed to purchase a limited amount of government debt.[415] Last, the desire of creditors to constrain the actions of the Reichsbank led to the imposition of foreign control within the bank of issue.[416] The Board of the Bank would be half German and half foreign and there would be a technical adviser. Norman noted: ""The technical adviser" idea was shoved in as being more effective than the mere strengthening of the Reichsbank and less obnoxious than the Caisse de la Dette."[417]

This structure was crucial because the transfer of reparations payments managed by the Transfer Committee, under the infamous Transfer Protection Clause, depended upon close and ongoing cooperation between the Reichsbank and the Entente powers. Under this Clause, transfers of commercial claims on Germany were protected from reparations. Hence, the Reichsbank would have to make foreign exchange available for reparation transfers only after all commercial claims had been satisfied. Thus, with private creditors' interest claims superior to reparations, there was a basis for credit to flow to Germany. This arrangement depended on the Reichsbank not manipulating commercial claims, frustrating subsequent reparations remittances, or otherwise tweaking the exchange rate to

[412] Strong to Norman, 3 June 1924, BOE G35/8.
[413] Costigliola, 1984, 129.
[414] The statutes of the new bank also built in the gold exchange standard rules of the game. For instance, the discount rate could not be below 5% if the reserve cover was below its statutory requirement and the bank would face a pecuniary tax for its excess liabilities (Bank of England, 'Memorandum for Committee No. 1 of the Expert Committee of the Reparations Commission, Plan for the Bank of Issue in Germany, Recommended by Special Sub-Committee', February 1924, BOE OV34/120).
[415] The Bank Law of 1924 and the statues of the Reichsbank also automated Discount Rate adjustments to changes in reserves.
[416] Norman resisted this initially, perhaps fearing a loss of his personal influence in Reichsbank or excessive politicisation of the central bank (Norman to Harvey, 3 March 1924, BOE OV34/120).
[417] Norman to Strong, 14 November 1921, BOE OV31/5.

undermine the program. At the same time, the bank had to be sufficiently independent that it could resist remittances when they could not be afforded without impairing the exchange.[418]

The British government was disappointed by the failure to attain a pure sterling standard. The Treasury noted that, in addition to the expense of the eventual agreement for Britain, "a very serious problem will arise for this country if Germany (as the scheme demands) with the help of a foreign loan gets back onto a gold standard before we do."[419] However, although the British could not totally control the transaction, the Plan still reflected the modalities of appropriation. Crucially, the German central bank was still lifted into the defence of the international monetary construct. This was reflected in the way that the Dawes Plan made exchange stability its determining objective. That is to say, what was protected by the Dawes Plan was not actually reparations, but rather the value of the mark. It followed that German domestic institutional structures, and the international control arrangements through the Reparations Commission, were enmeshed in commitments that would defend the international monetary construct at the expense of all other considerations. As a result of this appropriation, the Reichsbank was detached from domestic sources of legitimacy, without any due regard being given to the inherent dangers of such an arrangement. Presaging the resistance that was to come, well before the long struggle against external controls began, complaints about the dependence of Schacht on the Bank of England were voiced in Germany.[420]

The solution to the policy conflict over the Reichsbank's design, regarding the proper basis for the system, on gold or sterling, gave rise to other developments congruent with the explanatory framework of this study. Most notably, the distributional dispute between the dollar and sterling was not resolved, but rather was managed through technocratic solutions and drafting ambiguities that produced maladaptation in ongoing practices and institutions. Germany was suspended between the gold standard and a gold exchange standard. This created uncertainty in the long-run. There was no clarity over whether the constitution of the central bank should be permanent or temporary. As late as 1928, the central bank was still equivocating as to whether to take the necessary formal steps to establish itself firmly on a gold basis.[421] Onerous statutory rules and compensatory control arrangements were instituted to manage the ambiguities. The Reichsbank, and Germany itself, was caught in the uncertainty of opportunistic trades between competing interests. In the long-run this meant that it could not respond to evolving domestic needs.

Another central contention of this thesis' explanatory framework is that deals struck between monetary authorities tend to avoid issues with implications for the balance of power within a system. In exactly this manner, the Dawes Plan obscured the link between reparations and inter-allied debts. In addition,

[418] Treasury, "The Reparations Report", 14 April 1924, BOE OV9/337.
[419] Treasury, "The Reparations Report", 19 April 1924, BOE OV9/337.
[420] Schacht to Norman, 25 November 1925, BOE OV34/73.
[421] H.A.S. to Niemeyer, 22 February 1928, BOE OV9/187.

the dispute between Britain and France over the Weimar Republic's capacity to pay was not resolved, but rather circumvented by officials who elaborated a complex set of devices with an unclear and unstable pecuniary value. Thus, the reparations problem was 'resolved' not through setting a clear sum, but rather by calibrating a large figure against a prosperity index and protecting the mark through the elaborate structure of safeguards for international transfers.[422] However, while the Transfer Protection Clause gave investors the protection they demanded, it created perverse incentives to lend without fear of exchange losses. Worse still, the lack of a clear and final settlement reduced the German interest in instituting painful internal reforms, or limiting the amount it borrowed, because it wanted to retain bargaining chips for the future.[423] The Dawes Plan was maladaptive, and could never provide a long-term settlement, because it was full of short-term fixes and glaring omissions.

iii. *Summary*

Analysing the history of the stabilisation of the mark has revealed certain mechanisms operating just as described in this study's explanatory framework. The British set out to put the German economy on a sterling basis, but were met with American resistance. The logics of appropriation still applied nevertheless. Reflecting British and American creditor interests, the Dawes Plan put exchange stability above every competing consideration. Following the designs put forward by the League, a massive structure of external controls, resented by many Germans, along with an independent central bank, would secure the extraction of resources. The Reichsbank was thus appropriated into the gold exchange standard. Furthermore, tough distributional questions, such as those concerning competition between the dollar and sterling, were superficially 'resolved' through concessions to special interests and short-term fixes. These measures left the monetary structure in a state of ambiguity, with slim political and economic reserves. Once again, the opportunistic and boundedly rational calculations that drove the policy solutions should be noted. As early as 1923, Bradbury, the principal British delegate to the Reparation Commission, had warned London that the policy trajectory of fixes and short-term compromises "would only purchase a monetary respite without alleviating the real menace."[424]

c. The "Norman Club" of Central Banks

The League stabilisation programs and Dawes Plan grab much attention in the literature on the 1920s.[425] However, after 1924, most countries were brought onto gold without being subject to external control. Nevertheless, they still relied upon concerted central bank credits, and on the coordinating capacities of the Bank of England and Federal Reserve to help raise funds in London or New York. The cost of this support was that countries implemented the institutional and administrative reforms that would

[422] Treasury, "Memorandum by Mr Leith Ross on the Transfer Committee set up by the Dawes Report", 14 July 1924, BOE OV9/377.
[423] The archival records suggest that these time-inconsistency problems were known to contemporaries. They have since been modelled to explain German behaviour. See Ritschl, 2012.
[424] Bradbury to Norman, 8 January 1923, BOE OV34/117.
[425] There are important exceptions to this lack of scholarly attention. See Meyer, 1970; and Jack, 1927.

reinforce and consolidate the gold exchange standard. The cases of Belgium and Italy will illustrate the point.

i. *The stabilisation of Italy and Belgium*

The Belgian central bank wanted to return to the gold standard at its pre-war parity, and worked towards this objective between 1919 and 1925. However, stabilisation talks only began in October 1925.[426] Upon agreeing to support the deal, which carried a risk of French backlash, Norman wrote to his counterpart at the Belgium central bank to explain that: "In agreeing to take a share in the temporary credit, I did so partly to help you to reach stability, partly because the participation of London seemed to me to be necessary if the Credit was to be arranged without loss of time, but mainly in the expectation that the way would thus be paved for the gradual reestablishment of intimate and exclusive relations between our institutions."[427] Thus, in accordance with this study's explanatory framework, the expectation of reciprocal support was the price of British assistance.

The Italian stabilisation scheme provides a further example of appropriation. Norman repeatedly delayed Italian incorporation because he feared the Italian central bank was not sufficiently independent.[428] A secret Bank of England memorandum reveals the British calculations. In Siepmann's hand is written: "Because of its intrinsic advantages we may welcome stabilisation in every case. But it can be used to defeat our purposes." The memorandum continues: "As bankers we cannot discriminate between clients and Italy conforms outwardly to our conditions. But we have no reason to believe Italy is really cooperative." However, the existence of the Federal Reserve is pointed to as a reason not to delay. "At the same time, if we did not cooperate, it is probable that stabilisation would proceed without us and our apparent defection might cost us the cooperation of America. […] Therefore we must go ahead, even if we suspect we are being duped. But it may well be to indicate to the Italians from the very start that they are not invited to join the circle of cooperating Central banks unless they are both able and willing to accept the spirit as well as the letter."[429] Thus, Italy was only admitted into the central bank network when it committed to "adopt and defend the gold exchange standard."[430] To this end, Italy could not use its balances in London for any reason other than maintaining the system's stability.[431] Furthermore, the Banca d'Italy was forced to adopt the British view that the appreciation of gold was a problem, and to "be prepared, in cooperation with other central banks, to take concerted measures to prevent its natural consequences."[432]

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[426] Cottrell, 1998, 4.
[427] Norman to Hautain, 20 October 1925, BOE OV88/38 file38.
[428] Norman to Strong, 4 March 1926, BOE G1/307.
[429] Siepmann, 'Secret', [Undated], BOE G1/307.
[430] Indeed, in writing to other central bankers in search of collective support, Norman conceded that "he had not examined the position in detail" but nevertheless offered confirmation that the essential institutional foundations were in place (Norman to Strong, 29 November 1927, BOE OV9/440).
[431] Bank of England, "Bank of Italy", 14 December 1927, BOE OV9/440.
[432] Bank of England, "Bank of Italy", 14 December 1927, BOE OV9/440.

ii. *The resistance to the central bank network*

Britain was able to secure its aims through appropriation even when stabilisations occurred outside the parameters of the League or external controls. However, appropriation through the central banking network still generated antagonisms, because it turned national monetary authorities towards external objectives. Indeed, Italy paid a high domestic price to come onto the gold exchange standard. As Gianni Toniolo and Pierluigi Ciocca note: "The turning point [towards worsening Italian economic performance] stemmed from the inability of the industrial system to adapt to the new structure of world demand, as well as from the determination of the international financial community to pursue the normalisation process of financial markets that commenced around 1924."[433] Appropriation, while strengthening officials against politicians, robbed the Bank of Italy of the flexibility it needed to act as a central bank for its domestic markets.

3. Information Distortions and the Gold Exchange Standard

This section studies the informational means that were devised to sustain the gold exchange standard structure in spite of underlying dysfunction and political resistance. The first assumption of this study's explanatory framework on the subject of information, which is that the leader of a system will distort information to misrepresent its capability and willingness to maintain the status quo, needs little elaboration here. The Bank of England's systematic manipulations, through under- and overstatement of losses and gains of foreign currencies and gold, calculated to avoid political pressures and persuade the markets that the exchanges were under control, have been masterfully documented elsewhere.[434] This section focuses instead on the concerted patterns of trade in distorted information about the stabilisation schemes, which resulted in huge misalignments between shared images and underlying realities.

a. Masking the Problems with Dawes

Huge sunk investments made the failure of the Dawes Plan difficult to contemplate. However, almost from its inception, there were signs of strain. The central dilemma, as already noted, was that stabilisation brought with it the possibility of external borrowing that could help avoid the deflationary sacrifices, wealth transfers, and belt-tightening that came with stabilisation schemes and reparations. Yet, in the longer-term, such borrowing would put pressure on balances of payments and credit positions. This issue was worsened by the cheap credit policies of the Federal Reserve, and the high savings rate in the US that produced a bonanza of funds to be lent. From 1925 to 1931, Germany accumulated massive foreign liabilities on a persistent current account deficit: "Germany ran what is

[433] Ciocca and Toniolo, 1976, 17. See also Fratianni and Spinelli, 1997, 143.
[434] Most comprehensively in John Garrett's study of Norman's effort to manipulate market expectations. (Garrett, 1995, 612-636).

commonly called a Ponzi scheme, financing reparations and debt service by issuing even more debt."[435] This pattern depended on distorting information.

The dangers of excessive lending were recognised as early as 1925.[436] At the central bankers' conference in Long Island in 1927, Strong, Schacht and Rist all foresaw that the machinery of recycled credit, by which US financiers subsidised German reparations payments rather than facilitating the transfer of real resources, was in danger of coming apart.[437] However, no action was taken because the loans to Germany were compatible with opportunistic interests. Without the loans, the payment of reparations would not have been made, nor inter-allied debts serviced. The loans also accorded with British interests to the extent that the lenient monetary conditions in the US took the pressure off sterling. The economic boom on cheap credit also enabled reconstruction and stabilisation to continue, and central bankers and finance officials attached personal and institutional significance to its success.

The vested interests in the status quo were revealed when Parker Gilbert, Agent General for Reparations, blew the whistle on the maladapted credit structure and the technocratic fix that was supporting it. The historical record has paid much attention to Gilbert's public attack on reckless American bankers and his open letter to the German government warning of "overborrowing and overspending […] that if allowed to continue unchecked, are almost certain [...] to lead to severe economic reaction and depression."[438] However, from the perspective afforded by this study's analytical framework, a more revealing intervention occurred when Gilbert took aim at the Dawes Plan itself. In the Report to the Reparations Commission in December 1927, Gilbert traced the root of the German loans problem to the technical keystone of the Dawes Plan, its Transfer Protection Clause, which he identified as having given lenders excessive confidence .[439] However, the British immediately moved to shut down Gilbert's intervention, describing it as "highly undesirable."[440]

The Treasury argued that: "our present policy must be to let the Plan work itself out. Under the Plan, there is no guarantee that any reparations will be transferred and the Allied Governments must accept any restrictions on transfers which may be imposed in order to protect the German exchange. It is possible that the Plan, in providing this safeguard, allowed too wide a loop hole, but we are bound to the Plan and cannot modify its provisions without the consent of Germany. This being the case, it cannot be too strongly emphasised that a restriction of transfers to protect the German exchange is a process which the Dawes plan contemplated and provided for; and such a restriction is not merely a breakdown

[435] Ritschl, 2012, 953.
[436] Schuker, 1976 [1988], 36-38.
[437] On this crucial conferences of central bankers (see Clarke, 1967, 123-24; Clay, 1957, 236-37; Eichengreen, 1994, 212–13; and Sayers, 1967, 336-345).
[438] US Congress, "Hearings before the Committee on Finance, Sales of Foreign Securities", United States Senate, 72d Cong. (Washington, D.C.: GPO, 1932), 23.
[439] Gilbert, Reparations Commission, "Report of the Agent General", 10 December 1927, 19, 102, BOE OV9/187.
[440] Treasury, Memorandum, Undated [Presumably December 1927], BOE OV9/187.

of the Plan, but a necessary step to a final settlement."[441] In other words, the fear in Whitehall was that the Report's assertion that the exchange might not be untouchable could undermine market confidence in the sanctity of the Transfer Protection Clause and consequently also the complex structure of credit and monetary flows dependent upon it.[442] Ultimately, this British position that the status quo could and must persist was untenable. The only money that the Allies were getting from Germany was money lent there first by America.[443] At the League Council in Geneva in September 1928, a new Expert Committee, headed by Owen Young, was established to look again at the reparations question. However, by this point, the political disjuncture and maladaptation were already too great. The fate of the Young Plan was predetermined by the fragile political and economic conditions its predecessor had created.

b. The Wider Problem

This pattern of information distortions was not unique to Germany. The League stabilisation programs were bound up in strikingly similar misrepresentations. Again, it was recognised early on that the League loans had generated a risk of excessive foreign borrowings.[444] It was also apparent that countries tended to avoid the costs involved in undertaking the administrative reforms and fiscal retrenchments that would have stabilised their external positions.[445] In Hungary's case, for instance, the League reported that while some steps had been taken, "it is most striking, however, that the proposals, while desirable in themselves, do not concern any reductions on a large scale."[446] However, these concerns were not discussed openly, because officials did not want to frustrate the flow of foreign credits.[447] Indeed, countries' need to consistently raise fresh capital limited the open sharing of concerns about existing arrangements and the viability of current levels of indebtedness. Such short-termism also affected political calculations. Officials looked for ways to avoid countries' representatives having to make humiliating trips to Geneva to plead for funds. This created pressures to give biased representations of the schemes, rather than admitting known weaknesses.[448]

c. Imagined Stability

Ultimately, these distortions meant a shared image of relative stability was built around an inherently fragile international credit structure. Thus, shortly before he died in 1928, Strong felt that the reconstruction of Europe was virtually complete.[449] In 1929, Norman also judged his own work a

[441] H.L.R. to Sargent, 16 December 1927, BOE OV9/187.
[442] Gilbert, "Report of Agent General", (handwritten comments by Niemeyer', 24 February 1928, BOE OV9/187.
[443] Niemeyer, "Gilbert", 22 February 1928, OV9/187.
[444] Tyler to Niemeyer, 18 December 1926, BOE OV9/438.
[445] Tyler to Niemeyer, 18 December 1926, BOE OV9/438.
[446] League of Nations, "Financial Reconstruction of Hungary, Report by the Commissioner-General on the Work of the National Commission on Economics", 24 February 1926, BOE OV9/438.
[447] Marcus, 2010, Chapter 4.
[448] Niemeyer, Memorandum, "Austria", 27 May 1929, BoE, OV 28/2.
[449] Strong to Young, 17 August 1928, BOA G35/8; also see, Chandler, 1957, 457.

triumph.[450] The magnitude of these miscalculations is startling in hindsight. However, the distorted image had developed slowly, through recurring needs to close points of cognitive dissonance, justify prior actions, and secure the flow of future pecuniary rewards. The gold exchange standard system was thus extended, at the cost of becoming increasingly divorced from reality, on a trajectory towards collapse.

4. The EFO Gold Delegation: Information Distortions and Limits to Appropriation

One insight arising from this study's explanatory framework is that negotiating forums are liable to deformation into devices for pretension and extension, rather than places where necessary policy recalibrations are made. This pattern is especially likely to occur as the limits of appropriation are reached and distributional conflicts become harder to resolve. The present section shows that the EFO Gold Delegation fell victim to such maladaptive logics. The Gold Delegation was created by the British to promote their view that the system was suffering from a shortage and misdistribution of gold; that is, to push back against the limits being imposed by French and American advocacy of gold standard orthodoxies. Upon realising that its view could not be imposed on the rest of the members, the Bank of England had to abandon and supress the committee.

a. Background

In May 1927, facing constant speculation on the franc, the Bank of France decided to convert its sterling holdings into gold, to pressure the Bank of England into raising its discount rate and tightening credit.[451] This was considered a legitimate solution to a technical problem, according to gold standard orthodoxy. However, the Bank of England responded with alarm, given its rapidly diminishing reserves, and domestic deflation and retrenchment. At the meeting in Long Island of July 1927, Norman used his political influence to steady the ship and mobilise his supporters in foreign central banks. This episode prompted deeper questions and a backlash against British leadership. For Strong, the episode demonstrated the problem with the gold exchange standard system.[452] The French also thought they had uncovered a fundamental problem: "A gold exchange bank with its reserves in London is certainly not on a gold standard, and is not even on a gold exchange standard unless it is admitted to have an effective right to sell sterling in unlimited quantities, in default of a right to convert its sterling balances into actual gold to any amount of demand. Either or both of these two rights would be admitted in theory, but neither is effective in practice."[453] The British thought the episode confirmed the opposite: that there was a shortage of gold and the use of the gold exchange standard needed to be extended.[454] For some

[450] Norman, "Some Notes on the Return to the Gold Standard", 29 April 1929, BOE OV9/264; also see, Clay, 1957.
[451] Mouré, 2002, 162; and Moreau, 1954, 290.
[452] Clarke, 1973, 135.
[453] Siepmann, "Monsieur Quesnay on the Gold Exchange Standard", 22 September 1927, BOE OV 48/1.
[454] H.A.S., "Reply to some observations by M. Quesnay on the Gold Exchange Standard", 6 November 1927, BOE G29/1. Bank of England, Memorandum, 19 February 1929, BOE OV 48/1.

British officials, even Genoa, which endorsed an exchange standard rather than a more purely fiat system, had started to look like an inconvenience in its strictures.[455]

The Gold Delegation was established by London to promote their view.[456] In this, they were aided by Strakosch and Cassels, who pushed the issue in Geneva. The League of Nations Council, on 8 June 1928, called on the Financial Committee to "assist in the study and solution of the problem of undue fluctuations of the purchasing power of gold."[457] Britain, in the Gold Delegation, sought a way of convincing the world that there was a shortage and fundamental misallocation of gold in the international system.[458] As ever, self-interest was the key driver. Britain was facing deflation, and officials increasingly accepted that: "It is extremely difficult, without immense social friction, to reduce wages anything like proportionally to price falls."[459] To avoid domestic deflation, Britain had to push back the limits on appropriation. This was a desperate strategy.

b. Pushing Back Against the Limits of Appropriation

The Bank of England knew its motives would be doubted. A memorandum noted: "It will be easy to show that the demand [for an enquiry] centres in England, and it can be easily argued that England, having a far bigger industrial population and a higher percentage of wage earners than other countries, has most to fear from a shortage of gold. It may be said that […] the League of Nations, on whose Financial Committee England is strongly represented, is being used, in the characteristic English way, to pull the chestnuts out of the fire for England."[460] The British also recognised that the limits of appropriation were being reached because credence was being "given to the view that a gold exchange standard is merely a transition to the old ideas of the gold standard, which are still regarded in some quarters as the only hallmark of a respectable nation."[461] It was noted that certain central banks were "encouraging smaller central banks to acquire and hoard gold" and "statutes [were] being passed requiring the hoarding of gold."[462] In this context, the British determined that: "If we do nothing, we shall find all the smaller central banks in Europe slipping back into the gold hoarding tradition without realising that thereby they will produce prolonged economic distress by forcing a fall in prices."[463]

However, the very establishment of the Gold Delegation could jeopardise the fragile structures of appropriation, both because of the lack of an international consensus about gold's position, and because of the implications for the power relations between the countries in the system of any change in gold's

[455] H.A.S. "Reply to some observations by M. Quesnay on the Gold Exchange Standard", 6 November 1927, BOE G29/1; and Bank of England, Memorandum, 19 February 1929, BOE OV 48/1.
[456] Strakosch to Salter, 9 May 1928, BOE OV9/262; also see, Clavin, 2013, 52.
[457] League of Nations, 1928.
[458] Bank of England, Memorandum, 30 December 1927, BOE OV9/262.
[459] Bank of England, Memorandum, 30 December 1927, BOE OV9/262.
[460] H.A.S. "Note on the Proposed Enquiry into the Stabilisation of the Value of Gold", 19 November 1928, BOE OV9/262.
[461] Bank of England, Memorandum, 30 December 1927, BOE OV9/262.
[462] Bank of England, Memorandum, 30 December 1927, BOE OV9/262.
[463] Bank of England, Memorandum, 30 December 1927, BOE OV9/262.

distribution or monetary use. In order to circumvent US and French resistance to the Gold Delegation, as Patricia Clavin has documented: "Norman told Strong and Moreau that he did not approve of the League looking into the operation of the gold standard while at the same time [he was secretly] encouraging the secretariat to pursue the issue."[464] This misrepresentation was enough for the League secretariat to get the Gold Delegation moving, because other central banks had been misled into believing that the grouping was unlikely to happen. The Geneva secretariat also couched the entire investigation as a study of the Austrian and Hungarian stabilisations and the effect of gold exchange rate volatility and relative price level changes.[465] The implications of the study that went to the very core of the gold exchange standard project were impossible to mask, however.

c. The Bank of England's Retreat

The next issue to be determined was the composition of the Gold Delegation. The EFO secretariat wanted central bankers to join. However, this posed a problem. The central bank cooperation that had been orchestrated to control the price of gold through the manipulation of currency and credit, that is, discount rates and gold market intervention, was always conducted away from the purview of governments. Even the Bank of England felt "it most undesirable to have any public discussion of whether they should [be conducting these actions]."[466] Moreover, generally, there was a desire to make sure international monetary issues continued to be "dealt with by central banks rather than governments."[467] As Moreau put it, "it can be anticipated that in certain quarters a demand will be made for political control of the possible power of the banks of issue in this connection, and there is a risk that the enquiry which is opened will lead to very different results than those desired by the League of Nations itself."[468] This collective attitude, together with the US's interests in preventing any investigation, drove Strong, together with many other central bankers (including Schacht, Bachmann, Vissering, Frank and Moreau), to insist on only a fact finding mission. At a secret meeting in Paris, on 25 February 1929, the Bank of England agreed, for tactical reasons, to stall the appointment of the French expert to the committee.[469]

Thus, even before it was established, the Gold Delegation had been reduced to an information device that would never dictate policy. However, it still risked blowing the entire exchange standard edifice apart, by exposing the massive differences between the 'British view' that gold needed to be slowly demonetised, and other countries' view that doing so would endanger the very foundations of the international monetary order. The Gold delegation stifled its own work, seeking to avoid open

[464] Clavin, 2013, 54.
[465] Clavin, 2013, 54.
[466] H.A.S. "Note on the Proposed Enquiry into the Stabilisation of the Value of Gold", 19 November 1928, BOE OV9/262.
[467] H.A.S. "Note on the Proposed Enquiry into the Stabilisation of the Value of Gold", 19 November 1928, BOE OV9/262.
[468] Moreau to Norman, 28 December 1928, BOE G1/30.
[469] Moreau to Norman, (handwritten annotation of Norman), 28 December 1928, BOE G1/30.

discord.[470] The First Interim Report of the Gold Delegation produced in the summer of 1930 focused overwhelmingly upon the long term price trends, and was extremely technical in its presentation. However, in the Statistical Annexes, the British view of the problem came to the fore.[471] The contents highlighted the deflationary effects of the gold standard, the issues of sterilisation in the US and France, and raised doubts about the value of minimum gold covers in newly stabilised powers.

Following the publication, the US and France looked set to revolt. Under pressure, the British Treasury and Bank of England backed down. Norman wrote to Harrison, Strong's replacement at the Federal Reserve, to falsely assert: "I have always been opposed to the Gold Committee [i.e. the Gold Delegation] under present conditions but have been powerless to prevent or impede its activities. […] Similarly, I am powerless with the Financial Committee and with the Council who can only be approached through diplomatic channels." [472] Norman's next letter warned that "later reports could hardly fail to be more controversial, more contentious, and more troublesome to us all than this first Interim Report".[473] The loss of British backing undermined the Gold Delegation. The Second Interim Report, published in January 1931, was more orthodox and designed primarily to infuse confidence in the system, which was now in crisis.[474] It was only after the system had broken down in September 1931 that discord would be openly expressed through the Gold Delegation.

d. The Gold Delegation and the Gold Exchange Standard

This study's explanatory framework outlines how, in negotiated orders, institutionalised bargaining forums tend to become maladapted instruments through which appropriated monetary officials give rhetorical support to the status quo, rather than making necessary recalibrations. The Gold Delegation was a final effort by the British to impose the gold exchange standard on the world. The failure of this effort was the result of years of growing resistance to appropriation. As *La Tribuna* noted in 1930, "the English decoction prepared in Geneva too evidently displays its laboured artificiality."[475] It was only a matter of time before the disjuncture between British wishes and the advocacy by rival members of the system for a more orthodox gold standard would tear the exchange standard system apart.

5. The Collapse

The preceding analysis has introduced three central vulnerabilities that resulted from appropriative leadership in the gold exchange standard order. First, the dependence of member monetary authorities on short-term capital and external support. Second, the rigid manner in which countries had been attached to the standard, and orientated towards external objectives: this gave them little room for

[470] Clavin, 2013, 58.
[471] Clavin, 2013, 58.
[472] Norman to Harrison, Cablegram, 6 September 1930, BOE OV9/264.
[473] Norman to Harrison, 16 September 1930, BOE OV9/264.
[474] Clavin, 2013, 58.
[475] "The British Agitation for Gold", *La Tribuna*, 8 October 1930.

technical adjustments or domestic legitimacy. Third, the resistance of the Entente to the continued extension of sterling through the system. These factors limited the potential for appropriation. The British authorities continued to direct international central bank coordination and policy towards the defence of sterling, up until devaluation. However, by September 1931, it had become clear that international support would no longer be forthcoming. The domestic problems facing the British authorities could not be mastered by international means on the established policy track. At this point, the British abandoned the gold exchange standard; such a decision is completely congruent with the explanatory framework of this thesis.

The facts surrounding the breakdown of the gold exchange standard are well known. In the late 1920s, Central and Eastern European countries were suffering from chronic deficits, compounded in Germany's case by reparations demands. Such pressures made the defence of exchange rates difficult. Unless nations could attain large foreign loans, the gold exchange standard would be under threat. However, the supply of these loans was hit by monetary tightening in New York in 1928. In the global credit crunch, central banks and officials faced a stark choice between devaluation and deflation. In every case, they took the orthodox medicine, resorting to deflation and protectionism to stay on gold. They did this not only because of the mentality of the gold standard orthodoxy, but also because of the manner in which they had been tied to the gold exchange standard in legal terms, and because Britain and America continued to tie financial support to deflation.[476] The financial situation in Europe deteriorated through deflation as external loans denominated in gold or foreign exchange were backed by depreciating domestic securities.

The pressures caused a crisis in Austria, when the covert support of Creditansalt by the ANB was frustrated by British and French recriminations over the policy.[477] The Austrian banking crisis quickly spread to Germany in June and July of 1931. This was the moment when the "world depression was turning from a mere cyclical adjustment to the apparent failure of the whole system."[478] In the most crucial member state of the system, the German government clung on to its gold parity through the infamous Brüning austerity budget of June 1931, largely because so much of the indebtedness was held in gold. However, for reasons of political survival, Brüning determined that no more could be asked domestically without at least some symbolic gesture of resistance to international pressure. The result was the "fatal decision to denounce reparations and say Germany had paid all that it could."[479] The markets took the announcement to mean that Germany could not pay its international creditors. This led to a revelation of just how slim domestic reserves of goodwill towards the central government had

[476] Eichengreen and Temin, 2000, 183.
[477] Aguado, 2001; and Cottrell, 2001.
[478] Bennett, 1962, 242.
[479] Ferguson and Temin, 2000, 35.

become, notably as the Ruhr industrialists revolted despite the central government's apparent change of trajectory.[480]

Continued acquiescence of European monetary authorities to British power and influence was impossible. The pressures inside Germany for the Reichsbank to cut the link with gold were extraordinary. No less than 21,000 signed petitions were sent to the Reichsbank and the Berliner Handelshochsule (Berlin Business School) calling for an end to the deflationary policy stance.[481] The Brüning government survived until the summer of 1932, but by then Germany was effectively off gold and the Reichsbank was facing calls from labour and industrialists to create credit. Eventually, credit controls were imposed by the central banks, and these developed into exchange controls, the freezing of foreign assets, and standstill agreements with London. The fact that the country had been locked into the international monetary structure in such a flawed fashion meant that this departure from the gold exchange standard carried a high price. These events heaped pressure on the pound, imposing massive liquidity constraints on the London banks.

The publication of the Macmillan report in July 1931 exposed the vulnerability of the British external position. The confidence in British leadership among the members of the system and the markets would never be recovered. The report recommended the liquidation of the French short-term balances that had been built up through the promotion of the exchange standard. The Bank of England managed to secure foreign loans through July and August, but only by raising the bank rate against domestic pressures. Nevertheless, the pressure on the pound continued and the Bank of England quickly exhausted its foreign credits. By September 1931, the terrible drain on London's gold and exchange reserves had become unsustainable. The British budget and national payments position were dire. The City was insolvent. It would be impossible to implement further deflation. The willingness and ability of London to support the gold exchange standard was being tested to the limits.

Yet officials in London still agonised over the idea that abandoning the gold exchange standard system would sacrifice Britain's international leadership. Britain endeavoured to show that it had been forced off gold: "It can do us nothing but damage, at home and abroad, if we are believed to have chosen to abandon the gold standard, and not to have been forced off it by irresistible circumstances, and after the exhaustion of all our defensive reserves."[482] The reason was that "to denigrate the old, abandoned parities," to speak of advantages from going off gold, "is to impugn our whole financial policy since the war, and our stubborn defence of the currency during the past two months."[483] However, when Britain went off gold, the view everywhere was that Britain had done so wilfully. There was no hiding that "England would never have gone off the gold standard had there not been a belief that this would

[480] Ferguson and Temin, 2000, 35.
[481] Holtfrerich, 1990, 68.
[482] Bank of England, Memorandum, 20 October 1931, BOA OV49/1.
[483] Bank of England, Memorandum, 20 October 1931, BOA OV49/1.

yield certain economic advantages."[484] The unmasking of British self-interest shook the foundations of the system. Siepmann, now at the BIS, wrote to Rodd at the Bank of England to lament that: "The Bank of England have always been regarded as the chief exponent of sound financial and monetary principles and their technical competence has been above all criticism. Consequently, the surprise is all the greater now that the very doctrines which the Bank of England have been preaching all over Europe for years past appear to have been completely ignored in the defence of sterling."[485] The crisis revealed the asymmetries of power that appropriative leadership had facilitated and helped to conceal.

The exit of the leader pulled the gold exchange standard down. Table 4.2 indicates the situation by October 1931.

Table 4.2. Countries off Gold by October 1931

Countries Officially Off Gold in Europe	Countries Officially Off Gold Internationally	Countries with Foreign Exchange Restrictions in Europe	Countries with Foreign Exchange Restrictions Internationally
Europe	Argentina	Austria	Columbia
Demark	Australia	Bulgaria	
Norway	Bolivia	Czechoslovakia	
Portugal	Brazil	Finland	
Spain	Egypt	Germany	
Sweden	India	Greece	
	New Zealand	Hungary	
	Nyasaland	Iceland	
	Rhodesia,	Italy	
	North and South	Latvia	
	San Salvador	Lithuania	
	Uruguay	Romania	
		Yugoslavia	

Source: Bank of England, Memorandum, 20 October 1931, BOA OV49/1

The widespread economic dislocation and distress was an outcome of the way that countries had formerly been held together in the system. Under the designs that had been instituted in the preceding decade, the pound was the trading and primary reserve currency of Europe. The central banks who had been introduced to the sterling exchange standard saw reserve losses that meant their gold cover was now well below the legal minimum. In some cases, the losses were so great that the central banks required support from their respective nations. The French state needed to intervene to support the Bank of France, and imposed an import surcharge to try to limit the impact of the violent depreciation of sterling. In Germany, the devaluation undermined their positive trade balance to create still more acute pressures and provoked a tightening of exchange controls. In the former Latin Union countries, large losses were suffered, especially in Italy and Belgium, two countries that had joined the gold exchange

[484] Osborne, "Summary", 26 October 1926, BOA OV49/1.
[485] Siepmann to Rodd, 20 October 1931, BOA OV49/1.

standard late and held large sterling reserves. In Eastern Europe, similar losses were suffered because of trade dependence and reserve holdings in pounds. The result was that international trade came almost to a standstill, as other countries imposed exchange restrictions and sought to protect themselves from British competition. Countries either followed sterling and devalued, or converted whatever pounds and dollars they could into gold in an effort to find security in the European gold bloc under French leadership, or US protection. The gold exchange standard had effectively ended.

6. Conclusion

As he was retiring in 1944, Norman received the following reflection from a friend: "When history comes to be written from a point of vantage somewhat remote from currency controversies, it will […] be judged that your leadership in monetary reconstruction gave the world the best chance it had after the First World War for peace and law and order. [It] might have had ultimate and durable success if the politicians had done a better job."[486] This expectation that Norman would be exonerated has proved correct. The dominant explanations of the failure of the inter-war monetary order locate the origins of the collapse everywhere other than in the substantive content of British leadership: either changed structural and environmental conditions are said to have made the operation of the gold standard impossible;[487] or it is claimed that an American recession created a depression that then spilled into the international realm;[488] or a more general lack of British and American leadership is held accountable.[489] These perspectives all downplay the significance of the monetary governance and policies that actually built up the inter-war monetary order, and which are so central to the present analysis.

A central assumption of this study's explanatory framework is that leaders will exploit the opportunities before them to maximise their gains: so it was that the British built the gold exchange standard on terms that supported their own national objectives and priorities. The structural properties and political base of the inter-war monetary order led the British leadership to pursue their interests by means of appropriation. The League became a central instrument for the British to implement their designs through the European stabilisation process. The cornerstone of this project was to free the domains of currency and finance from the troubling influence of national politics. The gains available from participating in this endeavour were sufficient to co-opt and absorb the US Federal Reserve, the Bank of France and the monetary authorities of the defeated powers (although crucially not those whole nations), into the project. The ensuing appropriation facilitated a precipitate return to gold for London, and other short-term gains. However, the foundations of the system were laid over suppressed

[486] Péteri, 1992, 235.
[487] Temin, 1989; and Eichengreen, 1992.
[488] For instance, Milton Friedman and Anna Schwartz argue that the determinative cause of the Great Depression and the collapse of the international economic order was the Federal Reserve System's "great contraction" of money in the late 1920s and the early 1930s (Friedman and Schwartz, 1963; see also, Bernanke 2000).
[489] Kindleberger, 1963.

disagreements about its object and purpose, and major inequalities in terms of how its costs and benefits would be distributed.

The cover of 'financial' diplomacy could not mask the contested nature of the British plans. As the 1920s progressed, it became clearer that Britain had a domestic interest in arresting deflation, which motivated its international effort to stabilise prices and to extend the position of sterling in the international monetary order. As the chief architect of those plans at the British Treasury, Sir Otto Niemeyer, wryly noted with reference to the political controversies: "In a sense politics come into all reconstruction, as I believe the central banks [have] also found in their independent reconstructions."[490] In this context, the bonds and relations that were fostered by appropriation were always vulnerable to political revision. Indeed, while valuing their new powers and autonomy, European monetary authorities were uncomfortable with their subordinate status. After all, when they had signed up to the stabilisation schemes, most had possessed few options other than "to throw both arms around the League of Nations [and] refuse to be torn from it."[491] The resistance to appropriation extended also to the Entente, as evidenced by President Hoover's criticism of Benjamin Strong as "a mental annex to Europe."[492]

Little by little, this resistance began to limit the options for further appropriation and the extension of the gold exchange standard. The League was sidelined and the position of sterling in the stabilisation process was diluted. The Dawes Plan, in 1924, represented the starting point of this resistance, as the Americans refused to cede Germany to sterling. However, as can be expected of a deal made in a closed bargaining forum, the competition between sterling and the dollar was covered over by technocratic fixes and instrumental concessions, which could not unify the competing interests. The same logics of maladaptation through appropriation carried into other issues with consequences for the balance of power between members of the system: most notably, reparations and war debts. The result of the fixes was that the targets of stabilisation were caught in a web of administrative controls, dependent on foreign credit and support, and unable to respond to domestic needs.

