University of Cincinnati

Date: 2/19/2022

I, Igor Kovac, hereby submit this original work as part of the requirements for the degree of Doctor of Philosophy in Political Science.

It is entitled:

Persistent Imbalance of Power – A Pervasive Hegemony Theory

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Persistent Imbalance of Power – A Pervasive Hegemony Theory

A dissertation submitted to the Graduate School of the University of Cincinnati in partial fulfillment of the requirements for the degree of

Doctor of Philosophy

in the Department of Political Science of the College of Arts and Sciences by

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June 2021

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ABSTRACT

Most International Relations literature suggests that when power becomes imbalanced, such a situation will be corrected – hegemony cannot persist over time. However, history offers us several examples of hegemonies lasting over a century, e.g., Ancient Rome, Ming China. So far scholars have offered four explanations for such enduring hegemony (Coercive Hegemony, Cooperative Hegemony, Cultural Hegemony, and Opportunist Hegemony), with a common mechanism: ineffective balancing. Namely, the hegemon has the capacity to put balancing at bay using different strategies flowing from the nature and fundamental principles of its hegemony. Hence, the hegemon uses coercion, institutional leverage, ideological indoctrination, or buyout, in order to assure its hegemony can endure. Yet, through time and through crisis the capacities of the hegemon to make the balancing ineffective diminishes. As such, these theories all share a similar assumption – imbalance is transitory and thus hegemony will breakdown. But what if that common assumption is incorrect. What if under certain conditions, imbalance is not resisted, but rather serves interests of non-hegemonic states as well as the hegemon? Twentieth and twenty-first century US hegemony suggests such conditions may exist. This American imbalance displays a different nature and fundamental mechanism behind its functioning. Although US relative power is declining, its global monetary network centrality is not. Moreover, even in times of severe crisis, such as the breakdown of the Bretton Woods system, or the Global Financial Crisis in 2008, we have not witnessed US monetary centrality decline. In fact, quite the opposite is true. The dynamics associated with an imbalance of power in favor of the United States runs against the expectations of existing theories. Therefore, we need a different theory to make sense of these particularities and make better policy recommendations. Thus, I have developed a Pervasive Hegemony Theory,

which is based on a 'buy-in' behavior, that better explains US hegemony compared to existing alternatives. The 'buy-in' behavior relates to non-hegemonic states as well as the hegemon, in which all countries continue to use hegemon's monetary unit in their monetary relations, even in times of severe economic crisis. This reinforces the hegemony. Even though non-hegemonic states may not prefer the imbalance of power, they prefer conducting their economic relations within the hegemon's monetary unit and thus perpetuate the imbalance. Subsequently, they can only maximize their selfish interests and autonomy by buying-in to the hegemony and reproducing the imbalance of power. Conversely, the hegemon may not like the current rules and norms of the international system, but it can change those and obtain the support of the non-hegemonic states if it accepts to provide its monetary unit as the central currency of the system. In pursuing this argument, I use both quantitative (Network Analysis and Time Series) and qualitative methods (Process Tracing). I use the former on available economic data to establish the claim of US economic centrality, and that it is something different than what we have seen in the past. Second, I process trace the mechanisms of hegemonic and non-hegemonic state behavior in two international monetary systems (Bretton Woods and post-Bretton Woods) in order to isolate and identify the buy-in mechanism and provide an explanation of enduring imbalance – ownership over the central monetary unit in global economy. The dissertation, thus, assesses existing theories and indicates their inadequacies in explaining an important international phenomenon and provides a more robust explanation of enduring hegemony with the economic centrality, namely the ownership of the central monetary unit.

ACKNOWLEDGEMENTS

I would like to thank my supervisor prof. Harknett for prudently guiding me between Scylla and Charybdis of this research project, as well as through the whole Ph.D. program. You have never lost sight of our end goal and you have never doubted my capabilities to reach it. Thank you for your help and support. A grateful and humble thank you goes to prof. Green, whose comments were sharp and whose company was always invigorating. You restored my hope in academic meritocracy and integrity, showing me that intellectuals still (can) exist. The hearty comments of prof. Moore deserve a special appreciation. Thank you for your patience and reminding me about the importance of work-life balance.

Outside my dissertation committee, I would like to thank three more people at University of Cincinnati. Prof. Mockabee for his unselfish commitment to help students with his methodological advice. Colonel Klein for his numerous conversations over lunch. Prof. Ivanov – with whom I share so many things. Through time we have become good friend. I could always count on him to go an extra mile in helping me whatever I needed. Thank you!

I am extremely grateful to Tina Teater for reading earlier drafts of this research, meticulously correcting my otherwise incomprehensible thoughts, and being there for me to vent, when I needed to.

In the process of writing this dissertation I have spent some time at Institute for Security and Conflict Studies at the George Washington University. Prof. Glaser and prof. Downes gave

me the opportunity to be a part of a great group of scholars and colleagues. Thank you for your kindness and affinity. I am also in debt to prof. Spear for her 'real life' conversations about … what else than football, coffee, tea, and of course Brexit. I express a very special gratitude to my ISCS fellows in arms. You were the colleagues one could only wish for – committed and benevolent; encouraging and humble. I apologize to Vanes and Michelle for talking to much in our office. Alex K. for being the heart of the group, Julie for her car-rides (with Eric of course), Alex L. for making me push harder, Eleni with whom I could share the difficulties of raising a family while pursuing a Ph.D. – usually while eating her fantastic baklava, Andrew for the brown liquor experiences, Dani for genuinely being a good person and scholar, Shah for teaching me everything about military technology, Ryan for being soft-spoken but always spot on, Nick for his positive attitude, Do Young for all the latest information from the academic world, and all others. Thank you for making me a better scholar, colleague, and person.

I want to express a unique appreciativeness and give my accolade to the Charles Koch Foundation and Charles Koch Institute. Scott, David, Michelle, Haley, Kerby, Hugo, Andrew – it may be a cliché to say so, but in this case, this is 101% true: I would not finish this research if it not for you! When my situation was dire, you guys appeared like angles. I will never forget your generosity, professionalism, and help!

Last but definitely not least, I want to thank my academic colleagues and peers, with whom I have collaborated at conferences, workshops, papers, roundtables, articles, book chapters, books, or other activities. I have enjoyed every single step of the way. You made academic hardships

easier. Thank you prof. Ripsman for teaching me things that I should have already know without losing your nerves. Thank you, Matt, for painting every conference town red with me.

Outside academia, I want to thank my parents, for giving me the opportunity to nurture my curiosity and enable me to be student for life – having an academic career. I pray that I will be able to pass on your loving family embrace to my girls. Thank you also to Ludmila, Andrej, and Vincent, for their making me feel as home.

I dedicate this research project to my girls – Manja, Hana, and Nina. Thank you for 'peacefully accommodating' my selfish yearns of pursuing a Ph.D.

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1. INTRODUCTION

> "Every ten years, it is decline time in the US. In the late 1950s, it was the Sputnik shock, followed by the 'missile gap' trumpeted by John F. Kennedy in the 1960 presidential campaign. A decade later, Richard Nixon and Henry Kissinger sounded the dirge over bipolarity, predicting a world of five, rather than two, global powers. At the end of the 1970s, Jimmy Carter's 'malaise' speech invoked 'a crisis of confidence' that struck 'at the very heart and soul and spirit of our national will.' A decade later, academics such as the Yale historian Paul Kennedy predicted the ruin of the US, driven by overextension abroad and profligacy at home.[1]"

And now, throughout the decade after Josef Joffe's observation, the rise of China is said to threaten US dominance and the waning of American prestige globally is predicted.[2] Yet, US hegemony has withstood all anticipated demise moments in the past. The result has repeatedly been the same—the United States maintained the imbalance of power. Regardless of this empirical fact, the question of US decline continuously engages scholars.[3] Why is this the case? Why do

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[1] Joffe, Josef. 2009. The Default Power, The False Prophecy of America's Decline. *Foreign Affairs*. Accessibility: http://www. foreignaffairs.com/articles/65225/josef-joffe/the-default-power (2 March 2012).