As would later be the case with the gold-dollar and EMS orders, administrative controls and information distortions sustained the system in spite of maladaptation and resistance, at least for a time. Indeed, in the mid-1920s, the reconstruction effort looked to have been a success, but there were elements of self-deception in this. A deep commitment to the status quo, which had been engendered around the bureaucratic core of the system, meant it took longer than it might otherwise have done for weaknesses to be acknowledged. Meanwhile, the political cleavages in the system, which could be traced all the way back to the post-war monetary conferences, were forever widening. The final British effort to force

[490] The memorandum records that Benjamin Strong knowingly smiled in response (Niemeyer, "League Relations with US", (handwritten note), 28 February 1928, OV9/331).
[491] Norman to Spencer Smith, 7 December 1922, BOE OV28/53.
[492] Meltzer, 2003, 193.

an extension of the gold exchange standard using the League's Gold Delegation ended in humiliating defeat. When the crisis in the international monetary order came to a head in 1931, it was clear that the game was up. The structure, which had long been precarious, collapsed when the British realised no more gains could be extracted from it. Faced with the full cost of staying on gold without the prospect of international props and supportive devices, British policy changed. Like the gold-dollar system, the gold exchange standard collapsed when its founder and leader abandoned it.

5

The Decline of the Sterling Area

Sir Herbert Williams, British parliamentarian and imperialist, lamented in 1952: "Today, the Sterling Area is like some shipwrecked people on a raft at the mercy of the wind and the stormy seas. We have no control over our own destinies."[493] This chapter offers an explanation as to why, quite remarkably given this apparent absence of British control, a quarter century would pass before the Sterling Area system finally disappeared. It provides a test case for this study's explanatory conjecture, that spontaneous monetary orders establish the conditions for prolonged processes of monetary disintegration. The chapter shows how exclusory leadership was induced by the structure of the Sterling Area, with its disorganised and unassociated membership, and by the fact that the Area had an economic (as opposed to political) historical foundation. When solving problems in the Sterling Area, the British Treasury and Bank of England preserved a monopoly over policymaking, discriminated between members, and withheld information. The British held onto gains and deferred losses by exploiting the strategic advantages of leadership like this, but the costs of retaining the initiative were policy restraint and, sometimes, inaction. If these logics of exclusory leadership were imperfectly understood inside the Treasury and Bank of England, they were bewildering to outsiders used to seeing Britain cracking the whip over the Commonwealth. Nevertheless, the exclusory policy approach maximised utility for the British. It also gave members, who were otherwise bent on severing the economic ties of imperialism, good reason to refrain from assertively challenging Britain's vital monetary interests (although some opted for, and gained from, surreptitious defection). Still, these strategic advantages and sources of the system's strength had a price. In important policy areas, like exchange controls and reserve pooling, institutional sclerosis set in and defection went unpenalised. Thus, while exclusory tactics were optimal for the British at each policy juncture, they subjected the system to maladaptation, causing it to slowly bleed out.

The case study begins by observing the low initiation costs of the Sterling Area. The system was unplanned; it emerged spontaneously in the early 1930s as a remnant of Britain's nineteenth century economic dominance, when the inter-war gold exchange standard collapsed. The absence of a designer and sense of voluntarism that came with these spontaneous origins would be important background factors later. However, they were barely considered when, at its peak in the mid-1930s, the monetary order included almost all of the British Commonwealth, and independent countries stretching from the Far East to Latin America.[494] The members of the system seemed naturally united in their dependence on British markets, the use of sterling as a reserve currency, the conduct of their external trade in sterling

[493] Sterling Area (Closer Cooperation), HC Deb, 22 February 1952, vol. 496 cc567-665.
[494] Canada was the notable Commonwealth exception from the Sterling Area.

(at least formally without exchange restrictions), and the use of London as their common banking centre. However, they did not participate in the system's management. There was no collective institutionalised bargaining. Instead, all effective policymaking occurred inside the British Treasury and Bank of England, which exerted influence via informal and bilateral intergovernmental and central bank relations with the Rest of the Sterling Area (RSA), and long-established connections with private associations in London's international credit markets.[495]

The Sterling Area was a major asset to its leader. The gold and dollars Britain received under the Sterling Area's mechanisms were much more valuable than the sterling paid back to the RSA. In addition to enabling Britain to command resources and borrow cheaply, the Sterling Area helped carry the pound through numerous crises threatening its stability and convertibility. The system offered a means for the UK to cheaply offset its deficit with the outside world and bolster its reserves through the pooled RSA dollar earnings. However, after 1945, the Sterling Area began to unravel. Officials had to handle a series of crises, including the convertibility fiasco of 1947, devaluation in 1949, the post-war dollar shortage, the return to convertibility in 1958, the sterling squalls leading to a second devaluation in 1967, and the collapse of the gold-dollar system. They also confronted radical transformations in the RSA connected with member nations' newly won political independence, and movements sworn to destroying the vestiges of imperialism. This unstable context makes the slow decline of the Sterling Area remarkable. This study offers a powerful new explanation why the crises and stresses did not "burst the system asunder."[496]

The British authorities managed the Sterling Area by manoeuvring to avoid collective bargaining with members. Leslie Rowan at the British Treasury, writing in 1954, captured the essence of the distributional conflict between the UK and the RSA: "What is at stake here is that in future the reserve policy, and therefore sterling, [might] not be run by the UK but [instead] by some sort of Sterling Area body."[497] George Bolton, at the Bank of England, noted that "the establishment of such a committee would, I think, be very unwelcome to us and we should, I believe, be prepared to sacrifice much to avoid agreeing to it."[498] In order to retain the advantages of exclusive control, in contrast to the leaderships of the gold exchange standard and the gold-dollar system, the UK authorities avoided appropriative devices and much policy activism. They opted instead for discrete forms of influence and strategic discrimination, especially between the independent and dependent members of the RSA. The lower initiation costs, and monetary officials' lesser needs for control over spontaneous orders (relative to negotiated ones), helped them to pursue strategies. The Treasury acknowledged the invaluable power

[495] The RSA comprises the Commonwealth and independent Sterling Area nations.
[496] Bank of England, "Sterling Area Official Talks", 8 January 1952, BOE OV 44/50; Butt to Downie, "Sterling Area", 17 November 1956, PRO T236/4304. This was a constant fear of officials from the 1950s onwards.
[497] Rowan, "Problems Facing the Sterling Area and System", 3 November 1955, BOE OV44/30.
[498] Bolton, 'Comments on Sir Leslie Rowan's Memorandum, 'Problems Facing the Sterling Area and System", 19 November 1955, BOE OV44/30.

to price discriminate, noting that the British, Australians and New Zealanders "[had] been 'bailed out' by some other parts of the Sterling Area, primarily Middle East oil states and in some cases the Colonies."[499] Withholding private information on the bilateral relations that comprised the Sterling Area was crucial to this agenda.

In accordance with this study's explanatory framework, Britain's monopoly over policy making consistently yielded short-term distributional gains and deferred losses, but the price was growing dysfunction and non-compliance from members. Over the long-term Britain paid "a higher and higher price – political, commercial and economic – for the continued existence of the Commonwealth club."[500] The British authorities were fully aware by the mid-1950s that "if the United Kingdom is to maintain her position as the leader and financial centre of the Sterling Area she must be ready to meet this additional strain."[501] However, in the years following, the UK continued to avoid these adjustment costs through exclusory behaviour. As a result, the UK was forced to seek external insurance for its liabilities rather than update practices, to tolerate departures from agreed practices, and to give powerful members of the RSA much of what they demanded in secret side-deals. This leadership modality was maladaptive in the long-term, but gave the RSA an incentive to help conserve the strength of British leadership. The muted prospect of a collective attack by the members protected the status quo. However, participants still stood to gain by edging out of the order through trade and monetary diversification. Little by little, defection drained the lifeblood of the system. Eventually, when emptied of its residual common interest and purpose, the Sterling Area disappeared. Today it is usually only mentioned as a footnote to the history of the world's move to the gold-dollar regime.

This chapter counters the longstanding claim, most systematically defended by Catherine Schenk, that the Sterling Area's longevity was the product of international support.[502] Certainly, US and later European finance helped support the pound in the 1960s, because sterling's weakness was a liability to the international monetary system. However, only the Sterling Area's internal constitution can explain how and why the system produced the necessary endogenous conditions for slow decline. The argument also discredits the widely held belief that the system was irrationally prolonged in response to a Commonwealth myth or *amour-propre*.[503] British policy was not attributable to delusions of grandeur or irrational imperialist habits. Of course, bounded rationality and opportunism meant things were far from efficient, but Sterling Area policy was always geared towards British power and interests. Indeed, policymakers were pretty modest; the Bank of England and Treasury were eager to "kill the mystical idea that these uses of sterling [as international reserve and trading currency] carry with them *great*

[499] Kahn, ""Bailing Out" the Sterling Area", 19 November 1955, PRO T236/3998.
[500] Strange, 1971, 321.
[501] Rickett, "Note by the Chairman, Report of the Sterling Area Working Party", October/November 1956, PRO T236/4303.
[502] Schenk, 2010.
[503] Shonfield, 1958; and Strange, 1971.

economic and political advantages for this country."[504] Nevertheless, until at least 1967, the Sterling Area enabled its leader and members to prosper more than they would have without it. When this calculation began to shift, British officials were keenly aware of the implications. Equally, the RSA did not assist the UK out of misguided loyalty, nor does the suspicion of colonial exploitation hold the key to the story of the Sterling Area's survival.[505] There is some truth to the claim that the colonies were forced to pay a higher membership price than independent RSA members. However, in general, the RSA had good reason to stay with the declining leader. Simultaneously, the RSA limited its exposure to the decaying core, knowingly undermining the system in the process. Neither loyalty nor coercion drove much of what members did.

The chapter has five main sections. Section 1 describes the origins and structural underpinnings of the Sterling Area. Section 2 elaborates on why the UK did not arrest the subtle beginnings of decline in the 1950s. Section 3 reviews the 1960s, paying attention to how Britain handled defections and the possibility of winding up the system. Section 4 completes the history with the Sterling Agreements made between 1968 and 1974. The final section summarises and concludes.

1. The Historical Foundations and Organisational Structure of the Sterling Area

This section introduces how the patterns and materials of the Sterling Area evolved and changed from its emergence in the 1930s to the restoration of peacetime parameters in the 1950s. Unlike after World War II, in the 1930s the sterling bloc was led by a powerful creditor state with sterling fully convertible into other currencies and gold. Moreover, before 1939, unlike afterwards, exchange reserves were not consciously pooled, and there were no common external exchange controls. However, the system's economic (rather than political) basis, and its organisational structure of relations characterised by an unassociated membership, remained constant. In accordance with this study's thesis, these legacies of the system's founding period were important to the operation and performance of the Sterling Area.[506]

The Sterling Area had no single moment of creation, and most members did not consciously decide to join. The system grew out of British economic hegemony established in the nineteenth century, and its emergence was usually attributed to custom and convenience. The sale of British goods to the world, and the export of capital from London, had fuelled the pound's internationalisation. By the twentieth century, sterling was the world's leading trading and reserve currency.[507] These forces were largely indifferent to international geography. However, some nations, especially ones in the Empire, but also

[504] Clarke, "S.W.A.P.", 23 May 1956, PRO T236/4304 (*emphasis* added).
[505] Lord Balogh typified the former opinion when he referred in the 1950s to "emotional relationships, which are more stable than some economists seem to give credit [in building the] solid basis of mutual interest" that held the Sterling Area together (quoted in Kirby, 1981, 120). The argument of Cain and Hopkins (1993) that Britain replaced political imperialism for economic and financial control has at least some basis in fact.
[506] The differences between the Sterling Area before and after the War are elaborated in a range of places (see Bareau, 1949a; Crick 1949a; and, 1949b and baruea 1949; and Perkins, 1956)
[507] Lindert, 1969.

certain independent countries, came into especially close monetary relations with Britain. For them, Britain was the principal export and import market, and sterling the common currency of trade.[508] Imperialism also sheltered the private financial and banking infrastructure of the sterling system, linking the banks and acceptance houses of the City to the imperial exchange and clearing banks in the dominions. The export earnings of the Empire were realised in sterling and then sold to the London-based exchange banks, and, if another currency was involved, the banking network would convert the exchange earnings into pounds as its common source of liquidity.[509] This made London the leading location for raising capital via private and government issues.

All monetary and financial roads led to London. In the 1920s, "the Sterling Area, in essentials, was already in existence [although it] operated without a name and for the most part without any attention from within or without."[510] Britain's departure from the gold-standard in September 1931 "brought out the true nature of the Sterling Area."[511] It shifted from being part of a worldwide system of monetary relations to a distinguishable entity. The suspension of gold convertibility meant sterling came to stand behind this group of countries which, given their pre-existing monetary dependence, were driven to peg their currencies to the pound and to maintain their existing external reserves in sterling. The result was an association of states led by Britain in which sterling would remain freely convertible and exchange rates stable. The negotiation of the Imperial Preference in Ottawa in 1932 provided the trading dimension behind this monetary association, although the two systems were different in membership and administration.[512]

Though the building blocks had been in place for a long time, Britain took an administrative hand at this pivotal moment.[513] The Treasury acknowledged the value in making it "easy for as many as possible of the unstable currencies to base themselves on sterling so that we may become leaders of a sterling bloc which, pending our stabilization on gold, would have the best opportunities for mutual trade and would give sterling a new force in the world."[514] Moreover, the Bank of England accelerated its effort to establish a network of central banks across the Commonwealth.[515] Sir Josiah Stamp explained: "The Dominions on a sterling exchange standard are critically interested in the fortunes of sterling and must

[508] In the case of the colonies, currencies were statutorily backed versions of the pound. The history of the British colonial currency system is told in several places (see especially Clawson, 1944).
[509] Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[510] Crick, 1949a, 2.
[511] Clay, 1949, 213.
[512] UK Treasury Memorandum (quoted in Drummond, 1981, 81; also see, Cain and Hopkins, 1993).
[513] Keynes drew up a memorandum which envisaged most of the basic parameters of the area in 1931 (Keynes, Memorandum, 16 November 1931, PRO CAB 58/169, EAC (S1) (31)).
[514] Drummond, 1981, 10.
[515] Central banking, already present in Australia and South Africa, came to New Zealand, Canada and India under this momentum (Plumptre, 1940, 191-192).

join with Britain as custodians of the validity of sterling values especially if, as trade relations make most probable, the chief external reserves are in sterling."[516]

However, proposals to create a collective administrative architecture for the system were shunned. The reason, as this study's explanatory framework would predict for a system with foundations set mainly by economic actors, was that the monetary authorities' administrative capacity was limited by their late arrival.[517] The Bank of England argued that the sterling group "ought not to mean a group of currencies who are "pegged" on sterling since the level of sterling can only be imperfectly controlled and cannot be guaranteed."[518] This was because enormous sterling balances were held by private foreigners, meaning the Exchange Equalisation Account (EEA) could not be confident of stabilising exchanges given its resources at the time. Moreover, the status quo gave rise to a policy monopoly, whereby the UK could manage the pound with maximum discretion and autonomy. The value of sterling and the sterling bill's place as an international medium of exchange would remain in British hands. The key administrative resource was control over the licensing of foreign issues in London through the Capital Issues Committee (CIC). The capital outflows were calibrated to maintain stable exchange rates between members, and rates were allowed to adjust periodically. The CIC almost entirely confined new capital issues to imperial borrowers in the 1930s to ensure this.[519]

The sterling bloc therefore remained a loose association in the 1930s: its appeal deriving not from collective control and institutionalised cooperation, but from the pound's relative utility.[520] The glue was sterling's convertibility. An Australian government economist explained: "Up to the outbreak of the war, almost every country with whom we traded was prepared to accept payment in sterling and, partly for this reason, we were prepared to receive payment in sterling. The currencies of countries which were not prepared to accept sterling could in all cases be bought with sterling."[521] The Second World War suspended these conditions, causing some independent countries to leave the system and radically changing things for those that remained.

A new basis was created for the Sterling Area by the decision taken on 3 September 1939 to ban payments of foreign exchange or gold to non-residents of Britain, other than with Treasury approval, unless their countries of residence agreed to keep their exchange reserves in sterling and impose common exchange controls with the UK. The countries that entered into such agreements were defined as the 'Scheduled Territories' and included the Commonwealth (except for Canada), the Colonies, Burma, Iceland, Ireland, Iraq, Jordan, Libya and the Persian Gulf Territories. This established a monetary system in which exchange rates were pegged, a common exchange control was set up with

[516] Stamp, 1934, 21-22.
[517] Drummond, 1981.
[518] Bank of England, "The Sterling Group", 21 December 1931, BOE OV9/246.
[519] Stewart, 1937, 190.
[520] Aldcroft, 2000; and Drummond, 1981.
[521] Nimmo, 1949, 2.

outside countries, free current and capital account relations with the UK were created, and a collective pool of sterling foreign exchange reserves was accumulated.

The other key effect of the war upon the Sterling Area was to invert the pattern of credit between the UK and substantial parts of the RSA. The 'abnormal' sterling balances – wartime sterling IOUs – issued by the UK to the RSA to support the war effort meant many nations became net creditors to the UK. Catherine Schenk has shown that the wartime accumulations were short-lived. They were reduced in the early 1950s through a series of bilateral and short-term deals, sterling's 1949 devaluation, and Korean War inflation.[522] By the mid-1950s, the RSA sterling balances "more closely reflected a combination of ordinary foreign exchange reserves among the independent holders and the colonial monetary system for the rest of the Sterling Area."[523] Schenk's analysis also shows how the balances shifted geographically. Middle East and colonial shares increased while India and other South-East Asian countries reduced theirs. However, in this formidable dissection of RSA sterling balances, Schenk somewhat obscures the two wartime changes that mattered most.

First, RSA sterling balances remained three to four times the size of the UK's owned reserves.[524] The UK was less solvent and the pound less liquid after the conflict. Flight could occur from this sterling overhang with disturbing effects on reserves and stability. Indebtedness also created political tensions within the Commonwealth. Moreover, the UK was no longer on a floating rate, so although the UK retained an ultimate say over the rate at which the RSA sterling balances were redeemed, it had less day-to-day flexibility. In other words, the RSA sterling balances provided a greater constraint, both real and psychological, on the British authorities' operational freedom. Therefore most policymakers at the time believed there was "good reason to worry about the future of the sterling balances", Schenk's retrospective assessment notwithstanding.[525] Second, Schenk insufficiently emphasises how the RSA sterling balances' distribution mattered in terms of who bore the weight of the Sterling Area, especially as they represented the collective reserves of the entire membership. To understand the distributional dimensions of the post-war RSA sterling balances, we must review what the basic logic of the Sterling Area system was believed to be, when it emerged in 1945.

A simple description of the mechanism underpinning the Sterling Area is that the UK acted as the banker for the RSA. Members pooled their foreign exchange earnings by selling these to the Bank of England in return for sterling assets. They could then call on the collective reserve pool to meet their

[522] Schenk, 1994, 17-27. The eventual agreement of a longer term deal on India's balances in 1952 played a major role in stabilising the issue (on the Indo-British sterling balance negotiations between 1947 and 1949 see Tomlinson, 1985; and on the balances and colonial policy more generally see Hinds, 1987; and, 1991; and Morgan, 1980).
[523] Schenk, 1994, 17.
[524] Treasury, "Historical Memorandum No. 16: Sterling Balances since the War", PRO T267/29.
[525] Treasury/Bank Working Part of the Sterling Area, "Note of a Meeting Held at Treasury Chambers Great George Street, S.W.1.", 10 May 1951, BOE OV44/33.

foreign exchange needs and individually draw on their sterling balances as required. The reserve pool acted as a form of collective insurance, where some countries contributed to the pool while others drew from it, thereby allowing the total amount of the reserves to be lower than if countries had to retain independent reserves. The value of the balances held in London to the RSA countries depended upon the stability of the pound, the scope for free deployment, and the rate of interest payable.

The RSA sterling balances, as its international reserves, were largely by its balance of payments position in relation to the UK and outside world. The theoretical aim was to ensure the UK ran a surplus with the RSA to offset a deficit with the rest of the world, while the RSA would run a surplus with the rest of the world to offset a deficit with the UK. Where the RSA surplus with the rest of the world was insufficient to cover the deficit with the UK, the RSA would draw on its sterling balances and reduce the UK's external liabilities. In this way, part of the UK surplus would increase reserves and part would reduce the RSA sterling balances. When the RSA was in balance, the UK surplus would go entirely into increasing the reserves, and the balances would not change. The RSA sterling balances would increase when the RSA's overall surplus more than covered its deficit with the UK, because the remaining foreign exchange earnings were deposited in London.

It follows that, provided the UK retained a surplus with the RSA, increases in the RSA sterling balances should be due to the RSA surplus with the dollar area and matched by increases in central gold and dollar reserves. In this ideal model, the RSA sterling balances had a positive (or neutral) effect on the strength of the pound. Indeed, the Treasury sometimes argued that the RSA sterling balances should not concern British policymakers, because it was the UK's own balance of payments position that mattered.[526] The case for the Sterling Area seemed compelling. The system carried negligible costs and reaped seigniorage gains to its reserve centre by covering payments deficits with member countries with secure credit in RSA sterling balances, by delivering gold and dollars that helped bolster reserves and cover dollar deficits, by assisting the UK's current position through the establishment of secure export markets and a large source of invisible earnings, and lastly, by providing international prestige and bargaining power.

However, these potential advantages notwithstanding, there were also disadvantages. In practice, the RSA sterling balances could act as a constraint on improving the position of sterling, particularly once sterling was impaired and non-RSA sterling holders were intent on getting out of the currency. In this situation, even a healthy current account surplus was inadequate to secure improvements in the UK's external position. This was because the UK's surplus would often be taken up by overseas investment in the RSA, which would frustrate the potential to reduce the RSA sterling balances, while the drawing down of the RSA sterling balances would frustrate the increases in reserves that might be expected from

[526] Treasury, "Floors and Ceilings to Sterling Balances: Comments on Mr. Goldman's Paper by the Economic Section", 3 May 1951, PRO T236/2913

the surplus. Once problems started to develop, increases in the RSA sterling balances were difficult for the UK to stomach, even if reserves floated up with them, because they made the balance of payments numbers look bad and represented deeper indebtedness, while decreases in the RSA sterling balances made the reserve numbers weaken, with the potential to induce panic, even though they helped bring external liabilities down.[527]

The UK was therefore stuck in a precarious position from which it could only independently escape by earning an external surplus large enough to cover its overseas investments and/or any reduction in the RSA sterling balances.[528] The other way out was to orchestrate the RSA's behaviour in terms of their use of the sterling balances and/or to adjust their external position with the dollar area. The compensatory benefits for any such limitation on freedom of individual action for members of the RSA were variously identified as the ability to draw on a larger pool of gold and foreign exchange than they might have individually, the privilege of free exchange within the area, and the right to access London's capital market on preferential terms.[529] This background contextualises the distributional conflict over the terms of Sterling Area continuity after the Second World War. In short, the more the UK was able to lean on the RSA when problems emerged, the less strain it would have to take itself.

The UK's incentive to influence behaviour across the RSA had therefore increased through the War and the post-War dollar shortage. The UK and RSA orientated their dollar import programmes after 1947 to preserve the strength of the central reserves. The aim was to allow dollar imports only when the central reserves' level made this possible. The import controls were agreed at a series of Colonial conferences and implemented on a decentralised basis in consultation with the Bank of England.[530] The spirit of cooperation embodied in these controls led to the establishment of certain 'club-like' characteristics in the system.[531] However, the consultations were not intended to produce standardised policies, but to conduct intermittent reviews and specify general objectives. Even at this political high watermark, there was no regular committee of the governments in the Sterling Area, and no collective bargaining. The Treasury put it thus: "The Commonwealth meets to discuss matters, but responsibility for the conduct of sterling remains the responsibility of the UK government; Commonwealth discussions never assume the character of a board of management for sterling."[532]

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[527] Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[528] Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[529] Perkins, 1956, 36-58.
[530] Perkins, 1956, 11.
[531] Two new London based standing committees were established to improve the exchange of information: the Sterling Area Statistical Committee and the Commonwealth Liaison Committee. However, these committees met only to exchange balance of payments data and played no role in developing common policies.
[532] Boothroyd, "E.E.C. Questionnaire on the Sterling Area", 28 December 1961, PRO T312/213.

The present analysis emphasises the crucial element of continuity in the Sterling Area: the British monopoly on policy. The Sterling Area was always without a constitution, a united policy plan, regular institutionalised bargaining, or any collectively managed administrative machinery. This extended to all areas of policy, including exchange controls where coordination was greatest. As the Bank of England put it, the idea "that the Sterling Area does in fact operate common external policies is something of a polite fiction."[533] Equally, the independent RSA members retained almost total *de jure* freedom in overseas financial policies, and the dependent territories were also largely free of binding or formalised commitments. The RSA also never acted concertedly to press its goals vis-à-vis the UK. The system thus retained the basic structural characteristic of a spontaneous order: the UK made separate take-it-or-leave-it policy offers to the members of the RSA. This, coupled with the economic base of the system, would crucially impact how policy problems were handled.

2. The Beginnings of Decline in the 1950s

The UK Chancellor of the Exchequer avowed in 1952: "If, as I believe, the Sterling Area must go on and if, in present circumstances we need a tighter rather than a looser control over dollar expenditure, if we must have a swifter reaction to external changes, then I think we must face the fact that the muddle-through, muddle-along, no constitution system that we have had in the past must come up for review."[534] However, the Sterling Area moved the opposite way, "back to the concept of a 'banking group' of earlier years and away from the concept of a 'club'."[535] Slippages were widespread: the RSA sterling balances problem found no clear resolution; the gold and dollar holdings of several key countries increased; the network of exchange controls sprung leaks; the limits on dollar imports were diluted; the commitment to greater coordination dissipated; and the prospect of adding new members was abandoned.[536] This study's theoretical framework explains why the UK's monetary authorities reacted to the forces of disintegration not through a tightening, but rather though a relaxation of the ties binding the system.

The starting point for the British discussion of the future of the Sterling Area in the 1950s was an internal review conducted by the Treasury and Bank of England.[537] While acknowledging certain costs,

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[533] Bolton, "Comments on Sir Leslie Rowan's Memorandum, 'Problems Facing the Sterling Area and System'", 19 November 1955, BOE OV44/30.

[534] Gaitskell, 1952, 176. 19 November 1955, BOE OV44/30. 49 Gaitskell, 1952, 176. This determination to keep the Sterling Area going through greater formalisation also had widespread public support. Indeed, economic experts from across the diverse regions of the Sterling Area felt the system should be continued (see Crick 1949a; Bareau, 1949b; Clauson, 1949; Baxter, 1949; and Hutt, 1949).

[535] Treasury/Bank Working Part on the Sterling Area, "The Future of the Sterling Area", February 1950, PRO T236/2640.

[536] The hope of adding new members was still present in 1950 (Treasury/Bank Working Party on the Sterling Area, "The Future of the Sterling Area", February 1950, PRO T236/2640). However, it had been abandoned a few years later (see Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304).

[537] Treasury/Bank Working Party on the Sterling Area, "The Future of the Sterling Area", February 1950, PRO T236/2640.

the report concluded that the Sterling Area remained an asset to its leader. Nevertheless, it was felt that remedial action was needed to build the system's strength.[538] This section follows how the Treasury and Bank of England set out to retain "the essential features of the sterling system and of the Sterling Area" while dealing with the RSA sterling balances and diversification issues that arose in the 1950s.[539] It elaborates on how policymakers preserved the most valuable element of the status quo – the UK's policy monopoly – and the distributional gains this monopoly afforded. The defects of this exclusory line of policy, in turn, account for the slippages noted above.

a. Performance Problems and Exclusory Leadership Responses

According to this study's explanatory framework, the leaders of spontaneous orders, when facing performance problems and distributional conflicts with members, are incentivised to minimise the probability of collective resistance. The low initiation costs in spontaneous orders, and the limited needs that monetary authorities have for control over such orders, are factors that allow policymakers to withhold policies. The British management of the sterling balances problem in the 1950s offers an example of such exclusory calculations. Given the mechanisms of the Sterling Area after 1945, running down RSA sterling balances hampered improvements in the UK's balance of payments position, whereas increasing RSA sterling balances worsened the ratio of assets to liabilities, jeopardising confidence in the exchange, which would strain the ability of the British authorities to improve the position of sterling once it was deemed impaired, even if they were running a payments surplus. The period between 1950 and 1956 revealed this weakness to policymakers. The RSA sterling balances increased rapidly. Yet, as Table 5.1 summarises, the lack of confidence in the pound contributed to a rundown of the sterling balances held by the world outside the sterling area. As such, although British liabilities fell, British reserves also fell by £77 million, despite a payments surplus in this same period of over £500 million.[540]

[538] The British authorities set out "to develop and improve the system of Sterling Area co-operation and the sense of common responsibility for safeguarding and building up the central and hard currency reserves" (Treasury/Bank Working Party on the Sterling Area, 'The Future of the Sterling Area', February 1950, PRO T236/2640; also see, Treasury/Bank Working Party on the Sterling Area, 'The Future of the Sterling Area', February 1950, PRO T236/2640).
[539] Rowan, "Problems Facing the Sterling Area and System", 3 November 1955, BOE OV44/30.
[540] Treasury/Bank Working Party on the Sterling Area, "S.A.W.P. Report: Bank Version No.2", 22 May 1956, PRO T236/2640, Chart and Table, 10-12.

Table 5.1. Change in UK Reserves and External Liabilities between 1951 and 1955

		End 1951	End 1955	Change
Reserves	Gold and dollar holdings	834	757	- 77
	Other holdings	14	13	-1
	Total	848	770	-78
Liabilities	RSA(a)	2791	1972	181
	Non-sterling countries(b)	1018	770	-248
	External org. (c)	566	469	-97
	EPU debt(d)	166	121	-45
	Total (a,b,c,d)	4541	4332	
Net liabilities all kinds		3693	3562	-131
Assets as a percentage of liabilities		23	21.5	

Source: Treasury/Bank, "Working Party on the Description of the Sterling Area", BE OV44/32.

However, despite the RSA sterling balances being a near constant source of instability, the British never developed a concerted plan to deal with the problem, nor did they sit down with their creditors in the Sterling Area to negotiate. They came closest to imposing collective discipline on the RSA sterling balances when some in the Treasury put forward the idea of a "floors and ceilings plan".[541] This would have limited the extent to which RSA sterling balances could rise and fall, moderating their impact on the UK's balance of payments and reserves position. However, the British shelved the proposal without offering it to the RSA. Therefore no collective machinery was ever introduced to control the accrual and disbursal of the RSA sterling balances. Instead, the UK established bilateral agreements with major independent sterling balance holders. The reason for this withholding of policy, and preference for bilateral deals, is explained by this study's theoretical framework.

The UK feared the RSA would demand a voice in the operation of any such mechanism. The pressure to share control was considered almost inevitable, if countries were not allowed to make independent domestically determined choices about their reserves and spending.[542] The UK also feared a costly share-out from any initial bargaining. The moves in the RSA sterling balances were sometimes complementary and sometimes came at the expense of the UK balance of payments or reserve requirements. Yet consistently the level of the RSA sterling balances was more important to London than to the RSA. Therefore the Bank of England had reservations about the floors and ceilings plan, not just because the RSA would probably want a say in its operation, but also because agreeing and maintaining the 'floor' and 'ceiling' was expected to impose a large burden in terms of guaranteed

[541] Snelling, "Schemes for Retarding the Increases in Sterling Balances", 29 January 1953, PRO T236/2913.
[542] Indeed, the Treasury felt the mere suggestion of limits "might arouse their worst suspicions and weaken that confidence in the United Kingdom's good faith on which the present Sterling Area system must rest" (Treasury, "Floors and Ceilings to Sterling Balances: Comments on Mr. Goldman's Paper by the Economic Section", 3 May 1951, PRO T236/2913).

reserves, and it might have taken even more pressure off members to make internal adjustments.[543] The upshot was that the RSA sterling balances grew, fell, and changed hands without London having much control over these developments. This hands-off response to a policy problem contrasts strikingly with the activism of monetary authorities in negotiated systems, emphasising the impact of lower initiation costs and monetary authorities' lesser needs for control in spontaneous orders.

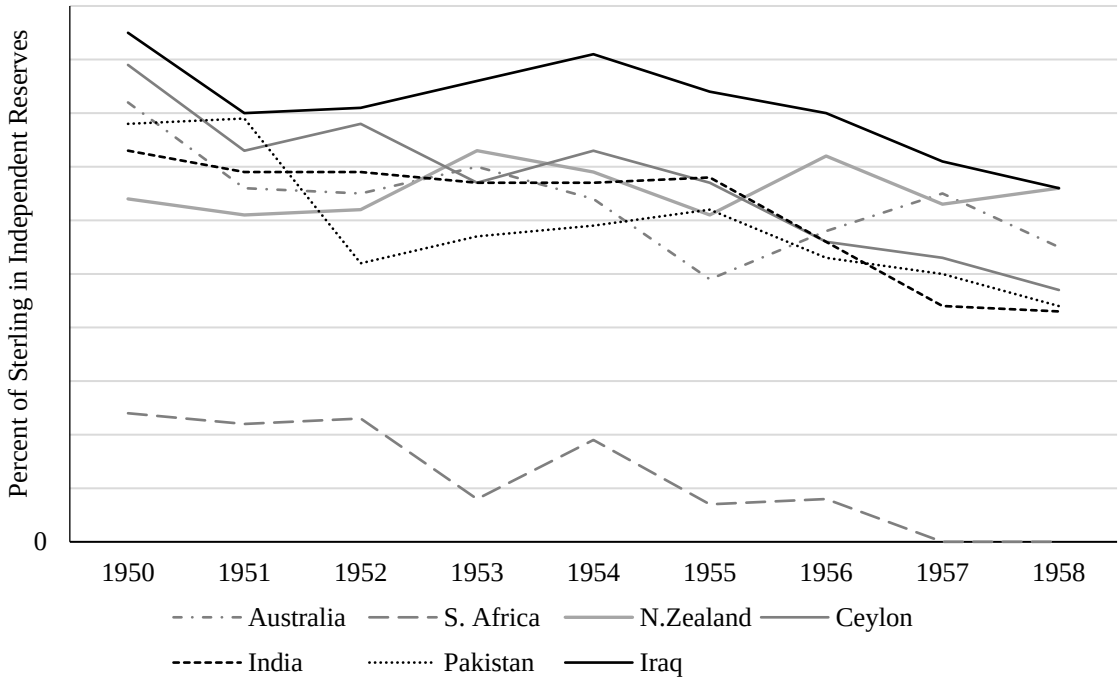
The process of reserve diversification (the RSA retaining and reinforcing their own gold and dollar earnings), was connected with anxieties over the security and value of the RSA sterling balances. Taking control of diversification was vital to increasing confidence in the pound, because it signalled a lack of faith in the UK reserves. In the short-term, diversification could trigger a run on the pound. In the long-run, it would dissolve the system. While there was no easy answer, the Bank of England noted that "if a solution is found [to diversification] most of the other Sterling Area problems fall away."[544] On the other hand, "any sharp acceleration in the growth of the [RSA independent] reserves, whether secured by the retention of gold and dollars accruing directly to the Sterling Area, or by the conversion of existing balances, could have the gravest effects."[545] Yet British authorities lacked an incentive to arrest the diversification process.

This was partly because of the voluntarism in the historical foundations of the Sterling Area. Sir Dennis Rickett observed in 1956 that it "[is] not so much the result of a definite agreement that all dollar earnings shall be pooled in a central reserve, but [this] tends rather to come about by free choice, and because it is in the interests of the countries concerned. Similarly expulsion is a weapon of doubtful value. You can expel a member from a club, but a banker does not normally expel a customer simply because he no longer pays the whole of his income into his account. If they quarrel so badly that the account has to be closed, the banker may be in some difficulty if the account which he owes the customer is very high."[546] Moreover, there was a feeling among Sterling Area countries that it was legitimate to increase their independent reserves, not only because this had always been deemed a right of the system, but also on the grounds of economic efficiency, as new sources of economic security were sought in the aftermath of the 1949 devaluation.

By the mid-1950s, Britain had conceded to diversification in a series of bilateral talks. Figure 5.1 and Table 5.2 demonstrate how the independent gold and dollar reserves of the RSA grew as the percent of sterling held as reserves fell almost universally, although at variable rates and to different degrees.

[543] Fisher to Stone, "Working Party on the Sterling Area "Floors and Ceilings"", 31 May 1951, BOE OV44/50.
[544] Bank of England, 'U.K. and Sterling Area Policy', 30 September 1955, BOE OV44/32.
[545] Treasury/Bank Working Party on the Sterling Area, "The Future of the Sterling Area", February 1950, PRO T236/2640.
[546] Rickett, Note by the Chairman, "Report of the Sterling Area Working Party", October/November 1956 PRO T236/4303.

Figure 5.1. Sterling as Percentage of Independent Reserves among Selected Independent RSA Countries, 1950 to 1958



Source: Bank of England, 'Monthly Report on External Finance', BOE, EID3/97 -104

Table 5.2. Gold and Dollar Reserves of Selected Independent RSA Countries, 1950 to 1958

		1950	1951	1952	1953	1954	1955	1956	1957	1958
Australia	$	19	39	47	59	48	75	84	85	79
	Gold	88	112	112	117	138	144	107	126	162
S.Africa	$	44	7	24	38	33	53	53	38	30
	Gold	197	190	170	176	199	212	114	217	211
N.Zeand	$	3	5	3	2	2	2	2	2	2
	Gold	29	32	33	33	33	33	33	33	33
Ceylon	$	8	19	14	17	19	33	41	34	34
	Gold	-	-	-	-	-	-	-	-	-
India	$	56	62	65	99	87	73	76	82	77
	Gold	247	247	247	247	247	247	247	247	247
Pakistan	$	11	13	14	10	4	6	20	13	6
	Gold	-	27	27	38	38	48	49	49	49
Iraq	$	3	13	14	14	10	15	17	20	18
	Gold	-	-	-	-	-	8	14	20	34

Source: International Financial Statistics, International Monetary Fund, Washington, DC

Note: £ million.

The question as to what strategy should be adopted to limit reserve accumulations was first directly considered in 1955, when the Bank of England sought to enforce upon India an agreement established

in 1953 to reduce their dollar balances to working needs.[547] India pledged resistance. In the end, sensing the discrimination in the system, India reduced their dollar holdings on the condition that they would not be forced to discuss the issue bilaterally again. The Working Party on the Sterling Area then considered whether to initiate collective talks in 1956. The Working Party's decision was that Britain should not do so, because "there is little that this country could achieve in a general discussion of this difficult and delicate problem."[548] In the discussion papers informing the final report, officials reasoned that collective negotiations would result in a "costly share-out by the United Kingdom."[549] Therefore, it was argued, Britain would be better off exploiting the ad hoc opportunities for bilateral discussion in order to persuade the worst offenders to reduce their independent reserve holdings.[550] Pursuing an exclusory logic, Britain avoided collective bargaining.

Dealing instead with each country case by case, the Treasury and Bank of England set out to constrain RSA diversification, not without success.[551] This was particularly because the divided members of the Sterling Area withheld private information from each other about their own independent reserves. However, Britain's success was not universal. For instance, the Cabinet Office noted that "we and our predecessors have hammered away at Ceylonese Ministers [to desist from diversification] for many years without result."[552] This demonstrates the limits of private and informal bilateral agreements. The Treasury concluded in 1957 that "generally speaking, events […] afford rather striking evidence of the coherence of the Sterling Area at a time of acute strain."[553] However, the dominant strategy was really yielding gains at a cost to overall coherence, with some clear defections from common practices. These outcomes accord with the explanatory model put forward in this study.

A further problem arose through progressive trade diversification. Its rate in the 1950s should not be overstated. In 1958, the UK was still the largest export market for the RSA and largest source of imports for all but the Asian countries.[554] However, the British share in the RSA, and the RSA share of British markets, were both falling in relative terms. The policy choices of the early 1950s would decide whether this trend was to be arrested. The central policy issues were dollar import controls, and the preferential trading agreements dating back to the 1930s. The exclusory calculation among British officials in the realm of trade diversification reflected the one made about monetary diversification. They determined

[547] The following paragraph draws on Bank of England and Treasury notes (see, especially, Treasury/Bank, Note by the Secretaries, Working Party on the Sterling Area, Draft Report, 4 May 1956, BOE OV44/32).
[548] Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[549] Treasury/Bank, "Note by the Secretaries, Working Party on the Sterling Area, Draft Report", 4 May 1956, BOE OV44/34.
[550] Treasury/Bank, "Note by the Secretaries, Working Party on the Sterling Area, Draft Report", 4 May 1956, BOE OV44/34.
[551] Treasury, "Sterling Area Work Party Report", 16 January 1957, PRO T236/4034.
[552] R.B.C. to Prime Minister, "Ceylon Dollar Holdings", 3 May 1957, PRO PREM11/1738.
[553] Treasury, "Sterling Area Work Party Report", 16 January 1957, PRO T236/4034.
[554] Schenk, 1994, 55-59.

that pushing too hard would cause further "disintegrating forces … to appear."[555] It was therefore decided not to impose a dollar rationing system.

The key point is that Britain, confronting an unorganised membership, did better by not pushing against trade diversification, which would have risked a collective response. However, in the absence of a collective dollar rationing agreement, exchange controls continued to be managed through informal conversations between countries.[556] The inevitable consequence was the controls were diluted, even before Commonwealth members, in 1951, "resolutely set their future on the liberalisation of trade and payments."[557] The die was then cast when the Commonwealth backed the General Agreement on Tariffs and Trade **(**GATT) No New Preference rule (NNP).[558] The Commonwealth thereby forced the UK to hold the trade exit door open. These events show that it is particularly difficult to tighten constraints on the voluntarism that accompanies the low initiation costs of spontaneous systems. The members of the Sterling Area considered flexibility and freedom in choosing trading partners to be an established principal of the system. Already in the 1950s, such choice was eroding the trading relationships that underpinned the Sterling Area. As Table 5.3 shows, between 1953 and 1959 manufactured imports from the UK fell from 62.4 to 42.8 percent at the expense of US, European and Japanese competitors. Nevertheless, R.W.B. Clarke of the Dominions Office concluded that the Sterling Area could not be held together coercively, but only by positive inducements.[559]

Table 5.3. Percentage Share of the Sterling Area Market for Manufactures, 1953 to 1959

	UK		US		W Germany		Japan	
	1953	1959	1953	1959	1953	1959	1953	1959
RSA total	62.4	42.8	11.9	12.8	6.9	12.2	3.8	10.7
Australia	70.7	52.0	11.5	17.5	4.5	9.0	14.9	17.7
Ceylon	64.2	57.7	4.8	4.1	6.1	9.2	14.9	17.0
India	49.8	44.3	14.0	10.6	11.5	21.6	4.7	7.0
Malaysia	60.3	40.3	9.9	8.8	5.9	9.3	13.8	27.4
N. Zealand	84.5	72.2	5.9	9.2	1.9	4.8	0.2	3.1
Nigeria	70.0	61.4	2.0	2.4	10.0	9.4	6.1	16.6
Pakistan	43.2	35.9	10.2	17.0	11.2	18.8	8.1	10.8
South Africa	50.5	42.0	20.9	19.3	8.8	15.4	3.4	5.3
Iraq	52.6	42.8	13.3	13.0	6.7	16.3	11.0	11.5

Source: Wells, 1964, 17.

[555] Treasury/Bank Working Party on the Sterling Area, "The Future of the Sterling Area", February 1950, PRO T236/2640.
[556] Treasury to UK Commissioner in Pakistan, "Dollar Import Policy", 20 October 1950, 18 October 1950, PRO T236/2501.
[557] On how the dollar import controls established in 1947 were progressively weakened after 1949, see see Schenk, 2008, 277; Treasury/Bank Working Party on the Sterling Area, "The Future of the Sterling Area", February 1951, PRO T236/2640; and Shillito, "India Pakistan: Open General Licence Policy", 19 November 1950, PRO T236/2501.
[558] Treasury, Preparatory Meeting of Officials, "Commonwealth Economic Conference", 26 December 1952, PRO T236/3080.
[559] Clarke, "Report on External Economic Policy", 24 June 1952, PRO DO35/6488.

b. Foundational Economic Interests and Policy Drift

One theoretical tenet of this study is that leaders will be constrained in certain policy areas by the private sector interests forming the bedrock of spontaneous systems. Most symptomatic of this were the limits placed on British policymakers when dealing with capital outflows to the RSA. Well before Andrew Shonfield made his forceful critique that "the British economy is robbed of necessary nourishment, that its growth is stunted, as a result of this too vigorous pursuit of overseas investment,"[560] the idea that it might be necessary to reduce capital outflows in order to reinforce the UK reserve position was part of official thinking.[561] The best use of UK resources in the 1950s would have been realised through uniform rules on the export of capital to the non-dollar world, and the Bank of England concluded that "discrimination in capital exports probably represents a net cost to the U.K. of maintaining the Sterling Area system."[562] In the end, as Table 5.4 shows, British policymakers did almost nothing to limit outflows, which steadily increased, and they retained a discriminatory pattern vis-à-vis the rest of the world.

Table 5.4. Official Estimates of Net Long-term Capital Flows from the UK to the RSA and Rest of World, 1952 to 1959

	1950	1951	1952	1953	1954	1955	1956	1957	1958
Investment in RSA									
Public	13	14	11	11	21	19	10	15	34
Private	195	151	150	190	180	110	180	280	220
Total	208	165	161	201	201	129	190	295	254
Investment in rest of world									
Public	1	54	-2	20	-1	44	41	-87	15
Private	-115	-21	21	20	40	10	10	0	-10
Total	-114	33	19	40	39	54	51	-87	5

Source: UK Balance of Payments for 1946-1957, IMF Balance of Payments Year book, 1958

Note: £ million.

The reason for this, which accords with this study's explanatory framework, was that the Sterling Area emerged through an unplanned process of trade and financial integration, establishing a powerful sphere of autonomous private interests at the system's core. The most important of these were the discount houses and acceptance firms in the City who handled the sterling bill, and the British-based imperial exchange banks which monopolised the foreign exchange markets in the key Empire countries and handled investments in those countries. To slow capital outflows, policymakers would have needed to stand apart from these interests. The difficulty was not simply that any change would prompt "political outcry in the UK."[563] These private entities also penetrated the architecture of the Sterling Area. Within

[560] Shonfield, 1958, 107.
[561] Treasury/Bank Working Part on the Sterling Area, "The Future of the Sterling Area", February 1950, PRO T236/2640.
[562] Bank of England, Note, 4 November 1955, BOE OV44/30.
[563] Bolton, "Comments on Sir Leslie Rowan's Memorandum, 'Problems Facing the Sterling Area and System'", 19 November 1955, BOE OV44/30.

the UK, the Bank of England and Treasury had long-established relations with the private associations of the City including the London Discount Markets Association, the Accepting Houses Committee, and the Committee of London Clearing Banks. These associations provided special access to City interests and took a hand in the operational management of the Sterling Area. They connected the Bank of England and the CIC to the London markets and, in the RSA, were often directly involved in the Colonial Currency Boards.[564] The machinery of the City and the British colonial banking base therefore held the Sterling Area together, not just through the commercial value and relations of merchant banking, but also through the merchant bankers' political influence at home and overseas.[565]

These interests also meant that official policy was further constrained by political commitments to widen access to the London capital market at the 1952 and 1954 Commonwealth conferences.[566] The British were aware that capital outflows were increasingly crucial to keeping the RSA onside.[567] That is, British capital was the membership benefit of "greatest relative importance" to the RSA.[568] It was believed that with any reduction in the outflows there was "likely to be a gradual erosion of their loyalty to the Sterling Area."[569] Thus, rather than take on domestic interests, and for fear of undermining the basis of continued RSA membership, the UK overstretched itself through continuing capital outflows. As the National Institute of Economic Research observed, "it is inappropriate for a country with an extremely weak reserve position, substantial medium-term debts, and a current balance of payments deficit, to try to maintain a world role as a major provider of capital in unforeseeable and unlimited amounts."[570] Yet the UK was attempting precisely this.

c. Member Responses to Exclusory Leadership

The direct benefits of exclusory leadership manifest themselves through price discrimination and the avoidance of costly collective bargaining. This study's theoretical framework also highlights an ancillary benefit: the members of a system under exclusory leadership tend to exercise self-restraint, rather than resisting the leadership. As would be expected, British policy restraint and price discrimination lowered the probability of member resistance within the Sterling Area. This enabled the UK to permit the independent RSA members (and those approaching independence) greater discretion in managing their own policies than dependent or weaker members. Thus, in contrast with the negotiated inter-war and gold-dollar systems, the Sterling Area did not produce resistance. This was true even

[564] For example, see Bank of England, L.D.M.A, Friday 12 December 1952, BOE, LDMA 1/8.
[565] The Treasury gave implicit recognition to this influence in a 1957 memorandum on the relationship between monetary policy and external relations prepared for the Radcliff Committee. (Treasury, Committee on the Working of the Monetary System, Memoranda of Evidence, "Monetary Policy and External Economic Problems", 14 April 1957, PRO T236/5438).
[566] Schenk, 1994, 89.
[567] Katherine Schenk has argued that the outflows continued because of the "over-riding political consideration [that was] the cohesion and continued stability of the Sterling Area" (Schenk, 1994, 93).
[568] Butt, "Sterling Area", 16 January 1956, PRO T236/4304.
[569] Treasury, Note, 17 January 1956, PRO T236/4304.
[570] Quoted in Strange, 1971, 154.

though, as a system partly founded on an imperial legacy that was fast being dismantled, resistance would have seemed more likely. Nowhere was this clearer than with South Africa.

As Peter Henshaw has written: "South Africa's long and loyal membership of the sterling area is one of the most remarkable features of that country's relations with Britain in the twentieth century."[571] This was remarkable because for the Afrikaner nationalists who dominated the South African government after 1948, "there was no higher ambition than to free their country from subordination to Britain."[572] Henshaw identified economic dependence as being at the core of this relationship, particularly South African agricultural interests' dependence upon British markets. Conversely, however, if South Africa had left the Sterling Area, this would have caused "immeasurable damage to the UK", which would have lost an export market, a source of invisible earnings, and access to South African gold reserves.[573] Thus, while Henshaw's analysis helpfully traces the bilateral adjustments to relations between the two countries from 1931 to 1970, it fails to mention a crucial reason for South Africa's continuing membership of the system. That is, South Africa remained inside on almost entirely idiosyncratic terms, such that the central bank was never required to hold more than a working balance in sterling and was permitted almost complete flexibility in trade and financial policies.[574] This provides a striking example of how, through price discrimination and a tactical refusal to 'wave the big sticks' at its disposal, Britain kept countries within the system.[575]

South Africa provides an extreme case of a general phenomenon. India is another notable example of a country that was lessening its ties with the system.[576] Across the disconnected membership, and increasingly over time, countries inside the Sterling Area requested bespoke terms that the British acquiesced to. Some, like India, were allowed large private gold and dollar reserves; others, like Ceylon, had relaxed licensing laws; and Hong Kong and Kuwait retained free sterling markets. In contrast, some Commonwealth countries had limits placed on the use of their balances. Britain prevented these discriminatory and ad hoc terms from causing the system to disintegrate, by keeping the information on each country's terms of continuation private. Requests for information from members were met with silence or the platitude that banking relationships were necessarily private. Secrecy and price discrimination were vital to prolonging the system, because these practices held back resistance, and because not all countries could be treated like South Africa. Indeed, "any considerable or concerted

[571] Henshaw, 1996, 197.
[572] Henshaw, 1996, 197.
[573] Bank of England, "South Africa", 29 December 1967, BOE OV44 115.
[574] Bank of England, "South Africa", 29 December 1967, BOE OV44 115.
[575] British policy restraint is discussed by Henshaw (see Henshaw, 1996, 211-216).
[576] Bolton, "Comments on Sir Leslie Rowan's Memorandum, 'Problems Facing the Sterling Area and System,'" 19 November 1955, BOE OV44/30.

attempt by the Sterling Area to withdraw the sterling balances and turn them into gold or another currency could swamp the reserves."[577]

d. The Maladaptive Effects of Exclusory Leadership

The explanatory framework of this thesis contends that leaders' refusal to share power in order to organise collective responses to problems comes at a cost. The secondary literature universally supports the view that incoherence and non-conformity were growing problems in the Sterling Area as the 1950s progressed.[578] There were also signs of institutional sclerosis and policy drift. These developments always mark the onset of limits to exclusory leadership. In line with this study's overall emphasis, the focus here is on problems seen from the perspective of the whole system. However, officials were also aware of domestic policy distortions that followed from avoiding collective adjustments.[579]

The refusal to impose collective controls on the sterling balances problem, and the refusal to limit capital exports, came at a price. Without any means to shift more of the burden onto the RSA, the UK's balance of payments needed to deliver an improbable ever-larger surplus. Moreover, without collective administrative structures, the UK could not prevent the RSA members that ran dollar deficits from freeriding on the dollar pool. Worse still, these members had every incentive to draw down their sterling balances, before using IMF reserves, or their own, to cover the deficits.[580] The result was that these RSA deficits were placed wholly upon the UK, rather than on a collective Sterling Area support or elsewhere. This practice of using sterling reserves first to cover payments imbalances also had the undesirable effect of suggesting that sterling balances were second class reserves. This weakening of sterling's status was compounded by the growing tendency of Sterling Area countries that ran dollar surpluses to retain these reserves for their own purposes. As a result of all these developments, the common ties of the monetary mechanisms of the Sterling Area were wearing thin. The Treasury sought to "underline the increased burden which [was] likely to fall on the United Kingdom current balance […] as a result of economic and political developments in the Commonwealth and Sterling Area."[581]

The benefits to the UK of Sterling Area trade were also diminishing. Britain was letting the RSA gradually defect from the constraints on dollar imports, while remaining entirely open to Commonwealth goods. The Federation of British Industries (FBI) noted in 1958 that after 25 years "much has happened to attenuate the Commonwealth Preference System and reduce its value to British manufactures."[582] Commonwealth countries had developed their own manufacturing, the preferential

[577] Treasury/Bank Working Party on the Sterling Area, "S.W.A.P. Report: Rate Policy and Trade Policy", 18 May 1956, PRO T236/4304.
[578] Schenk, 1994; and Perkins, 1956.
[579] Cohen, 1971, 86; Strange, 1971; Schenk, 1994, especially Chapter 1; Schenk 2010; Rowan, "Problems Facing the Sterling Area System", 4 November 1955, BOE OV44/30.
[580] Allan to Thompson-McCausland, 7 May 1956, BOE OV44/32.
[581] Rickett, "Note by the Chairman, Report of the Sterling Area Working Party", October/November 1956, PRO T236/4303.
[582] Federation of British Industries, 1958, 15.

agreements had ceased to apply in their original form or had been renegotiated, and some newly independent countries had no preferential agreement with the UK at all. The value of RSA as a soft export and import market was reduced, as it was progressively opened to West European imports and American capital. The move to convertibility reinforced this trend. For instance, in 1955, the UK modified its exchange controls such that the 'transferable account' area included the whole of the non-dollar world. This widened the area of free sterling payments to include Western Europe. The effect was to remove the monetary protection of British exports in the RSA, while the RSA faced little additional competition, because transferable account countries tended not to be primary exporters.[583]

e. The 1950s: Continuity and Change Under Exclusory Leadership

The distributional and developmental trends in the early post-war period accord with the conjectures of this study's explanatory model. The Treasury felt in 1951 that "if anyone were to be dissatisfied with, or desirous of altering, the present arrangements one would certainly not expect it to be this country."[584] Despite mounting problems, Britain secured many benefits through the 1950s. However, in reviewing the decade, it is clear that the Sterling Area was weakening. Members were driven to diversify their trade and monetary relations, or at least keep open the option of recalibrating them. Why did Britain acquiesce to these forces of disintegration?

The explanatory model offers an answer: Britain acquiesced to keep its policy monopoly. It was able to follow this path of policy restraint because in a spontaneous system the low initiation costs, and lesser control needs of monetary officials, meant the system did not need to be proactively sustained. The Treasury and Bank of England were clear that "if we expect Sterling Area countries to surrender their dollars with no exchange guarantee, to continue to hold larger balances in London than they would do of "their own free will", and to peg to sterling [… it] is too much to expect that they will be content to see the sterling exchange rate and sterling reserves manipulated without any voice in the policy with regard to sterling."[585] Thus British policymakers had limited options. The best course was exclusory opportunism. This yielded short-term gains and deferred losses. However, by repeatedly failing to challenge slippage and sclerosis, the UK allowed their insidious extension.

To be sure, the British policy trajectory muted the prospect of RSA resistance. However, this tended to obscure the reality that the RSA's position was self-serving, not system-serving. In the capital-scarce post-war world, the RSA needed London even as they sought new trading partners and sources of investment. But RSA participation in the Sterling Area was only a holding position: most countries did

[583] Perkins, 1956, 80.
[584] Treasury, "Floors and Ceilings to Sterling Balances: Comments on Mr. Goldman's Paper by the Economic Section", 3 May 1951, PRO T236/2913
[585] Bolton, "Comments on Sir Leslie Rowan's Memorandum, 'Problems Facing the Sterling Area and System'", 19 November 1955, BOE OV44/30.

nothing to increase their commitments and investments in the system.[586] Moreover, many independent RSA members began to cautiously "edge out while professing continued membership."[587] For much of the 1950s, maladaptation and defection were still marginal to the Sterling Area. However, unless halted, these developments would hollow out the system.

3. The Slide Continues: Decline Going into the 1960s

The economic complementarities across the Sterling Area continued to contract entering the 1960s. The system's embattled leader was forced into the arms of international creditors outside the Sterling Area to take the pressure off its currency. The political climate also soured, prompting further defections from established practices by some members.[588] The developments prompted two key questions in London: Should the Sterling Area be liquidated? And if the system must continue, what might increase its stability? This section explores the British calculations responding to these questions.

This study's theoretical framework reveals why Britain rejected the idea of winding up the Sterling Area: The historical process through which the foundations of the system had been laid made it difficult to contemplate. In response to the question of how the system might be continued, two practices developed. First, the UK did not raise barriers to exit. Second, in key policy areas, officials stuck with the status quo. In both respects, the logics of exclusory leadership were at work. First, recall that in spontaneous orders, leaders are expected to allow exit options so that members will choose these over resistance. Second, Britain's continuation of policy restraint, even as the system's afflictions deepened, confirms the existence of path-dependent logics in exclusory leadership. The unintended consequence was that the system became progressively less well adapted to the needs of its leaders and members. The outcomes are discussed in the final subsection of this part.

a. The Question of Winding-up the System

The Suez crisis in 1956, the sterling exchange crisis of 1957, and accelerating moves towards full independence in the Commonwealth lent urgency to the question of whether the Sterling Area system should be disbanded.[589] However, the possibility never received serious consideration inside Whitehall or the Bank of England. L.P. Thompson-McCausland's private papers show the Bank of England asking: "[H]ave we any option but to go on with the Sterling Area?", and responding: "No. We have not the means to liquidate; and the sterling system could not be replaced by anything else."[590] Another

[586] Indeed, where bilateral agreements were in place regarding the RSA sterling balances and diversification, the independent RSA members set out "to test these limits to the utmost" (see Reserve Bank of India, 2012, 594).
[587] Treasury/Bank Working Party of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[588] The nationalisation of British exchange banks in several RSA countries was a notable trend in this period (see Haslam, "British Banks in Commonwealth Countries", 15 August 1963, BOE OV44/18; and Haslam to Crosthwait, 2 September 1963, BOE OV44/18).
[589] Lee to Rowan, 31 July 1956, PRO T236/4303; also see Downie to Butt, "Sterling Area", November 1956, PRO T236/4303.
[590] Thompson-McCausland, "Questions on the Sterling Area", 18 June 1956, BOE ADB 14/44 807/5.

official noted, "I do not believe that anybody seriously contemplates [liquidation]."[591] The Prime Minister was thus informed in 1957 that "we do not really have a choice" but to keep the system.[592]

This continuation was not because the authorities worked blindly "on the assumption that [the Sterling Area's] value to the United Kingdom is not to be questioned."[593] Rather, winding up the Sterling Area was not investigated because the idea that the close financial and trade relations that formed the economic foundations of the system could somehow be undone made little sense. Hillier, in the Colonial Relations Office, thus wrote that the whole idea was not "a particularly practical line of policy."[594] Another official stressed that the Sterling Area is "not in fact an artificial thing which we could liquidate at will, however gradually."[595]

Two other factors emphasised in this study's analytical framework also went into determining the British approach to liquidation. First, to wind-up the Sterling Area, the authorities would need to stand apart from the economic interests at the system's core. For instance, proposals to wind up the Sterling Area presented by A.C.L. Day and Andrew Schonfield would have cut investment in the Sterling Area and imposed constraints on the London market in return for exchange guarantees and limits on balance withdrawals, and would have seen the expropriation of private assets to pay for reductions in the balances.[596] There was little prospect of such proposals becoming politically acceptable. Second, the British had no strategic incentive to threaten to wind-up the system, because they were not bargaining with members. As such, threats of exit would make no difference to their leverage, because they held all the power. This contrasts sharply with the negotiated orders considered in this study, where leaders often threatened exit to extract bargaining concessions from members.

b. Exclusory Responses Under Worsening Pressures

With termination off the table, the system entered the choppy waters of the 1960s. Sterling's journey to devaluation was uncomplicated in economic terms. The reserve to liabilities mismatch was compounded by sluggish exports, pent-up demand that sucked in imports, a labour market growing in domestic force and declining in international competitiveness, and sufficiently open capital markets to permit outflows on the whisper of a rumour. The UK government's domestic response was to rely on ad hoc devices to improve competitiveness, dampen demand, restrain capital outflows and improve the trade balance: "the government […] would neither devalue nor deflate [… so officials] devised a third line of policy in the hope of nudging the economy toward balance."[597] This strategy infamously failed.

[591] Makins, "The Sterling Area Working Party", 18 January 1957, PRO T236/4304.
[592] T.L.R. "The Sterling Area", 4 November 1957, PRO T236/4303.
[593] Board of Trade, Note, October 1956, PRO T236/4304.
[594] Hillier to Rowan, 9 October 1956, PRO T236/4304.
[595] Colonial Relations Office to Rowan, 10 August 1956, PRO T236/4303.
[596] Day, 1957; Schenk, 1992; and, 2008, 267–270; and Shonfield, 1958.
[597] Cairncross and Eichengreen, 1983, 168.

The pound remained on life support for much of the 1960s only to be devalued in the most damaging of circumstances in 1967.

As monetary crises ebbed and flowed, the relations and practices of the Sterling Area continued to be undercut. As Table 5.5 shows, the RSA reduced its trading ties with the UK between 1956 and 1966. In addition, the RSA increased the amount of aid and investment it received from sources other than London, as shown by Table 5.6. These changes diluted the financial ties with the UK and increased a "not unnatural desire among many Sterling Area countries to hold more of their reserves in non-sterling assets."[598] RSA diversification also intensified.[599] In addition, most members pressurised the Bank of England to offer them greater protection for their holdings in the form of some guarantee. In 1964, sterling still represented 83% of official reserves of member countries. By 1966, this was down to 75%, only to drop a further 10% the following year. Even if countries were not actively moving out of sterling, in almost every case they were putting new reserves into different currencies and gold. Furthermore, it was increasingly the case that the RSA members ran down sterling balances when in deficit, but would not raise those balances when in surplus. The relative decline of sterling as a reserve asset was unmistakable.[600] This mattered because unless RSA countries put new reserve accumulations into sterling, the movements in the balances increased the relative burden on the UK reserves.[601] The Treasury was clear: "In the longer run […] policies of indirect diversification could be very damaging."[602] The established practices of the system were disintegrating and an RSA run on sterling looked ever more likely.[603]

Table 5.5. Shares of Trade between UK and RSA and RSA and Sterling Area, 1955 to 1966

	1955 (percentage)	1966 (percentage)
UK exports to RSA	48	31
UK imports coming from RSA	40	30
RSA exports to UK	35	23
RSA exports to Sterling Area	54	39
RSA imports from the UK	34	22
RSA imports from Sterling Area	53	36

Source: Treasury/Bank Working Party on the Future of the Sterling Area, Final Report, 2 November 1966, BE OV44/115.

[598] This support had begun on a small scale in 1961 and 1963. However, in November 1964, September 1965, September 1966 and November 1967 additional stand-by facilities and swaps were created at the BIS each larger than that which preceded it. The importance of sterling as a first line in the defence of the dollar was central to these deals being possible (see Toniolo, 2005, 388-399; and Treasury, "O.S.A. Diversification", February 1967, PRO T312/1700.)

[599] Treasury, "Commonwealth Finance Ministers, Brief on Diversification", 11 November 1966, PRO T312/1700.

[600] French Finance Minister, M. Michel Debré, in an interview with *The Banker* in 1967, questioned whether sterling was in fact acting as a reserve currency, because its position was static rather than being renewed and refreshed (see Strange, 1971, 75).

[601] Norton and Spengler, "OSA Diversification", 10 February 1967, PRO T312/1700.

[602] Treasury, "O.S.A. Diversification", February 1967, PRO T312/1700.

[603] Ryrie, "Brief No. 8 (Defensive) Diversification of Sterling Area Reserves", 6 December 1966, PRO T312/1700; and Treasury, "O.S.A. Diversification", 27 January 1967, PRO T312/1700.

Table 5.6. Proportion of RSA Receipts of Long-term Capital and Aid from UK, 1955 to 1966

	1955 (percentage)	1966 (percentage)
Long term capital to RSA	57	34
Aid to RSA	39	19
Net private capital to RSA	56	42

Source: Treasury/Bank Working Party on the Future of the Sterling Area, Final Report, 2 November 1966, BE OV44/115.

Note: *1955 figure is average from 1952-955.*

The absence of any convention or agreement regarding diversification started to look like a costly oversight at this point.[604] Under such intensifying pressure, it might reasonably be imagined that the British would have changed tack. Yet still the idea of blocking the balances or even containing them through some collective agreement was vehemently rejected.[605] The Bank of England noted: "We would regard the blocking of the sterling balances as coming into the same category as a forced abandonment of the sterling parity. Full blocking of sterling would be tantamount to a default on debt by the UK, and even a partial restriction of their free use would come dangerously near to default: it is inconceivable that steps of this kind should be undertaken as an act of policy."[606] The available positive inducements that might halt the process of diversification also seemed unfeasible. The controls needed to boost reserves through manufactured surpluses could not be tolerated, while a gold guarantee or forward cover would be hugely expensive.[607] The objections to diversification when it was discovered were also more muted than ever. In relation to Malaysian diversification, for instance, it was known that a punitive restriction on her access to London could have put pressure on Malaysia. However, the Treasury counselled that "it is difficult to see any effective steps we could take [...] to dissuade her [from diversifying], should she be bent on doing so [other than to stress] how much we value our financial association with her in the Sterling Area."[608] The British were so constrained they even feared moral suasion might "seem alarmist and thus make things worse."[609] The story is familiar: the British opted to minimise their losses by taking an accommodating stance. This contrasts with the leaders of negotiated systems, who become increasingly coercive as appropriation fails.

The fragmentation between members that characterised the Sterling Area system started to create problems of its own at this juncture. The UK lacked information on the actual non-sterling holdings of

[604] Treasury, "O.S.A. Diversification", February 1967, PRO T312/1700.
[605] Treasury/Bank Working Party on the Future of the Sterling Area, Draft Report, (Bank of England annotation), Undated [Presumably August 1966], BOE OV44/115.
[606] Morse to Goldman, "Annex 1", 22 August 1966, PRO T312/1700.
[607] For the arguments against a guarantee, see Treasury/Bank Working Party on the Future of the Sterling Area, Final Report, 2 November 1966, BOE OV44/115.
[608] Treasury, "Secretary of State's Visit to Far East, February – March 1967, Sterling Reserves and the London Market", January 1967, PRO T312/1700.
[609] Hubback, "Diversification of Sterling Area Country Reserves", 10 August 1966, PRO T312/1700.

newly independent central banks garnered by indirect accumulation.[610] Compounding the problem, the general level of volatility made it hard to detect these holdings. The Treasury complained: "It is not possible to distinguish, from month to month or quarter to quarter, between reversible movements in the [member] balances attributable to balance of payments factors and irreversible movements attributable either to over expenditure of reserves by the countries concerned or to diversification."[611] No less importantly, the members of the area had no information on each other's sterling holdings because of their disassociation, and this could damage confidence in a crisis.[612] Thus, in accordance with this study's explanatory framework, the long-term strategy of price discrimination had created vulnerabilities that now needed a solution. Diversification had been allowed to progress so far that certain important countries (e.g. India and South Africa) continued to enjoy the benefits of membership of the Sterling Area without really being holders of sterling. This made it difficult for Britain to refuse others' calls for the freedom to spread their own risks.[613]

Despite the obvious limitations of the established policy track, the official calculation in Britain remained that collective discussions would be impractical and potentially harmful.[614] This shows how exclusory leadership becomes self-limiting and rules out alternatives. The British had little choice other than to continue to try to exploit the advantages of price discrimination, even though its strategic effectiveness was diminishing. The main reason why diversification did not proceed still more aggressively was that the RSA had an interest in not capsizing the boat. The volatility in sterling in crises was driven primarily by private holders, especially those outside the Sterling Area. In these periods, the RSA central banks moved with caution, and the sterling balances held up reasonably well. However, once the squalls had passed, the Bank of England noted that the shaken members would begin to silently but deliberately defect from the pound.[615] Countries used periods of calm and rising tides in sterling to obscure efforts to limit their exposure to the pound. The largest diversification came, according to the Treasury, "from countries which never say a word to us about it."[616]

c. Member Defection

When a country pursued processes of defection far enough, it effectively exited the Sterling Area. Countries began to drop out of the system in the 1960s. However, the British never defined a threshold of reserves for membership, still less acted to stop countries from falling below such a threshold. That is, confirming this study's hypothesis, the door was left open for members to leave the system. In fact, beyond its juridical meaning as removal from the list of 'Scheduled Territories,' the meaning of exit

[610] Ryrie, "Sterling Area Diversification, Annex 1", 30 August 1966, PRO T312/1700.
[611] Treasury, "The Problem of the Sterling Balances", 1 November 1965, PRO T312/1700.
[612] Ryrie, "Sterling Area Diversification", 30 August 1966, PRO T312/1700.
[613] Ryrie, "Sterling Area Diversification", 30 August 1966, PRO T312/1700.
[614] Treasury, "Commonwealth Finance Ministers, Brief on Diversification", 11 November 1966, PRO T312/1700.
[615] Treasury, "O.S.A. Diversification", February 1967, PRO T312/1700.
[616] Ryrie, "Sterling Diversification: Secret", 26 January 1967, PRO T312/1700.

had become ambiguous by the 1950s, because there was an exception to almost every generalisation that could be made about the Sterling Area. The UK never stopped countries from leaving, because the "only measure open to us in the financial field [would have been] the blocking of [a country's] sterling balances [but this would have been] … highly dangerous to sterling, and could only be resorted to if there were clearly no alternative."[617] That is, exit could not have been blocked by Britain without conceding collective management. Therefore, the British authorities elected to pursue a different path. They would approach each case depending on "the circumstances […] especially the size of the balances concerned, the importance of [the country's] economic relationships with us and the reaction of other [area] members."[618] In contrast to negotiated orders where exit is almost always represented as an existential problem for the whole system, and threats of exit are widely bandied around for bargaining leverage, in the Sterling Area some countries would be quietly let go, while others would be given what was necessary to keep them in the system, while information on all such processes was withheld from the other system members and wider world.

The Iraqi government's decision to sever ties with the Sterling Area and to diversify its currency reserves and foreign balances in June 1959 prompted the UK to respond, setting a precedent for how it would handle subsequent defections. As this study's framework would lead one to expect, the UK acted permissively rather than coercively. The object was to avoid Iraq triggering the exit of other countries, especially those in the Middle East which had become a crucial source of savings in the area.[619] A specific concern was Kuwait, which had huge sterling balances.[620] Therefore the British authorities elected to allow Iraq to exit. They made almost no effort to oppose Iraq's wish to leave, nor to block its balances, and neither did they offer it any special inducements to keep the balances. The Treasury explained the strategy to the Prime Minister: "if it appeared that the Iraqis were getting especially favourable treatment, the Kuwaitis might be tempted to ask for conversion of part of their balances. On the other hand, if we made any attempt to control Iraqi sterling, it might make the Kuwaitis suspicious. On balance, the more important consideration may be to avoid giving the Kuwaitis any justification for considering that their balances are not at their free disposal."[621] Again, the exclusory calculation was to let Iraq defect freely (but to keep other members ignorant about this) in order to avoid expensive demands being made by Kuwait or somebody else.

[617] Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[618] Treasury/Bank Working Part of the Sterling Area, "Problems of the Sterling Area", 25 June 1956, PRO T236/4304.
[619] The Bank of England listed the countries in danger of experiencing contagion as being the Persian Gulf States, Jordan, Libya, Malaysia and Ghana. Johnston, "Iraq and the Sterling Area", 22 September 1968, PRO T236/479
[620] Smith, 2003.
[621] Treasury to Prime Minister, "Iraq and the Sterling Area", 15 Mary 1959, PRO PREM 11/4318.

Britain's approach was also designed to minimise the pace and extent of Iraqi withdrawal. The hope was that after some initial reduction in her sterling balances for political reasons, Iraq would continue to hold most balances in sterling and conduct trade in sterling.[622] It was to increase the likelihood of this outcome that the British avoided "any public suggestion that Iraq was under any sort of commitment" or pressure to stay with sterling.[623] They worked to depoliticise the issue, playing down the importance of the negotiations and wherever possible confining the discussions to informal central banks liaisons and accords.[624] This episode confirms the power of this study's explanatory framework. In a spontaneous order, where the hegemon must consider the risk of triggering collective action, it stands to gain from an accepting stance towards exit. Moves to close the exit door, to stop one member from leaving, not only risk triggering a costly rush by others to get out, or an expensive collective response, but also provoke a more violent rejection of the established order by the departing participant.

The decision of Burma to leave the Sterling Area in October 1966 indicates how the ties of the Sterling Area had disintegrated still further by then. It also offers an example of a departure where there was minimal direct negotiation between the parties. After the coup in 1962, the Revolutionary Council set a course that was bound to conflict with the interests of the Sterling Area. Following a raise of gold holdings from zero to 25% in 1962, the Burmese reduced their sterling reserves in 1964 to 50%. In the words of the *Financial Times*, this took things "far beyond what had hitherto been considered as appropriate."[625] In addition, Burma nationalised the holdings of Chartered Bank in 1963 and refused to offer compensation or even to arbitrate the issue. Remarkably, even under this almost direct attack, the British responded with silence and acquiescence.

To be sure, the Bank of England strongly recommended expulsion, because in taking these actions "Burma was already acting as if she were outside the area, and in some respects [was] behaving badly even as a non-Sterling Area country in demanding gold clauses in contracts covering her exports."[626] However, the Treasury preferred to delay, waiting for either a change of attitude in Rangoon or at least a strengthening of sterling. London appealed in vain, repeatedly, for Burma to end practices "inimical to the fair working of the Sterling Area financial system."[627] Ultimately, Britain had no choice but to end the relationship and so to make official "a state of affairs which has now existed for some time".[628] To limit the damage, the British stressed that it was fairness that concerned them, rather than the strength

[622] Bagdad to Foreign Office, Addressed to Foreign Office telegram No. 756, 11 June 1959, PRO PREM 11/4318.
[623] Foreign Office to Washington, Addressed to Washington telegram No. 2766, 19 June 1956, PRO PREM 11/4318.
[624] Treasury, "Iraq and the Sterling Area", 12 May 1959, PRO T236/479.
[625] "The £ area system and the Burmese "Revolt."' *Financial Times*, 19 October 1966, PRO T317/460.
[626] Goldman,"Burma", 16 September 1966, PRO T317/460.
[627] Rangoon to Foreign Office, "Burma's Withdrawal from the Sterling Area", 19 October 1966, PRO T317/460.
[628] Bank of England, "Extract from '*Dawn*'", 25 October 1966, PRO T317/460.

of sterling.[629] They also ensured that there was no suggestion that any recrimination or punishment was to be exacted. The British High Commission in Rangoon was briefed by the Treasury that "future actions would be unaffected [and] Burma would therefore be free to use [her remaining balances] as she thought fit."[630] The primary calculation, as in Iraq, was to avoid contagion.