[2] E.g.: MacDonald, Paul K., and Joseph M. Parent. 2011. Graceful decline? The surprising success of great power retrenchment. *International Security*, 35(4). Pp. 7–44; Lieber, Robert J. 2011. Staying power and the American future: Problems of primacy, policy, and grand strategy. *Journal of Strategic Studies*, 34(4). Pp. 509−30; Kirshner, Jonathan. 2012. The tragedy of offensive realism: Classical realism and the rise of China. *European Journal of International Relations*, 18(1). Pp. 53−75; Acharya, Amitav. 2014a. Power shift or paradigm shift? China's rise and Asia's emerging security order. *International Studies Quarterly*, 58(1). Pp. 158−73; Montgomery, Evan Braden. 2014. Contested primacy in the Western Pacific: China's rise and the future of US power projection. *International Security*, 38(4). Pp. 115−49; Nye Jr, Joseph S. 2015. The decline of America's soft power. In Skidmore, David (ed.), *Paradoxes of power: US foreign policy in a changing world*. London: Routledge, Pp. 39–44; Brooks, Stephen G., and William C. Wohlforth. 2016a. The rise and fall of the great powers in the twenty-first century: China's rise and the fate of America's global position. *International Security*, 40(3). Pp. 7–53; Beckley, Michael. 2017. The Emerging Military Balance in East Asia: How China's Neighbors Can Check Chinese Naval Expansion. *International Security*, 42(2). Pp. 78−119; Shambaugh, David. 2018. US-China Rivalry in Southeast Asia: Power Shift or Competitive Coexistence?. *International Security*, 42(4). Pp. 85−127; *The Soft Power 30*. 2019. Accessibility: https://softpower30.com/wp-content/uploads/2019/10/The-Soft-Power-30-Report-2019-1.pdf (13 December 2019).

[3] Kaplan, Morton A. 1957. Balance of power, bipolarity and other models of international systems. *American Political Science Review*, 51(3). Pp. 684–95; Organski, Abramo F. K. 1958. *World politics*. New York: Knopf; Knorr, Klaus Eugen (ed.). 1959. *NATO and American Security*. Princeton: Princeton University Press; Masters, Roger D. 1961. A multi-bloc model of the international system. *American Political Science Review*, 55(4). Pp. 780–98; Deutsch, Karl W., and J. David Singer 1964. Multipolar Power Systems and International Stability. *World Politics*, 16(3). Pp. 390–406; Waltz, Kenneth N. 1964. The stability of a bipolar world. *Daedalus*, 93(3). Pp. 881–909; Hanrieder, Wolfram F. 1965. The International System: Bipolar or MultiBloc? *Journal of Conflict Resolution*, 9(3). Pp. 299–308; Rosecrance Richard N. 1966. Bipolarity, Multipolarity, and the Future. *Journal of Conflict*

International Relations scholars repeatedly claim that 'this time is different' and decline is really happening?[4] Why does the literature time and again answer the question of US decline incorrectly? Moreover, why would the expectations for today with all its severe crises (e.g., 2008 global financial crisis, or 2020 after the Corona virus pandemic) be any different than the established historical pattern of US hegemonic endurance? Lastly, why is the literature not engaged with the

Resolution, 10(3). Pp. 314–27; Crabb, Cecil V. 1968. *Nations in a Multipolar World*. New York: Harper and Row; Haas, Michael. 1970. International subsystems: stability and polarity. *American Political Science Review*, 64(1). Pp. 98–123; Goldmann, Kjell. 1972. Bipolarization and tension in international systems: a theoretical discussion. *Cooperation and Conflict*, 7(1). Pp. 37–63; Hart, Jeffrey. 1976. Three approaches to the measurement of power in international relations. *International Organization*, 30(2). Pp. 289–305; Rapkin, David P., William R. Thompson, and Jon A. Christopherson. 1979. Bipolarity and bipolarization in the Cold War era: Conceptualization, measurement, and validation. *Journal of Conflict Resolution*, 23(2). Pp. 261–95; Gilpin, Robert. 1981. *War and Change in World Politics*. Cambridge: Cambridge University Press; Keohane, Robert O. 1984. *After hegemony*. Princeton: Princeton University Press; Russett, Bruce. 1985. The mysterious case of vanishing hegemony; or, Is Mark Twain really dead?. *International organization*, 39(2). Pp. 207–31; Sabrosky, Alan Ned (ed.). 1985. *Polarity and War: The Changing Structure of International Conflict*. London: Routledge; Kennedy, Paul. 1989. *The rise and fall of the great powers: economic change and military conflict from 1500 to 2000*. New York: Vintage Books; Krauthammer, Charles. 1990/1991. The Unipolar Moment. *Foreign Affairs*, 70(1). Pp. 23−33; Mearsheimer, John J. 1990. Back to the Future: Instability in Europe After the Cold War. *International Security*, 15(4). Pp. 5−56; Nye Jr, Joseph S. 1990. *Bound to lead: The changing nature of American power*. New York: Basic Books; Layne, Christopher. 1993. The Unipolar Illusion: Why New Great Powers Will Rise. *International Security*, 17(4). Pp. 5−51; Mastanduno, Michael. 1997. Preserving the Unipolar Moment: Realist Theories and U.S. Grand Strategy after the Cold War. *International Security*, 21(4). Pp. 49−88; Kupchan, Charles A. 1998. After Pax Americana: Benign Power, Regional Integration, and the Sources of a Stable Multipolarity. *International Security*, 23(2). Pp. 40−79; Huntington, Samuel P. 1999. The Lonely Superpower. *Foreign Affairs*, 78(2). Pp. 35−49; Wohlforth, William C. 1999. The Stability of a Unipolar World. *International Security*, 24(1). Pp. 5−41; Ikenberry, G. John. 2004. Liberalism and Empire: Logics of Order in the American Unipolar Age. *Review of International Studies*, 30(4). Pp. 609−30; Layne, Christopher. 2006. The Unipolar Illusion Revisited, The Coming End of the United States' Unipolar Moment. *International Security*, 31(2). Pp. 7−41; Singh, Robert. 2008. The Exceptional Empire: Why the United States Will Not Decline—Again. *International Politics*, 45(5). Pp. 571−593; Brooks, Stephen G., and William C. Wohlforth. 2008. *World out of balance: international relations and the challenge of American primacy*. Princeton: Princeton University Press; Haass, Richard N. 2008. The Age of Nonpolarity, What Will Follow U.S. Dominance?. *Foreign Affairs*. Accessibility: http:// www.foreignaffairs.com/articles/63397/richard-n-haass/the-age-ofnonpolarity (31 May 2012); Calleo, David P. 2009. *Follies of power: America's unipolar fantasy*. Cambridge: Cambridge University Press; Kupchan, Charles A. 2011. The false promise of unipolarity: constraints on the exercise of American power. *Cambridge Review of International Affairs*, 24(2). Pp. 165−173; Ikenberry, G. John. 2011. *Liberal Leviathan: The origins, crisis, and transformation of the American world order*. Princeton: Princeton University Press; Schweller, Randall L., and Xiaoyu Pu. 2011. After unipolarity: China's visions of international order in an era of US decline. *International Security*, 36(1). Pp. 41−72; Beckley, Michael. 2011/2012. China's Century? Why America's Edge Will Endure. *International Security*, 36(3). Pp. 41−78; Monteiro, Nuno P. 2012. Unrest assured: Why unipolarity is not peaceful. *International Security*, 36(3). Pp. 9−40; Monteiro, Nuno. 2014. *Theory of unipolar politics*. Cambridge: Cambridge University Press; Brooks, Stephen G., and William C. Wohlforth. 2016b. *America Abroad, The United States' Global Role in the 21st Century.* Oxford: Oxford University Press; Beckley, Michael. 2018. *Unrivaled: Why America Will Remain the World's Sole Superpower*. Ithaca: Cornell University Press.

[4] E.g., Layne, Christopher. 2012. This time it's real: The end of unipolarity and the Pax Americana. *International Studies Quarterly*, 56(1). Pp. 203−13; Drezner, Daniel W. 2019. This Time Is Different: Why US Foreign Policy Will Never Recover. *Foreign Affairs*, 98(3). Pp. 10−7.

opposite question, one that seems to logically flow from such empirical record—what makes US hegemony endure?

This project answers these questions by arguing that the existing literature misunderstands US hegemony, and the predictions it makes are an incomplete picture. Hence, I present a new theory of persistent imbalance of power—*Pervasive Hegemony Theory*. I show that the latter better captures the essence and mechanism of US hegemony than existing theories. In general, International Relations scholarship tells us that when power becomes imbalanced, such a situation will be corrected – hegemony cannot continue over time.[5] Still, history offers us several examples of hegemonic endurance, e.g., Ancient Rome, British Empire, and Ming China. Hence, so far scholars have offered four explanations for such enduring hegemonies (Coercive Hegemony, Cooperative Hegemony, Cultural Hegemony, and Opportunist Hegemony), with a common mechanism: ineffective balancing.[6] The hegemon uses its capacities to push balancing at bay and assure its hegemonic endurance. However, these theories expect that sooner or later the hegemon will fall under the balancing pressure and its hegemony will breakdown. Such events and dynamics

[5] E.g., Waltz, Kenneth N. 1979. *Theory of International Relations*. Reading: Addison-Wesley Publishing; Walt, Stephen M. 1987. *The origins of alliance*. Ithaca: Cornell University Press; Schweller, Randall L. 1994. Bandwagoning for profit: Bringing the revisionist state back in. *International security*, 19(1). Pp. 72–107; Mearsheimer, John J. 2001. *The tragedy of great power politics*. New York: WW Norton & Company; Layne, Christopher. 2007. *The peace of illusions: American grand strategy from 1940 to the present*. Ithaca: Cornell University Press; Ripsman, Norrin M., Jeffrey W. Taliaferro, and Steven E. Lobell. 2016. *Neoclassical realist theory of international politics*. Oxford: Oxford University Press.

[6] James and Lake (James, Scott C., and David A. Lake. 1989. The second face of hegemony: Britain's repeal of the Corn Laws and the American Walker Tariff of 1846. *International Organization*, 43(1). Pp. 1–29) talk about three faces of hegemony, but their argument does not go as far to claim that these are separate mechanisms, nor that these mechanisms are in fact characteristic of different types of a hegemony. Moreover, at points these faces overlap and the borders between them become murky. Thus, this typology is inadequate. Krasner (Krasner, Stephen D. 1976. State Power and the Structure of International Trade. *World Politics*, 28(3). Pp. 317–47) also distinguishes only two mechanisms: hegemony persists because of the sacrifices borne by the hegemon, or because of the coercion exercised by the hegemon.

are studied by Power Transition theories, Hegemonic Stability theories, and Power Cycle theories.[7] Instead, I argue that US hegemony is unique in that it is reproduced and reinforced not only by the hegemon, but also by the non-hegemonic states. I name such behavior a 'buy-in' dynamic.[8]

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[7] E.g., Modelski, George. 1978. The long cycle of global politics and the nation-state. *Comparative studies in society and history*, 20(2). Pp. 214−35; Keohane, Robert O. 1980. The Theory of Hegemonic Stability and Changes in International Regimes, 1967-I977. In Holsti, Ole, Randolph M. Siverson, and Alexander L. George (eds.), *Change in the International System*. Boulder: Westview Press. Pp. 131−62; Doran, Charles F., and Wes Parsons. 1980. War and the cycle of relative power. *American Political Science Review*, 74(4). Pp. 947−65; Kindleberger, Charles P. 1981. Dominance and leadership in the international economy: Exploitation, public goods, and free rides. *International Studies Quarterly*, 25(2). Pp. 242−54; Väyrynen, Raimo. 1983. Economic cycles, power transitions, political management and wars between major powers. *International Studies Quarterly*, 27(4). Pp. 389−418; Modelski, George. 1987. *Long cycles in world politics*. Seattle: University of Washington Press; Goldstein, Joshua S. 1988. *Long cycles: Prosperity and war in the modern age*. New Haven: Yale University Press; Gowa, Joanne. 1989. Rational hegemons, excludable goods, and small groups: An epitaph for hegemonic stability theory? *World Politics*, 41(3). Pp. 307−24; Houweling, Henk W., and Jan G. Siccama. 1991. Power transitions and critical points as predictors of great power war: Toward a synthesis. *Journal of Conflict Resolution*, 35(4). Pp. 642−58; Goldstein, Joshua S. 1991. The possibility of cycles in international relations. *International Studies Quarterly*, 35(4). Pp. 477−80; Kim, Woosang, and James D. Morrow. 1992. When do power shifts lead to war?. *American Journal of Political Science*, 36(4). Pp. 896−922; Thompson, William R. 1992. Dehio, long cycles, and the geohistorical context of structural transition. *World Politics*, 45(1). Pp. 127−52; Kim, Woosang. 1992. Power transitions and great power war from Westphalia to Waterloo. *World Politics*, 45(1). Pp. 153−72; Geller, Daniel S. 1992. Capability concentration, power transition, and war. *International Interactions*, 17(3). Pp. 269−84; Kindleberger Charles P. 1996. *World Economic Primacy: 1500-1990*. Oxford: Oxford University Press; Hebron, Lui, and Patrick James. 1997. Great powers, cycles of relative capability and crises in world politics. *International Interactions*, 23(2). Pp. 145−73; Lemke, Douglas. 1997. The continuation of history: Power transition theory and the end of the Cold War. *Journal of Peace Research*, 34(1). Pp. 23−36; Harkavy, Robert E. 1999. Long cycle theory and the hegemonic powers' basing networks. *Political Geography*, 18(8). Pp. 941−72; Tammen, Ronald, Jacek Kugler, Douglas Lemke, Alan C. Stam, Mark Abdollahian, Carole Alsharabati, Brian Efird *et al*. 2000. *Power transitions: Strategies for the 21st Century*. Washington: CQ Press; Denemark, Robert. A., Jonathan Friedman, Barry K. Gills, and George Modelski (eds.). 2000. *World system history: the social science of long-term change*. London: Rutledge; Doran, Charles F. 2003. Economics, philosophy of history, and the "single dynamic" of power cycle theory: expectations, competition, and statecraft. *International Political Science Review*, 24(1). Pp. 13−49; Abdollahian, Mark, and Kyungkook Kang. 2008. In search of structure: the nonlinear dynamics of power transitions. *International Interactions*, 34(4). Pp. 333−57; Kaldor, Mary. 2018. Cycles in World Politics. *International Studies Review*, 20(2). Pp. 214−22.

[8] Ikenberry and Kupchan have used the phrase 'buy into', by which they refer to a process where non-hegemonic elites "internalize norms that are articulated by the hegemon and therefore pursue policies consistent with the hegemon's notion of international order" (Ikenberry, G. John, and Charles A. Kupchan. 1990. Socialization and hegemonic power. *International Organization*, 44(3). Pp. 283–315. At Pp. 283). However, I use the term 'buy-in', and it denotes states' reinforcement of the hegemon's currency centrality in the international monetary system even in a time of crisis due to their selfish interests. Internalizing the norms have nothing to do with it.

Defining hegemony as a set of rules, norms, and principles of the game that the hegemon sets for the region it dominates[9] to center the economy around it,[10] the existing theories of hegemonic endurance share the fundamental rule of maintaining hegemony—preventing effective balancing. How the hegemon does this varies across four ideal types of existing theories. Namely, they differ in their operationalization of putting balancing at bay.[11] These different mechanisms of how hegemons put balancing at bay determine the nature of their respective hegemonies, their operating mechanism, and existential threats. Moreover, this criterion can also serve to create a taxonomy of theories of hegemony. Hence, I classify four types of theories of hegemony.[12]

First, Coercive Hegemony: ineffective balancing against the hegemon is a consequence of the leverage of the hegemon's coercive capabilities, by which the hegemon assures its dominance.[13] The argument is nuanced in two ways. One stresses coercive capabilities and military power projection capabilities[14], by which the hegemon assures its dominance by force. It stresses the importance of victories in military disputes, while the second group focuses rather on deterrence. The latter looks to the power gap, which *per se* dissuades states to balance against the hegemon.[15] Nevertheless, both groups agree that in order for the hegemony to endure, the hegemon needs to display or threaten with the use of force. Therefore, the nature of the Coercive Hegemon

[9] Lobell, Steven E. 2003. *The challenge of hegemony: Grand strategy, trade, and domestic politics*. Ann Arbor: University of Michigan Press. Pp. 8.
[10] Goldstein. 1988. Pp. 281.
[11] Some explanations cut across these ideal types. For example: Monteiro talks about the need for military dominance, as well as the need to generate economic growth of non-hegemonic states – fusing Coercive and Opportunist Hegemony arguments (Monteiro 2014). Moreover, Embedded liberalism (Ruggie, John Gerard. 1982. International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order. *International Organization*, 36(2). Pp. 379–415) argument synthesizes Cooperative and Cultural Hegemony.
[12] For an interesting debate on how hegemony relates to constitutional order, see Zidar, Andraž. 2019. *The World Community Between Hegemony and Constitutionalism*. Den Haag: Eleven International Publishing.
[13] E.g., Modelski. 1987; Mearsheimer 2001; Brooks, Stephen G., and William C. Wohlforth. 2008; 2016a; 2016b.
[14] E.g., Modelski. 1987.
[15] E.g., Brooks Wohlforth. 2008.

resides in its (military) power capabilities, and the fundamental mechanism by which such hegemony functions is coercion. Hence, the existential threat for the hegemony, or non-hegemonic balancing target, is diminishing the relative military power of the hegemon.