To summarise, there was always a strong case to be made that some countries should be formally removed from the Sterling Area when they approached de facto independence, whether because of diversification, gaps in exchange control, or attacks on private British financial interests. However, the UK, responding to exclusory logics, consistently elected to take no action, whether by raising the costs of exit or forcing countries out of the system. This was precisely how the leader of a spontaneous order would behave, according to this study's theoretical framework. In order to retain monopolistic control and the benefits of price discrimination, the UK had to leave the exit door open. Any move to increase the costs of defection risked provoking the RSA to seize the initiative. As such, the practices of exclusory leadership persisted, and their limitations were increasingly felt.

d. System Maladaptation: Three Decades of Exclusory Leadership

This study's framework explains that exclusory leadership has unintended maladaptive consequences, the primary sources of which are policy drift and institutional sclerosis. In support of this thesis, it can be observed that when the Treasury and Bank came together in the late 1960s to review the Sterling Area system, their analyses highlighted the maladaptive shifts that had taken place in the preceding two decades. These shifts had resulted in developments that ran against the viability of the system, negating its advantages for Britain.

Ongoing trade and monetary diversification (that is, defection), across the RSA, coupled with the reintroduction of convertibility in 1958, meant that the UK's continuing vast investments in the Sterling Area no longer fuelled the same proportion of expenditure on British goods and services. In consequence, the Sterling Area pattern of trade and investments helped the UK balance of payments less than it had formerly. At the same time, net sterling balances had risen rather than fallen, absent any controls, and capital outflows from the UK continued at an unsustainable level. Furthermore, the instability in the 1960s had led Britain to put exchange protections on transactions with the rest of the world, but not with the RSA. This fuelled a discriminatory pattern of capital and trade flows.[631]

Eventually, in May 1966, the British Chancellor of the Exchequer announced the Voluntary Programme to restrain direct and portfolio investment in Australia, New Zealand, South Africa and the Irish Republic. However, this was too late and too weak to save the Sterling Area. The Chancellor presented

[629] Rangoon to Foreign Office, "Burma's Withdrawal from the Sterling Area", 19 October 1966, PRO T317/460; Commonwealth Office to British High Commissions, 18 October 1966, PRO T317/460.
[630] Hubback, "Guidance to Rangoon, Burma Membership of the Sterling Area", 13 October 1966, PRO T317/460.
[631] Strange, 1971, 147.

The Voluntary Programme to the general public as an act of loyalty to the UK by the Sterling Area. However, the negotiating history tells a different story, of a British climb-down under threat of exit. The initial British plan was to impose exchange controls via a statutory scheme. However, Australia threatened retaliation. The Irish Department of the Taoiseach also appealed the move. The Australians then presented the UK with a number of less coercive alternatives. These formed the basis of the Voluntary Program.[632]

By 1967, the Treasury described the Sterling Area as "unsound economically."[633] The absence of a uniform exchange control system covering the RSA and non-sterling world appeared to lack any rational basis.[634] The Sterling Area had become an inefficient arrangement from the UK's point of view, because it placed a constraint on the UK's balance of payments, and hampered the UK's ability to control capital outflows to the RSA. The arrangement was also riddled with leakages and evasions, and if RSA members complied with the constraints put on them at all, it was because this aligned with their self-interest, rather than out of goodwill to the system. In contradiction with prior assessments, it was now felt that there was no good reason why the Sterling Area should be incompatible with an exchange control between the UK and the RSA, and there was also felt to be no clear reason why there should be such a lack of controls on countries that enjoyed privileged access to London's capital.[635] Yet, as insiders noted, this path had been repeatedly endorsed by the official policy.[636]

If the maladaptive legacy of British policies in the 1950s and 1960s confused insiders, it has left analysts at even more of a loss. Many have accepted Susan Strange's argument that the "Commonwealth myth" and "top-currency syndrome" were the primary factors causing politicians and officials to act with "a kind of blindness or impotence towards the particular, national interests of Britain. […those factors] powerfully prevented British policy-making from the contemplation of any radical changes in the heavy commitments undertaken by the British economy and [have] therefore been [a] powerful rationalisation for a do-nothing strategy for sterling."[637] This study's analytical framework, applied to the British calculations at each historical juncture, offers a rational explanation for British policy. The reason for the maladaptations – as we have seen – was that the British had been designing policy not to optimise the whole system, but to retain monopolistic control over policies for short-term gains.

By the late 1960s, the repeated deployment of exclusory leadership had created such disassociation and incoherence in the system that collective remedial action was almost impossible, even though it had

[632] Treasury to Prime Minister, "Control Over Capital Exports", 25 April 1966, PRO PREM 13/829; Department of the Taoiseach to Wilson, 30 April 1966, PRO PREM 13/829.
[633] Treasury/Bank, "Future of the Sterling Area", 25 January 1968, BOE OV44/116.
[634] Treasury, 'Exchange Controls in the Sterling Area', April 1966, PRO T295/134.
[635] Indeed, as was noted, the RSA often had controls in place over transactions with the UK. Treasury/Bank, Note, 22 January 1968, BOE OV44/116.
[636] Treasury/Bank, Note, 22 January 1968, BOE OV44/116.
[637] Strange, 1971, 322.

become increasingly desirable from a system perspective. To set a new course would have demanded tough internal and external measures, but Britain tended not to take such actions, because it could not stand apart from key vested interests at home.[638] Thus, the price the British had paid for retaining day-to-day control was finally becoming visible: the benefits available to the UK from continuing the Sterling Area, in terms of the large trading area and seigniorage it used to provide, had almost disappeared. The Treasury and Bank recognised that the only remaining question was how to mitigate the costs of retirement. To this end, policymakers committed themselves to trying to put the UK on the best possible footing, while dragging out the apparently unstoppable process of reserve diversification.[639] The British authorities began to contemplate the previously unthinkable: "that it might be possible, and perhaps unavoidable, to [trade] limiting the use of [RSA] sterling with selective guarantees which [would save] something from what would otherwise be a total shipwreck."[640] However, about a year later, the shipwreck came.

4. The Sterling Area Agreements

The devaluation of sterling in November 1967 severed a core tie of the Sterling Area, revealing the extent to which the system had degenerated.[641] To devalue their own currencies along with the pound was unappealing to most of the RSA, because they now held uncovered non-sterling assets, owed large amounts in dollars, and had major export and import markets outside the UK.[642] The implications of the refusal to move with sterling were stark. The losses incurred by sterling reserve holders and traders, unable to cover for disparities between sterling rates, would inevitably drive them to seek ways to cover such losses in future, leading to forward markets and speculation within the Sterling Area. Moreover, the presence of multiple rates of exchange across countries would only accelerate the disintegration of the trading area. However, it still took almost a decade after this point for the system to fully unravel. This section investigates how the British authorities dealt with pressures that arose from devaluation in 1967 through to the final termination of the Sterling Area in 1975.

Treasury and Bank officials meeting in January 1968 were in "general agreement that, following the changes that had taken place over the years and particularly as a result of devaluation, there was now less economic justification for the existence of the Sterling Area than there used to be."[643] However,

[638] Downie,"Sterling Area", November 1956, PRO T236/4304.
[639] Treasury/Bank Working Party on the Future of the Sterling Area, Final Report, 2 November 1966, BOE OV44/115.
[640] Treasury/Bank Working Party on the Future of the Sterling Area, Draft Report, Appendix A; Treasury, "O.S.A. Diversification", 30 November 1966, BOE OV44/115.
[641] Only 12 of 23 countries devalued by the same amount as the UK (see Bank of England, "Sterling Area and Exchange Rates", 4 January 1968, BOE OV44/116).
[642] Bank of England, "Sterling Area and Exchange Rates", 4 January 1968, BOE OV44/116.
[643] Treasury/Bank, Note, 22 January 1968, BOE OV44/116.

they determined that they needed to hold the line.[644] The immediate danger to be prevented was a run on the bank, so that sterling could be retired from a position of strength. The authorities thus set out "to dissuade countries from […] leaving the Sterling Area in the near future."[645] What had been largely true since the early 1960s thus became formal policy: the British position was one of strategic defence. The main aim was to "keep the pace of [diversifying] moves as slow as possible, if we cannot actually prevent them, in order to reduce additional strains on our reserves which we are in no position to accept."[646]

In this post-devaluation situation, UK officials considered four ways in which attack might be the best defence. First, the Treasury prepared a memorandum contemplating the introduction of exchange controls.[647] The move was considered "logical" given the dreadful balance of payments position. Discriminating in favour of Commonwealth markets made less sense than ever before.[648] However, the move was rejected because "the potential loss by way of additional diversification, possible retaliatory measures and general uncertainty, would outweigh the balance of payments advantages."[649] Second, the Treasury and Bank discussed blocking the sterling balances. However, this was deemed unacceptable for fear of the reaction among members, and because of the implicit message it would send that there were no free holders of sterling. Third, they considered expropriating the UK's private overseas investments to meet the strain on reserves.[650] However, the move was precluded because, unless it was forced upon the UK by its external creditors refusing to lend more money, the liquidation of fixed assets would be a huge sacrifice. The private interests at the centre of the sterling area were therefore still able to preserve their autonomy. Finally, the officials discussed collective negotiation. This was rejected for familiar reasons. UK officials determined that "to take the initiative at this stage would be premature and possibly dangerous; moreover, there would be no point in holding a conference unless we were in a position to make some positive proposals or at least were able to hold a general discussion from a rather stronger position than at present."[651]

The UK therefore found itself in the familiar position of reasoning that a largely inert policy of decentralised persuasion was its best option. Less generously put, the British authorities were

[644] The termination of the Sterling Area was only really considered after devaluation in 1967 and even then it failed to appear a convincing option (see Fenton, "Arab Middle East: The Aftermath of Devaluation", 30 November 1967, BOE OV44/115)
[645] Hall, "Sterling Area", 29 January 1967, BOE OV44/116.
[646] Treasury/Bank of England Work Party, "Probable Developments", 9 January 1968, BOE OV44/116.
[647] Bank of England, "Exchange Control of the Sterling Area", 2 January 1968, BOE OV44/116; and Bank of England, "The Future of the Voluntary Program", 3 January 1968, BOE OV44/116.
[648] The Treasury's initial paper had argued that exchange control discrimination between the sterling and non-sterling area was an example of "economic nonsense" (Treasury/Bank, Note, 22 January 1968, BOE OV44/116). The meeting on the future of the Sterling Area held on 25 January 1968 did not go so far, but admitted that, despite years of justifying this policy, it now made less sense (Treasury/Bank, "Future of the Sterling Area", 25 January 1968, BOE OV44/116).
[649] Treasury/Bank of England Work Party, "Conclusions", 10 January 1968, BOE OV44/116.
[650] Treasury/Bank, "Possible Avenues of Policy", 23 January 1968, BOE OV44/116.
[651] Treasury/Bank of England Work Party, "Probable Developments", 9 January 1968, BOE OV44/116.

committed to merely hanging on. The policy was successful insofar as there were no immediate demands from members to leave the Sterling Area, or any major collective resistance. However, diversification marched onward. While many countries' official policy was to remain within the Sterling Area, the policy of central banks, currency boards, commercial banks and individuals was to diversify. In reality, the UK lacked the reserves to meet any major switch-out of the sterling balances by the RSA. In such a situation, the Bank of England noted that "it is worth considering whether there is a case for a deal, bartering Exchange Control Freedom for the maintenance of a certain percentage of official holdings in sterling."[652]

Against this background, in 1968, the Bank of England went to the BIS to seek medium-term financing to protect against diversification of the sterling balances. The negotiations, held between February and June, organised for a $2 billion support for sterling to offset reserve losses arising from diversification, on the condition that Britain made a deal with the RSA to slow diversification. Thus, it was only when all other means of securing advantages were lost, that the Bank of England moved to change the constitution of the Sterling Area by entering into formal agreements with the RSA. If the large moves out of sterling were not enough, the precondition for the Basel facility was. The Bank of England offered a dollar guarantee to the holders of sterling above 10% of their reserves, in return for the RSA countries each holding a minimum sterling proportion of balances (MSP). This guarantee was credible because of the external support.

Over the summer of 1968, the Bank of England set out to separately negotiate the guarantee for the deal with each of the countries in the RSA. The result was the signing of the Sterling Agreements in September 1968. The Agreements marked the end of uninhibited exclusory leadership. As Schenk notes, they represented the fact that "the benefits that drew the partners together had declined to such an extent that the system had to be stabilized through additional contractual arrangements."[653] The Bank of England's preference was to negotiate bilaterally, because countries were participating in the Sterling Area on different terms, and because this offered the prospect of the best deals for the UK. However, as the UK had long feared, the effort to coerce the RSA into formal agreements to hold minimum balances induced an unprecedented degree of collective action on the part of the RSA. The Bank of England observed in 1970 that a notable "feature of the negotiations was the degree of regional consultations, not only among larger holders such as Australia, Malaysia and Hong Kong, but also in the Caribbean. Such consultations both delayed final agreement and prevented the UK from reaching some of its negotiating objectives."[654] In another confirmation of this study's framework, the UK had to pay a higher price to get the arrangements than it had wanted to, because it was bargaining with collective units. The British were driven to offer significant concessions in the size of the guarantee and

[652] Bank of England, "Sterling Area Work Party", 19 December 1967, BOE OV44/115.
[653] Schenk, 2014, 192.
[654] Bank of England, "Tenor of 1968 Negotiations", 28 April 1970, BOE OV44/120.

the charges for it. They also could only secure short-term deals of three to five years. The minimum sterling requirements that were agreed were also less than they had wanted. Yet, the UK did manage to get the deals and to avoid negotiating with the RSA as a single collective group. Table 5.7 gives a sample of the variation among the final agreements.

The Sterling Agreements were broadly successful, even if difficulties arose in their administration. They resulted in a reversal of the reserve drain and a rise in the sterling balances and sterling proportion up to 1969, although this was largely a result of one-off switches of private balances into official reserves in Ireland and Hong Kong. The UK also retained its policy monopoly. However, the move to formalised agreements brought renewed pressure for collective management. Almost immediately after the announcement of the arrangements, Trinidad proposed an executive committee to manage sterling.[655] Jamaica then called for the establishment of a Sterling Area Committee to share information and give everyone a say in decision making.[656] The British rejected these long-feared proposals, with a response prepared by the Treasury for the Chancellor listing the impracticalities of any sharing of managerial responsibilities, but offering improved monthly telegrams.[657] However, it was unavoidable that groups would work out independent positions amongst themselves before the renegotiation of the agreements.[658]

Table 5.7. Sample of Guarantees and Minimum Sterling Requirements in 1968 Sterling Area Agreements

	MPS Target %	£ Guaranteed
Australia (inc. banks)	40.0 (48.3)	192,396
Ceylon	80	-
Ghana	80	8,795
Hong Kong	99.0	379,625
India	13.0	99,670
Ireland	65.0	161,394
Jordan	30.0	26,148
Kenya	66.0	47,043
Kuwait	25.0	177,144
Malaysia	40.3	116,485
N. Zealand (inc. banks)	70	90,801
Nigeria (inc. semi govt. funds)	60.0	41,151

Source: Bank/Treasury Sterling Area Work Party, Agreements as at May 19, BE OV44/120.

Note: £ million.

[655] Hubback, "Sterling Area Consultations", 25 September 1968, PRO T312/1847.
[656] Hubback, "Sterling Area Consultations", 25 September 1968, PRO T312/1847.
[657] Treasury, "Draft Speaking Note for the Chancellor on the Suggested Sterling Area Committee", Undated [Presumably 1968] PRO T312/1847.
[658] Hubback, "Additional Information for Sterling Area Countries: Closer Consultation with the Commonwealth", 29 October 1968, PRO T312/1847.

Moving towards the renewal of the Sterling Agreements in 1971, it was clear that there would be pressure to reduce the minimum sterling holdings, while the UK would want these maintained. As the Bank of England recorded, with sterling stronger and interest rates lower, "there is now very little remaining incentive for the [RSA] to remain voluntarily locked into sterling, hence our marked preference for a straight two-year renew of the Agreements and the obvious question mark over our ability to obtain it."[659] The Bank recognised that the UK would have to go most of the way to accepting the RSA demands in order to secure the deals. The Sterling Agreements were renewed for two years in September 1971. A few weeks earlier, Nixon had reordered the international landscape by closing the gold-window, and the consequences would soon wash away most of the remnants of the Sterling Area.

In 1972, the British authorities elected to float the pound and amend the list of Scheduled Territories in the 1947 Exchange Control Act, in order to impose exchange controls on all countries other than Ireland and the Channel Islands. This caused another wave of departures to the dollar and ended the *de jure* basis of the Sterling Area. The UK then joined the EEC on 1 January 1973. Nevertheless, only Malaysia abrogated its Sterling Agreement. For the other members, the value of the guarantee seemed worth retaining. The extension of the Sterling Agreements into 1974 was based again on the offer of privileged access to the London capital market in return for holding minimum amounts in sterling. The final renewal, in March 1974, was for nine months. The minimum sterling amounts were reduced again and the guarantee changed to a more flexible effective exchange rate measure. The Sterling Agreements thus brought the Sterling Area into the mid-1970s, when, "without much ado, the main vestige of the economics of the British Empire was quietly abandoned."[660]

5. Conclusion

The Treasury wrote in 1957 that the Sterling Area "is not a planned association, in the sense that an initiative was ever taken to organise it as an economic, financial, political or any other kind of bloc. It grew out of mutual convenience and confidence, and it has continued, subject to the vast changes in the world picture, on the same lines."[661] Using this study's explanatory framework, this chapter has shown how the spontaneous mode of historical development shaped the UK's preferences and ability to determine the fate of the Sterling Area as it began to decay. The astonishing finding is the enormous price the system and members paid as the UK set out to maintain its prize asset: a monopoly on policymaking. The absence of any collective coordinating machinery gave the UK power and distributional advantages, especially in the form of deferred losses. However, maintaining this monopoly produced the great paradox of the decline: as long as the initiative rested with the UK, no decisive action would be taken to arrest the decay of the order, for fear that such a decision would

[659] Bank of England, "The Sterling Agreements", 4 May 1970, BOE OV44/120.
[660] Schenk, 2013, 196.
[661] Treasury, "The Sterling Area", Undated [Presumably 1957], PRO T312/213.

disturb that power of initiative. The system became maladapted through policy drift and institutional sclerosis, and members found ways to lessen their ties to the UK.

The rationale behind the British management of the Sterling Area has long vexed commentators, and the maladaptation it produced in the long-run was certainly unintended. Susan Strange famously attributed British policy to the "Commonwealth myth" and "top-currency syndrome" that caused officials to ignore the UK's real interests. The explanation put forward in this chapter does not accept that the policymakers were so deluded. In each substantive policy area, including sterling balances, trade and monetary diversification, flagrant gaps in the ring of exchange controls, politically motivated departures, and the tide of draining capital, the UK found its best course of action to be relative passivity and *in*action. The comparatively low initiation costs, and officials' minimal control needs over the market-based patterns of action that sustained the system, enabled the British monetary authorities to pursue comparatively low levels of policy activism. In this way, they avoided the costs of collective bargaining, retained rents achieved through charging the unorganised and divided members different amounts to stay in the system, and stalled direct attacks on the system.

Britain's approach also worked because, unless pushed, the RSA had little to gain from driving the UK into bankruptcy, from forcing their own sterling accounts to be blocked, or from having the pound devalued. They could also gain no leverage from threatening disruptive actions, because they were not bargaining. The RSA was crucial in supporting the economic relations around the UK that had been the mainspring of the system since the nineteenth century. The effect was to slow the system's disintegration. However, there was never a grand strategy to help the system survive. Officials in the RSA, like in Britain, were merely responding to short-term incentives and seeking satisfactory solutions as problems arose. Indeed, the long-term consequences of exclusory leadership were maladaptive, and would eventually leave Britain at the centre of a distorted and dysfunctional system, with many wondering how they had got there. In its final days, the system was held together in a state of near absurdity, whereby the UK borrowed from American and West European creditors to stay solvent, while lending massive sums to RSA countries that already held enormous, costly and risky deposits in London.

The final state of the Sterling Area provides powerful confirmation that international monetary leadership is boundedly rational and opportunistic. Viewed over the long term, it might have been better for the UK to divest itself of the Sterling Area and start again as a tight economic trading bloc after the war. On the other hand, if it was essential that the system should continue, it might have been wiser to establish some mechanism of consultation with the RSA, together with proper rules and clear understandings. Equally, habitual non-compliers might have been brought into line if they had seen another member punished for insubordination. However, the weight of history cannot be shrugged off so easily. Where key sources of structural power are at stake, arrangements cannot be freely remoulded

to create incentives for the leaders to pursue system optimal courses of action. British officials made the best of the system they inherited. At every turn, the short-term opportunities and costs in view prompted Britain to keep its all-important monopoly, condemning the Sterling Area to suffer a slow and ignominious death.

6

The Decline of the Latin Monetary Union

The "entangling engagements" of the Latin Monetary Union (LMU) took nearly half a century to untangle.[662] Extraordinarily, from its foundation in 1865, the LMU would survive dramatic fluctuations in bullion prices, war between France and Germany, the rise of the gold standard, the first great depression (1870s – 1880s), and the Great War, only to be abandoned with little fanfare in the inter-war period, in 1927. This chapter argues that this extended and tortuous decline resulted from exclusory French leadership.

During this period, the French strategically exploited the advantages of leadership and monopolistic control over monetary developments in much of continental Europe. France was hegemonic over the franc zone and the LMU, which were defined as follows: The franc zone consisted of those European countries that were on the Napoleonic standard (or had similar institutional and legal arrangements), all of which depended on French capital markets and investment. The Napoleonic standard was set by an 1803 French law granting anyone who brought gold or silver to the Mint the right to have it coined at a fixed nominal charge and at a stable ratio of gold to silver of 15.5 to 1. The Napoleonic standard therefore created a basis for bimetallism across much of Europe. The LMU was a subgroup of the franc zone, and it was constituted of those countries that were formally part of the 1865 monetary convention.

The French strategies for control over these orders included avoiding collective bargaining, withholding information, and discriminating between the members of the LMU, and between them and the wider franc zone. By these means, the French sustained the commercial and political gains afforded them by the widespread use of the Napoleonic standard. They also deferred the losses that could be expected as their monetary power declined, bimetallism was called into question, and economic nationalism challenged the foundations of French hegemony. Furthermore, through these strategies, the officials in Paris avoided conflict with the financial interests of the *haute banque* that comprised the economic base of the LMU and wider franc systems. However, under this exclusory modality of leadership, the LMU never expanded its membership nor deepened its monetary ties. In the long-run, the LMU became incoherent and maladapted, because the French leadership failed to update practices, and continuously left defections unpenalised. These defections took the form of gradual diversification of trade and monetary relations and periodic devaluations by Southern partners. All these maladaptations made the system inefficient, and it slowly degenerated.

[662] 'The Latin Monetary Union.' *Economist*, 22 August 1885, 1291, The Economist Historical Archive, 1843-2011. Web. 4 May 2015.

Like all leaders of international monetary systems, the French had to confront chronic governance problems. The LMU was originally formed to address difficulties frustrating the operation of bimetallism in the franc zone during the 1860s. The franc zone had emerged spontaneously around French economic and political hegemony. The problems incident to bimetallism meant that changes in the gold and silver markets put pressure on exchange rates and the availability of coinage for commercial transactions in the franc zone. In 1865, France, Italy, Belgium, and Switzerland established a monetary convention to address these problems, creating the LMU; they were joined by Greece two years later. Thereafter, matters were complicated by the diverse levels of development among the states bordering France. The weaker members of the LMU, notably Italy and Greece, persistently devalued their currencies by issuing paper money or debased coins. These unwanted coins would flood into France as market participants exploited arbitrage opportunities created by countries sharing common currencies. In the wider world, one context of these difficulties was a battle between partisans of the gold and bimetallic standards. The LMU was established on a bimetallic basis only to gradually move under French direction to a limping bimetallic foundation, a limited form of the gold standard. The LMU was therefore caught first on one side, then the other, of the battle of the standards.[663]

The spontaneous emergence of the franc zone established a monetary hierarchy with a non-associated membership. The history by which it came into being meant the system rested on an economic foundation. The explanatory framework of this thesis posits that exclusory leadership will emerge in such settings, so the creation of a formal union might seem surprising. However, when the LMU was created, France ensured that there would be no permanent supranational bargaining structure or ongoing central bank cooperation. To be sure, periodic monetary conventions were held to amend the 1865 treaty. However, these conventions were typically held at around five-year intervals, and sometimes less frequently. Moreover, France limited the agendas at these conventions. The major treaty changes in 1874, 1878, 1885 and 1893 largely formalised unilateral steps taken by France in the intervening periods.[664] The LMU therefore developed under a *de facto* French policy monopoly. Important recalibrations were made in France, without prior consultation, and presented to members on an effectively take-it-or-leave-it basis. This exclusory leadership induced restraint among the membership in ways that supported French interests, but it also produced policy drift, institutional sclerosis, and defections, all of which frustrated the LMU's functionality.

When confronting problems, the guiding purpose of the authorities in Paris was to minimise the constraints that the LMU placed on domestic monetary conditions. The Bank of France had learnt to operate the bimetallic Latin area without any formal union. This made officials sceptical about the LMU, because it threatened the central bank with undesired managerial responsibilities.[665] The French

[663] The conflicts between mono-mentalism and bimetallism created a huge literature (see Wilson, 2002).
[664] Willis, 1901.
[665] Plessis, 1985; and Flandreau, 2001.

officials' desire for autonomy and control, coupled with the voluntarism of the franc zone, shaped the 1865 treaty. As well as lacking any concerted institutions, the convention placed only limited negative obligations on its signatories. It was a mere coinage agreement, designed to mitigate the impact of subsidiary coins flowing across borders.[666] France therefore succeeded in asserting its preference to keep most status quo relations in the franc zone unchanged. Yet exclusory leadership came at a cost. The minimalist arrangement left gaps in the coverage of the convention. In particular, the LMU did not regulate the issuance of paper money. The Italian, Papal and Greek states were quick to resort to the *cours forcé* (that is, inconvertible paper issuances), when facing budgetary constraints. On each occasion, France was inundated with unwanted subsidiary coins.

France's policy responses to this new problem were driven by the desire to retain exclusory control. This study's theoretical framework explains that exclusory leaders are disposed towards using policy restraint, to reduce the probability that system members will overcome the barriers to collective resistance. Policy restraint protects the leader's policy monopoly. Thus Paris displayed remarkable tolerance towards its difficult Southern partners. The issuance of inconvertible paper money of a given currency, which would depreciate that currency, amounted to *de facto* exit from the LMU. When this happened, the Bank of France had to accept huge amounts of unwanted foreign silver *écus*. Nevertheless, France did not resort to coercion.[667] France benefitted from this by avoiding a collective push for the gold standard. Furthermore, in this way, France slowed the substitution of British and German commercial and financial relations for French ones across the LMU and the wider franc zone. The exclusory strategies of restraint and a permissive attitude towards temporary defection maximised utility for France. They allowed Paris to prolong the LMU and franc zone, even as the economic advantages that had fuelled the franc's dominance were being eroded.

In relation to potential members of the LMU within the wider franc zone, France took a different attitude. The French monetary authorities progressively tightened the so-called 'Latin criteria', the terms of incorporation for new members. In the French view, several of these aspirant nations lacked the necessary domestic institutions to become dependable members. Without consulting the other members of the LMU, France either denied these nations access to the system, or granted them admittance on limited and discriminatory terms. The countries in question included Spain, Austria-Hungary and Romania. France's price discrimination between the various non-LMU franc zone members, and, moreover, between all of them and the LMU, enabled France to retain the appearance of a deeper and wider union than actually existed, without paying the full costs it would have really entailed. In accordance with the conjectures of the framework, France's strategy depended on

[666] I owe this observation and language to an anonymous commentator on this chapter.
[667] There is a small specialist literature that compares European monetary integration in the nineteenth century with its twentieth century counterpart (see Bartel, 1992; Capie, 1999; de Cecco, 1992; Cohen, 2001; and, 2008; Hamada and Porteus 1992; and Vanthoor 1992; Cohen 2001, 2008).

withholding information about the differences between the terms upon which the various members of the system were incorporated.

Following French military defeat by Prussia in 1870, the LMU received a massive shock. The gold price of silver collapsed when, upon its foundation in 1871, Germany moved to demonetise silver. France adjusted the LMU through incremental policy changes. Once more acting independently, the French government first limited and then suspended silver coinage, thereby inaugurating limping bimetallism. The reforms were subsequently spread throughout the LMU by treaty changes in 1874 and 1878. This response from France was criticised by contemporaries as "too tardy and too hesitating."[668] Today's literature makes a related argument that the competing bimetallist and gold standard interest groups paralysed French state policymaking.[669] The exclusory rationale behind holding back from actions and taking temporising measures has not been obvious to outside commentators. The French authorities actually pursued their trajectory partly because they could not stand apart from the private sector interests at the core of the system, and relatedly because they wanted to retain as much as possible of the status quo, including their policy monopoly. The limited capacities and needs for control of the central banks in the bimetallic system played into the gradualist French response.

Thus, in the debate about the motives of officials in Paris, this study's theoretical framework establishes a novel perspective. It shows that the key French ministers and advisers operated according to consistent precepts when taking decisions. They adopted temporising measures and preferred to impose adjustments on other nations one by one, in secret bilateral adjustments. The boundedly rational and opportunistic basis of the officials' decisions is evident throughout. Paradoxically, by pursuing so-called "wait and see" policies, the French ministers in fact responded to short-term incentives.[670] At each decision point, France held back from action, to prevent fundamental questions regarding the monetary organisation of bimetallism from being opened to collective bargaining. This policy was also promoted by the incentives arising from the fact that the system had its historical foundation in a particular pattern of private economic relations. French statesmen refrained from infringing upon the interests of the *haute banque* in bimetallic arbitrage, limiting free silver minting only when they had no alternative, and even then taking the smallest steps to intervene in the private sphere of monetary action and financial transactions.

To reiterate: by means of exclusory transactions, France averted a collective push for the gold standard, left in place the core materials and practices that supported the LMU, and maximised the franc's monetary hegemony in Europe. Yet, just as this study's theoretical framework would lead one to expect, the endogenous limits of exclusory leadership inevitably emerged. The patterns of action that supported

[668] Willis, 1901, 141; also see, Plessis, 1985.
[669] Einaudi, 2001, 118-142.
[670] Plessis, 1985; and Flandreau, 2001.

the LMU were gradually rendered null and void because France did not reconstitute the LMU, nor allow any originally non-LMU members of the franc zone full admittance to the LMU, nor update the LMU's practices and institutions. Moreover, defections became more widespread. By the 1880s, policy drift and institutional sclerosis left a catalogue of problems created by incomplete prior solutions. Most troubling were the silver *écus* sitting in the Bank of France. Members of the LMU that feared the costs of redeeming these silver coins in the context of plummeting silver prices began to defect more openly. To accumulate gold rather than silver, they raised loans in London rather than Paris. The final major treaty change in 1885 made the repatriation and re-melting of silver coins compulsory upon exit from the LMU. This marked a change in the materials that sustained the system. In its final years, the costs of redemption under the 1885 contract became an important reason why the LMU persisted. Yet, the gradual disintegration did not halt, and the open circulation of subsidiary coins continued to spill over into France with negative effects. The degeneration continued until the First World War, when the massive expansion in paper money and different levels of depreciation made the continued free convertibility of foreign coins impossible. The LMU was officially retired in the mid-1920s.

The application of this study's theoretical framework to the history of the LMU presents a novel perspective. To be sure, the analysis strongly agrees with Marcello de Cecco's, in arguing that "the LMU lasted as long as it did because France wanted it to."[671] However, here this claim is put into a richer context. The key point is that the LMU was sustained by a modality of leadership that followed from the spontaneous form of the system, with the consequence of slow decline. The study challenges those who have argued that the LMU declined slowly because of the stubborn refusal of France to embrace gold standard techniques and ideologies.[672] The French were not engaged in some misguided attempt to salvage silver. Equally, the gradualist responses taken by monetary officials were not simply the product of internal divisions within the French state as has been recently argued by Luca Einaudi.[673] On the contrary, the analysis here finds a coherent exclusory rationale underpinning French actions. The analysis also complements Marc Flandreau's findings that the acts leading to the end of the LMU displayed limited time horizons.[674] Starting from this study's assumptions that policymakers in international monetary systems act on the basis of bounded rationality and opportunism, the chapter confirms that French officials were unable to see the long-term consequences of their decisions in both political and economic terms. The slow decline of the LMU was not a planned response to problems, but rather a result of opportunistic leadership frustrating more efficient alternatives.

The following discussion proceeds chronologically, but does not give a full history of France's monetary policy choices, nor of the controversies of bimetallism. The focus is on how the explanatory

[671] de Cecco, 2007, 74; and Willis, 1901.
[672] Willis, 1901; and Reddish, 1995.
[673] Einaudi, 2001; Plessis, 1985.
[674] Flandreau, 1989, 1993, 1995 and 2004.

framework can shed light on important aspects of the development and demise of the LMU. The first section outlines the history of the LMU. The second section offers an account of the constitution of the LMU in 1865. The third section discusses the first years of the treaty, ending with the Franco-Prussian war in 1870. The fourth section offers an account of the transformative 1870s. The fifth section elaborates on the LMU's final years. The final section concludes the chapter.

1. The Franc Zone and the Spontaneous Origins of the LMU

The spontaneous origins of the LMU were initially obscured by the notion that the arrangement "was one of the many political schemes of the emperor Napoléon", who, like Napoléon I, "wished to become a lawgiver to foreign nations".[675] This interpretation is superficially attractive. Unfortunately, it finds little support in the archives, contemporary French works, or recent historical accounts.[676] The historical basis of the LMU was, in fact, more economic than political. The LMU rested on a spontaneous franc zone of French monetary influence that was not induced by any individuals's ambition, and, under this influence, actors were not associated amongst themselves.[677]

Trade integration and capital market developments, both exemplary of the economic liberalisation in the later years of the Second Empire, established the conditions for monetary integration in continental Europe. France led this process. The franc provided the model and the money behind the integrative forces. The stability of the French bimetallic system, instituted under the law of 1803, had led to its adoption by Piedmont (1816), Belgium (1832), Switzerland (1850) and Italy (1862) – see Table 6.1. The desire of newly formed states for access to French capital was an important driver behind this growing uniformity, as was the historical legacy of the French empire.

The economic ties among the states neighbouring France deepened after the turmoil of 1848. The core dynamic was greater trade interdependence. As Flandreau notes, contemporaries understood monetary integration to be a natural function of closer trading relations.[678] For instance, the Minister of Foreign Affairs wrote to Napoléon explaining how the reforms fitted "very nicely into the series of economic reforms [in particular the Cobden-Chevalier treaty in 1860] that had been achieved under the Emperor's reign."[679] The geographic proximity of the states involved also meant that currencies were widely accepted in cross-border transactions between individuals. In other words, before 1865 there existed a

[675] Willis, 1901: 56; and Russel, 1898.
[676] Flandreau, 1995, 2000; Einaudi, 2001; and Reddish, 1994.
[677] In fact, despite perceiving an opportunity to expand his influence, Napoléon III took little interest in the monetary integration project. According to Félix Esquirou de Parieu: "Napoléon III, to whom all decisions were submitted according to the governmental practice of the time, showed some benevolence for the general idea [of monetary unification] without entering into the details of implementation" (Parieu, 1875, 148).
[678] Flandreau, 2000, 28.
[679] Moustier to Napoleon, 21 June 1867, Archives du Ministère des Affaires Estrangers, Paris [hereafter AMAE], Séries F 29A 600 bis (Flandreau, 2000, 28).

spontaneous monetary union through mutual acceptance and mixed circulation of coinage among the countries of the First Empire.

Table 6.1. Coinage Systems of the Latin Monetary Union

	France	Belgium	Switzerland	Italy
Date of Legislation	1803	5 June, 1832	7 May, 1850	24 August, 1862
Silver				
Basic coin	1 franc	1 franc	1 franc	1 lira
Weight	5 gm.	5 gm.	5 gm.	5 gm.
Fineness	90%	90%	90%	90%
Value/kg fine silver (MEs)	222.2	222.2	222.2	222.2
Denominations	5f, 2f, 1f, 50c, 20c.	5f, 2f, 1f, 50c, 20c.	5f, 2f, 1f, 50c, 20c.	5f, 2f, 1f, 50c, 20c.
Gold				
Basic coin	20f	20f	N/A	N/A
Weight	6.45	6.45		
Fineness	90%	90%		
Value/kg fine silver	3444.4	3444.4		
Denominations	20f, 40f	20f		

Source: Willis, 1901, 68.

The Second Empire also witnessed the development and modernisation of the Parisian capital market.[680] In addition to the private banks of the early nineteenth century, the most powerful of which were still giant, if fading, there had emerged large public credit institutions.[681] The operations of the *haute banque* (using the term loosely to include merchant bankers, discount houses, and the public and private banks), became increasingly international and integrated. They formed a network from Paris to Florin and Brussels to Vienna, and beyond the Latin states. Their activities fuelled the internationalisation of the franc and deepened French financial hegemony. Eugène Rouher, who held various central positions in the Second Empire, received the following description of this process from an official in 1865: "France now enjoys together with England the privilege of providing capital to the world and reaps the profits therefrom." The note continued, with reference to a loan to Italy: "The amounts collected in France will be used to pay the balance of supplies of weapons, ammunitions, materials for public works, and we shall retain with one hand as suppliers what we give with the other as lenders."[682] This bimetallic arbitrage and banking network was the primary adjustment mechanism in the bimetallic system. In the

[680] Lévy-Leboyer, 1977, 80.
[681] Flandreau, 2003.
[682] Des emprunts d'états, 19 May 1865, Direction du Mouvement Général du Fonds au Ministère des Finance a Son Excellence M. Rouher, Archives national, AN, Archivés privées Rouher, 45AP, carton 20, dossier et impôts 2.

language of the present study, this network historically constituted the economic foundations of the LMU.[683]

By the 1860s, Paris was emerging as the main continental centre for foreign exchange, clearing transactions between London and much of Europe, as well as directly servicing the financial needs of Austria, Belgium, Italy, Spain, Switzerland and other countries.[684] Lévy-Leboyer records increases in foreign lending of 424 million francs per year in the decade leading up to the Franco-Prussian War.[685] Paris' development as an international financial centre incentivised countries to connect to France.[686] This encouraged the adoption of French-style bimetallism in standardised coinage laws. The Italian decision to adopt the French bimetallic order upon unification provides a case in point. The Report of the Italian Monetary Commission of 1861 concluded that the gold standard system was, in fact, a superior form of monetary order to bimetallism, but Italy's close financial links with France and need for French capital attracted it to bimetallism and led to the institution of the Napoleonic regime in 1862.[687] The same process extended beyond the official members of the LMU. At its peak, 13 European nations were inside the wider franc zone.[688]

French statesmen and currency internationalists were happy with the prestige France had gained by the spread of the Napoleonic monetary system. Indeed, many in France began to harbour the ambition of creating a single international currency standard based on the franc. The leading advocate for this was Félix Marie Louis Pierre Esquirou de Parieu, a technocrat who would head the French Council of State in 1870. But from the perspective of this study's theoretical framework, what matters is that through the 1850s a natural currency union, the bimetallic franc zone, had emerged on the European continent. States and private actors had spontaneously coordinated their monetary actions and policies around France. The foundations of the system were primarily economic, with the interests of the *haute banque* embedded in the system's central patterns of lending and adjustment. The LMU convention of 1865 constituted a formal monetary structure among some of the countries in this wider franc zone. The convention itself rested on this spontaneous franc zone, the practices that comprised it, and the voluntary participation of the actors within it.