Second, Cooperative Hegemony: effective balancing is prevented by international regimes, which are put in place to lock other states into the hegemon-led international system.[16] Again, there are nuances to this explanation. One form claims that it is the sheer set-up and utility of the international regimes providing "information, reduce transaction costs, make commitments more credible, establish focal points for coordination, and in general facilitate the operation of reciprocity", which is the mechanism by which a hegemony endures.[17] An alternative operationalization is that it is the nature of the hegemon itself (liberal democracy in the case of United States), which influences the nature of international institutions and state behavior. As such, this ensures the protection of the weak, diminish fears of hegemonic exploitation, and assures persistent hegemony.[18] Still, both variations of Cooperative Hegemony agree that the hegemon needs to establish and work through the international regimes to generate cooperation, which in turn make balancing attempts against it rare and futile. Therefore, the nature of Cooperative Hegemony resides in the capacities of the hegemon to upload its interests onto international institutions and the fundamental mechanism by which such hegemony functions is institutional leverage. Hence, the existential threat for the hegemony, or non-hegemonic balancing target, is the erosion of international regimes.

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[16] E.g., Keohane, Robert O. 1984. *After hegemony*. Princeton: Princeton University Press; Ikenberry, G. John. 2001. *After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order after Major Wars*. Princeton: Princeton University Press; Ikenberry. 2011; Slaughter, Anne-Marie. 2009. *A new world order*. Princeton: Princeton University Press.

[17] Keohane, Robert O., and Lisa L. Martin. 1995. The promise of institutionalist theory. *International Security*, 20(1). Pp. 39−51. At Pp. 42.

[18] E.g., Ikenberry. 2001; 2011.

Third, Cultural Hegemony: by shaping the interests of other actors subliminally and latently using culture and ideology, the hegemon can hold-off balancing tendencies.[19] Therefore, non-hegemonic states do not follow their objective interests, but are programmed to fulfill the interests of the hegemon.[20] Still, there are different ways to achieve cultural hegemony, one of which is the hegemon's 'soft power'—a weapon of mass attraction.[21] By using culture, education, and moral policies, the hegemon creates an undisputable image of itself and non-hegemonic states follow its lead since they adore their role-model. Alternatively, the hegemon can generate a dominant ideology in the international community, which everyone is indoctrinated into. For example: the capitalist world system is reinforced by its own ideological influence—the creed of free market, free trade, and economic development.[22] Either way, this account of hegemonic endurance stresses the need to establish a universal idea in the international community that shapes actions of states to assure hegemonic persistence. Thus, the nature of Cultural Hegemony resides in the ideational capacities of the hegemon to dominate the world of ideas and its fundamental mechanism is brainwashing. Hence, the existential threat for the hegemony, or non-hegemonic balancing target, is fading hegemon's favorability in the international community, as well as the political ideas associated with the hegemon.

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[19] E.g., Nye. 1990; Wallerstein, Immanuel. 2003. *Historical Capitalism with Capitalist Civilization*. New York: Verso; Kupchan, Charles A. 2014. The normative foundations of hegemony and the coming challenge to Pax Americana. *Security Studies*, 23(2). Pp. 219–57.
[20] Lukes, Steven. 2005. *Power: A Radical View.* London: Palgrave Macmillan.
[21] E.g., Nye. 1990.
[22] E.g., Wallerstein. 2003.

Finally, Opportunist Hegemony: the hegemon 'buys-out' other states not to balance against it by providing public goods, or economic benefits.[23] The causal logic of a 'buy-out' is payment first, desired behavior second, or in other words, the hegemon bribes non-hegemonic states to accept the hegemony. However, the non-hegemonic states are aware of extortion possibilities of the hegemon, so over time they demand more benefits. If the hegemon cannot or is unwilling to provide additional freebies, then the non-hegemonic states become dissatisfied with the system and balance against the hegemon. As such, the nature of Opportunist Hegemony resides in the capabilities of the hegemon to produce and distribute public goods, and its fundamental mechanism is buy-out. Thus, the existential threat for the hegemony, or non-hegemonic balancing target, is a stagnant economy of the hegemon, which reduces the capacity for providing public goods.

Therefore, to answer the question whether US hegemony is in decline or not, we need to know first what type of hegemony we are dealing with? What is its nature and its fundamental mechanism of functioning? Otherwise, we may be barking up the wrong tree. However, it is precisely the latter, which I claim is the case with existing literature. For example, the aforementioned four explanations of US hegemony cannot fully account for occurrences that we have witnessed after the fall of Lehman Brothers and subsequent global financial crisis.[24] This crisis comes a close second in its calamity since 1900, the first being the great depression after

[23] E.g., Kindleberger, Charles Poor. 1973. *The world in depression, 1929-1939*. Berkeley: University of California Press; Organski, Abramo F. K., and Jacek Kugler. 1980. *The war ledger*. Chicago: Chicago University Press; Gilpin, Robert. 1981. *War and change in world politics*. Cambridge: Cambridge University Press.
[24] Due to their location (Manhattan) as well as their temporal (first half of September) equivalence many have compared terrorist attach of 9/11 to the collapse of Lehman Brothers on 9/15, claiming that it will be the latter that will change the structure of the international system, and announce the end of US hegemony. See e.g., Rachman, Gideon. 2010. Why 9/15 changed more than 9/11. *Financial Times*, 13 September. Accessibility: https://www.ft.com/content/3d9c0b28-bf6b-11df-965a-00144feab49a (2 April 2020).

1929.[25] Therefore, one would expect that non-hegemonic states would seize the opportunity and balance against United States in a moment when its hegemony and economy were fragile. Furthermore, the 2008 crisis came on top of shrinking the output gap (see Figure 1)[26], and the favorability of United States globally had been at an all-time low (see Figure 2).[27] Moreover, to reinforce the diminishing gap in capabilities between United States and its greatest competitor, I present two more statistics. First, Figure 3 shows that China has overtaken United States in the absolute amount of global trade.[28] Second, Figure 4 portrays how China has overtaken United States in material capabilities measured in CINC (Composite Indicator of National Capability) Scores.[29]

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[25] Reinhart, Carmen M., and Kenneth S. Rogoff. 2009. *This time is different: Eight centuries of financial folly*. Princeton: Princeton University Press. Pp. 253. See also Ch. 16.
[26] Gourinchas, Pierre-Olivier. 2019. *The Dollar Hegemon? Evidence and Implications for Policy Makers*. Asian Monetary Policy Forum. Accessibility: https://www.parisschoolofeconomics.eu/IMG/pdf/chaire-bdf-sept-2019-speaker-gourinchas.pdf (20 March 2020).
[27] Data from: Datta, Monti Narayan. 2014. *Anti-Americanism and the rise of world opinion: Consequences for the US national interest*. Cambridge: Cambridge University Press; and PEW Research Center. 2020. Global Indicators Database. Accessibility: https://www.pewresearch.org/global/database/indicator/1 (20 March 2020).
[28] Data taken from Version 4.0 Correlates of War International Trade: Barbieri, Katherine, Omar M. G. Keshk, and Brian Pollins. 2009. TRADING DATA: Evaluating our Assumptions and Coding Rules. *Conflict Management and Peace Science*, 26(5). Pp. 471–91.
[29] Data taken from Version 5.0 of Correlates of War National Material Capabilities: Singer, J. David. 1987. Reconstructing the Correlates of War Dataset on Material Capabilities of States, 1816-1985. *International Interactions,* 14(2). Pp. 115–32.

Figure 1: Share of the Global Output (real GDP per capita) by Global Powers

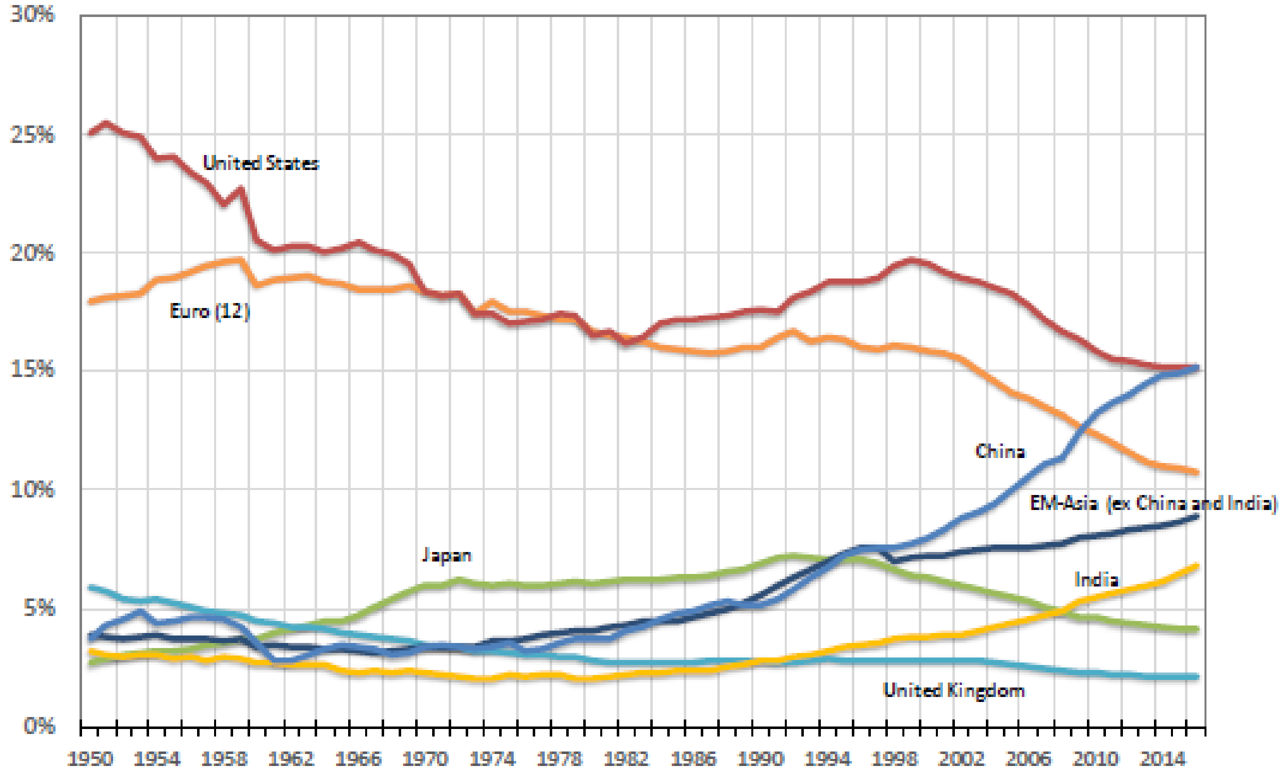


Figure 2: Global Favorability towards United States

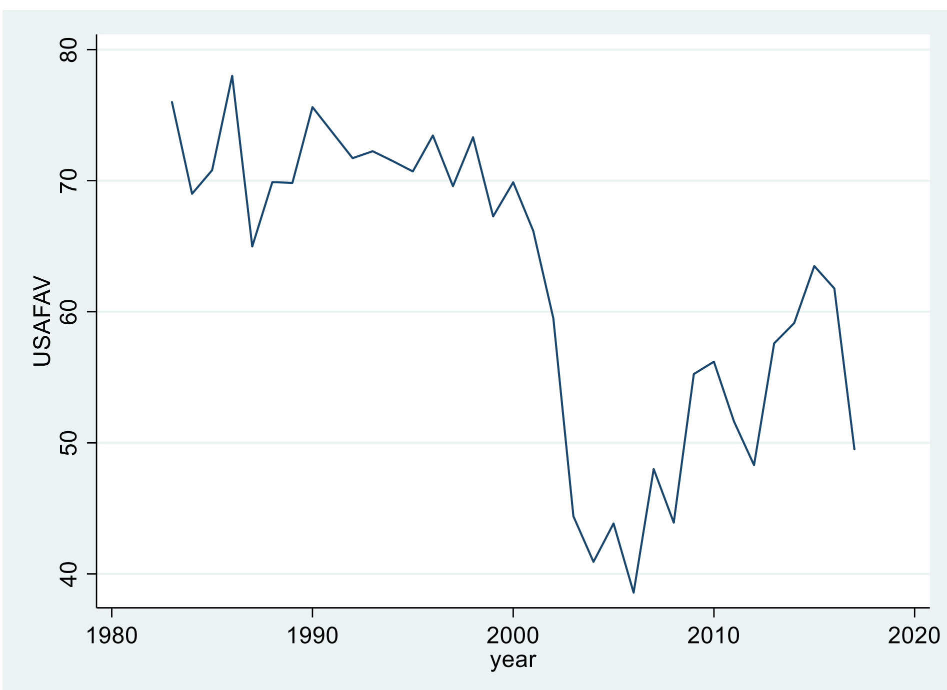


Figure 3: Absolute Amount of Trade of United States and China

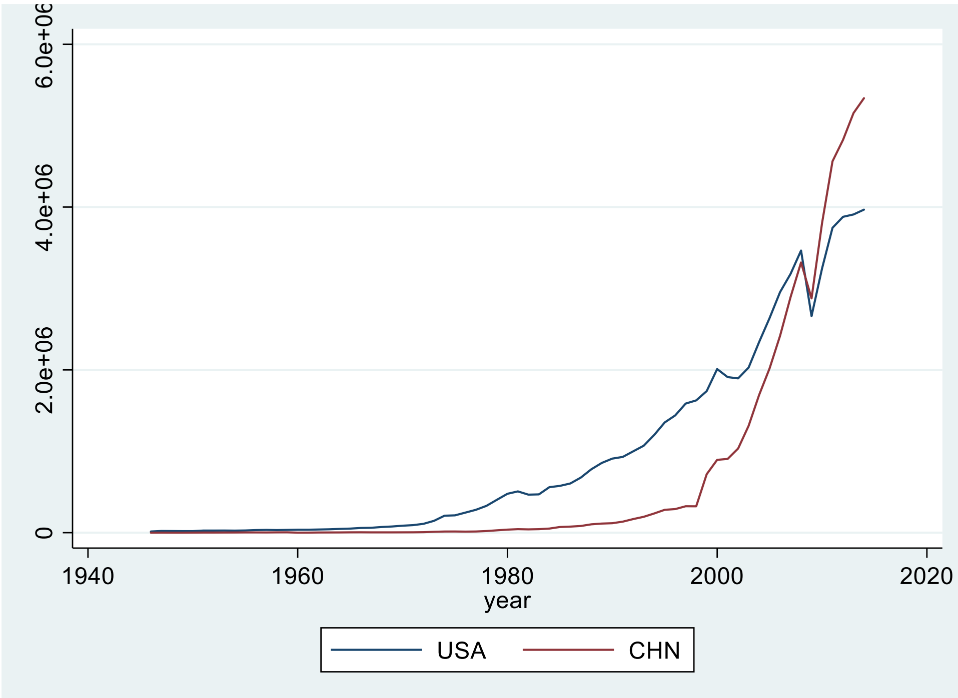
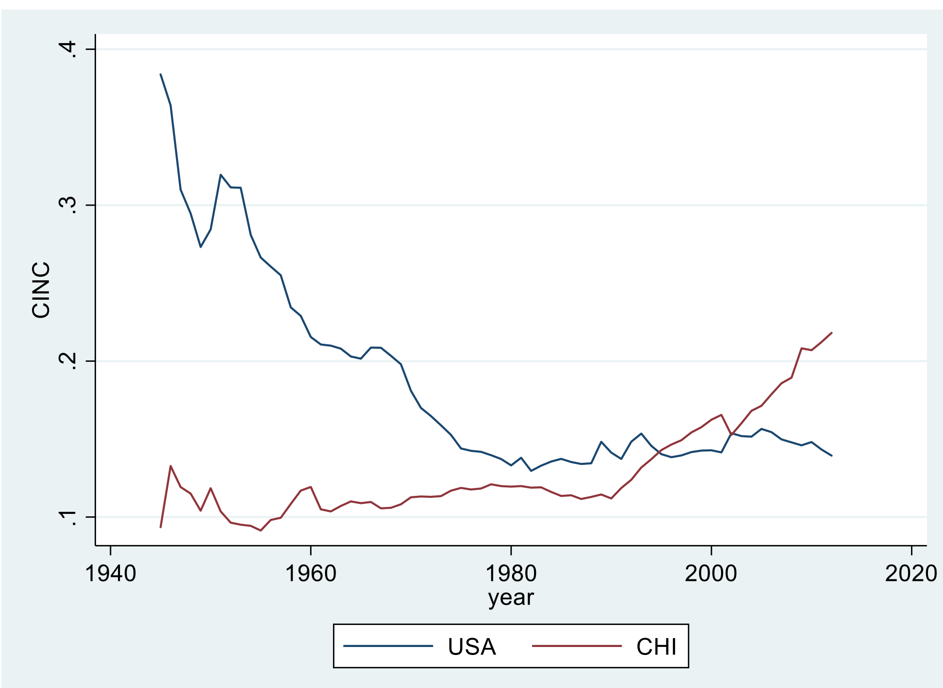
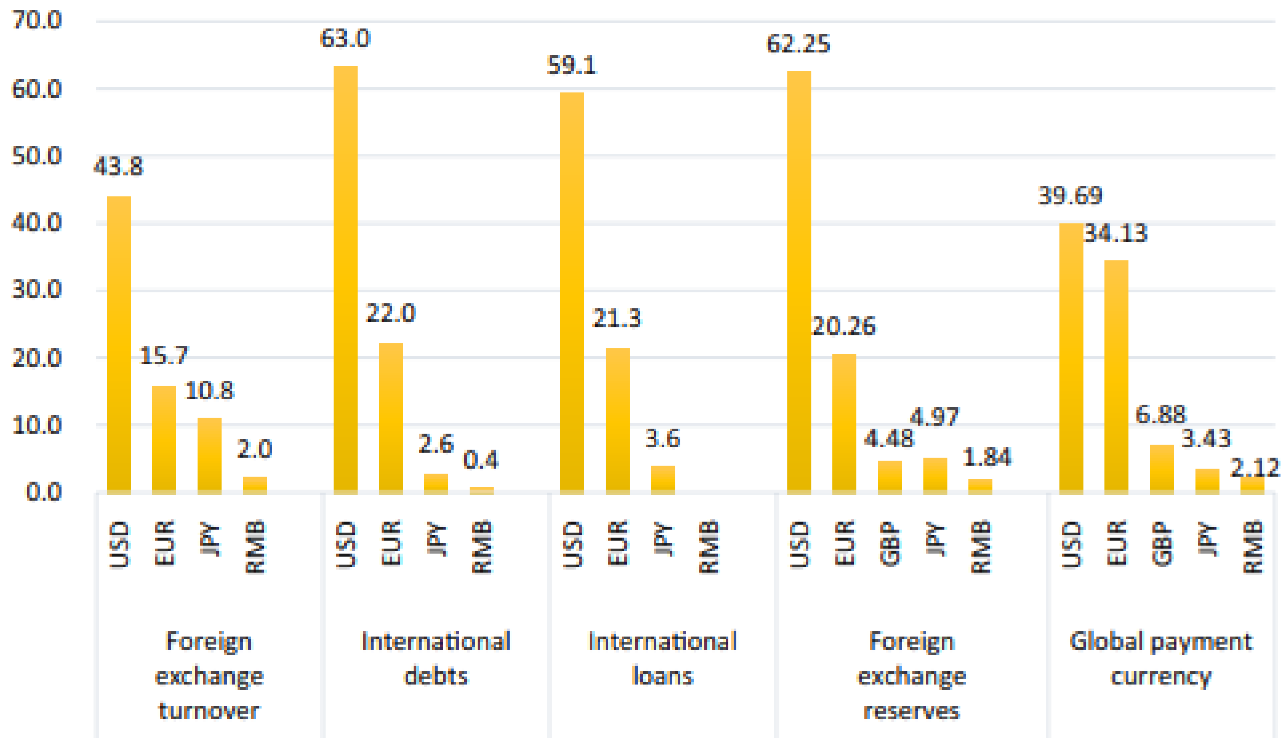


Figure 4: CINC Scores of United States and China



As such, conditions for successful balancing against United States and breaking up its hegemony were perfect in 2008. Thus, if non-hegemonic balancing were to take place, one should expect it to be seen at that point. Such balancing should be reflected in diminishing global confidence in the US dollar and its