2. Performance Problems and the 1865 Convention

The franc zone began to experience problems incident to its bimetallic foundation in the early 1860s. Europe was experiencing a gold invasion that was driving silver coin out of circulation. These problems

[683] Flandreau, 2000.
[684] Flandreau, 2000, 37.
[685] Lévy-Leboyer, 1977, 80.
[686] Flandreau 2000, 37.
[687] de Cecco, 2007, 34; Fratianni and Spinelli, 1984, 409.
[688] Flandreau, 1995. Willis gives a different figure of 18 states, including the colonies of France and Spain (Willis, 1901, 84, fn2).

are captured in Gresham's Law that "bad" (cheap) money drives out "good" (expensive) money.[689] The 1865 convention was an effort to coordinate a common response to these difficulties, among the members of the franc zone geographically closest to France.[690] The present section elaborates on this response. The central insight is that because the 1865 convention was layered onto a pre-existing spontaneous system, it took shape under exclusory leadership. Although not consciously acknowledged by officials, French thinking was dominated by the desire to avoid constraints on its own freedom of action. This decisively impacted upon the eventual constitution of the 1865 convention.

By the early 1860s, the fall in the price of gold had begun to undermine the 'natural' integration of the 1850s. Upon the discovery of large gold deposits in California and Australia, it became profitable to buy gold as specie in the market using silver and then to convert it into coinage of much higher nominal (mint) value. This encouraged arbitragers to export silver and bring gold to the mint. In order to prevent the disappearance of small denomination silver coin, which was vital for everyday trade and exchange, states began to issue token (sometimes called divisionary or subsidiary) coins with a lower metal content. These coins were less likely to be used to buy gold, but nevertheless provided an arbitrage opportunity. The uniform coinage arrangements among countries using the French standard meant the token coins could be exported to other nations and exchanged at par for silver coins with a higher metal content. Such practices forced countries into defensive measures. France banned Swiss silver token coins from circulation in April 1864 and reduced the fineness of her own small silver coins in May.[691] Other countries followed suit. Thus, in the 1860s, the unofficial currency union was under pressure. The coherence of the spontaneous system was being undermined, and the free exchange between its members progressively frustrated.[692]

The Belgian government first proposed a collective response to this problem in 1864.[693] French Finance Minister Achille Fould responded positively. He noted with reference to recent developments that: "These restrictive measures create trouble in international relations and their disappearance would be in the interests of all governments. I think it would be possible to achieve such a result through diplomatic means, regulating in a uniform manner the issue and circulation of subsidiary coins in all countries concerned by way of a special convention."[694] As can be understood through this study's explanatory framework, the spontaneous underpinnings of the system shaped how the French state,

[689] See, Griffin, 1891.
[690] Einaudi, 2001.
[691] Bae and Bailey, 2003, 4.
[692] These problems were documented in a letter from French Finance Minister Fould to French Minister for Foreign Affairs Lhuys. Fould to Lhuys, 19 January 1865, AMAE, ADC 602, fol. 2; also see, Ministère des Affaires Etrangères, 1865; and Einaudi, 2001, 37-40.
[693] Einaudi, 2001, 38.
[694] Fould to Lhuys, 19 January 1865, AMAE, ADC 602, fol. 2; Einaudi, 2001, 38.

particularly its monetary authorities, conceived of the LMU and the scope of the 1865 convention's provisions.

The central concern of the French Finance Ministry (as led by Fould, under Rouher's oversight), was to sustain the bimetallic character of the continental system and to limit the extent to which any reforms encroached on domestic priorities. This was also the central concern of the Bank of France.[695] Both the Bank and Finance Ministry wanted to restore the conditions of free and uninhibited exchange that had existed before the 1860s. They also recognised that formalising a single unit of account and rules of exchange could reduce transaction costs and ensure "in Europe a large monetary circulation, attached to a single system and identical in its real and nominal value."[696] The currency internationalists, the chief among whom was de Parieu, sought the deepest and widest possible deal in 1865.[697] For political and ideological reasons, de Parieu wanted the treaty to form a basis for "uniform monetary circulation for the whole of Europe."[698] Léonel de Moustier, the Minister of Foreign Affairs, provided much impetus to this vision, as he sought to expand French commercial interests and political influence.[699]

As the 1865 conference approached, it became clear that France wanted a different kind of monetary arrangement to the members of the franc zone. The membership, in particular Belgium, wanted to establish the monetary union on a monometallic gold standard.[700] However, France remained committed to bimetallism, as it was established in the economic base of the franc zone. The vested interests of the *haute banque* were particularly important to French calculations. The bimetallic system offered the prospect of enormous arbitrage profits for bankers in Paris. As Alphonse de Rothschild put it: "the more precious metals we have, be it gold, be it silver, the better it will be, because there will be more work. Bullion is not wealth, properly speaking, but it is the muscle and the fuel of work."[701] Largely due to French power and the weight of these foundational interests, the 1803 standard prevailed and the LMU was constituted on a bimetallic basis.

The substantive terms of the 1865 convention were also dictated by French priorities. Fould wanted a minimalist deal that would permit only that "all subsidiary coins minted in neighbouring countries should be admitted to circulate in France and vice versa."[702] Thus, paper money was not included in the convention, but uniform divisional coinage was introduced and granted reciprocal admittance into government offices. The silver *écu* and gold coinage remained unchanged and free to move across

[695] Einaudi, 2001, 40-46; Flandreau, 2000, 26-27.
[696] Fould to Lhuys, 19 January 1865, AMAE, ADC 602, fol. 2; Einaudi, 2001, 38.
[697] Einaudi 2001. Fould to Lhuys, 19 January 1865, AMAE, ADC 602, fol. 2; Einaudi, 2001, 41.
[697] Fould to Lhuys, 19 January 1865, AMAE, ADC 602, fol. 2.
[697] Einaudi 2001, 47-54 ; also see, de Parieu, 1865; 1866; 1867; and, 1875.
[698] Ministère des Affaires Estrangers, 1865, 269; and Einaudi, 2001, 42.
[699] Flandreau, 2000, 27.
[700] Ministère des Affaires Etrangères, 1865, 8.
[701] Flandreau, 2000, 152.
[702] Fould to Lhuys, 19 January 1865, AMAE, ADC 602, fol. 2; and Einaudi, 2001, 38.

borders. The issuance of divisional coins was limited to six coins per inhabitant, in an attempt to constrain the stock and flow of minor silver coins to a reasonable amount. The silver divisional coins had a reduced fineness and were given a legal price higher than the market price, to remove the prospect of hording and melting. The free movement of exchange was legalised with the fixed rate of exchange of 1:1 between the French, Belgian, Swiss and Italian francs. The government offices had to accept the coins at par. The coins of other states could be refused by private individuals and institutions, but they were encouraged to follow the public authorities' example and accept them. This was important, as the Bank of France remained a private institution and would reject subsidiary coins on several occasions. The 1865 treaty had an initial life of 15 years, but would be updated and renewed at differing intervals until 1927.[703]

The terms of the convention fit with this study's theoretical framework. France's decisive objectives were to avoid constraints on its freedom of action and to minimise potential collective influence. The voluntarism and low initiation costs of the pre-existing spontaneous system also left an indelible mark on the convention. The freedoms of individual states to make paper issues and coin amounts of gold and silver without limitation were taken as natural and not subject to interrogation.[704] There was nothing in the convention that was designed to increase the costs of exit or to demand positive contributions to support the monetary order. Equally, the marginalisation of the monetary authorities meant they could not impose their will on the *haute banque* even if they had wanted to challenge the bimetallic foundations of the franc zone. Thus, while the 1865 convention produced a formal treaty, this was layered on top of an informal and spontaneous 'Communauté monétaire'. The object and effect was to leave in place as much as possible of the liberal, voluntaristic and non-coercive system. As Willis notes, the LMU "had simply provided for a uniform fineness and weight of the coins of the different countries, but had not even prohibited issues of paper or […] dictated the amount of coin which should be issued. The limitation of the coinage of silver had been merely intended as a means of protecting the members of the union from one another's over-issues."[705]

From this study's perspective, a further crucial point is that no collective administrative architecture was instituted to manage the LMU: neither a permanent governmental body nor a network of cooperating central banks. The Belgian delegate asked for the centralised issuance of divisional coin, but met with French objections.[706] As a result, the French state would dictate the day-to-day policy developments in the Union and the membership would remain largely unassociated. As Luca Einaudi put it, due "to the lack of common institutions, the French Ministry of Foreign Affairs became in fact the coordination institution of the Union. It hosted all the conferences, received communications for all

[703] Ministère des Affaires Etrangères, 1865.
[704] Ministère des Affaires Etrangères, 1865.
[705] Willis, 1901, 219.
[706] Ministère des Affaires Etrangères, 1865.

the members, summarized the various options, dealt with candidates, negotiated controversial agreements, and dispatched circular replies to the whole Union."[707] This *de facto* French policy monopoly and the fragmented arrangement of the members would have crucial implications for the subsequent development of the system.

3. Exclusory Leadership in Action, 1865 to 1973

The LMU faced challenges from its inception. The first came from the continued issuance of debased coins, as had first prompted the formal Union. Pressures also arose from a dispersion of economic power and the diminution of the forces that had led to the internationalisation of the franc.[708] In particular, Britain's trading links with the continent were deepening and becoming more direct. Germany presented a further source of growing competition. Another consideration for French officials was the rise of gold standard ideology.[709] This section discusses how these early problems were met. Exactly as the explanatory framework elucidates, the French maximised their utility through exclusory leadership. In particular, in showing restraint by not forcing countries to redeem their subsidiary silver coins, and in offering subtle variations in the terms of membership when negotiating the admission of new members, France retained exclusive control over developments. These actions secured the continuity of bimetallism in Europe, and French political and economic influence in the franc zone. However, exclusory policies also produced maladaptations through policy drift, and provoked negative member responses and defections.

a. Closing the Door on the Franc Zone Countries

Problems arose before the LMU had even been ratified. Italian unification and a potential war between Italy and Austria placed enormous pressure on Italy's fiscal position.[710] The gold and silver reserves of Italy were also being drained by a trade deficit and debt repayments.[711] In response, the Italian government introduced non-convertible paper money, (i.e. they adopted a policy of *cours forcé*)," on 1 May 1866. As recorded in a note to Rouher from a senior monetary official, this action amounted to a suspension of Italy's membership of the LMU and created a fundamental issue with the functioning of the system.[712] There was now an arbitrage opportunity as speculators could purchase Italian token coins at a discount using the paper money and then convert these at par in member states for a profit. This would flood France with silver coin from Italy.[713] Upon realising this implication of leaving paper money out of the 1865 treaty, Moser, a monetary expert in the French administration, advised that "the

[707] Einaudi, 2001, 51.
[708] Flandreau, 2000, 41.
[709] Schumpeter, 1954, 770; and Gallarotti, 1994, 18-23.
[710] Frattiani and Spinelli, 1984; and de Cecco, 2007, 31-32.
[711] de Cecco, 2007, 31-32.
[712] Note adressée à son Excellence le Ministre d'Etat par Rod. Moser, le 10 juin 1866, archives privées Rouher (AN, 45, AP, carton 20, dossier 20).
[713] Willis 1901, 68-70.

monetary convention of Paris goes beyond what prudence allows in international circulation. It must not be ratified."[714] However, rejecting this advice, not only did France tolerate the Italian move, it also ratified the 1865 terms without further amendment.

The French government did occasionally threaten to return the Italian subsidiary coinage. However, the messages coming from Paris lacked consistency and conviction.[715] The Bank of France was obliged to absorb the Italian subsidiary coin into an already congested domestic circulation. The fear in Paris was that any move to restrain the Italian practice would embarrass a monetary ally who lacked the necessary funds to redeem the coins at par.[716] The increasing range of potential rival trading and financial partners for member states was an important consideration. As Flandreau notes: "France continued [trading] with its existing European debtors who could very well decide in the future to use French funds to buy German equipment […] French financial arithmetic needed to be supplemented by policies discouraging the substitution of imports from France by imports from other countries."[717] Furthermore, France still had ambitions to extend the LMU. This desire raised the potential cost of imposing any forced redemption of subsidiary coins on members.[718] Lastly, from a practical perspective, it was recognised that any coins repatriated to member countries would most likely re-enter France unless draconian steps were taken.[719] In this context, the French pursued a policy of bilateral communications and moral suasion in an effort to change Italian policies.[720]

The Papal State, though never more than a potential member of the LMU, behaved in destabilising ways, similarly to Italy.[721] Through three years of negotiations on a potential accession to the LMU, the French patiently absorbed Pontifical subsidiary coinage.[722] The members of the LMU were almost ready to accept full participation when the Vatican rejected the proposed limits on coinage. The French government could not continue to accept this open free-riding. They finally determined to refuse the Papal coins in 1868. However, the Papal government had already flooded France with debased silver coin. The accommodation of the Papal State had been largely determined by Napoléon's need to retain Catholic support in the domestic arena.[723] This shows that a circumscribed theoretical framework cannot account for every policy action of a monetary leader. Nevertheless, the general ability of leaders to discriminate between potential members of a system, by offering them different prices to join, as France

[714] Note adressée à son Excellence le Ministre d'Etat par Rod. Moser, le 10 juin 1866, archives privées Rouher (AN, 45, AP, carton 20, dossier 20).
[715] Einaudi, 2001, 95.
[716] Einaudi, 2001, 95, note 25. The repeated but ultimately fruitless efforts by the Italian government to restore convertibility are well documented (see Minghetti and Finali, 1875).
[717] Flandreau, 2000, 39.
[718] Einaudi, 2001, 98.
[719] Einaudi, 2001, 95, note 25.
[720] Einaudi, 2001, 98.
[721] Einaudi, 2001, 98-105.
[722] Crocella, 1983; and Flandreau, 1995.
[723] Einaudi, 2001, 99.

did in favour of the Pontifical State, is a prominent feature of spontaneous orders as described in this study's explanatory framework.

The incorporation of the Greek government in 1868 occurred on terms that sought to avoid the kind of problems that had arisen with the Italian and Papal states.[724] Greece was accepted as a member on the condition that all its coins would be minted in Paris. The long negotiations with Greece also saw special measures introduced to keep Greece's coins from being minted elsewhere than Paris, and others to limit the issuance of paper money.[725] These unequal terms of incorporation would, in theory, mean that France had greater control over Greek indiscipline. But ultimately the measures proved insufficient. Pressures on Greek finances due to Turkish rebellions led to the introduction of the *cours forcé* in 1868, and a depreciation of the drachma.[726] As a result, France demanded even tighter control over Greek coinage, and Switzerland refused to accept Greek coins. The eventual terms meant that Greek coins could not circulate freely in the LMU. Indeed, the drachma remained inconvertible between 1868 and 1910 (when Greece formally left the LMU), with only one momentary exception. Thus, in reality, Greece never acquired true member status nor ever fully integrated into the LMU.[727] This limited the impact of the Greek incorporation on France.[728]

The Greek case marked an evolution in French thinking. The 'Latin criteria' for the admission of new members were subsequently hardened. France now demanded "rigorous observance of the provisions limiting the issue of 835 thousandth coins [i.e. the debased coins which tended to be exported first in case of exchange depreciation] according to the size of the population."[729] The Paris Mint made a similar case: "Before admitting any new member state into the LMU, it is necessary to ensure that it presents all the desirable guarantees; these would not exist if the applicant is without well-organised Mint Workshops and Administration."[730] The result was that no new members were admitted to the LMU after Greece in 1868.

The practice of limiting applicants to a formal Union (such as the LMU) from a disorganised group of associated states (such as the wider franc zone), is entirely compatible with the logics of exclusory leadership. This practice represents a form of price discrimination. Through such denials of access, France sought to maximise the benefits of the LMU, and minimise the costs of an increasingly malfunctioning set of arrangements. France selected this route, rather than updating the LMU and tightening its terms, because it did not want to accept constraints on its own freedom of action, or to drive existing members out. This exclusory calculus caused France to reject applications from

[724] Einaudi 2001, 105-111.
[725] Einaudi 2001, 106.
[726] Einaudi 2001, 107.
[727] Lazaretou, 1995.
[728] Lazaretou, 1995, 33.
[729] Flandreau, 2000, 41.
[730] Flandreau, 2000, 41.

Luxembourg (1869), Romania (1867), San Marino (1869), Colombia (1871), Venezuela (1879), Bulgaria (1880), and Serbia (1874, 1879, and 1880).[731] These rejections were usually kept private and never discussed with the wider membership.

The problem with tightening the 'Latin criteria' was that this foreclosed the political benefits and prestige that came with the idea of an "ever advancing" Union. To retain these benefits, the LMU was *partially* extended by France to include Sweden (1869), Spain (1868), Austria-Hungary (1879), and Russia in the 1870s.[732] In each case, political motives drove the desires on all sides to incorporate another country into the LMU. For instance, the accommodation given to Austria-Hungary was motivated primarily by France's desire to isolate Prussia.[733] Also, the Dual Monarchy was eager to augment its commercial and financial ties with France after it had been rejected from the Zollverein a year earlier.[734] However, even with these strong political pressures to do a deal, Austria-Hungary still failed to obtain full membership, because, as the French Finance Ministry saw it, there were "more problems than advantages proceeding further, since once again we would have to lose our freedom of action."[735]

By being selective about which countries to admit to the LMU, and on what terms, France was able to retain political and economic benefits across the franc zone. In addition to the prestige acquired in Paris through the appearance of near universal acceptance of the LMU standards, the French were able to stall pressures to move the system to a gold standard. At the 1867 international monetary conference held in Paris, it appeared that the French state had committed to a change in its monetary standard, in return for an international coinage based on the franc.[736] However, the *haute banque*, in conjunction with the Bank of France, blocked the implementation of the commitment. The Bank of France would have had to pay large costs in any demonetisation of silver, and it had no desire to undermine the interests of its most important clients and owners. The Finance Ministry was also unsure about the benefits of a change, preferring investigatory commissions over actions.[737] These considerations contributed to the French desire to frustrate the full membership of Austria-Hungary and Spain; France was hesitant about newly admitted members that were clearly eager to move onto the gold standard. Thus, the French monopoly over the accession process was crucial to ensuring the bimetallic basis of the system and stalling the scramble for gold.

[731] Einaudi, 2001, 98. 76.
[732] Einaudi, 2001, 98.
[733] On the wider diplomacy of the period see Bury, 1964.
[734] Flandreau, 2000, 36.
[735] Dutilleul to Secretarire General, 2 July 1873, AMdP, K2 23, 1.
[736] Ministère des Affaires Etrangères, 1867.
[737] Eight monetary commissions were held between 1858 and 1870. Until 1868, all reported in favour of the bimetallic standard and the recommendations of those that later supported gold were not acted upon.

The diversified terms of membership that had developed under France's exclusory management, although not a deliberate policy feature, helped to preserve the bimetallic constitution of the system. The variegated terms that prevailed after 1866 constrained the capacity of the membership to form a common voice to advocate a move to gold. In 1869, the Swiss government wrote to Italy to encourage it to "convince the French government to take this last step [towards] a single gold standard."[738] There followed a similar request in 1873. The reply is indicative of the challenges uneven membership had created. The Italian Prime Minister, Marco Minghetti, explained: "I perfectly agree and if a conference was held with our participation, I would not abstain from supporting the idea. But, being under a forced paper currency regime, under which gold and silver have become a myth, although they still have some influence on our circulation, I do not think that we can take the initiative."[739]

France's ability to control and withhold information was crucial to these exclusory practices. As Einaudi notes: "No individual writer or foreign government had complete access to the information the French had, hence they could not assess entirely the weight of the French claims. Few would know that the Swedish and Austrian gold coins in francs were only trade coins, without any extended internal circulation, or that the Greek and Romanian LMU issues were initially limited to bronze, or more generally that most statements in favour of monetary unification were counterbalanced by opposed statements."[740] France's withholding of information created tensions with members when conferences were held. Belgium complained that France had failed to share information as required by the terms of the 1865 convention.[741] They also pushed for all countries that had partially adopted the convention to be put on a common basis.[742] However, the French had no reason to accommodate the request for uniformity or to share information more widely.

b. The Endogenous Limits of Exclusory Leadership

France's exclusory leadership maximised its gains and minimised the prospect of political and economic pressures emerging from the LMU. It slowed the diminution of France's monetary influence in an increasingly competitive international economic environment, and retained the widest possible bimetallic zone in Europe. However, as adumbrated by the explanatory framework of this thesis, the inexorable trends of weakening influence could never be arrested by exclusory leadership. The system therefore progressively declined.

The most persistent issue was devaluation, which inhibited the LMU from becoming a common currency area with stable exchange rates. Unless devaluation could be prevented, the LMU would remain locked into its minimalist constitution as a mere coinage agreement. This presented an almost

[738] Einaudi, 2001, 93.
[739] Einaudi, 2001, 94.
[740] Einaudi, 2001, 193.
[741] Willis, 1901, 133.
[742] Ministère des Affaires Etrangères, 1874.

circular conundrum for the French state. As long as France insisted on retaining the initiative and power that exclusory leadership provided, it would be frustrated in its stated preference to achieve a deeper Union, because it could not prevent states from pursuing measures obstructing the realisation of that goal. As Luca Einaudi has put it, because France refrained from using the "big stick" of coercive options at its disposal, few French requests to prevent countries from taking steps that were harmful to the goal of a deeper union "were successful and [the steps France itself did take] usually remained secret, creating evident frustration in the population and in policymakers."[743] This is a clear example of the costs of exclusory leadership, especially those unintended maladaptive consequences that play out over the long-term. French officials clung to their policy monopoly at the cost of optimising the system.

4. Plus ça change: From Limitation to Suspension

After the Franco-Prussian war of 1870, the system came under a new threat. This time the pressures stemmed from the demonetisation of silver in Germany after 1871, which the war-indemnity had made possible, and silver's world-wide fall in value. These events reversed the pressures that had led to the adoption of the 1865 convention. It became profitable to buy silver as specie in the market and then to convert it into coinage of much higher nominal (mint) value. There was a risk that countries would be flooded with silver coins and gold would disappear from circulation. The bad money, silver, was driving out the good money, gold. This section traces how France led the system under these pressures. The French government took a series of measures that would move the LMU onto a limping bimetallic standard, before finally ending bimetallism: first, through limits on free silver coinage in 1873 (i.e. artificially limiting the circulation of silver coin) and then in the cessation of free silver minting in 1876 (i.e. ending the convertibility of silver while allowing for it to be used as a means of payment). These steps were taken without prior consultation with LMU members. They were temporising acts directed to address immediate problems rather than towards long-term change. The logics of exclusory leadership set out in this study's framework provide a powerful explanation for France's policy trajectory, and for the sequence of decision and action whereby unilaterally predetermined solutions were formalised in collective conventions.

a. Dealing with the Challenges of the 1870s

The possibility of liquidating the LMU was first seriously debated in the early 1870s. The LMU had been created to preserve the silver subsidiary coin, but was now confronted with the prospect of an overabundance of *écus*. Willis argues that "had any of the countries been able to withdraw, they would have likely done so."[744] Willis too readily accepts the polemics of the time, where advocates of the gold standard and advocates of the bimetallic standard were calling for the termination of the LMU as a

[743] Einaudi, 2001, 98.
[744] Willis 1901, 141. This is not the sense one gets from reading the official transcript of the verbal debates at the conference (Ministère des Affaires Etrangères, 1874).

means of instituting or sustaining their preferred systems. He also understates the continued benefits available to members from staying in the LMU.[745] The French interest in promoting its monetary influence through the LMU was undiminished. Moreover, while London and Berlin had started to emerge as alternative sources of capital, the threat of being cut off from the Parisian market remained highly unattractive for LMU members. Furthermore, the spontaneous historical foundations of the franc zone that supported the LMU made termination difficult to imagine.

Nevertheless, Willis correctly observes that there were no easy means by which countries could exit the LMU. France and the members all now had large holdings of silver, with a market value far lower than its face value. The cost of liquidating these holdings was daunting. It therefore seemed worthwhile to stay in the LMU and look for some means of managing the problem. In a repetition of the situation of the early 1860s, the lack of any collective institutional structure or association between members meant that the initial responses to the problem were uncoordinated. Various countries introduced unilateral limits on silver coinage: Belgium was the first, while France followed shortly after in September and November 1873.[746] The absence of coordination meant that in some countries minting came to be exclusively reserved as a governmental right, whereas in others private individuals retained the right to mint silver within the previously prescribed limits.[747] The limitation on private minting in some countries represented an important change in the foundations of the system, as this frustrated the private arbitrage on which bimetallism was based. The state thereby became a larger presence in the system, though not necessarily a stabilising one.[748]

The fall in the price of silver and the disparity between the mint and market values across the LMU created an opportunity for governments to pocket the difference, particularly if they had exclusive control over the minting of silver.[749] To manage the destabilising influence of this incentive, which resulted in the issuance and export of depreciated silver for profit, the LMU was brought together in a convention, upon a request by the Swiss.[750] The objective was to institute a treaty change to control and coordinate silver minting. The treaty of 1874 agreed annual limits on silver minting for all Union members.[751] In a familiar pattern, the treaty reflected a French preference for continuity in the status quo.[752]

The French saw the limits on silver minting as temporary, and the French Finance Minister Magne drafted a memorandum setting out this position.[753] The monetary committee of the French Chambers

[745] An insightful contemporary review made a series of relevant points in this regard (de Foville, 1901).
[746] Flandreau, 2000.
[747] Reddish, 1993, 80.
[748] Flandreau 2000; also see, Reddish, 1993, 80.
[749] Flandreau, 1993.
[750] Willis, 1901, 141.
[751] Ministère des Affaires Etrangères, 1874.
[752] Ministère des Affaires Etrangères, 1874.
[753] Flandreau, 2000, 200.

also argued that "far from infringing upon the basis of our monetary regime or indicating a tendency toward any change of this kind [i.e. limits on silver minting] has for its object, on the contrary, to maintain this regime intact by not allowing normal conditions to become diseased."[754] The logics of exclusory control dominated French calculations.[755] In this context, the Italian request to continue free silver minting was nullified by the Bank of France, while the Swiss and Belgian agitation for a complete and immediate move to the gold standard also came to naught.[756]

As Flandreau has shown, the limitations on silver minting effectively terminated the bimetallic system. The market could no longer stabilise the price of silver around the mint ratio through arbitrage.[757] In the context of the debates of the mid-1870s, there was no clarity about whether free minting would be restored. This undermined the system's economic rationale. The holders of silver coins, therefore, took them to the Bank of France and sought insurance in paper form against the eventual demonetisation of silver. This huge influx of silver, according to Flandreau, shifted the Bank of France's position, as it was not prepared to act as the final guarantor of the silver *écu*. This altered the central bank's long-standing defence of the bimetallic order. This, in turn, weakened the French Finance Ministry's resistance to the establishment of the gold standard and paved the way for the French decision to suspend silver coinage on 5 August 1876.[758] Once again, such a crucial step was taken without prior negotiations among the LMU. The silver *écu* remained legal tender in France, but no more of these coins would be created. France was on a limping bimetallic basis. The suspension of silver coinage was eventually extended to the LMU and formalised in the 1878 monetary convention.[759]

b. Exclusory Leadership and the End of Bimetallism

The long duration of the LMU's transformation, and the fact that it survived the 1870s at all, are remarkable. Having been the reservoir and guardian of bimetallism in Europe, the LMU became instead a bastion of the gold standard. The LMU's ability to make such a transformation speaks to its particular spontaneous constitution, and the patterns of leadership that guided it. Absent a conscious decision to save the LMU, France oversaw an incremental transformation in the operating principles of the LMU, by taking calculated steps to defend its own monetary interests and to ameliorate the pressures on the system. These changed principles placed the LMU on a new basis without undermining its existence.

In explaining this transition, Flandreau correctly argues that "the political acts leading up to the extinction of the double [i.e. bimetallic] standard obeyed a sequential pattern marked by a limited

[754] Willis, 1901, 146.
[755] Officials in Paris took particular alarm at Belgium's proposal to have annual conferences to supplement the information exchange agreements and to agree annual coinage limits. France guarded against this by securing guarantees that the annual discussions would be limited only to issues of expedience rather than substantive policy (see Ministère des Affaires Etrangères, 1874, 37-40).
[756] Willis, 1901, 163.
[757] Flandreau, 1989 ; 1993 ; 1995 ; and, 2004.
[758] Ministère des Affaires Etrangères, 1876.
[759] Ministère des Affaires Etrangères, 1878.

amount of rationality."[760] The application of this study's explanatory framework concurs, while also showing that, despite their unintended consequences, French actions maximised the leader's freedom of action in a spontaneous order facing uncertain developments. France's tactics kept at bay the growing antipathy among members towards the bimetallic basis of the system. Despite potentially explosive pressure from the member nations, France avoided triggering a collective response, and, so far as possible in the dramatically changing external conditions, moved LMU policy forward in a way that paid attention to its own domestic conditions and priorities. Moreover, it kept the LMU together through a period of growing economic nationalism. However, the developments were not an unmitigated success with regards to optimising the LMU system as a whole. Although it survived after the 1870s, its scope, economic importance, and political significance became more circumscribed than ever.

5. The 1885 Redemption Clause

In the early 1880s, the continued decline in the price of silver and the growing attachment to the gold standard brought up the question of how to deal with the silver coins still in circulation and in the vaults of the Bank of France. The costs of redemption created a distributional conflict between France and the other LMU members. France wanted to force redemption in gold or bills of exchange on the LMU. However, the LMU members feared that this would be unaffordable. In response, they started to spurn silver and move ever closer to full gold standards. These efforts to edge out of the limping system forced France's hand. A new treaty imposed by France in 1885 introduced a clause that demanded the redemption of coins in gold or bills of exchange upon exit from the LMU. The LMU continued to survive after this date, but on a rather different basis than before. The contractual threat of redemption to a great extent substituted for the positive economic ties and relations that had previously sustained the LMU. As Alfred de Foville, one time director of the French Mint, put it, "if the convention of 1865 has been compared to a marriage contract; the one of 1885 has somewhat the form of a will."[761]

The issue of redemption first arose with respect to Italy at the time of the suspension of silver minting across the LMU in 1878. Given its weaker financial position, Italy wanted to keep its silver coinage rights against the wishes of the rest of the LMU. In fact, Italy needed to increase its silver circulation in order to suspend the *cours forcé*. Other countries, as already noted, wanted to diminish the circulation of silver coin. France went further still in these discussions, advocating that Italy should move towards redeeming its coins. The traditions of voluntarism that went back to the origins of the system provided Italy with an argument with which to resist this proposal, saying that it ran contrary to "common sense."[762] The other members were also ambivalent about this demand. They were keen to limit Italian silver coinage but had little desire to redeem the substantial amounts of their silver circulating in

[760] Flandreau 2004, 208.
[761] de Foville, 1901, 113-119,
[762] Ministère des Affaires Etrangères, 1878, 28.

France.[763] The eventual terms of the 1878 treaty imposed expensive requirements on Italy to redeem in gold the silver coin in circulation in other countries.[764] However, the deal was watered down in the implementation phase. The final deal allowed Italy to retain sufficient amounts of silver coin to avoid constraints on trade.[765] Despite France having pushed Italy hardest, it was France's freedom to make particularistic adjustments and concessions that was the key to retaining Italian membership. Although superficially paradoxical, these events make sense in terms of this study's explanatory framework.

The threat of redemption sent shock waves through the LMU. Even if it was, in theory, affordable for members, it would be costly. They set about trying to reduce their dependence on silver and increase their gold reserves as a contingency. Nobody wanted to be left holding large stocks of silver if and when it was demonetised throughout the LMU, because this would entail a major capital loss.[766] Even Italy, the longest standing supporter of a bimetallic foundation to the LMU, started to move decisively towards gold. Reflecting these pressures for diversification, the loans raised by countries were increasingly put together in London on a gold basis. This was because if countries went to Paris, they would be burdened with unwanted French payments in silver.[767]

France, facing the risk of widespread defection, recognised the need for change. At the same time as France was unable to get rid of its huge stock of silver *écus*, the process by which members were lessening their silver holdings was tilting the distribution of costs and benefits against Paris. In the lead up to negotiations on redemption, France felt entitled to take a hard line. After all, France held more foreign coins than any other nation. Officials in Paris insisted that upon exit from the LMU, silver coins would have to be paid for in gold or bills of exchange.[768] Italy and Switzerland accepted these terms, as the amounts involved were no longer of huge importance to them. However, the onerous nature of the French demands caused Belgium to withdraw from the negotiations. In a sign of how the ties binding the system had loosened, the expectation in Brussels was that Belgium could bear the costs of withdrawal from the LMU.[769] However, it soon became apparent that France intended to deposit its holdings of Belgian silver coins at the Bank of Belgium and draw bills upon them in order to compensate holders of Belgian silver in France (the largest of which was the Bank of France).[770] There would be little Belgium could do about this without a great disturbance in exchange. Again, the case was resolved in bilateral discussions under which special arrangements and concessions were made.[771]

[763] Ministère des Affaires Etrangères, 1878, 17.
[764] Ministère des Affaires Etrangères, 1878, 13.
[765] Willis 1901, 150.
[766] de Cecco, 1998, 73-74.
[767] de Cecco, 1998, 73-74.
[768] de Cecco, 1998, 73-74.
[769] Willis, 1901, 150.
[770] Ministère des Affaires Etrangères, 1878.
[771] Willis 1901, 150.

The redemption clause set the LMU on a clearer foundation. It reduced the incentive for smaller states to issue devalued silver coin, because they would have to redeem it. However, this did not prevent further problems. Greece and Italy still needed subsidiary coins in greater amounts than the LMU could permit. This saw the introduction of a new Italian law in 1893 that would nationalise subsidiary coins. This law represented a major departure from the free circulation of subsidiary coins that had inspired the LMU.[772] Greece made a similar law in 1908. The LMU was adapted through an *ex post facto* treaty adjustment that accommodated rather than directly punished these moves of defection.[773] The convention survived until the First World War under exclusory leadership, through the tolerance of partial defection and a limited number of exits, which this study's theoretical framework defines as normal features of spontaneous orders. However, after the war, and following the printing of paper money on a massive scale, huge flows of silver coins occurred between nations, in pursuit of the point of lowest depreciation. The Swiss authorities, who had suffered the least depreciation, were forced to suspend the free convertibility of silver coins minted outside their territory. This departure from the convention was formalised in 1921, effectively bringing the LMU to an end. In a sign of how unimportant the LMU had become, however, it was not until 1925 that Belgium formally left. This final episode in the history of the LMU was completed in 1927 when all countries exited the system and it was declared defunct.[774]

6. Decline in a Turbulent Age

Remarkably, the LMU survived for over 60 years without ever properly performing the function for which it had been established. The problems of subsidiary coinage were constant and the LMU never fulfilled its promise of becoming a common currency and exchange rate regime. The LMU never became more than a limited coinage agreement created to mitigate the difficulties that had arisen in the spontaneous franc zone. This, perhaps, should be less surprising than it sounds, because the slow decline of the LMU can be logically connected to the story of its origins, and to the ongoing deployment of exclusory policies by the French leadership.

The LMU was formed to deal with the problem of subsidiary coinage, while avoiding any undue constraints being placed on autonomous French monetary policy choices. Creating a Union under this guiding exclusory precept came at a cost: the minimalist constitution of the 1865 convention gave excessive freedoms to the members. The early years of the LMU were defined by efforts to plug the resulting gaps. France secured the persistence of the system in spite of: the *cours forcé*; military defeat at the hands of Prussia and a huge indemnity of five milliards; the death of bimetallism; and the rise of

[772] Ministère des Affaires Etrangères, 1893.
[773] The convention was updated through a revised protocol in March 1898 relating to the fractional currency of the kingdom of Italy (see Ministère des Affaires Etrangères, 1878). Reflecting its different status in the union, when Greece took similar action in 1908 its relationship with the Union was effectively terminated.
[774] De Cecco, 1998, 74-75.

the gold standard. In managing these difficulties, France exploited the strategic advantages of leadership to minimise the burdens on its own economy, keeping its notes either at par or close to par for much of the life of the LMU, while also retaining the political and economic benefits of the franc zone. By avoiding debates over the fundamental principles of the Napoleonic system, France was able to employ a "wait and see" approach in its external monetary relations, and to move its domestic monetary arrangements forward at a pace tolerable to the financial sector interests that formed the economic foundation of the system. These benefits of leadership were retained not by holding the system static and disregarding the changing world (as is the case in negotiated systems), but rather by keeping a monopoly over policy developments, discriminating between the members of the LMU and franc zone, and avoiding conflict with the entrenched economic interests of the *haute banque*.