shrinking role in the global economy. Yet, the story we have experienced since 2008 is very different. Figure 5 shows the contemporary dominant position of the US dollar in comparison to other currencies according to five criteria.[30]

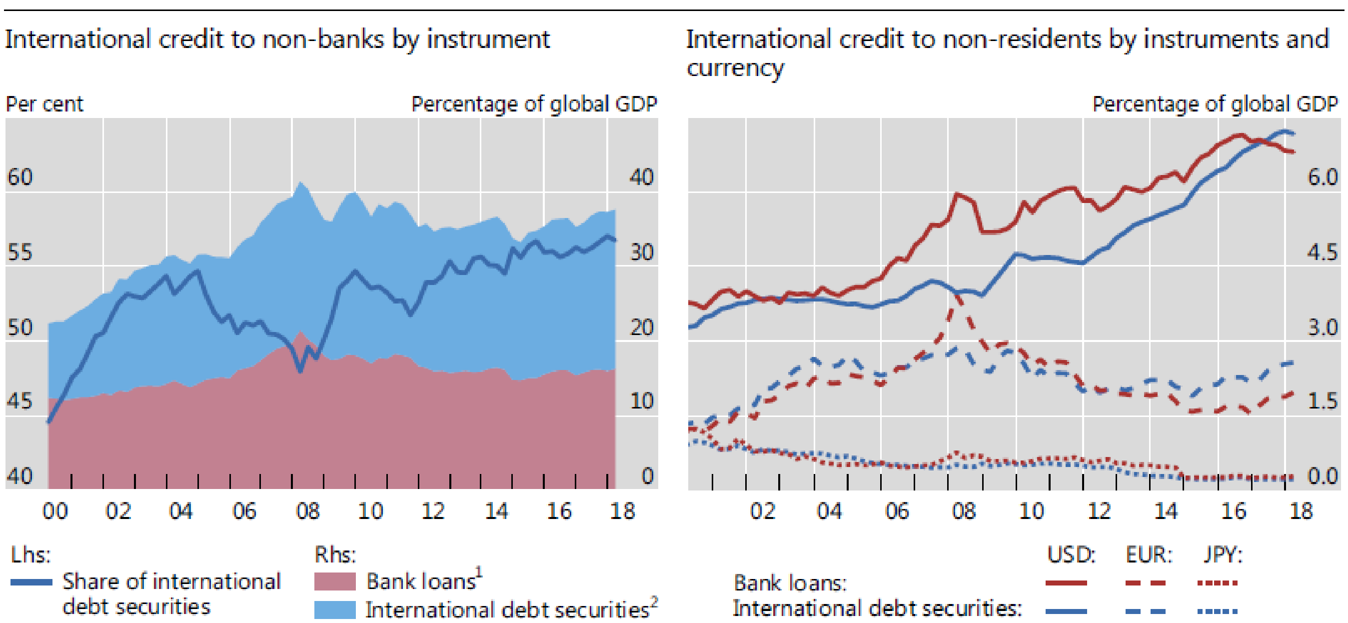
Figure 5: Dominance of the US dollar



[30] Eichengreen, Barry, and Guangtao Xia. 2019. China and the SDR: financial liberalization through the back door. *Quarterly Journal of Finance*, 9(3). Pp. 1–36. At Pp. 31. Foreign exchange turnover data is reported for April 2016; International debts and loans data are reported for the fourth quarter of 2016; Foreign exchange reserves data is reported for the second quarter of 2018; and Global payment currency data is reported for August 2018.