However, the LMU could not continue indefinitely. After its foundation in 1865, the system was never fundamentally reconstituted: it began and ended its life as a minimal agreement intended to deal largely with the problems of silver in a world where gold and paper were the increasingly important monetary phenomenon. The LMU also never truly expanded to include more than its initial members. Exemplifying the logics of exclusory leadership, as described in this study's theoretical framework, and anticipating similar developments in the case of the Sterling Area, the French leadership's failure to drive forward the integration of the LMU was, paradoxically, crucial to the LMU's longevity. This leadership modality allowed France to avoid member resistance, and enabled the system to coexist with its chief competitor, economic nationalism. Moreover, French actions were not intentionally designed to draw out the length of the decline, but this was nevertheless the result. However, as France did nothing to deepen the LMU's grip on state practices or expand its appeal, the LMU became ever less relevant to a world that was rapidly changing its monetary practices. As France did not update the LMU, failed to impose stricter disciplines on members, and only sustained the LMU defensively, the LMU gradually lost much of its purpose. The functional and political needs of a new world made themselves felt, and the members of the LMU defected and drifted apart. Over the long term, a system that had been founded upon private action and arbitrage was incrementally marginalised by the rise of economic nationalism and the international gold standard.

PART III

7

The Eurozone: A Pathway to Collapse?

What will become of the euro? The explanatory framework of this thesis generates the striking conjecture that the Eurozone is destined for rapid collapse. To explore this provocative claim, this chapter applies the framework to investigate the origins and development of the Economic and Monetary Union (EMU) of the European Union (EU). In the 1970s, the political foundations of the EMU were established by the Werner Report. The goal of EMU, which was supposed to be achieved in a decade, was finally realised in 1999 with the launch of the single currency and the establishment of the European Central Bank (ECB). At that moment, the EMU was declared irrevocable. Nevertheless, it is currently undergoing a crisis. Even before the current crisis of the established EMU, progress towards monetary union had faltered in two prior systems: the Snake and the European Monetary System (EMS). With their common initial conditions and negotiated structural forms, those systems developed and experienced setbacks in ways that not only form part of the history of the EMU, but that can also help to interpret its current predicament. The Snake and EMS took shape under appropriative German leadership, which was facilitated by repeated collective institutional bargaining. The patterns of coordination established by this modality of leadership culminated in a crisis in the early 1990s that shares striking parallels with the challenges facing the EMU today. The application of the explanatory framework to recent policies in the Eurozone, conscious of this history and analytically attuned to the clashing interests between the German leadership and the members of the EMU over the terms of monetary integration, demonstrates the ominous continuation of technocratic fixes, information distortions, policy maladaptation and rising resistance. The lesson from history is that if the EMU leadership continues along these appropriative tracks, the system will be driven to rapid collapse.

The monetary integration process was faced with problems, and policy choices had to be made about how to solve them. The explanatory framework of this thesis helps to comprehend the faltering progress towards the EMU, by calling attention to the integrated and negotiated organisational hierarchy through which policy choices were made. Germany has always stood at the apex of this hierarchy and led the project for monetary integration. German monetary officials have broadly been able to impose their will on policy choices, although they have always had to compromise and bargain to a certain extent. As Kenneth Dyson notes, the Bundesbank "had the power of leadership in the policy process that came from its credibility as the authority presiding over the ERM's 'anchor currency' defined as the currency with the best record on inflation and the only one never to be devalued within the ERM."[775] Progress

[775] Dyson, 1994, 2. The ERM refers to the exchange rate mechanism which was introduced by the European Economic Community (EEC) on 13 March 1979, as part of the European Monetary System (EMS), to reduce exchange rate variability and achieve monetary stability in preparation for economic and monetary union.

towards the EMU was achieved through repeated collective institutionalised bargaining. The intensive structured communications centred on institutions extending well beyond the intermittent Council Meetings and Committees of Wise Men. Prior to the foundation of the ECB, the most important loci of decision and power were the Committee of Governors (CoG)[776] and the Monetary Committee (MC) of the European Community (EC). In these forums, policies were shaped by a chronic conflict between the members of the system and its German leadership, although this conflict was not always obvious. As one German banker put it: "We should be under no illusions – the present controversy over the new European monetary order is about power, influence and the pursuit of national interests."[777] For three decades, the strongest currency in the system, the German mark, was pitted against weaker member currencies, notably the French franc and the Italian lira. The clash of national interests between Germany and other members continues today, notwithstanding the inauguration of the single currency. The hope of the French and the Italians, that the supranational authority of the ECB and the creation of a common currency would rid the system of its fundamental power asymmetry and source of conflict, has proven to be a castle in the air.

Underlying the explanatory framework of this thesis is the observation that monetary systems often face policy problems, and the leaders and members come into conflict over which solutions to adopt, since the different options would distribute benefits in different ways. This clearly applies with respect to the European integration process. In order to maximise its utility in conflicts over policy, which were resolved via repeated collective institutional bargaining, Germany guided the integrative transactions through logics of appropriation. Whenever performance problems arose, Germany used its power and influence to co-opt the monetary authorities and treasuries in European member states into defending constructs that served its own particular interests. In this way, disproportionate benefits were consistently channelled to Germany. However, other national monetary authorities and supranational interests also benefited, through special forms of traded reciprocity. Through repeated bargaining, the integration process was infused with the interests of Europe's monetary authorities. Central banks and treasury agencies developed strong institutional and personal attachments to the EMU. These were connected to the enormous initiation costs involved in launching each integration scheme. Yet, despite its desire to realise the EMU, this concerted technocratic core consistently opted for short-term gains at the expense of the system's long-term performance. The integration process was guided through technocratic fixes and information distortions that reinforced the lack of symmetrical pressure on the German balance of payments.

The structure of monetary relations that exists in Europe today took time to embed. The Snake case study illustrates a negotiated system where appropriative leadership never quite took hold, because

[776] This is a reference to the Committee of Governors of the Central Bank of the Member States of the European Community (subsequently "Communities", then "Union").
[777] Dyson, 1994, 112.

Germany never stepped into an uncontested leadership role. It was only in the 1980s that Germany came to dominate monetary conditions more clearly.[778] As a result, from this point onwards, appropriation took a stronger hold on the EMS. By fixing exchange parities to the mark, national monetary authorities accepted Frankfurt's leadership. In return, they attained a means to augment their own domestic power, in particular through patronage from the Bundesbank, and through the EMS as an external constraint. The apparent stability of this pattern of relations led to the belief that a *de facto* monetary union had emerged in the 1980s. However, this belief amounted to a huge image distortion that obscured major points of dysfunction and vulnerability in the EMS. The faltering of the EMS in the 1990s was an enormous shock to insiders in the CoG and MC. Yet, the trajectory towards crisis is readily observable from the perspective of the explanatory framework.

Like the gold-dollar order before it, the EMS transitioned from planned symmetry to German dominance. Policies and practices were tilted towards the centre through technocratic fixes that became generalised means to solving cooperation problems. The "Belgium Compromise" and the Basel/Nyborg Agreement offer prototypical examples. The distributional disjunctures and functional misalignments that formed under these policies were difficult to identify, because of strong logics of mutual self-empowerment. However, despite the members' voluntary self-subordination to German power, limits to appropriative leadership emerged. The central vulnerability arose from the unequal payoffs between Germany and the members. This source of resistance to integration was compounded by economic trends that diverged between the member nations. The dual shocks of German reunification and the depreciating dollar exposed the slim political and economic reserves of the system. In the final act, Germany in [year], like America in 1971, refused to subordinate its national interests to those of the system or its members. After a short period of more coercive governance, the EMS reverted to a loose arrangement.

The evidence that appropriative leadership undermined the process of European monetary integration presents a challenge to the mainstream historical narrative. According to conventional wisdom, the EMS faltered due to exogenous shocks and technical issues that were effectively addressed by a stronger technocracy and deeper integration.[779] Few asked whether there might be a political and structural explanation for the lurch from failure to failure. Still fewer were prepared to recognise that Europe's monetary leaders had been opportunistic. Nobody really acknowledged that the spoils of the supposedly gilded path towards the EMU had been distributed unequally. On the contrary, as an article of faith and expedience, it was espoused that the irksome politics of the past had been removed through deeper integration and the depoliticisation of decision-making structures. This, of course, was pure ideology. The most elementary historical reflection teaches that monetary integration always produces winners and losers. The EMU is no exception. With recent events, the inequitable payoffs between Germany

[778] de Grauwe, 1994, 3.
[779] See, for example, Delors, 2004; European Commission, 2004; and Scheller, 2004.

and other countries have proven to be even more explosive than before. The reason is simple: in sharing a single currency, there are fewer instruments through which nations and disenfranchised groups can be sheltered from losses.

The second part of this chapter turns to the problems the Eurozone faces today. These can be traced to the fundamental economic and political maladjustments that the EMU has inherited from the past. Fundamental imbalances between strong and weak Eurozone countries have persisted. According to the IMF, the current account surpluses of Germany and the Netherlands are heading towards ten percent of gross domestic product per annum this year, an asymmetry that will not self-correct and which is not sustainable.[780] Furthermore, Germany, as well as some strong countries around it, has maintained low unemployment rates and manageable levels of debt. By contrast, concerns remain regarding the high levels of debt and unemployment in the South, in Greece, Portugal, Spain, Ireland, Cyprus, Italy, and some may even add in France, and the decades of real-terms deflation that they face to adjust. The history of the Snake and EMS reveals how deeply embedded are these inequitable distributional patterns. They cast a long shadow over the single currency. The Eurozone has deprived member governments of the monetary and exchange rate instruments of macroeconomic management through which these inequities and sources of disjuncture might have been handled. The key questions are: What policies and mechanisms have guided the development of EMU? How have these choices affected the historical disjunctures and fissures between nations? And what long-term implications can be expected?

This thesis reveals that the central elements standing between the supposedly irrevocable EMU and its potential collapse are, first, the leadership and financial power of Germany, and, secondly, a small appropriated technocratic elite. This elite includes the monetary experts of the Commission, national treasury departments, and national central banks brought together in the European Central Bank (ECB). The power of these agents should not be understated. From the outset, they have occupied a privileged position at the political centre of the EMU, as both its managers and guardians. They have enormous technocratic capacities. Moreover, they have deep-rooted personal and bureaucratic interests in maintaining the system, both to secure the rents it provides them and because they were responsible for creating the EMU, which would make the costs of its failure to their reputations enormous. Notwithstanding these sources of resilience, the framework of this thesis posits that such groups are prone to advancing technocratic fixes and maladaptive information distortions when they bargain over policy solutions amidst clashing national interests. The following analysis shows how policy reforms in the Eurozone since 2008 have had just such an appropriative character. Resistance has taken root among insiders and outsiders who resent the continuation of German dominance and the unequal distribution of payoffs under the EMU. In theory and in history, the ultimate fate for international monetary systems driven along the trajectory of appropriation is rapid collapse. Logically, therefore,

[780] International Monetary Fund, 2015; also see, International Monetary Fund, 2014.

unless the character of the Eurozone leadership should change, and the structure in which policies are made is fundamentally reformed, the only outcome that can be reasonably anticipated for the EMU is collapse.

Before setting out the full argument, it is worth noting the basis of this conjecture. The framework of this thesis was developed primarily as an explanatory instrument rather than a predictive one. However, this does not render the conjecture unhelpful. The logic of the argument presented throughout this thesis is that to understand varying temporal structures and patterns of dissolution, it is essential to pay attention to the period of stability before the onset of dissolution, and to the evolutionary dynamics of the dissolution process. When pressures for adaptation arise from emergent problems, alternative historical contexts (spontaneous and negotiated orders) will induce and sanction alternative strategic responses from leaders (exclusory and appropriative) that will shape the way systems come to look and operate. That is, these historical conditions will determine how different systems build up both differing sources of resilience and differing vulnerabilities over time. Leadership responses and system developments are readily observable. If behaviours and policy innovations that could be deductively anticipated – and that are evident in similar historical cases – are observed in contemporary systems, then this provides good cause to anticipate that future changes in these systems will follow the predictions of the framework. An informed historical perspective can strengthen the interpretation of current events and help to discriminate between competing projections, establishing which scenarios are the most plausible.

1. The Origins and Path to the EMU

The 1957 Treaty of Rome rekindled the dream of European monetary union, which had previously ended when the Latin Monetary Union did. Before the goal was reached, two pan-European exchange rate regimes were established. Each, while differing in technical particulars, took a negotiated form and was established around political elites in Brussels who wanted to irrevocably affirm monetary union. At the turn of the millennium, EMU was achieved. This apparent success has masked the lessons of history. The present section recalls those lessons by returning to the troubled path to the EMU through the Snake, in the 1970s, and the EMS, in the 1980s. This path has important contemporary implications: the governance of the EMU suddenly appears far from *sui generis.* On the contrary, and in accordance with the explanatory framework of this thesis, it is revealed to be taking a predictable form under the historical and structural conditions of a negotiated order.

1.1. The “Snake” on the EMU ladder

In the 1960s, Europe was divided by capital controls, separate currencies and differing national monetary traditions and institutions. This made it difficult to operate common policies, notably the Common Agricultural Policy. In order to remedy this problem, the heads of state of the EC, at the 1969 Hague Summit, committed to a “phased plan for the establishment of an economic and monetary

union".[781] Establishing a modus operandi that persists today, the commitment to monetary union was subsequently taken forward by a closed committee of high-ranking European officials and politicians, chaired by the prime-minister of Luxembourg, Pierre Werner. The Interim Werner Report, published in May 1970, set out an ambitious target to reach full monetary union through several stages by 1980.[782] The concrete outcome was an exchange rate mechanism known as the "Snake", which was intended to progressively narrow the margins of fluctuation between the currencies of the EC member states. In terms of the explanatory framework of this thesis, the Snake is an interesting case because it shows signs of appropriation emerging under the supranational leadership of the European Commission, in response to the incentives of a negotiated order. However, it was never possible for the leadership to skew the interests of national monetary authorities towards defending the Snake, and, as a result, the system never got off the ground.

The ideal of monetary integration enthused policymakers in Brussels in the early 1970s. Europe was awash with competing plans and roadmaps.[783] Beneath the technocratic papers lay deep-seated political disagreements between France and Germany regarding the objectives to be adopted for monetary union. The "French monetarists" were diametrically opposed to the "German economists."[784] France wanted a fixed-rate EC system with sovereignty over economic and fiscal policies remaining national. Frankfurt was convinced that monetary union could not precede economic and fiscal harmonisation. Behind this German position lay the belief that France was pushing for monetary union "so that they would be able to solve their problems without reforming their economic policies and by relying on European reserves which would basically be German reserves."[785]

The Final Werner Report, like the Delors Report some twenty years later, avoided the "monetarists" versus "economists" debate.[786] In a sense, therefore, the whole EMU project was founded upon a technocratic fix: a decision to avoid confronting issues with implications for international power relations. The compromise made was that monetary and economic integration should proceed in parallel. This was not the only area where difficult political and ideological disagreements were circumvented. The French and Germans also clashed over the concrete proposals to transfer powers to the Community level to support integration. The political structures and policymaking architecture that would be needed to realise monetary integration were conspicuously absent from the Final Werner Report. Instead, a gradualist approach was suggested in which monetary union would be realised over three distinct steps. This avoided establishing prior conditions for the project and thereby enabled

[781] Communiqué of the Conference of the Heads of State or Governments of the Member States of the European Community (The Hague Summit Declaration), The Hague, 2 December 1969.
[782] Werner, 1970a.
[783] A non-exhaustive list would include the German Schiller Plan, the Belgian Snoy Plan, the Luxembourg Government's vision, and the second Barre Plan of the Commission (see Werner, 1992).
[784] Maes, 2007; and Corden, 2003.
[785] Lefèvre, 2002, 73-84.
[786] Werner, 1970b.

countries to commit to the goal of European monetary union.[787] However, as with all such fudges, most of the important political and distributional issues were deferred to a later stage.

The Werner Report, endorsed by the Six EC members in March 1971, represented only a weak commitment to introduce monetary union at some point in the future.[788] The first stage, involving the narrowing of currency fluctuation margins, was established on an experimental basis, but this did not entail any commitment regarding the continuation of the process. The debates about how to get to the second and third stages of integration, where real distributional issues arose, proved impossibly contentious. The discussions planned for later in 1971 were derailed by the oil shock and the collapse of the gold-dollar system. In a fashion that foreshadowed future developments, the Commission sought to use the crisis to drive integration forward.[789] The turmoil thus saw a loose exchange rate arrangement, the Snake, established as a holding device, until conditions improved to the point that the Werner Plan could be implemented.

The Snake, formally launched in February 1972, represented a flimsy compromise between French and German interests. In accordance with French preferences, EC currencies would be held within certain bands (known as "the tunnel") with the help of capital controls, while the German desire for greater economic coordination would see the establishment of an EC Monetary Steering Committee. The initial participants in the Snake, from April 1972, were the six EC members; from May 1973, Britain, Ireland, Denmark and Norway (not EC members) also took part. Each participating nation was centrally assigned a bilateral exchange rate with each other nation in the system. Monetary authorities were required to intervene if the rate moved outside the margins of 2.25 per cent either side of the central rate. The ambition was that, through progressive narrowing of rates, full monetary union could be realised within a decade.

The Snake system never stabilised, still less promoted integration. Members regularly left the confines of the parity tunnel in a series of currency crises. The system was hopelessly bound up with the collapse of the gold-dollar system in its first year. The coexistence of the two systems created political tensions amongst the members of the Snake, as smaller EC countries felt marginalised from pertinent debates.[790] In 1973, the link between European currencies and the dollar was finally broken, but the series of devaluations and revaluations continued, leading to the fateful French exit in 1974. After this juncture, the Snake existed only as a small D-mark zone, including Germany, the Netherlands, Belgium and sometimes Denmark. Leading this zone importantly gave Germany a sense of the influence that the structure of the Snake brought it. When the time came to negotiate the EMS, German officials therefore

[787] Werner, 1992.
[788] Werner, 1970b.
[789] European Commission, 1971.
[790] McNamara, 1998, 108.

insisted on continuing with essentially the same set of institutional and policy arrangements, which would ensure their continued predominance.

As a system designed to facilitate integration and policy coordination, the Snake was a total failure. Despite some signs of limited policy convergence in 1972, the discussions in the CoG and MC were marked by long and elaborate statements where officials failed to stake their positions. As one official put it, "so far coordination amounts to little more than ministers of economics and finance swopping ideas . . . and at the Council of Ministers level, agreeing to anodyne commitments to allow surplus countries to purse more simulative policies than deficit countries."[791] Bernard Clappier, the governor of the Bank of France, later called this "the coordination of lips."[792] The institutional developments that would promote integration also went nowhere. As Peter Ludlow notes, the movement towards monetary union was complicated by "the evident unwillingness of the French to accept the political and institutional implications of a commitment to monetary union."[793] Other countries, including Germany, were similarly reluctant to accept the costs of unification for their sovereignty. The progression towards the pooling of reserves was constantly deferred, because no central bank, least of all the Bundesbank, wanted to give up control of its assets. The European Monetary Cooperation Fund (EMCF) was a key institution whose creation was delayed amidst conflicts between surplus and deficit countries over the creation of international credit facilities.[794] In the end, the EMCF turned out to be a paper tiger with limited bookkeeping tasks, because since "the legal basis of the EMCF brought it under the control of the Community institutions, the Member States and their central banks were reluctant to assign it policy functions."[795]

Divisions between Germany and France meant that the leadership of the Snake was essentially left to the European Commission after the initial bargain was struck. In a triumph of hope against experience, the Commission pressed for a move to the second stage of integration in 1973. As Loukas Tsoukalis notes, "there was an element of absurdity in all this."[796] The high sunk costs of entry, and associated personal and institutional interests that the Commission had invested in the project, meant that nobody was prepared to admit that unification by 1980 was an unrealisable goal. The only actual development in the second phase was that the EMCF was finally constituted in 1973. Yet, for the aforementioned reasons, the EMCF would make "very little practical difference to the existing status quo."[797] Eventually, it was admitted that the 1980 unification target had to be abandoned.[798] The Marjolin Report

[791] Tsoukalis, 1977, 142.
[792] James, 2012, 312.
[793] Ludlow, 1982, 14.
[794] Tsoukalis, 1977, 142.
[795] Scheller, 2004, 18.
[796] Tsoukalis, 1977, 151.
[797] Tsoukalis, 1977, 142.
[798] Ludlow, 1982, 3.

published in 1975 recorded that, in the aftermath of the failure, "national economic and monetary policies have never in 25 years been more discordant, more divergent, than they are today."[799]

In summary, at the time of the Snake, international crises continued to dominate European monetary conditions and the process of integration stalled. Paris and Frankfurt stood miles apart on most issues and the Commission was forced to fill the leadership void. In this climate, it is somewhat surprising to find any evidence of appropriative leadership. Yet, several features of appropriation consistent with the explanatory framework of this thesis did develop. However, the most important legacy of the Snake was that those committed to integration were strengthened in their ambition. The 1970s fused together a tight band of officials, including, among others, Bernard Clappier, Jacques van Ypersele, Raymond Barre, Giovanni Magnifico and Robert Marjolin, who shared the belief that monetary union was essential to the future of Europe. The central bankers of Europe also acquired a taste for the power that unification could deliver them through mutual empowerment. Together these national and supranational technocrats forged the historical platform of the unification project. The grouping was not necessarily stable in its membership or economic philosophy. Nevertheless, they represented the priesthood of a new religion. For the time being, they lacked a church. As Conrad Oort, the Dutch treasury secretary candidly noted: "The Snake has become the favourite animal of the Eurocrats. It resides on an empty floor in Luxembourg, called the European Monetary Cooperation fund. So far, its most distinctive virtue is that it has created a whole series of serpentine folklore and Eurolingo exclusively developed to the life and habits of the snake."[800] This priesthood ensured that the project of European monetary union would acquire a new skin in the 1980s – the EMS.[801] What would critically improve the fortunes of the integration project, which they so desperately wanted to advance, would be the impetus of German leadership. The EMS would deliver just that.

1.2. The Rise and Fall of the EMS

The 1970s were troubled years for the European project, and the sitting President of the European Commission saw monetary unification as "the most open axis of advance for the Community in the circumstances of 1977."[802] A push from the Commission coincided with the desires of President Giscard D'Estaing of France and Chancellor Schmidt of Germany to engineer greater monetary autonomy for Europe, specifically from the influence of the depreciating US dollar, which was hampering German and European competitiveness. This political impetus, coupled with the historical commitment to monetary union, gave birth to the EMS in 1979.

The EMS was stabilised by logics of appropriation that saw countries converge around German leadership and priorities. The history of the EMS provides strong confirmation of the explanatory

[799] Majolin, 1975, 1.
[800] James, 2012, 90.
[801] James, 2012, 91.
[802] Jenkins, 1991, 463.

framework of this thesis. Under appropriative leadership, central banks and monetary authorities augmented their powers by leveraging German monetary credibility and using the EMS as an external policy constraint. Moreover, central bankers entrenched their position at the centre of the policy-making process. They represented a powerful technocratic core, protective of their prerogatives, and prepared to collectively speak out in defence of the system. Yet national monetary authorities remained subject to domestic influences. They could never entirely surrender to Frankfurt's priorities. Equally, Germany remained a self-serving rather than system-serving leader. As the explanatory framework would lead us to expect, the tensions over the distributional outcomes of policy developments were dealt with through technical fixes that entrenched political cleavages and policy maladaptations. Notwithstanding collective representations of the system as robust, the dual shocks of German reunification and deteriorating European competitiveness exposed its latent vulnerabilities. When Germany was forced to choose between pursuing its national interests and continuing the EMS without the continued support of an appropriated membership, national interests trumped the ideological commitment to monetary union. The EMS shattered into a regime of managed floating.

a. The Birth of Asymmetry

Bargaining over the EMS began at the Copenhagen Summit in April 1978.[803] The Exchange Rate Mechanism (ERM) deal was hammered out quite quickly between British, German and French officials, before being presented to the rest of the community in Bremen in July 1978. The technical constitution of the ERM system looked much like the Snake. It was a system of fixed but adjustable rates orientated around the European Currency Unit (ECU). The ECU was a basket of ten member currencies that had two functions: first, to act as the *numéraire* in the system and, second, to provide the basis for a divergence indicator that would calibrate the burdens of adjustment.

Although the ECU was intended to bring about symmetry, the EMS was skewed towards German interests from the start. When German opposition to the more ambitious ideas of France and Italy became clear, the French and Italians acquiesced to a system that would resemble the asymmetry of the Snake, while the UK opted out of the arrangement completely.[804] The concerted position of France, Belgium and Italy nonetheless forced Germany into some compromises.[805] Formally, the rules of the EMS appeared to protect the interests of weaker powers. For instance, exchange rates could only be changed by mutual agreement. Moreover, divergence from the established parities was intended to impose equal adjustment obligations on surplus and deficit countries. However, according to the explanatory framework – and as the cases of the inter-war and gold-dollar orders have demonstrated – issues with implications for power relationships within negotiated orders will be subsumed in

[803] Ludlow, 1982.
[804] For a discussion of the British, French and Italian negotiating positions see Walsh, 1994.
[805] Ypersele, 1979.

technocratic fixes that serve to secure the interests of the powerful. The EMS was no exception to this rule.

The central technocratic fix of the EMS deal was the "Belgian compromise."[806] The compromise aimed to reconcile the differences between Germany and members with weaker currencies. The latter countries favoured relying on the "divergence indicator" to guide adjustment policies. Under the divergence indicator, the burden of intervention and monetary policy changes would fall on countries whose exchange rates were diverging from the EC average, whether the currency was strengthening or weakening. Germany and the Netherlands, which had stronger currencies, favoured a parity grid to determine intervention. With a parity grid, the burden of intervention would fall on countries with weaker currencies. Under the Belgian compromise, both the divergence indicator and parity grid were used. However, the divergence indicator did not require policy changes on the part of countries with stronger currencies, but spoke only of a "presumption of action." Technical difficulties in the operation of the divergence indicator, exacerbated by the German objection to the automaticity of the original design, meant it only ever became a signalling device that established nothing more than a very weak assumption for corrective action on the part of the strong currency.[807] The result was that the asymmetry of adjustment was not corrected, so deficit countries continued to face disproportionate pressures to adjust.

This was not the only area where the details of the EMS protected Germany's particular interests. For instance, in another effort at symmetry, the system included plans to pool reserves in the EMCF. Each participating member of the EMS was to contribute 20 percent of its gold holdings and 20 percent of its US dollar assets in return for ECUs. However, the ECUs would only be used to settle balances and the instrument was further limited by its transitional nature and limited size. The currencies for interventions would have to be conventional ones. In practice, this meant the mark and the dollar. In addition, a European Monetary Fund was planned to provide additional financing support to deficit countries. However, this support was never forthcoming. As a result, countries with weaker currencies had to rely on short-term financing controlled by the Bundesbank.

The EMS was skewed further towards German interests as practices of intervention stabilised. As long as the established parity was to be defended, the EMS prescribed mandatory interventions by the central bank of an appreciating currency. The Bundesbank, in other words, was expected to sell marks to buy weaker currencies when they came under attack. However, the Bundesbank could ask the issuing central bank to exchange the currency it purchased with its own currency. This would automatically sterilize the Bundesbank interventions and avoid any permanent increase in the volume of marks. In this way,

[806] Ypersele, 1985, 48-49. Ypersele was the Belgian representative to the EC Monetary Committee.
[807] The technical aspects of the divergence indicator created much room for manipulation (see Salop, 1981; and Ypersele, 1985).

the burden of interventions was shifted onto the central bank of the country with the weaker currency, which was required to reimburse (within 3–6 months) any amount borrowed from the Bundesbank. Thus, the Bundesbank was able to externalise the costs of its interventions. Moreover, by being ultimately free to choose whether or not to offer support, the Bundesbank could decide whether to help a country or force it to devalue. As the Italians and British would learn in 1992, lacking the full support of the Bundesbank could force devaluation on member countries.

To summarise, although the system was designed to achieve symmetry, the technical features of the EMS entrenched Germany's position as the dominant monetary power on the continent. The EMS arrangements would provide a means for Frankfurt to intervene in the monetary affairs of other states. Furthermore, the system would improve German competitiveness, in particular as against the higher inflation of Southern European countries, without sharing the burdens of the adjustment process equally.[808] In the words of Karl Otto Pöhl, the influential head of the Bundesbank: "The Bundesbank turned the original concept [of the EMS] on its head by making the strongest currency the yardstick for the system."[809] In short, Germany was the final arbiter of life and death in the EMS.

b. German Appropriation: The D-Mark System

An initial flexibility in exchange parities in the EMS gave way to ever more rigid rates.[810] The catalyst for this increasing rigidity was the exchange instability experienced in 1982 and 1983, especially in France. The inflationary effects of devaluations encouraged member monetary authorities to use the EMS as an external constraint to engineer competitive deflation.[811] It is sometimes forgotten, by those keen to emphasise the voluntary nature of the EMS, that the German government actively pushed for greater stability in rates, in order to prevent continued competitive devaluations in Southern Europe. And the German government threatened to suspend intervention unless Belgium's 1982 devaluation was smaller than the proposed 12 percent.[812] However, it is still true that the real drive towards rigidity came from members' national monetary authorities that used the EMS to strengthen their domestic hand against coalitions that wanted realignments and devaluations. The French "franc fort" policy marked the change in attitude in favour of rigidity. This policy was based on the theory of "competitive disinflation", which sought to achieve a real depreciation of the currency, low inflation and a strong currency, (i.e. the foundations of improved competitiveness and long-term increases in employment),

[808] There is a huge literature on the various dimensions of German leadership and hegemony under the EMS (see de Grauwe, 1987 and, 1988; Giavazzi and Giovannini, 1987; Marsh, 1992; and von Hagen and Fratianni, 1990).
[809] Pöhl Speech in St Paul's Church, Frankfurt, on 27 August 1991 (quoted in Marsh, 1992, 203).
[810] It has been argued that this period of flexibility was in fact the most successful era of the EMS (see Giannini, 2011).
[811] Giovannini and Giovannini, 1989; also see, Burdekin, et al., 1994.
[812] James, 2012, 193.

by imposing an external constraint on the possibility of depreciation to realise short-term economic gains.[813]

As German monetary conservatism was imported to augment the credibility of central bank commitments, member countries willingly subordinated themselves to the interests of the centre. In the words of Giavazzi and Alberto Giovannini, "Germany as the centre country, runs monetary policy for the whole system, similarly to the United States during the early Bretton Woods years."[814] Stanley Fischer described the substance of this system as "an agreement by France and Italy to accept German leadership in monetary policy, imposing constraints on domestic monetary and fiscal policies."[815] In other words, the member authorities did not lose autonomy, but were able to use the EMS system and German support to augment their autonomy and sphere of influence domestically. The chance partake of these mutual benefits of appropriation drew the monetary authorities of countries like the UK, Spain and Portugal into the EMS order. The price member countries paid was subordination to German power.

This process, while still appropriative, was more member-driven than the development of subordination in either the inter-war or gold-dollar systems. With perhaps a little overstatement, Wolfgang Rieke, the head of the International Department at the Bundesbank, argued that the "use of the DM as a preferred intervention currency and its role as 'anchor' of exchange rate stability was not an explicit component of the original design of the EMS, though it was perhaps unavoidable to begin with…. It was certainly not a role sought or imposed on the system by its largest member."[816] Paul Krugman wrote similarly that "what is particularly interesting is the way that this strongly asymmetric system is entirely implicit, a matter of latent rather than manifest function."[817] The explanatory framework of this thesis has no difficulty in accommodating member-driven appropriation, because such a process is characterised by mutual gains and reciprocity. However, the framework does caution that the automatic nature of appropriative relationships should not be overstated nor allowed to obscure the distributional implications that follow from them.

Germany was able to use the recurrent collective institutional bargaining in the EMS to sustain a pattern of appropriative action, by giving member monetary authorities the sense of a collective stake in the system.[818] Moreover, in subtle ways, Germany engineered its central position; for instance, it resisted the use of the medium term financial assistance that was provided for in the EMS structure. While these credit facilities remained dormant, member countries were forced to rely on central bank supports that the Bundesbank controlled, and on interest rate adjustments to channel private capital to finance

[813] Fitoussi, 1993.
[814] Giovannini and Giovannini, 1989, 63.
[815] Fischer, 1987, 41.
[816] James, 2012, 208.
[817] Krugman, 1990, 56-57; also see James, 2012, 208.
[818] Marsh, 1992.

deficits.[819] The general point – which accords with the explanatory framework of this thesis – is that Germany could cloak the pursuit of its particular interests in several ways: in the concerted mechanisms of the EMS, in the voluntary subordination of members, in the workings of reciprocity around the bargaining table, and in the development of a mutually beneficial common belief in monetarism and inflation targeting.

The important implication is that, notwithstanding the mutual empowerment and reciprocity internal to the D-mark system, Germany continued to gain disproportionate payoffs and retain key benefits in this period. To be sure, the EMS did experience a degree of nominal convergence in inflation and interest rates between 1983 and 1987. The average rate of inflation in EMS countries fell from 7 to 1 percent and the standard deviation fell from 4 to 2 percent.[820] There were other mutual gains through the reduction in competitive devaluations. Yet, the explanatory framework of this thesis pushes analysts to look behind economic convergence and shared gains and to distinguish between relative winners and losers. In this perspective, the key distributional implication of EMS was that the Bundesbank was free to set its interest rate according to domestic economic conditions, while other states in the system set interest rates with a view to retaining stable exchange rates.

Another feature of the EMS was that the CoG assumed an ever more dominant role in the policy process.[821] The CoG, already at the political centre of the system, not only considered themselves entitled to control the EMS, but were also able to exploit information asymmetries, and their strategic position, to entrench their dominance over the policy making process. Pöhl described this sense of entitlement and power with the observation that: "The EMS rested on an agreement between central banks and not between governments."[822] The central banks jealously guarded their key position, especially vis-à-vis the MC. Pöhl insisted that the MC "should not deal with subjects that lay within the competence of the central banks"[823] These subjects included discussions about reserve diversification, and the extension of swaps for the creation of ECUs. Thus, from their position at the centre of the political base of the system, the central banks augmented their capabilities and attained ever greater influence over the supranational policy-making space through the development of the EMS.

The framework posits that inequitable payoffs from appropriation will induce resentment and resistance. In the case of the EMS, there was a reaction against German dominance, especially amongst those groups of people within the member countries who had lost out as their central banks pursued competitive deflation. The fiscal and monetary contraction that had been pursued by central banks under the EMS had resulted in stagnant labour markets and unemployment rates above 10 percent in several

[819] Ungerer, 1993.
[820] Giavazzi and Giovannini, 1989.
[821] Baer, 2004; and Dyson, 1994, 183.
[822] James, 2012, 232.
[823] James, 2012, 232.

countries.[824] Thus there was an increase in domestic pressure against monetary policy decisions that defended the system at the expense of national priorities. Hans Tietmeyer, later President of the Deutsche Bundesbank, recalls that, "in 1986 and 1987 it was suggested on several occasions, especially by France and Italy, that the intervention obligations of the EMS should be made more symmetrical […]and the joint support mechanisms applied more generously."[825] In order to realise this objective, the French and Italians sought to promote reforms in the MC. The result was an intense turf war between the MC and the CoG that operated under the influence of the Bundesbank.[826]

French and Italian agitation led to the Basel/Nyborg Agreement of September 1987. Central banks agreed to use all available instruments in a flexible way, even when rates were within their margins, to defend stable internal prices and external exchange rates. In its fine details and substantive content, the Agreement was a classic example of a technocratic fix facilitated by mutual self-empowerment among monetary authorities. The Agreement provided a basis to extend the reach of monetary authorities in the operation of the market, but it did nothing to alter the underlying distributional trends in the system. Out of fear that intra-marginal adjustments would force the Bundesbank into excessive liquidity creation, Germany protected its position by retaining control over the obligation to intervene, and imposing hard limits on the levels of intervention vis-à-vis the domestic money supply. As a result, the burdens of intra-marginal adjustments fell largely on countries with weaker currencies. The view of many parties to the bargain was that the changes did not go far enough to correct the asymmetries in the system.[827] However, they had grabbed short-term gains.

The latent tensions in the system thus continued to build. France, in particular, continued to push for common intervention policies, the use of ECUs for intervention (as contemplated when the EMS was established), and a common basis for setting dollar policies. Germany resisted all such proposals, and refused to alter the distribution of payoffs from the EMS. This influenced France to respond by abandoning a long-standing attitude of resistance to the transfer of powers to supranational institutions for the promotion of monetary union. Describing this process, the British Chancellor, Nigel Lawson, saw Pöhl as having played a critical role in provoking, in Harold James' words, a "bitter and fateful backlash against German monetary hegemony."[828] According to Lawson, "it was the way in which Pöhl openly revelled in his role, via the EMS, of the ruler of Europe's monetary affairs and arbiter of its destiny […] that the French […] found so intolerable that they were prepared to sacrifice their own national independence in order to see the Bundesbank abolished."[829] This pressure to abolish the Bundesbank spurred the Germans to propose a new Expert Committee, comprised of the 12 central

[824] James, 2012, 232.
[825] Tietmeyer, 2003, 10.
[826] James 2012, 232.
[827] Ungerer, 1993, 4-12.
[828] James 2012, 208.
[829] Lawson, 1992, 662-663.

banks of the EC and chaired by the President of the Commission, Jacques Delors, which would map the path to the EMU.

c. Illusions of Stability and the Presage of Crisis

The explanatory framework of this study includes the hypothesis that negotiated systems are disposed to maladaptation through distorted trades of private information. So it was that the closed bargaining structures of the EMS in the MC and CoG began engage in systematic distortions of information. The inclination to distort information was acute following the Delors Report in 1989. There were intense political pressures to demonstrate that the EMS was performing well. Nobody wanted to be responsible for frustrating the final stages of integration. The officials who were embedded in the EMS therefore resorted, as a group, to huge image distortions. In consequence, maladaptations increased and political fault lines widened. In an embarrassing irony, the European monetary establishment was arguing that the EMS had become a *de facto* currency union exactly as it entered a period of generalised malfunctioning.[830]

The EMS system became increasingly rigid after 1988. This was primarily a result of French determination not to be subject to a parity realignment imposed by Frankfurt, and can be seen as a marker that the limits of appropriation were being reached. However, rather than this being recognised as a liability at the time, the stability of the parity structure was taken as a positive phenomenon. To be sure, the Bundesbank spoke privately of fundamental imbalances and the Basel Committee also proffered warnings about disequilibria.[831] However, the general tone of the discourse was one of confidence. The central bankers and supranational officials tended to discount information that threatened the image of stability. As Harold James has reported, "generally, the [CoG] did not respond favourably to […] potentially politically explosive warnings about the stability of the system."[832]

The systematic distortions of information resulted in a range of misrepresentations. For instance, capital flowing to Southern European countries was read as responding to long-term improvements in performance, whereas short-term interest rate differentials were the real drivers. Conversely, the macro-economic trends that saw inflation rates grow apart were ignored, or put down to temporary factors rather than a structural divergence in economic competitiveness. Perhaps most remarkably, a belief developed that the absence of parity changes had led to immutable exchange rates. Harold James reports the alternates of the CoG believing that "in certain respects the members of the ERM were already in a

[830] The sentiment among the policy elite in Brussels was well captured in a speech delivered in 1987 by Tommaso Padoa-Schioppa, who said, "the EMS is now sufficiently well established to justify the expectation of its having a long life" (see Padoa-Schioppa, 2000, 93). The European Commission's own history of the EMS, produced in 1989, described a progressive teleology including a 'learning phase', between 1979 and 1983, and a 'transitory phase', between 1983 and 1987, that culminated in a 'stability phase', from 1987 onwards (European Commission, 1989). The CoG also gave, in support of the EMS, a positive assessment of the EMS's actions (see Committee of Governors, 1990).
[831] James, 2012, 337.
[832] James, 2012, 340.

de facto currency union."[833] This belief produced complacency: officials in Brussels overstated the stability of the EMS structure, under the influence of confirmation biases and incentives to defend the status quo.[834]

The collective failure of the managers of the EMS to identify these manifold problems would receive sharp criticism after the events of 1992 and 1993.[835] However, an analyst applying the framework of this study will be unsurprised that the EMS bargaining arrangements became engulfed in systematic distortions, knowing how information exchanges are structured by appropriation. The insiders had benefited hugely, collectively and individually, from the EMS, and had still more to gain from the march towards monetary union. In the end, however, the distortions served only to hold the system on a trajectory towards crisis. The forums that were supposed to make functional adjustments to the system were instead just being deployed to insist that all was well, in spite of a rising tide of pressures.

d. The EMS in Crisis

The framework of this thesis posits that the gradual build-up of pressures under appropriation will eventually reach a tipping point, when the system becomes extremely vulnerable. In the case of the EMS, the build-up of endogenous pressures was compounded by the exogenous shock of global events around 1990. German reunification altered the balance of domestic forces in the system's anchor, encouraging fiscal deficits coupled with continuing monetary conservatism. The falling dollar also strained relations in the system. In addition, the incorporation of new members to the EMS added to the difficulties, as they were less integrated with the German economy. Lastly, there were doubts about the European project following the rejection of the Maastricht Treaty by Denmark, the Italian election in 1992, and Mitterrand's decision to put the Treaty before a referendum.[836] In this climate, neither deepening integration nor further appropriation could be taken for granted.

These proximate factors combined with the already existing latent tensions to negatively affect market sentiments about the stability of the EMS. The exchanges began to move against the managing authorities who suddenly appeared to have little room for manoeuvre. However, neither a general realignment of all currencies nor a broad realignment of weak currencies was discussed when finance ministers and central bank officials met in the first days of September 1992. The failure to negotiate a realignment partly reflected the fact that the CoG and MC had begun to fear rate changes, as these might have spilled over into speculative attacks in the more mobile capital climate. However, at a deeper level,

[833] James, 2012, 339.
[834] James, 2012, 338-344.
[835] Harold James quotes from a report of the deputies of the central bank governors that asserted that had "a procedure of periodic assessments of parities been currency practice in recent years, it would probably be fair to say that authorities would not have been taken so strongly by surprise by the crisis in the exchange market" (see James, 2012, 367).
[836] Harold James (2012, Chapter 9) notes these factors in conjunction with certain others.

the rigidity was a product of Germany's unwillingness to subordinate its interest rates to the needs of the system, combined with the refusal of members to continue to live with asymmetric adjustment.[837]

Years of tension and persistent distributional inequities under appropriative leadership had created a non-cooperative climate. The Bundesbank repeatedly refused to reduce the interest rate for fear of stoking domestic inflation, despite the mark sitting at near the top of its band against a continuously depreciating dollar. France and Britain, on the other hand, continued to resist a major realignment by weaker currencies. The standoff produced a generalised absence of confidence. In the member nations, public and political support for the EMS ebbed away due to a sense of German intransigence. Equally, in the German core, doubts were increasing about the costs of the system due to a sense of member profligacy. Market expectations turned decisively in mid-September 1992. For a few days, the CoG and MC delivered typical defences of the status quo. However, by now, the German policy stance had hardened. It was clear that the Bundesbank was not prepared to provide unlimited support for the system. The result was "Black Wednesday" when, on 16 September 1992, sterling and the lira were driven out of the EMS.

The lessons drawn from the 1992 crisis did nothing to build confidence. German policy was widely criticised in Britain and France. Jacques de Larosière charged that: "On the question of sharing responsibilities, the defence of a currency whose economic fundamentals were regarded as sound should be undertaken with the solidarity of the members of the system who should act in a coordinated manner."[838] This cut little ice with Germany. Helmut Schlesinger, who had replaced Pöhl at the Bundesbank, was adamant that "tension in the EMS could not be alleviated by requiring a country, the currency of which was strong in the exchange markets but which had inflationary problems at home, to cut its interest rates, that might lead to a further increase in the price level."[839] With the support of consensual appropriation removed, the Bundesbank assumed a less conciliatory, ever-hardening stance. Essentially, Germany started to talk in terms of a system where only the fittest currencies would be allowed to survive.[840]

After 1992, no changes were made to bolster the EMS. Appropriation had reached its limits. Germany refused to augment the committed credit supports, leaving France and other countries feeling vulnerable to speculation. When the franc first came under pressure in early 1993, Germany did reluctantly increase

[837] As Adalbert Winkler put it, when faced with the dilemma over leadership, the Bundesbank "had to decide whether to implement a national policy, reacting to the regional shock, or to stick to the European policy option" (Winkler, 1994, 68). In the end, Germany protected itself by "raising interest rates [to avoid domestic inflation; this] may have protected the anchor currency status of the Deutsche Mark, but it destroyed the currency area built on the anchor currency" (Winkler, 1994, 74).
[838] James, 2012, 369.
[839] James, 2012, 363.
[840] The *Financial Times* reported on this change (see "Bundesbank Begins to Make its Voice Heard", *Financial Times*, 2 December 1992; and "Schlesinger Gives Warning on Common Currency Rules", *Financial Times*, 2 December 1992).

the amount by which it was prepared to intervene. However, while the Irish, Danish, Norwegians and Swedes experienced similar pressures, the Bundesbank was unwilling to do the same for them. But the collective bargaining structure made this sort of price discrimination extremely difficult to sustain. This confirms the supposition of this study's explanatory framework, that where countries sit around a bargaining table, it is possible, but not costless, for the leader to pick which countries to help while letting the others succumb to attack. Such discrimination undermined the appearance of concerted action on which the EMS, like all negotiated systems, depended. Some analysts even suggested – and indeed found much supporting evidence– that Germany was trying to take the opportunity to "purge" the EMS of uncommitted members or "soft currencies", leaving only hard-core members.[841]

The final crisis came in August 1993 when the German authorities called for the bands of fluctuation to widen from 2.25 percent to 15 per cent; the call was met by French protestations that this amounted to an enforced devaluation of the franc. The only point of agreement was that the ERM and its central parity grid had to be preserved.[842] The widening of the bands was intended to be short-term. However, in reality, the hard EMS had given way to a regime of managed floating. The inherent vulnerability of the system running on such slim political support, particularly at its mark and franc hinge, was exposed. With exchange rates pinned to their upper and lower bands, and few prospects of domestic conditions changing, the Germans pulled the plug. Though the widening of bands was presented as an emergency measure, the backlash against German leadership was pronounced. France demanded that the Bundesbank cut its rates, take francs into its reserves and commit to unlimited intervention to defend the EMS.[843] Tietmeyer responded ferociously, arguing that the French demands amounted to insisting that Germany immediately renounce its monetary sovereignty.[844]

The absence of a "European view" and greater solidarity in the crisis shocked insiders.[845] Monetary union had been jeopardised by narrow national interests. Yet this comes as no surprise in an analysis guided by this study's framework. The EMS was dependent on appropriation that produced and sustained inequitable payoffs. Specifically, the disproportionate gains of Germany were secured through an arrangement in which the goals of national monetary authorities were endorsed and supported. Resistance to this pattern of relations had emerged well before the 1993 crisis. French and Italian insiders repeatedly sought adjustments, and other monetary authorities came under great pressure from domestic interest groups marginalised by competitive deflationary policies. The EMS became divorced from these underlying realities, because the tensions were only dealt with through technocratic fixes and information distortions. The false sense of stability that these distortions created was

[841] Eichengreen and Wyplosz, 1993, 61-63.
[842] See, for example, "How the Ministers Agreed: ERM Bands produce sort of Harmony", *Financial Times*, 3 August 1993.
[843] James, 2012, 377-378.
[844] James, 2012, 378.
[845] James, 2012, 380-387.

exacerbated by the desire to affirm monetary union. Nevertheless, in the end, despite the most powerful of incentives to promote continuity, when the limits of appropriation were finally reached, Germany sacrificed the EMS at the altar of its national interests. Although the EMS nominally continued, it was effectively finished.

2. From the EMS to the EMU Crisis

The plan to move towards the EMU had been affirmed by Europe's political elite before the EMS crisis. Indeed, after Maastricht, the EMU had a constitutional legitimation. The failure of the EMS did nothing to put this commitment on hold. The peculiar circumstances of German reunification did much to soften German concerns about monetary union and to strengthen the commitment among weaker nations to achieve it. Even away from these high politics, the remedy prescribed by Europe's elite central bankers and financial officials to overcome the failure of the EMS was deeper, quicker and more encompassing integration.[846] For insiders, the death of monetary union was impossible to contemplate. Jean-Claude Trichet reflected this sentiment when he declared that, "losing faith in the ERM was equivalent to losing faith in Europe."[847] The inconvenient lessons from the Snake and EMS were buried in the sands of time. This seemed justified by the apparent success of the Eurozone in its first decade. On its tenth anniversary celebrations in [year], the EU Commissioner for Economic and Monetary Affairs, Joaquin Almunia, captured the feeling that:

The Economic and Monetary Union and the euro are a major success. For its member countries, EMU has anchored macroeconomic stability, and increased cross border trade, financial integration and investment. For the EU as a whole, the euro is a keystone of further economic integration and a potent symbol of our growing political unity. And for the world, the euro is a major pillar in the international monetary system and a pole of stability for the global economy. As the euro area enlarges in the coming years, its benefits will increasingly spread to the new EU members that joined in 2004 and 2007.[848]

This self-confidence has since turned into embarrassment and doubt. Nevertheless, European policymakers now insist that the changes needed to make monetary union more sustainable have been implemented. This raises the following questions: could the Eurozone crisis and the response to it have been predicted? If so, what can we expect the future to hold?

Like its predecessors, with which it shares common initial conditions, the EMU has been anchored through logics of appropriation. Collective institutionalised bargaining has borne fruit, with predictable effects and many continuities with historical precedents. Solutions to problems by means of temporary expedients have facilitated the mutual self-empowerment of monetary authorities, but they have failed

[846] "High Speed to EMU Begins to Gather Steam', *Financial Times*, 27 November 1992; and "ERM Upheaval seen Hastening Two Speed Europe", *Financial Times*, 25 November 1992.
[847] James, 2012, 368.
[848] Almunia, 2008, 1; see also, European Commission, 2008.

to bring German leadership into stable political or economic equilibria with the members of the single currency. There is much evidence from the 2000s of collective information distortions, and of latent vulnerabilities being ignored by the system's managers. The massive capital flows to Southern Europe, which were deemed to be safe in the absence of exchange risks, are the most obvious example. Nobody wanted to question the success story. Yet this was a period of unusually benign market conditions that were apt to mislead. When the 2008 financial crisis hit, the fundamental weaknesses in the Eurozone were quickly exposed.[849] From the perspective of this study's framework, the critical question is whether appropriation has continued since the crisis, or whether some new policy pathway has been established. The answer, in short, is that evidence of a new pathway is thin on the ground. To the contrary, all the indicators suggest that policies of appropriation and technocratic fixes continue to dominate developments.

To recall the most pertinent part of the theoretical framework: technocratic fixes entrench the power, position, and interests of a system's leadership, and temporarily preserve the system, but do little to secure its long-term survival. Moreover, they can be harmful to system members' objective interests. These technocratic innovations can be difficult to distinguish from constructive cooperation, but are defined by having short time-horizons and being skewed towards the interests of the powerful, both in design and in practice. They tend to increase the complexity and density of rules, and ease the pressures for painful adjustment. Hence, these measures pacify political masters and anxious markets while doing nothing to resolve fundamental political conflicts. Is there evidence of policymaking along these lines through the current crisis? The short answer is yes.

One of the first responses to the crisis was the creation of the European Financial Stability Facility (EFSF) in May 2010. The EFSF provided emergency financing until 1 July 2013, when it was replaced by the supposedly permanent European Stability Mechanism (ESM). The ESM has a maximum lending capacity of €500 billion to provide financial assistance to Eurozone countries and looks like a powerful instrument. However, the decisions of the ESM are subject to the veto power of any country. This veto constraint is typical of a liquidity instrument produced in the context of competing national interests. The distributional consequences at stake in the ESM are such that further constraints have since been imposed by the German constitutional court, which ruled that the instrument would only be legal if the German federal parliament had enough supervision rights over it. The actual operations of the ESM have been further constrained by northern creditor nations that do not want bad debts in weak peripheral countries "dumped on the fund." Thus, the ESM, like the EMCF in the 1970s and 1980s, has already been skewed towards the interests of creditor nations and limited in its scope of application.

[849] These were well summarised by the ECB (European Central Bank, 2010); for another perspective, see Pisani-Ferry, 2010.

Furthermore, it is once again the central bankers, operating now in the ECB, who are the most innovative and dynamic element of the EMU governance structure, because of their incentives for action, and their strategic position, both of which derive from the historical foundations of the negotiated order. The ECB has been the real institutional winner from the recent crisis. An important aspect of the ECB's power is its technocratic expertise, which it has consistently leveraged to command debates, extend its reach into new areas, and hold political and economic pressures at bay. In January 2015, the Advocate General ruled on a question brought by concerned authorities regarding the ECB's legal overstretch, and asserted: "[The] ECB must have a broad discretion when framing and implementing the EU's monetary policy, and the courts must exercise a considerable degree of caution when reviewing the ECB's activity, since they lack the expertise and experience which the ECB has in this area."[850]

From the onset of the sovereign debt crisis in 2010, the ECB began to extend its capacities and role beyond its price stability mandate. It adopted wide-ranging measures to support financial stability by launching two government bond-purchasing programmes. First, it adopted the "Securities Market Programme" (SMP), which aimed at providing liquidity in order to lower the spreads on sovereign bonds and thus increase confidence. Second, because the SMP was limited in scope and size, the ECB launched the Longer Term Refinancing Operation (LTRO) in 2012. The LTRO granted low interest loans to European banks for a term of 3 years at 1% interest, and it accepted loans from the portfolio of the banks as collateral. Again, this instrument failed to bite as had been hoped. As such, later in the same year, the ECB took its most dramatic step with a new purchasing programme, "Outright Monetary Transactions" (OMT), which replaced the SMP. Under OMT, the ECB purchases - without official limit - government bonds issued by Eurozone member states on secondary markets with remaining maturities of between one and three years. However, crucially, the ECB will only support the country concerned if it has first sought assistance from the ESM and has adopted an economic adjustment plan endorsed by the Eurozone and the ECB. In effect, the ECB, a supposedly independent and technocratic institution, has become the final arbiter of the Eurozone, and holds a position much akin to that of the Bundesbank under the EMS. Finally, the ECB secured a further extension of its powers through the Single Supervisory Mechanism (SSM) and the European Banking Union. The Euro's liquidity provider and prudential regulator have been consolidated in a single institution: the ECB.

Thus, as would be expected, the crisis has induced a massive expansion in the administrative capacities of the EMU governance structure, augmenting the power and position of the ECB above all. The central bankers have pulled off a "land grab" and formed a powerful bulwark for the system. No central bank or finance official in the structure of appropriation has challenged the ECB's apparently limitless ambition. This reflects not just the unique capacity of the ECB to entrench itself by virtue of its

[850] Court of Justice of the European Union, Press Release No 2/15 Luxembourg, 14 January 2015, Advocate General's Opinion in Case C-62/14 Peter Gauweiler and Others v Deutscher Bundestag.

privileged position, but also the mutual gains available individually and collectively to those at this focal point. In addition, it reflects the enormous commitment to defending the single currency among those who have paid such massive costs to achieve it. On 16 July 2012, President Draghi famously said that the ECB was ready to do "whatever it takes" to save the euro from collapse.

Yet, as is normal with appropriative policymaking and promises of stability made by groups with a deep vested interest in the status quo, the basic distributional inequities in the Eurozone persist. The result is that the Eurozone remains out of political balance. Technocratic solutions and ideological declarations of unfailing commitment cannot dispense with really unequal distributional payoffs. For the avoidance of doubt: the empowerment of the ECB does not mean that it has become independent of German interests in a substantive way. On the contrary, the technocratic fixes and devices that the ECB has resorted to in the crisis demonstrate that it continues to be subject to the fundamental constraints of conflicting national interests, especially those between Germany and other members. The political cleavages persist beneath the professions of unity. In this context, the statements made about irreversibility cannot be taken at face value. Moreover, history teaches that the pronouncements of central bankers at the heart of monetary systems are the last place in which to find indications of impending failure. Instead, this study's framework prompts us to look for the sometimes subtle signs that the limits to appropriation are being reached, in small acts of resistance. In this regard, some recent trends are disturbing.

Since the election of the radical Syriza party in Greece in 2014, there has been an alarming rise in support for far-right and far-left parties across Europe.[851] In the South, democratic politics has fallen victim to the need for technocratic governments to keep extremist political forces at bay. Moreover, clashing national interests have become ever more difficult to supress and ignore in the debates over the trajectory of the EMU. On a practical level, still no mechanism exists to ensure the convergence of members' contending positions, as economic policies (spending and taxation, social policies, wage policies, etc.) continue to be devised nationally and there is almost no prospect of meaningful fiscal transfers between North and South. The technocratic policy responses have been piecemeal and incomplete in the face of these national interests. For instance, the so-called banking union has made only supervision supranational, leaving bank resolution and recapitalisation at the national level. The union is properly a "half-union."[852] In addition, the tough political choices between the Euro and painful structural reforms, including those that will squeeze the size of the state, are nowhere near completion in key countries, including France and Italy. The risk is that Germany will lose faith in its neighbours, while Paris and Rome will blame Berlin for their predicament. The EMS provides the pertinent precedent in this regard. In addition, there are signs of domestic politics in Germany putting limits on the extension of the system. The German constitutional court judgment, stemming from a case lodged

[851] Cakmak and Postaci, 2013.
[852] This is recognised even by supporters of the banking union (see Véron, 2014).

by some Eurosceptic activists backed by 37,000 people protesting against the ESM and OMT, signalled a cautionary note: "The treaty grants the bodies of the European Union no powers which affect the overall budgetary responsibility of the German Bundestag [nor does it] force the Federal Republic of Germany to make a permanent commitment regarding its economic policy that can no longer be reversed."[853] Finally, EMU governance has been forced to unveil its coercive side in the "Six Pack," "Fiscal Compact", and "Two Pack." Essentially, these mechanisms, bolstered by technocratic governments, have given the Commission and EU bodies greater powers of intervention in the national monetary affairs of member states and more means of surveillance in order to impose budgetary restraints and austerity. The EMU is fast becoming a more coercive and less democratic structure. Throughout all this, at the most basic level, the Eurozone remains a single currency operating in a world of unequal states. At summits, when opportunities have come to discuss the deep political integration and redistribution of powers that would set the EMU in a meaningfully different context, the political elites have hidden behind their napkins and wine glasses. Without a different context, the politics will not change.

The indications that the limits to appropriation are being reached represent an ominous gathering of dark clouds. The failure of practices of appropriation can often be masked by distortions of information, and 'pretend and extend' strategies.[854] In this vein, during the current crisis - as is well recorded - target dates have been ignored, loans have been extended, accounts have been window-dressed, and protestations that the EMU is not reversible have become more fervent. International monetary history tells us that these means of survival are always tried and always fail. Indeed, today, the pretence of irreversibility and fear of collapse comprise much of what is sustaining the EMU. Perhaps the instruments of manipulation possessed by Europe's elite, and the long-term suppression of democratic forces in the South, will be enough to hold the EMU together; in the same way as, for instance, Northern Italian powers forced economic and monetary unity on Southern Italy by causing its economic decline. However, it seems most unlikely that Germany would be willing to pay the high costs associated with coercion. The EMU is becoming infused with a growing sense of nihilism and unreality. This kind of atmosphere has often foretold monetary collapse on the European continent.

[853] This represents a major constraint on the legal approval given to the European bailout mechanisms by the German constitutional court (see "German Court Rejects EU Crisis Fund Complaints", *Financial Times*, 18 March 2014).

[854] This is to say, just as Charles Wyplosz argued was the case almost five years ago, that Europe is "levitating", because the EMU is being maintained in mid-air on the hope that reforms will address the underlying causes of the crisis (Wyplosz, 2010).

8

Rival Theories of Leadership and Dissolution

In this Chapter the most important theoretical implications of the study are discussed. The first part provides a note on the particular conception of opportunistic international monetary leadership that has underpinned this thesis and how it differs from conventional accounts. The second and third sections then turn to the theoretical challenges imposed by the problem of system dissolution and transition in an effort to highlight the new ground broken by this thesis.

1. International Monetary Leadership: Benevolent or Opportunistic?

The definition of leadership used in this study conforms with the traditional view of international monetary leadership in denoting the ability of hegemonic or dominant states to define or shape the 'rules of the game' and to make critical contributions to resolving collective action problems.[855] However, it makes a radical departure from the public goods and collective action understandings of international monetary leadership, specifically as classically formulated by Charles Kindleberger.[856]

In this dominant understanding, while the leader gains from providing global public goods, particularly in a common currency and countercyclical policies, the members of the system gain more in bearing none of the costs of provision and sharing fully in the benefits.[857] It follows that leadership is "benevolent," in simple terms, because the hegemon is weakened, not only by not being able to exclude members from consuming the good, but also because it cannot compel members to share in the costs of production.[858] In Mancur Olson's classic description, the "small exploit the large."[859] The theoretical question that follows is: how long will the leader remain large enough to sustain this benevolent basis of stability?[860] Broadly, the rate of dissolution will track the rate of absolute power losses in the leader. This study argues that such a theory fundamentally mischaracterises the nature of international monetary leadership. It is asserted here that almost all of the underlying assumptions of such a perspective are wrong, and they obscure most of the important questions pertaining to leadership. All

[855] Mattli, 1999; and Keohane, 1984.
[856] Kindleberger, 1973. On the specificities of this public goods approach to hegemonic stability theory see Snidal, 1985.
[857] This public goods and collective action approach to leadership has been considered particularly applicable to international monetary relations (see Lake 1993). There are competing accounts of international monetary hegemony that provide greater space for coercion. However, in contrast with the analysis presented here, they rely more on the application of structural rather than micro-foundational and strategic sources of power (see Gilpin, 1982; and Strange, 1987).
[858] Snidal 1985, 579-584.
[859] See Olson, 1965.
[860] Snidal, 1985, 588. This is a dominant question in the analysis of today's international monetary regime and speculations about its potential viability (see Cohen and Benney, 2014).

the strategy, power and politics are missing from this traditional theoretical conception of international monetary leadership.

While there doubtless are public good components to international monetary orders, the basic assumptions of the theory do not hold. First, while an assumption of joint benefit from system participation is broadly speaking reasonable, the assumptions of non-excludability and indivisibility seldom, if ever, hold. Second, the goods available are not just public, but are also obviously private. Indeed, international monetary systems are better analysed as private clubs. Third, participation in an international monetary order gives members an interest in the stability and value of the dominant power's currency and practices. Members are inclined to assume some costs of production, rather than engaging in unfettered free-riding. Thus the notion of a leader being unable to solicit contributions from members is wrong, because contributions are interest-compatible in the context of strategic interdependence, members do face the possibility of expulsion, and they can be seduced into contributions through the prospect of private gains. This means the leader is able to manipulate costs and benefits such that, "even if the aggregate payoffs are Pareto-superior" (i.e., they leave the leaders and all members as well off as before, or better off), "there is no longer any reason to assume that the distribution of benefits favours smaller states", as Duncan Snidal emphasised.[861]

Still more problematically, the conception of benevolent leadership is strangely disconnected from any meaningful analysis of international monetary power. Dominant states actually maintain exorbitant privileges at the expense of other states by, among other things, extracting seignorage, delaying and deflecting adjustment costs, maximising their own policy autonomy, and acquiring influence through the control and direction of capital and commercial advantages from exchange rate parities.[862] In this regard, the leaders are concerned not with public goods or the ideal arrangement for the system and its members, but with private benefits and control. Indeed, leading powers have an interest in entrenching their own positions and maximising their own freedom to act unfettered by the concerns of smaller members or system imperatives. Thus the leader can be expected to pursue strategies and to develop devices aimed at protecting these objectives. Such leadership is anything but benevolent.

The appeal of public goods theory and its benevolent conception of leadership, especially to US social science, indoctrinated with the virtues of Pax Americana, has for too long allowed shielded international monetary leadership from critical scrutiny. It has left the concept of leadership in an imaginary world of harmony that is entirely disconnected from the realities of conflict, power, and strategy. It has also trained the analytical lens upon the relative and absolute distribution of material monetary power, and so validated an excessive focus on the prospects for sustaining America's material position in the world.

[861] Snidal, 1985, 588.
[862] Cohen, 1977; 2004; and, 2006; Norrlof, 2010; and, 2014; Kirshner, 1997; Strange, 1971; and, 1987; and Walters, 1993; and, 2006.

Yet to understand how leadership affects the operation and performance of international monetary regimes, it is necessary to analyse the actual character and content of leadership (in conjunction, of course, with work on its material foundations). Indeed, rejecting the notion of passive and uninterested leadership requires that the macro-foundations of monetary power are connected to the micro-foundations of leadership that determine *how* that power is deployed and with *what* effects. This study has emphasised the validity of this claim by uncovering the opportunities and capabilities for strategic manipulation that belong to leading states, especially insofar as these have vitiated, stalled, and even reversed changes in the underlying distribution of power that would have been to the leader's disadvantage.

In brief, the missing element from theories of international monetary leadership has been a theoretical basis for analysing *what* leading states actually do and *why*. The framework developed in this study fills this gap by introducing two contrasting modalities of opportunistic international leadership, which can be seen to develop in spontaneous and negotiated systems respectively, and which can be causally linked to varying rates of dissolution. Both modalities arise because of the strategic advantages of leadership and the interests and capabilities of the powerful in manipulating the distribution of costs and benefits to their own advantage. The existence of conflicts and tensions between leadership and members, and the leadership's individual concerns as opposed to systems optimisation priorities, have been posited throughout the study and highlighted in all the empirical chapters. The next Chapter argues that those with an interest in the future of American monetary hegemony cannot afford to ignore such issues.

2. The Theoretical Puzzles of Dissolution and Transition

The problem of international monetary system dissolution has long posed questions. Every episode of dissolution inspires thousands of responses. Yet we still know little about what enables international monetary systems to sometimes survive enormous stresses, and even less about how and why they break apart in the ways that they do. The main reason is that most historical works have shied away from considering dissolution as a general phenomenon. They tend rather to investigate how changed structures and objectives resulted in particular macroeconomic systems becoming unsuitable or unsustainable.[863] There are many more books on the collapse of the gold-dollar system and the gold exchange standard than there are comparisons of these processes. The size and complexity of events and the distance between them causes scholars to rail against reductionism: they feel that too many intricacies and differences between systems will be lost and significant chronological and behavioural particularities obscured in drawing a comparison. [864] This paucity of comparative analysis

[863] Bordo, 1993; Eichengreen, 1992; and James, 1996.
[864] Political scientists and economists working in the traditions of comparative economic history are more comfortable with seeking generalizable propositions, but few have made monetary system dissolutions – at the system-level – the object of their comparative analysis. Instead, they have looked at cross-country variations

notwithstanding, there have been some efforts to offer generalised theories of monetary system transitions. Table 8.1 groups these into political and economic frameworks. The appellations - and acronyms – of technological and ideational transition theory have been newly invented for this study's purpose of grouping works that share an emphasis. The catalogue is necessarily somewhat over-simplified. This chapter will briefly discuss each of these theories in turn, considering their major strengths and limitations. The object is to stress the value added by this study to the problem of studying system transitions.

Table 8.1. Theoretical Approaches to International Monetary System Transitions

	Theory	Focus	Method	Stability	Dissolution
Political	Hegemonic Stability Theory (HST)	International power distribution	Positive Static Comparative	Addressed (central theme)	"Explained" in deterministic terms
	Capital Mobility Theory (CMT)	Degree of capital market integration	Positive Dynamic Particular	Un-addressed	"Explained" in deterministic terms
	Dynamic Interest Group Theory (IGT)	Power of domestic interests	Positive "Dynamic" Particular	Un-addressed	"Explained" via path dependency
	Ideational Transition Theory (ITT)	Ideas as causal forces	Normative Dynamic Particular	Un-addressed	"Explained" in deterministic terms
Economic	Network Externality Theory (NET)	Network effects as causal forces	Positive Static Particular	Un-addressed	"Explained" in cost/benefit and path dependent terms
	Optimal Currency Area Theory (OCA)	The costs and benefits of currency unions	Positive Static Comparative	Addressed (central theme)	"Explained" in cost/benefit terms
	Technological Transition Theory (TTT)	Monetary technologies	Positive Static Particular	Un-addressed	"Explained" in deterministic terms
This Thesis	*Leadership Modality*	*The policy solutions selected by leaders*	*Positive Dynamic Comparative*	*Addressed (central theme)*	*Explained in historical & comparative terms*

3. Political Theories of Dissolution and Transition

a. Hegemonic Stability Theory

The central proposition of hegemonic stability theory (HST) is that "for the world economy to be stabilized, there has to be […] one stabilizer."[865] Examining the inter-war period, Charles Kindleberger

primarily in exchange rate choices. From the pioneering specification of the Mundell-Fleming constraints in the early 1960s, a rich political economy tradition has developed that looks at these choices (for example, see Cooper, 1999; and Frieden and Stein, 2001). In this context, the fact that this thesis defines international monetary systems as being more than the sum of the exchange rate choices between states is important, as this imposes a different set of demands and questions.

[865] Kindleberger, 1973, 304.

argued that for the international monetary and trading system to be liberal, open and stable, a single leading state had to provide: a market for distressed goods; a steady and counter-cyclical flow of capital; and liquidity in the form of rediscount mechanisms. The inter-war period was therefore unstable because hegemony over the system was passing from Britain to America. For present purposes, the important implication is that the fall of a dominant power will (sooner or later) bring down its associated monetary order, because this will undermine the ability (or willingness) of the hegemon to internalise the costs of providing stability, and/or the bargain that underpins the system will break down as subordinated actors grow in power and recalibrate their assessment of the costs and benefits.[866]

This seems straightforward; however, HST has suffered from a failure to properly state its assumptions.[867] As already noted, HST rests on collective action being impossible, monetary stability being a truly public good (i.e. non-excludable and jointly consumed) and leaders being benevolent or passive. Furthermore, HST assumes actors that are able to judge economic costs and benefits with a high degree of certainty. International monetary systems are seldom as imagined by HST. International monetary stability is not a public good strictly defined, collective action is always theoretically possible, costs and benefits are difficult to determine, and the behaviour of hegemonic states is generally self-serving.

These factors explain why HST has proven such a poor predictor of monetary system dissolution.[868] Monetary systems dissolve with their leaders only with unpredictable lags, and not consistently. For example, the Sterling Area continued long after British hegemony subsided. On the other hand, monetary orders have collapsed around enduring hegemonic power, as, for example, US dominance persisted beyond the collapse of the gold-dollar system.[869] As Duncan Snidal notes, the efforts to fix HST to account for these dynamic effects and lags have usually done little more than to "plug the gaps between the static theory and empirical reality with plausible, and almost non-falsifiable, theoretical filler."[870]

b. Capital Mobility Theory

Capital mobility theory (CMT) emerged out of the Mundell-Fleming trilemma. [871] Robert Mundell and Marcus Fleming showed that policymakers pursuing the objectives of free capital flows, monetary policy autonomy, and fixed exchange rates, must forgo at least one of these objectives. For example, if there is high capital mobility and a fixed exchange rate, policymakers must target monetary policy at external objectives and so surrender monetary policy autonomy. The thesis gained wide acceptance

[866] Maier, 1988; Gilpin, 1987, Kindleberger, 1973; Krasner, 1976; and Keohane, 1984.
[867] This paragraph draws extensively on Snidal, 1985; also see, Lake, 1984.
[868] Webb and Krasner, 1989.
[869] Strange, 1987.
[870] Snidal, 1985, 585; also see, Lake, 1984.
[871] Mundell, 1960; and Cohen, 1977.

when advanced industrialised countries abandoned fixed exchange rates, following the collapse of the gold-dollar system, under conditions of increasing international capital mobility.

However, the Mundell-Fleming trilemma specified only a policy conundrum, not the policy selection that would be made in any given situation.[872] CMT goes beyond this limited scope, aiming to show how international capital mobility acts as a system-level variable that determines policy trajectories in the international monetary system.[873] The central proposition is that changes in the degree of capital mobility impose structural constraints on states and have induced (through competitive pressures or dynamics of socialisation) episodes of breakdown and moves toward an ever more market-based system.

CMT provokes two objections. First, the approach elides the concept of a stable international monetary system with a stable system of international exchange rates. Yet, as Barry Eichengreen points out, the latter is not a necessary condition for the former.[874] Second, CMT draws a negative correlation between capital mobility and monetary policy autonomy, and argues states will be forced to adopt market-orientated monetary policies under conditions of high mobility.[875] However, "depending on the exchange rate regime in operation and the policy blend in use, international capital flows can enhance rather than undercut a national government's ability to achieve its domestic macroeconomic objectives."[876]

This indeterminacy raises serious questions about the utility of capital mobility as the only structural variable in explaining transitions. The usefulness of CMT can be placed in a proper perspective by observing the fact that "changes in the degree of international capital mobility frame the context within which developments have taken place; but merely noting that the costs of monetary independence [rise with capital mobility] does not explain the particular distribution of these costs, nor the exact forms that national monetary policies and international monetary relations have assumed in response to them."[877] Moreover, the theory is historically bound to the recent developments in the international monetary system through which it has generally been developed and tested.[878]

c. Interest Group Theory

Interest group theory (IGT) was produced by Jeffry Frieden, in seeking to extend his pioneering work on how interest groups influence the domestic monetary arena, to account for the rise and fall of international monetary systems.[879] IGT initially set out to show how and why different sectors of the

[872] McNamara, 1997, 43.
[873] Webb, 1991, 312; Strange, 1986; and Goodman and Pauly, 1993.
[874] Eichengreen, 1993.
[875] Strange, 1986; Webb, 1991; and Goodman and Pauly, 1993.
[876] Willett and Wihlborg, 1990, 53.
[877] Andrews, 1994, 213.
[878] Webb, 1991; and Goodman and Pauly, 1993.
[879] Frieden, 1991.

economy seek to influence the degree of flexibility vis-à-vis monetary policy autonomy in both the national exchange rate regime and the level of the exchange rate as either high (appreciating) or low (depreciating). Frieden argued that international traders and investors and exporters prefer fixed exchange rates because volatility harms their business, while domestically orientated firms will be more concerned about internal price stability and prefer policy autonomy. In this form, IGT only seeks to draw out "the interests at play, not necessarily […] the outcome of political conflict among them."[880] However, Frieden tried to develop a dynamic variant of the theory to explain the rise and fall of the international gold standard. Feedback mechanisms formed the centre of this theory of transition:

> The more encompassing the international monetary regime, the greater the interests of internationally orientated firms in national societies in encouraging their governments to associate with the regime […] The proportion of the economy that is orientated to foreign trade and payments is likely to grow, and with it the influence of that sector's policy preferences – especially to remain committed to the system [… But of course] the mechanism can operate in reverse: as an international monetary system collapses it pulls the political rug out from under its supporters in national political economies by reducing the influence of internationally orientated groups and lessening their commitment to the system.[881]

The problem is that this theory relies on a path dependency argument, but it does not specify the mechanisms at work. The argument is therefore "too contingent and too deterministic."[882] Indeed, it is really a descriptive statement, rather than a theory of development and dissolution. It fails to specify what will cause systems to begin to integrate and disintegrate and says very little that is not obvious about the process in between.

d. Ideational Transition Theory

Ideational transition theory (ITT) argues that monetary systems dissolve when the ideational consensus underpinning them is displaced. The theory is helped by the fact that international monetary system transitions are usually accompanied by ideological shifts where old economic orthodoxies are replaced by new (or rediscovered) ones. Joseph Schumpeter emphasised how, at the end of the nineteenth century, the gold standard attracted states as it became "a symbol of sound practice and a badge of honour and decency."[883] Kathleen McNamara finds the absence of a "neoliberal consensus" to have been central to the failure of the European Snake.[884] Peter Temin and Barry Eichengreen argue that the inter-war gold exchange standard was underpinned by an ideological consensus: "the mentality of the gold standard was integral to the ideology of […] those segments of society that controlled economic

[880] Frieden, 1991, 450.
[881] Frieden, 1993, 141.
[882] Thelen, 1999, 385.
[883] Schumpeter, 1954, 770.
[884] McNamara, 1998.

policy."[885] They proceed to explain that "the world did not begin to recover [from the depression] when these people changed their minds; rather, recovery began when mass politics in its various guises removed them from office."[886]

Although attractive, ITT has problems. In particular, it spends more time on the causal importance of new ideas than on accounting for how and why old ideas are discredited. But as Sheri Berman eloquently put it, "the story of each period of ideological hegemony […] truly begins with the decline of its predecessors."[887] Moreover, ideas are often set up as factors that work against vested interests, following John Maynard Keynes' intuition "that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas."[888] This dichotomy is false and artificial because encroaching ideas must push some conception of interest and institutionalised ideas are usually working in the service of some entrenched group.[889]

These theoretical issues might be surmounted. However, the empirical record poses more intractable problems. To take one example, most analysts agree that Keynesian ideas were still hegemonic through the collapse of the gold-dollar system.[890] Although this interpretation of the historical record is the most plausible, other analysts, keen to verify causal propositions, identify crucial ideational shifts. Jacqueline Best suggests that embedded liberal norms were hollowed out before the collapse of the gold-dollar system by a "neo-classical synthesis."[891] Eric Helleiner goes a step further to argue that there was a shift away from embedded liberal norms and towards neoliberalism that precipitated the collapse of the system.[892] The prospect for reconciling these diverging perspectives is slim because international monetary systems always rest on contested ideational foundations. Actors must constantly fight to either defend and augment or reinterpret and upend ideas depending on their situational interests. ITT often fails to ask the most salient question: What explains who wins and who loses in these ideational contests?