Furthermore, looking at the US dollar position dynamically since 2008 brings us to the same conclusion. If anything, the global position, and dominance of the US dollar has actually increased after 2008. It has not stayed the same, nor has it declined. Figure 6 portrays the issuance of international credits and what is astonishing is that with the rise of the amount of credits issued, also the amount of them issued in US dollar increases, while those in Euro or Japanese Yen decrease. Therefore, the US dollar has also strengthened its relative credit issuance position after 2008.[31]

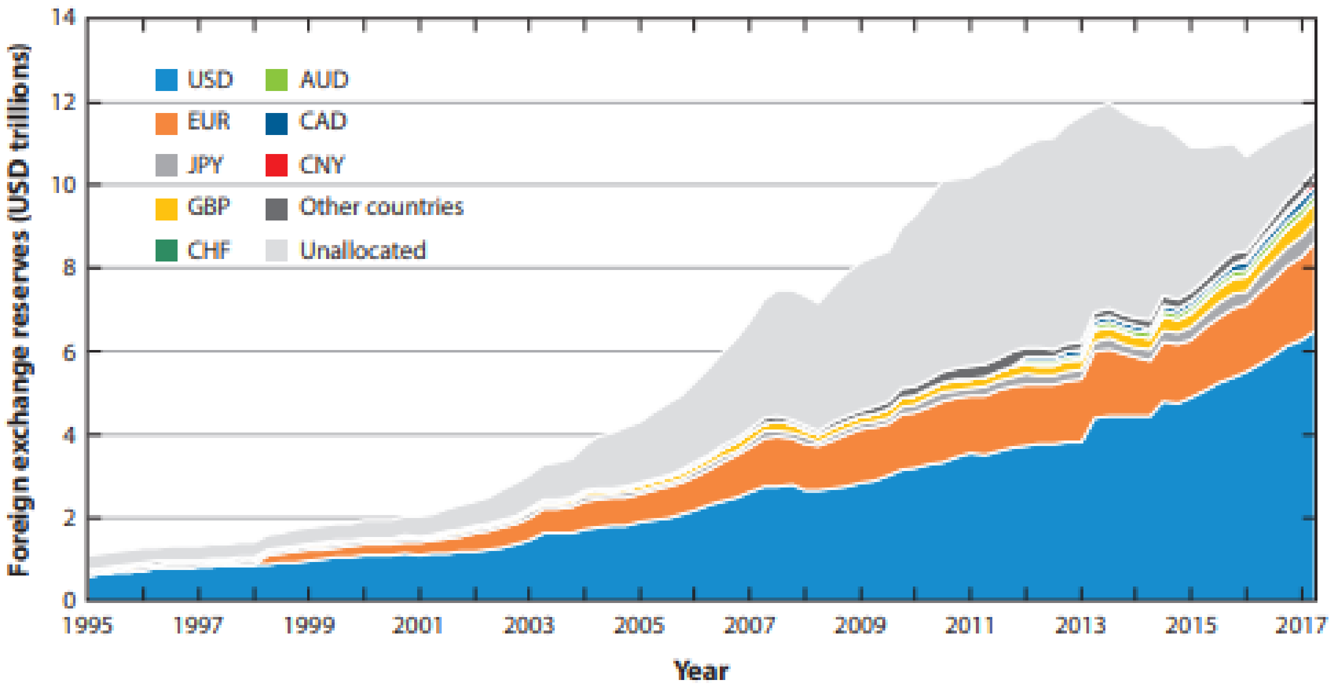
Figure 6: Issuance of International Credits



[31] Aldasoro, Inaki, and Torsten Ehlers. 2018. Global liquidity: changing instrument and currency patterns. *BIS Quarterly Review,* September. Pp 17–27. At Pp. 19.

Turning to the international reserves' dynamic, we see a similar trend (see Figure 7).[32] "The US dollar constitutes the lion's share of Central Bank reserves, with the euro a distant second.[33]" The amount of reserves denominated in US dollars has grown in correlation with exponential growth of global reserves. Moreover, even in relative terms, the US dollar has strengthened its global reserve position (see Figure 8).[34]

Figure 7: International Reserves – Absolute Amount



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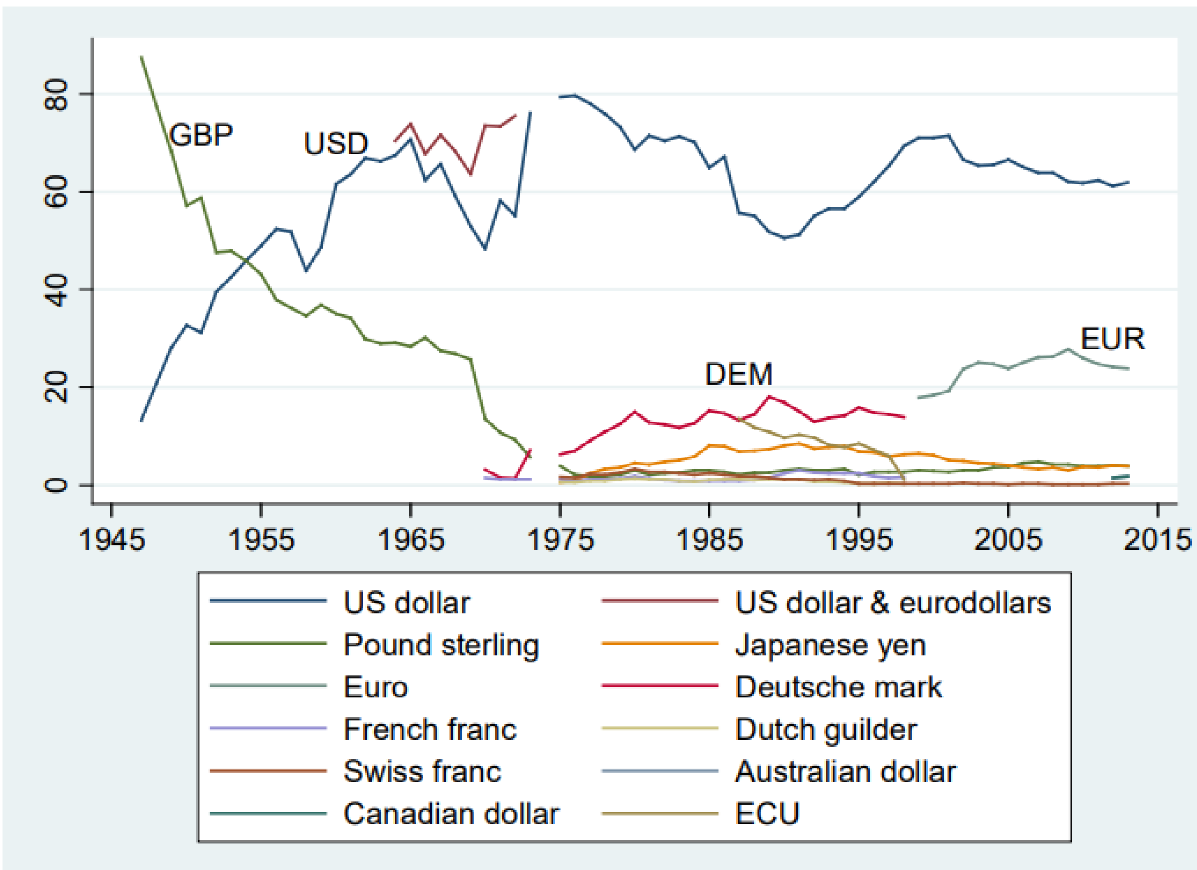
[32] Gourinchas, Pierre-Olivier, Hélène Rey, and Maxime Sauzet. 2019. The international monetary and financial system. *Annual Review of Economics*, 11. Pp. 859–93. At Pp. 864.
[33] Ibid.
[34] Eichengreen, Barry, Livia Chiţu, and Arnaud Mehl. 2014. *Stability or upheaval? The currency composition of international reserves in the long run*. Frankfurt am Main: European Central Bank. Accessibility: https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1715.pdf (27 June 2020). Pp. 25.