4. Economic Theories of Dissolution and Transition

a. Network Externality Theory

The classic statement of network externality theory (NET), provided by Michael Katz and Carl Shapiro, is that: "There are many products for which the utility that a user derives from consumption of the good increases with the number of other agents consuming the good."[893] The application of NET to

[885] Temin and Eichengreen, 2000, 185.
[886] Temin and Eichengreen, 2000, 185.
[887] Berman, 2004, 10.
[888] Keynes, 1936, 384.
[889] March and Olson, 1989.
[890] Ruggie, 1982.
[891] Best, 2004.
[892] Helleiner, 1994.
[893] Katz and Shapiro, 1985, 424.

international monetary systems transition is based on the recognition that the domestic monetary regime adopted by one participant will alter the value of the regimes adopted by all the other participants in the same system. The theory offers an account for why actors are drawn and locked-into monetary systems by the choices of their trading partners, and why when a participant resigns from a system it becomes less costly for others to resign too. This provides the basis for explaining why many transitions seemingly take the form of "chain gangs," where states follow their largest trading partners into and out of systems.[894]

NET traced to its logical end should lead to the emergence of a single system with a single currency. This *ad absurdum* is explained away by arguing that actors are constrained by switching costs and feasibility constraints.[895] Further problems arise because although the theory points to domino effects its origins are in the discrete choices made by actors as pay-offs alter. The processes and mechanisms involved in moving from one equilibrium to another are not accounted for in these comparative statics. Without additional content to fill this gap, NET offers only a limited insight into system transitions. It may provide a useful background variable or a mechanism within a wider theory. However, NET is not a theory of transition and has been too enthusiastically embraced as a substitute for one.

b. Optimal Currency Area Theory

Optical currency area (OCA) theory models the characteristics of an economic region that make the immutable pegging of exchange rates a desideratum, by reference to some definition of optimality.[896] In the original exposition of the theory presented by Robert Mundell, optimality was defined as maintaining an external balance (payments equilibrium) and avoiding internal imbalances (unemployment and inflation) with a minimum of government intervention (distortions from monetary and fiscal policies). In other words, optimality was defined by reference to endogenous stability – the capacity of the economic region and the regions in the wider system to return to equilibrium following some dislocation in the form of an asymmetric shock. To achieve this optimal point, Mundell argued currency areas must have internal factor mobility that can assume the role of exchange rate flexibility and so facilitate efficient adjustment: "If the world can be divided into regions within each of which there is factor mobility and between which there is factor immobility, then each of these regions should have a separate currency which fluctuates relative to all other currencies."[897]

The logical conclusion of Mundell's framework is that "regions ought to be defined so narrowly as to count every minor pocket of unemployment arising from labor immobility as a separate region, each of which should apparently have a separate currency!"[898] Mundell recognised however that this logic had

[894] Eichengreen, 2008; Flandreau, 2004; and Gallarotti, 1993.
[895] Liebowitz and Margolis, 1994; and Dowd and Greenaway, 1993.
[896] Mundell, 1961; Mckinnon, 1963; and Corden, 1972.
[897] Mundell, 1961, 663.
[898] Mundell, 1961, 663.

to be traded against the transaction costs of having multiple currencies. Ronald McKinnon's criteria for optimality provide a stronger basis for some areas having exchange rates that are fixed.[899] McKinnon took the ratio of tradable to non-tradable goods as the basis for calculating the costs and benefits of joining a currency union.[900] The more externally open a region (i.e. the higher the ratio of tradable to non-tradable goods), the less valuable exchange rate flexibility becomes because rate changes are simply passed through to alterations in internal prices without any improvement in the terms of trade or the competitiveness of real wages. The more closed a region is (i.e. the higher the ratio of non-tradable to tradable goods), on the other hand, the more it makes sense to peg the currency to the internally traded goods to maximise price stability and to let the exchange rate float to achieve external balance. "If we move across the spectrum from closed to open economies, flexible exchange rates become both less effective as a control device for external balance and more damaging to internal price stability."[901]

In this original formulation, the theory was abstract and static. The failure to present a dynamic theory and the apparent small currency area bias encouraged scholars to adapt its core insights, especially as the EMU project took shape. Their conclusions were almost always that currency unification would beget the conditions of optimality.[902] The central reason given for these EMU-friendly findings was that across all the important factors in the analysis (trade and financial integration, shock symmetries, and product and labour market flexibilities), endogenous dynamic effects would tend toward conditions of optimality. The pioneers of the theory were fully aware of these dynamic effects. However, they were clear that they "would not solve" the challenges of unification.[903]

OCA theory actually says little about the sustainability of different monetary systems. The concern was with what the ideal system should be, as defined in terms of economic efficiency. Its authors recognised that "noneconomic motives have been dominant" in processes of monetary integration, but they did not complement their economic analysis with political considerations.[904] This allowed them to build elegant and parsimonious equilibrium models. However, at the same time, the theory is strangely unreal. Some basic axioms about political behaviour and processes must be included to determine where the theory might apply and when it is apt to mislead.

This is not to deny that there are important lessons in the analysis. The central theme is sound: "If countries do not permit themselves appropriate exchange-rate adjustments (or import restrictions and similar devices), they impose on themselves losses that are essentially the losses resulting from enforced

[899] Mckinnon, 1963; and Corden, 1972, 16-21.
[900] Tradable goods are goods that can enter foreign trade (i.e., they are, at least in part, exportable and importable goods), while non-tradable goods cannot, due to transport costs.
[901] McKinnon, 1963, 719.
[902] Frankle and Rose, 1996; and De Grawe and Mongelli, 2005.
[903] Corden, 1972, 21-39.
[904] Corden, 1972, 17.

departure from internal balance."[905] Nevertheless, some space must be made for politics, if the aim is to understand how systems will actually respond to shocks, and how they can be expected to change through time.

c. Technological Transition Theory

As the name suggests, the basic contention of technological transition theory (TTT) is that the primary engine of transition is technological change. There are two such arguments: first, that changes in monetary technologies make systems unviable; and second, that technological changes make systems comparatively inefficient and so history marches on.[906]

The first variant of TTT has most often been applied to explain the breakdown of commodity standards. The performance and viability of these standards are influenced by the exogenous constraint of the commodity supply. A convertibility crisis is always possible, rendering the system vulnerable. The nature of the convertibility pressures will vary depending upon the technical constitution of the system. However, the basic logic is that the system's downfall will result primarily from changes in bullion supplies.[907]

The second variant of the theory turns on the costs and benefits of different monetary technologies. For instance, Angela Redish has argued that the steam-press enabled the transition from bimetallism to the gold standard.[908] The argument is that the gold standard was a more efficient regime because the transaction costs associated with the use of gold bullion were lower than silver and could better cope with the increasing size of international trading transactions. However, the gold-standard depended upon the production of alloy coins (coins made from a mix of metals) that could only be protected against counterfeiting through steam-press production techniques. More recently, commentators have predicted the death of the global fiat money system as this is replaced by virtual currencies, such as bitcoin, with arguably lower transaction costs and greater versatility, made possible by the Internet.

TTT's obvious problem is economic determinism.[909] To be sure, commodity standards are subject to an exogenous constraint and technologies will change the costs and benefits of different monetary systems. Nevertheless, these constraints and opportunities are always tempered by political and social responses. Technological shifts have rarely forced system changes even where material constraints have seemed quite severe.[910] As such, there are often marked lags between the creation of new monetary technologies

[905] Corden, 1972, 8.
[906] This distinction is made by Flandreau, 2004, 185.
[907] For example see, Oppers, 1993.
[908] Redish, 1993; 1995; and, 2006.
[909] On technological determinism generally, see Smith and Marx, 1994.
[910] For instance, material constraints are not generally considered determinative in either the case of the decline of bimetallism or the collapse of the gold-dollar order (see Flandreau, 2004, 179-181; and Garber, 1993).

and system transitions. This makes it necessary to subscribe to softer forms of the theory that allow room for political agency and contingency.

5. Conclusion

This Chapter has argued that the disappointing experience of those trying to understand the dynamic transitions of international monetary systems is indicative of two basic problems. First, the existing theories use unrealistic assumptions about the character and content of international monetary leadership. Second, these are usually not really theories of transition at all, but rather static accounts of the exchange rate choices made by states, or power distribution dynamics in the international system, looking at truncated periods of history. As a consequence, they do not capture the politics behind either the moves from system to system, or the processes by which systems adapt between equilibria. This study presents a very different type of theory that seeks to fill those two gaps. The analytical framework has put different forms of leadership, and of dynamic political adaptation, at the centre of the investigation of system change.

9

Conclusion: Overview and a Note on the Future of the US Dollar

This thesis has addressed the striking variance in rates of dissolution between different international monetary systems from history. At one polar extreme were cases of collapse, sudden and dramatic endgames, widely known and vividly remembered: the fates of the gold-dollar system and the inter-war gold exchange standard. At the opposing pole were two lesser-known cases of prolonged malaise and decline: the degeneration of the Latin Monetary Union and the decay of the Sterling Area. Despite the enormous efforts expended to institute and defend them, international monetary systems are apparently always condemned to suffer regrettable ends, in one or other of two contrasting scenarios. Rational actors would surely want to avoid both of these outcomes, so why can they not? This study has offered an explanation for this dissolution puzzle by distinguishing two logics of international monetary leadership – appropriative and exclusory – through which dominant states inadvertently drive systems towards particular modes of dissolution. This chapter briefly summarises the argument and empirical findings of the study, before concluding with some remarks on the contemporary US dollar regime, and on the central theoretical implications of the thesis.

1. Summary of Argument and Findings

This thesis has argued that those international monetary systems that emerge spontaneously around processes of trade and financial integration, and which suffer from an atomised membership and few mechanisms for adjustment by their leaders, actually (and counterintuitively) decline more slowly than negotiated orders, which are deliberately created, endowed with ready mechanisms of collective adjustment, and yet rapidly collapse. The argument centres on the policy choices made by leading states when confronted with performance problems and conflicts with system members over the costs and benefits of selected solutions. Historically determined structural and material differences between systems offer their leaders different incentives and opportunities to transact particular policies for the continuation of said systems. Thus two distinct logics of leadership – appropriative and exclusory – emerge in negotiated and spontaneous systems respectively. The repeated deployment of one or other of these logics will drive a system towards a faster or slower rate of decline. This explanatory framework was illustrated through in-depth comparative historical analyses of five distinct systems spanning two centuries.

The negotiated systems in this study (gold-dollar, gold exchange standard, and the EMU), were all characterised by the same basic pattern of development. They were built around the top-down designs of powerful states. Their leaders entrenched their positions, manipulated costs and benefits in their own interests, and distorted information, following the logic of appropriation. Appropriation turns the instrumental and technocratic capacities of national monetary authorities away from national priorities

and towards the defence of international systems that channel disproportionate benefits to their leaders. This process of appropriation depends upon bureaucratic activism. In this respect, the *high initiation costs* and special sense of responsibility carried by the designers and guardians that *founded* negotiated constructs serve as enabling factors. Moreover, the ability of monetary authorities to stand apart from the interests of financial market actors, by virtue of these authorities' central position at the *political base* of the system, encourages and enables them to resort to new institutions and rules of administrative control when problems emerge. This pattern was shown in the way that the onset of problems in the gold-dollar system in 1961 produced a veritable explosion of supranational forums, including the Gold Pool, BIS expert committees, WP3 of the OECD, and the G-10 Deputies. With striking similarities, the inter-war system witnessed the first ever forums for collective monetary management, in the League of Nations and institutionalised central bank cooperation. Ever-expanding bureaucracy, such as was seen through the Snake, EMS and EMU orders, is also a characteristic of negotiated systems, which distinguishes the twentieth century European monetary integration process from its spontaneous nineteenth century counterpart.

The institutionalisation of repeated collective bargaining, which is typical of negotiated systems, facilitates the special forms of international reciprocity, opportunities for mutual self-empowerment, and fulfilment of sub-group goals, upon which appropriation depends. These transactions enable leaders to co-opt already organised and integrated national monetary authorities into the concerted defence of systems. Participating monetary and financial officials will augment their autonomy and power in the domestic arena, by: accepting the patronage of the system's leaders; joining in mutually empowering concerted actions supported by internal reciprocity and opportunities to pursue sub-group goals; and drawing on the beliefs that are embedded in the institutionalised bargaining structures to justify interventions. When problems emerge, appropriative transactions create huge resources of strength and resilience. These include the enhancement of monetary officials' ability to expand administrative controls, to apply technocratic capacities in a concerted fashion, and to collectively exchange and manage private information to support the system. Across various periods of monetary history, appropriative leadership has spawned all of the following: independent central banks; manifold credit arrangements; joint exchange market operations; external support for exchange controls and other innovative domestic instruments for market intervention; common rhetorical supports and representations of stability; and multilateral surveillance and external controls. Moreover, institutionalised bargaining has supported the development of powerful shared beliefs and orientations, from the gold standard mentality to Keynesianism and monetarism. Whatever their differences and proclaimed normative objectives, all these ideologies at work in negotiated systems have enabled national monetary authorities to justify the encroaching hand of the state in international monetary management.

Thus, leadership through appropriation provides a powerful means through which to support international monetary constructs when problems emerge. However, appropriative leadership is opportunistic and maladaptive from the long-term perspective of a system. Three reasons for this will now be recapitulated. First: negotiated cooperation between monetary authorities with largely instrumental capacities, while powerful, is not well suited to resolving disputes over the distribution of costs and benefits between the members of a system. The case studies showed how the Gold Discount Bank, Dawes Plan Transfer Clause, pound-dollar SWAPS line, SDRs, Gold Pool, Werner Plan, ECUs, Belgium Compromise, and Bundesbank SWAPs were all limited *technocratic fixes*. Such fixes are intrinsic to the logic of appropriation. Their instrumental value is that they satisfy demands for change without imposing the costs of real adjustment. However, as such, they represent palliatives that do nothing to restore the system to actual balance. On the contrary, they entrench and extend inequitable payoffs. Second: the informational trades and exchanges in closed institutional bargaining forums manifest *private distortions and group misrepresentations*. Such patterns of manipulation transform negotiated forums into devices that extend systems by masking dysfunctions with shared illusions of stability. The EFO Gold Delegation, WP3 of the OECD, and the EMS central bank governors' committee were all co-opted into reproducing such images of stability. In the long term, they led to complacency, deferred recalibrations, and dysfunctional extensions of outmoded practices. Third: appropriation has consistently given rise to *resistance*. It has never been possible to entirely extricate monetary authorities from their national political contexts and into the defence of the particular interests of the system leader. In every case, member authorities have been uncomfortable with the asymmetric distribution of costs and benefits between themselves and their leaders. Moreover, they have also come under pressure from outsiders who were not able to partake of the benefits of appropriation. The search for bargaining leverage, and vested bureaucratic interests in the institutions of appropriation, serve as additional factors that encourage members to protest rather than exit when problems emerge. From the wide and authoritarian external controls of the inter-war era to the seemingly voluntary subordination of European central banks to German hegemony in the EMS, appropriative leadership has always, eventually, resulted in discontent and retaliation.

In accordance with this study's thesis, these syndromic developmental logics of appropriation have historically culminated in common endgames. The final days of negotiated systems can be traced to tipping points, when the system finally cracks under the growing strains of resistance and maladaptation. These pressures make further appropriative transactions increasingly expensive. Amid non-cooperative stand-offs, and sometimes following periods of increasingly coercive direction, the leader is forced to radically reassess its interests and redeploy its power. The markets often serve to exacerbate these escalating costs, as they speculate on the possibility that the leader may not be able to sustain the status quo. The British exit from gold in September 1931, the closure of the gold-window in August 1971, and the Bundesbank's refusal to support the lira and pound in September 1992, all

represented such tipping points. Leaders, in these moments, often with little or no warning, pulled down the monetary temples from which they had previously extracted enormous rents. The exception here is the EMS, the failure of which fuelled an accelerated rush to EMU.

However, the analysis in Chapter 7 was anything but optimistic about the future prospects of EMU. During the recent Eurozone crisis, an appropriated monetary elite under German leadership has introduced a raft of props and devices to support the status quo, largely by putting power into the hands of the ECB. Viewed through the analytical framework of this study, these mechanisms betray all the characteristics of technocratic fixes. As a result, the EMU today is more centralised and able to command more resources to defend itself than ever before. Nevertheless, the Eurozone cannot escape the conditions of its birth, nor has it been structurally reformed beyond such a point that the framework should cease to be predictive. The distributional tensions between Germany and its Southern European neighbours that have always conditioned the process of negotiated integration remain. The monetary governance of the Eurozone is becoming an increasingly coercive set of arrangements that seems ever more reliant upon the dogma that the status quo is simply irreversible. While detailed predictions are impossible, unless the Eurozone begins to operate by logics other than appropriation, there is no informed reason to be confident that it will escape collapse.

The examinations of the Sterling Area and Latin Union both demonstrated how the sharply contrasting modality of exclusory (rather than appropriative) leadership produces outcomes of slow decline, diametrically opposed to rapid collapse. Under this exclusory logic, the strategic advantages of leadership were entrenched, and costs and benefits manipulated, through the defence of policy monopolies, the withholding of information, and the deployment of price-discrimination strategies that yielded allocative efficiency gains. A different path of development from that found under appropriative leadership resulted in different strengths and weaknesses.

Spontaneous international monetary orders emerge when predominantly economic agents begin to coordinate their activities and practices around particular currencies and powerful states. The *low initiation costs* associated with the *historical foundations* of spontaneous emergence, coupled with the relatively *marginal position of national monetary authorities* in systems with an *economic basis*, diminish leaders' propensity for high levels of activism and initiative in response to the onset of problems. The Sterling Area, for instance, was understood by contemporaries to be a historical fact, rather than something that needed affirmation. Furthermore, the voluntarism that gave rise to the Sterling Area, and which embedded private sector interests in the status quo, constrained the willingness and capacity of those in London to install a large administrative architecture over it. The disassociated relations between leaders and members further reinforced a tendency for problems to be met through atomised adjustments. But the lack of collective institutional bargaining in spontaneous orders is always the product of power and interest. The British did not want to open decision-making to collective

determination, because they valued their policy monopoly. Thus, despite repeated calls to formalise the Sterling Area around the close political association of the Commonwealth, a striking paucity of collective institutional forums were created. The Latin Union was similarly operated on a minimally institutionalised basis. The treaty of 1865 established no supranational administrative architecture or central bank cooperation. Moreover, the treaty itself was only periodically recalibrated, and usually only in a manner that affirmed prior decisions and actions taken on a unilateral basis. The French had *de facto* exclusive control over the LMU.

The importance of a *policy monopoly* is that it allows leading countries to avoid a costly share-out of benefits from the terms of continuation of a system, which would be demanded in a situation with collective bargaining by members. In the case of the Sterling Area, the most striking example of this was in the crucial area of reserve diversification. By consistently *avoiding collective negotiations*, the British were able to lean on particular countries for balance of payments support and to slow and obscure the process of diversification. More generally, they were able to defer the losses that would have resulted from the diminishing economic pull of sterling. The French also kept at bay pressures on the Latin Union by avoiding any collective debates regarding its bimetallic foundations. In addition to these gains and deferred losses, having a policy monopoly over an unassociated membership enables leaders to exploit the advantages of *price discrimination*. The ability to systematically vary the price charged for ongoing membership enables leaders to pay members only what each member is deemed to be worth to the system. The Sterling Area saw both systematic patterns of discrimination between the Commonwealth and independent Sterling Area countries, and special dispensations for key countries such as South Africa. The Latin Union was founded on discrimination between insiders who were part of the Union and outsiders who operated the Napoleonic standard but did not fulfil the 'Latin Criteria'. The withholding of private information is crucial to the sustainability of price discrimination. The practice of discrimination is able to succeed to the leader's advantage, because disassociated members also have an interest in not sharing information horizontally, between themselves.

The object and effect of exclusory policy is to prevent members from overcoming their collective action problems and finding a common bargaining voice. This effect rests not only on information distortions, and price discrimination which allows for trouble spots to be bought off, but also on *policy restraint* by leaders, particularly with respect to membership *defection*. The British and French leaders of the Latin Union and the Sterling Area often *withheld remedial policies* rather than risk negotiations. They also retained a liberal attitude towards members wanting to alter their ties to the centre and move towards exit, for the same reason. Thus, in the 1950s and 1960s, independent and commonwealth countries gradually lessened their commercial and financial ties with Britain and opened up new trading and monetary relationships, especially with the US and Continental Europe. Similarly, the Latin Union allowed members to build financial links with London and Berlin while retaining the Paris connection. Crucially, therefore, *exit could operate as a substitute for resistance*. Thus, exclusory leadership

diminished the prospect of member resistance and instead generated endogenous support for the leader. Strikingly, despite the rise of economic and political nationalism in the eras of both the Sterling Area and the Latin Union, neither Britain nor France experienced a member revolt against their monetary hegemony. This absence of collective resistance sustained their position of leadership even as the foundations of their economic dominance were decaying.

Again, however, these distinctive advantages of exclusory leadership typically came with predictable costs. Three sources of maladaptation and political vulnerability were crucial factors in the case studies. First: the desire to retain the power of policy initiative prevented both France and Britain from imposing necessary disciplines and updating practices, when doing so might have arrested the dissolution process. In the case of the Latin Union, the tolerance of Italian and Greek digressions meant the system never progressed from being a mere coinage agreement to becoming a common currency area with stable exchange rates. In the Sterling Area, similarly, the insidious weakening of the system through reserve and trade diversification was permitted to continue. This propensity for *policy drift* was compounded by the inability of managing authorities to stand apart from the interests that made up the economic bases of the respective systems. Thus, the *haute banque's* interests in the bimetallic foundations of the LMU caused the French authorities to withhold reforms, while capital outflows from the Sterling Area continued at levels that were sub-optimal from the perspective of the system. Second: the loyalty of members to the centre was undermined by their relative lack of any say in how the system might develop. In both the LMU and Sterling Area, members began to limit their exposure to the centre almost as soon as issues emerged. The consequence was not only that members were happy to engage in *defection*, but also that they would not make new investments in the status quo. This fuelled still more leadership inertia and *institutional sclerosis*, as practices were not updated to meet new functional needs. Third: price discrimination drove increasingly varied terms of membership. This, in turn, caused common interests to drift apart and practices to become riddled with exceptions and non-compliance. For example, the nationalisation of various monetary instruments from the 1870s to the 1890s progressively limited the importance of the 1865 LMU convention. Eventually, in both of the cases studied, there were almost no common interests left, making the governance of already disassociated systems effectively impossible.

Despite mutual policy restraint and other sources of resilience, the insidious weakening of the ties that bound the spontaneous systems together, and the failure to update practices to respond to emerging functional needs, resulted in slow processes of decline. The Sterling Area and LMU were gradually hollowed out, as interests and common practices drifted apart to the point that the systems could no longer satisfy the interests of their constituent parts. In both systems, after decades of decay, their leaders found cause to put contractual floors in place. Such a historical turning point came in 1885 for the LMU, with the imposition of compulsory redemption, and in 1967 for the Sterling Area, with the

imposition of minimum reserve holdings. The foundations of these systems continued to slowly weaken under their contractual floors until the systems had to be retired.

Collapse and decline were not planned or intended in any of the cases studied. This observation confirms the assumption of this thesis, that system leaders decide their responses to problems on a basis of bounded rationality and opportunism. The leaders studied aimed to maintain a satisfactory degree of system stability, while sustaining or augmenting established channels of benefits, and deferring costs. In so doing, they systematically discounted long-term costs and adverse consequences. Indeed, the leaders' appropriative and exclusory actions, leading ultimately to system dissolution, obeyed sequential patterns showing that they had failed to anticipate all the subsequent branchings of their decision trees. While the strategic advantages of leadership were repeatedly exploited for individual gain, upcoming sources of system maladaptation and adverse member responses were often only partly foreseen, if at all. The difficulty of avoiding system dissolution arises from the fact that alternative leadership stratagems would demand less opportunism, and calculations with longer time horizons. However, for leaders who control the transactions of system development, such calculations would involve greater uncertainty, might impose additional costs, and could jeopardise established benefits. As a result, they tend to pursue policy options that clash with system optimisation. The outcomes of collapse and decline are not the result of pathologies or irrational human tendencies. On the contrary, they are the effects of opportunistic and boundedly rational leadership, which prevail over ideal outcomes.

2. The US Dollar Regime in Decline?

This thesis will now speak to one final contemporary issue, which it would be a pity not to address. That is, the likely fate of the US dollar. In terms of this study's analytical framework, the US dollar regime can be understood as a spontaneous system that developed by default, as efforts to negotiate a new international monetary order in the 1970s came to nothing. As a spontaneous system, with market forces at its foundation, this study would strongly concur with the mainstream opinion that the dollar remains economically attractive and useful.[911] That is to say, even if it is probably weakening, the dollar is firmly embedded in market based relations and practices that are likely to endure into the foreseeable future. However, the framework generates a further conjecture that is more controversial. That is, we should expect to find evidence of exclusory leadership in this spontaneous context. This perspective strongly opposes the mainstream view about the geopolitical and strategic sources of the dollar's strength.

What evidence, if any, is there of exclusory leadership in the dollar regime? The first thing to observe is the paucity of structures for collective dollar regime management. Despite repeated calls for more

[911] Cohen, 2009; Helleiner, 2009; James, 2009; and McKinnon, 2009.

monetary policy coordination, that stretch back to the 1970s, the international monetary system is not highly institutionalised. Ngaire Woods recently made the charge on *BBC Newsnight* that the United States' lack of consultation with other countries over coordinated monetary policy is "selfish and ill-advised", arguing that "by not consulting with major economies [and] by not pulling the G-20 together, making sure this is done in concert, what they're doing is creating chaos."[912] Yet, what her argument overlooks is the structural incentive for the US to disrupt collective action. To be sure, the US actions are selfish, but they are not ill-advised, at least from a short-term utility maximising perspective. However great the functional needs of other nations and the international system, the US calculation of its political interest in maintaining a monopoly over policy is rational, and their gains to be expected from this are non-trivial. This explains why the US is apparently unwilling to promote collective efforts to manage the international monetary system, beyond periodic accords such as the Plaza and Louvre Accords of the 1980s. The likelihood must be that the G-20 and other potential forums for coordination are destined to remain mere shells and talking shops.[913]

Another theoretical expectation is that the US will engage in price-discrimination strategies. That is, the US, in the words of Treasury Secretary John Connolly, will "screw" the fragmented and unorganised members of the regime by charging them different amounts for the privileges of participating in the dollar order. It is readily apparent that the US provides different degrees of support and concessions to different classes of dollar holders. For instance, following the global financial crisis, the countries in the G-20, except Beijing for political reasons, now have access to almost unlimited Federal Reserve Swaps. These privileges have not been extended to smaller countries. The special restraint the US has shown in dealing with some countries over adjustment issues provides further evidence of price discrimination. Hillary Clinton's leaked remark about China – "How do you deal toughly with your banker?" – supports the same point. Similarly, the importance of 'petro-dollar' states in the dollar regime provides another example of price discrimination, as the US has pledged particular forms of military support in return for oil trade in dollars.[914] Thus, there is much *prima facie* evidence that not all holders of dollars are equal.

There are other, more specific, features of the present operation of the US dollar order that this study can illuminate. For instance, the "fundamental paradox" of the recent financial crisis, according to some, is that the 2008 crash generated an increase in foreign investments in the dollar.[915] The explanatory framework put forward in this thesis is a useful aid in interpreting this finding. There are few incentives

[912] BBC *Newsnight* 31 January 2014.
[913] Gene Frieda, of Moore Capital, in an interview with the author, drew attention to the considerable complacency among US officials about macro-financial stability and the global consequences of spill-overs (email correspondence with author dated 26 February 2014).
[914] Spiro, 1999. The special deals between the US and the Organisation for Oil Exporting Countries (OPEC) since the end of Bretton Woods offer further evidence of this important and special relationship.
[915] Stokes, 2013.

for countries that are not arranged in a coordinated way to actively put in doubt their commitment to the dollar. The reason is simple: they will not gain much, if any, bargaining leverage by doing so, because they are not bargaining. They also have no means of collective influence in the system. Thus, by complaining, they would only put at risk the "implicit understanding that [their investments in the dollar regime] preserve US goodwill and access to the US market."[916]

The theoretical conclusions of this study also put in doubt the notion that the advantages of the dollar since 2008 are simply a product of incumbency and a lack of alternatives.[917] The pursuit of exclusory leadership provides an endogenous basis for member support of the US dollar, as they are not given reasons to actively protest US leadership. Furthermore, the historical analysis of the Sterling Area strikes a powerful note of caution for those who have declared the dollar invincible because of its recent strength in spite of the crisis.[918] The pattern of countries clinging to the centre in crisis and edging out in calmer periods has a historical precedent in the turmoil of the pound in the 1950s and 1960s. The strength of the dollar since 2008 should not be taken as an affirmation that it is not in decline. Instead it should be remembered that the support that members provide to dominant currencies in periods of crisis – in both spontaneous and negotiated systems – is ultimately self- rather than system-serving, and therefore necessarily qualified and limited.

This study's analytical framework also helps to explain the apparent inconsistency between indicators of the persistence of the dollar regime, and the mounting anecdotal evidence of ongoing monetary and trade diversification. Just because countries have an interest in the dollar, does not mean they owe any bonds of loyalty to the US or feel a sense of commitment to a system within which they are excluded from policy making. Thus China, Russia, and other emerging market nations, are finalising agreements on an almost weekly basis that weaken the dollar system of trade and monetary relations. Even those apparently staunch allies of the US, the ECB and the Bank of England, have partly diversified their reserves, at the risk of US condemnation. The fact that countries have a strong incentive to take these gradual steps out of the dollar-centric regime, and that neither they nor the US have any interest in advertising their actions of defection, explains the relative absence of indications of large-scale moves out of the dollar regime.[919] As would be expected according to this study's framework, the moves out of the dollar have been incremental and marked by restraint on all sides. This, however, does not make them any less real or important.

The instruments of power that the US has tended to deploy in its efforts to support the dollar are another set of examples where current practices map onto historical precedents. As Carla Norrlof notes, efforts to force the dollar onto reluctant holders "are the exception rather than the rule and cannot explain why

[916] Helleiner, 2008, 367
[917] Stokes, 2013.
[918] Prassad, 2014.
[919] Stokes, 2013.

dollars are held privately worldwide."[920] The use of coercive actions or blocking of public account holders is equally rare. This study's explanatory framework can explain this restraint. Imposing the dollar on members might catalyse collective resistance, accelerate diversification, undermine the established norms of voluntarism, and meet stiff resistance from the financial market interests that underpin the regime and vigorously defend their sphere of autonomous action. The consequence of these structural constraints on certain courses of leadership, as in any spontaneous system, is that the decline of the dollar will be slowed by policy restraint and accommodation. However, strong-arm actions necessary to arrest the weakening of the common interests and practices that support the dollar regime over the long-run will not be taken.

This study also suggests an important bias in many accounts of the dollar regime. There is a common notion that the future of the dollar order "rests on good governance and a US commitment to engage in internationalism."[921] This proposition goes essentially unquestioned. Yet, the findings of this thesis suggest just the opposite: the future of the dollar is more likely to rest on *opportunistic* governance and *anti*-internationalism, and the weakening of US power will be delayed by the US's ability to withhold information, avoid collective reactions, and discriminate between the uncoordinated members of the system. The more effectively the US holds countries in bespoke "dollar traps", while reaping allocative efficiency gains, the better placed it will be to sustain its hegemony by avoiding collective resistance. The historical analogies of the Sterling Area and the LMU suggest that only when the "dollar traps" shift from being a burden on the emerging markets to weighing down the US itself, will the US retire from its dominant position. In the interim, there is as much cause for pessimism as optimism. To be sure, the international monetary order will have a basis that provides a degree of stability. Nevertheless, much inefficiency can be expected as the US reaps the final rewards of its dominant but declining position at the centre of the international monetary order.

3. The Study of International Monetary Systems

A wish to address the puzzle of dissolution led this study to confront the relative paucity of analysis of international monetary leadership and governance. One might be forgiven for thinking that this gap in the literature has arisen because there is not much governing of international money markets going on today. However, the real problem is that the concepts of leadership and governance tend to be mistakenly conflated with efficient cooperation. From this erroneous assumption, it follows that the presence of leadership and governance will help to coordinate and empower decentralised actors and resolve international monetary cooperation problems. The corollary is that the absence of leadership and governance will result in dysfunction and dissolution.[922] The result of this line of thinking is an

[920] Norrlof, 2013, 1060.
[921] Kirshner, 2013, 1014. This view is found in all the contributions to Eric Helleiner and Jonathan Kirshner's recent edited volume on *The Future of the Dollar* (Helliener and Kirshner, 2009).
[922] Kindleberger, 1973; Eichengreen, 2008; and Flandreau, Holtfrerich and James, 2003.

overly simplistic dichotomy between, on the one hand, the pairing of cooperation with order and, on the other, the absence of cooperation with disorder.[923]

The roots of this conceptual distinction are buried deep in contemporary thinking. They give sustenance to core assumptions in the discipline of international relations about what brings order out of anarchy. The present study challenges those assumptions by distinguishing two different types of cooperation (negotiated and spontaneous), and two different forms of leadership (appropriative and exclusory) that arise in response to those types of cooperation. It also distinguishes the different sorts of disorder (collapse and decline) that flow from the two forms of leadership. The point is a simple one: we must investigate the substance of leadership and governance, rather than simply declaring them, by theoretical fiat, to be always inherently good.

The policy implications of this argument are no less provocative. The international monetary politics that have been investigated in this thesis are elusive, and often shielded, in theory and practice, by the specialist vocabulary of macro-economics and closed professional associations. The perspective espoused in this study is unconventional, in particular for those working, implicitly or explicitly, with theories of public goods and hegemonic stability. It puts self-serving rather than system-serving leaders at the centre of its explanation. It focuses on actual decision makers as opposed to disembodied forces and changing environmental conditions. And it emphasises political and distributional conflicts as opposed to considerations of technique and efficiency. The argument, if judged persuasive, should compel insiders to think beyond the three technical problems of liquidity, adjustment, and confidence. In order to understand how systems actually operate and, eventually, dissolve, the less benign troika of opportunistic leadership, political conflict, and policy maladaptation, which obstruct the most desirable historical paths, must be brought to the surface and critically scrutinised.

[923] Flandreau, Holtfrerich and James, 2003.

Appendix I

	Gold-Dollar System		Inter-war Gold Exchange		Sterling Area		Bimetallic*
	(start-date)	(end-date)	(start-date)	(end-date)	(start-date)	(end-date)	end-date
Argentina			1927	1929	1931	1972	1863
Australia			1925	1929			1852
Austria			1923	1931			
Austria-Hungary							1852
Bangla..					1931	1979	
Belgium-Lux	1958	1973	1925	1935			1878
Belize					1939	1978	
Bolivia			1928	1931	1931	1939	1908
Botswana					1931	1966	
Brazil			1927	1930	1931	1939	1906
Bulgaria			1927	1931			
Burma					1931	1966	
Brunei					1931	1979	
Cameroon					1931	1962	
Canada	1962	1972	1926	1931			1853
Caribbean (East)					1931	1976	
Caribbean (Other)					1931	1975	
Chile			1926	1932			
Columbia			1923	1933			1871
Congo					1931	1942	
Costa Rica			1922	1932			1900
Cuba			1919	1933			
Czech..			1926	1931			
Denmark			1927	1931	1933	1939	1873
Ecuador			1927	1932			1900
Egypt			1925	1931	1931	1947	1877
El Salvador			1920	1931			
Estonia			1928	1931	1931	1939	
Finland			1926	1931	1931	1939	1877
France	1958	1973	1928	1936			1878
Gambia					1931	1979	
Germany	1958	1969	1924	1931			1872
Ghana					1931	1965	
Greece			1928	1931	1931	1939	1910
Guatemala			1924	1933			
Honduras			1931	1934			
Hungary			1925	1931			
HK					1945	1973	
India			1927	1931	1931	1967	1899
Ireland					1931	1979	
Indonesia			1925	1936			
Italy	1958	1973	1927	1934			1884
Japan	1962	1973	1930	1931	1933	1948	1897
Kenya					1931	1977	
Lesotho					1931	1979	
Libya					1931	1971	
Malawi					1931	1970	
Mauritius					1931	1976	
Moz…					1931	1972	
Mexico			1925	1931			1905
Namibia					1931	1972	
Neth..	1958	1973	1925	1936			1875
New Zealand			1929	1931	1931	1971	
Nicaragua			1919	1931			1912
Norway			1928	1931	1931	1939	
Oman					1931	1972	

Pacific Islands					1931	1972	
Palestine					1931	1948	
Panama			1919	1933			
Paraguay			1927	-			
Peru			1931	1932			
Philip…			1919	1933			1903
Poland			1927	1936			
Portugal			-	-	1931	1939	1854
Qatar					1931	1972	
Romania			1929	1932			1890
Russia							1897
Salvador						1890	
Serra Leone					1931	1979	
Siam			1928	1932			
Singapore					1931	1978	
South Africa			1925	1931	1931	1972	
Somalia					1931	1964	
Spain							1883
Sudan					1931	1957	
Swaziland					1931	1979	
Sweden	1958	1973	1924	1931	1931	1939	1873
Swi..	1958	1973	1925	1936			1878
Tanzania					1931	1964	
Turkey							1880
UAE					1931	1979	
Uganda					1931	1977	
UK	1958	1973	1925	1931			1821
USA	1946	1971	1919	1933			1853
Uruguay			1928	1932			1863
Venezuela			1927	1930			
Yug..			1931	1931	1933	1939	
Yemen					1931	1971	
Zimbabwe					1931	1972	

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* This data is in fact a representation of when countries joined the gold-standard. This was used as a proxy for countries leaving bimetallism because the data actually gives a tidier presentation than the dissolution of the bimetallic system that the actual process and therefore is unlikely to prejudice the overall analysis. For instance Argentina, like many countries, flitted between gold and bimetallism and fiat systems, meaning "joined" the gold standard in 1863, 1883 and 1903.

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