In relative terms the amount of global US dollar reserves moves around its long-year average of 65%.[35] Moreover, the relative gap between the US dollar and Euro has since 2008 increased. Between the first quarter of 2008 and third quarter in 2019, the Euro position fell for 6.45 percentage points, while US position has fallen 1.15 percentage points in the same period (see Figure 9).[36]

Figure 8: International Reserves – Relative Amount

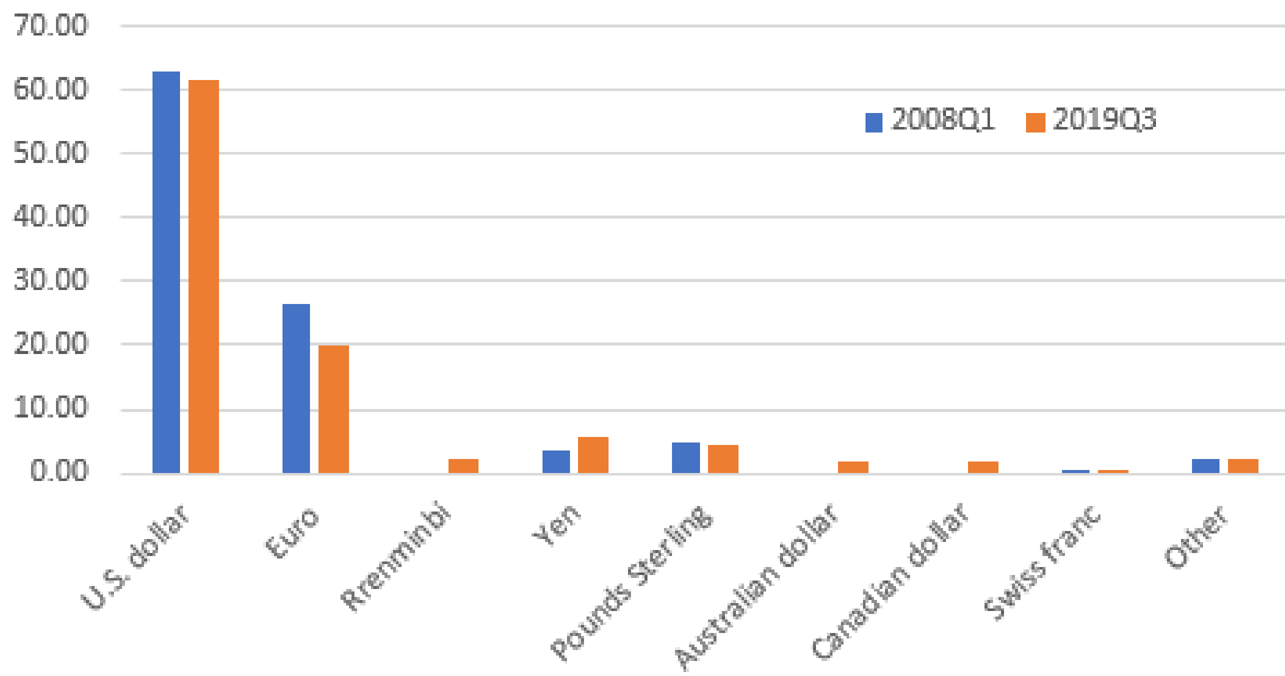


[35] See Appendix 1 in Eichengreen, Chițu and Mehl (2014) for details about the infrequent data reporting issue for the years prior 1999. Moreover, performing unit root tests (Dickey-Fuller – dfuller, Phillips-Perron – pperron, and modified Dickey-Fuller – dfgls) on their dataset – US dollar international reserves time series is stationary, which means that its mean and variance do not change over time. See results of these test in the Appendix 1 of this dissertation.

[36] Data from: International Monetary Fund. 2020a. *Currency Composition of Official Foreign Exchange Reserves (COFER) database*. Accessibility: https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4 (20 March 2020).

Finally, a closer look at the currencies used in global financial transactions shows the prevalence of US dollar also remains substantive. Figure 10 displays this data and shows how the global usage of the Euro has deceased since the Euro crisis, which begun in 2010 and was an offshoot of 2008 global financial crisis.[37]

Figure 9: Relative International Reserves in 2008 and 2019

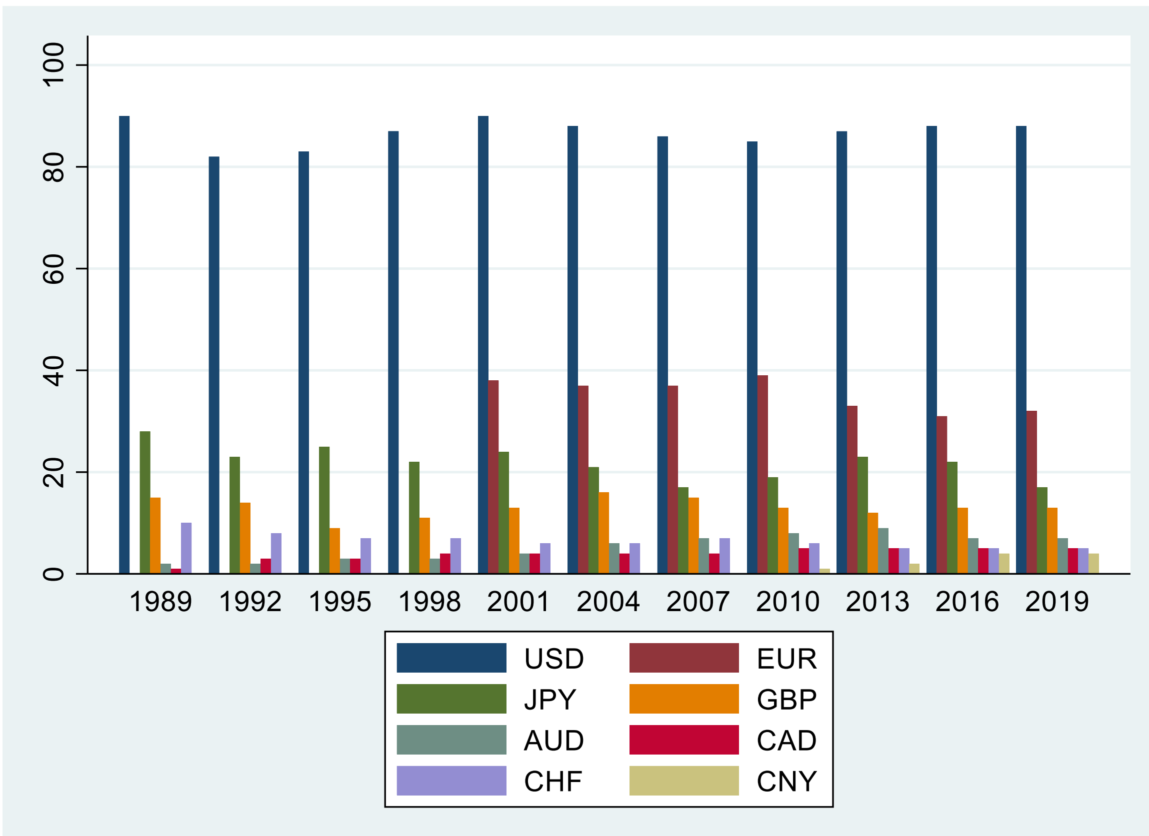


The different messages conveyed by global payment currency portrayed in Figure 5 and transactions shown in Figure 10 is attributed to two different aspects of economic interaction. The first refers to real economy – trade – and assigns intra-Euro zone payments to the aggregate number of payments denominated in Euros. The second focuses on financial economy and financial

[37] Data from: Bank for International Settlements. 2019. *Triennial Central Bank Survey of Foreign Exchange and Over-the-counter (OTC) Derivatives Markets*. Accessibility: https://www.bis.org/statistics/rpfx19.htm?m=6%7C32%7C617 (20 March 2020).

transactions, which is not sensitive to the intra- or trans- state transactions, or currency unions. What this tells us is that the Euro has indeed carved out its regional presence, however, its reach stops there.[38] Moreover, the US dollar's share of invoicing is approximately 4.7 times the share of US imports and 3.1 times the share of US exports.[39]

Figure 10: Global Financial Transactions per Currency[40]



[38] See Gourinchas, Rey, and Sauzet. 2019. Pp. 864–6.

[39] In fact, it surpasses the Euro, see Gopinath, Gita. 2015. *The international price system*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w21646.pdf (20 March 2020). There is also clear evidence that foreign investors want to denominate their holdings in US dollar, not domestic currencies, see Maggiori, Matteo, Brent Neiman, and Jesse Schreger. 2018. *International currencies and capital allocation*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w24673.pdf (20 March 2020). Pp. 39.

[40] The data measures the OTC (over the counter) foreign exchange instruments, which are far greater in terms of scope (absolute amount) and domain (types and number of agents) than official exchanges. The maximum value of the variable is 200%, since every transaction is, due to the balance of payment rules, counted twice. One cannot perform a unit root test here due to the small number of observations. The USD mean throughout the years is 86.7; hence last decade has been above average.

What these figures and numbers tell us is that the expectations of hegemonic breakdown were unfounded. Moreover, the mechanism by which the global position of the US dollar was enhanced is not captured by existing theories. First, there has not been a coercive action of the United States against non-hegemonic states to force the US dollar on them. Second, international regimes, or the liberal international order as referred often in the literature, eroded during this period – alternative global governance institutions were set up (Asian Infrastructure Investment Bank, G20), while existing ones struggled with their inefficiency, confidence and legitimacy, substitute modes of development and political practices became attractive.[41] Third, the favorability of United States has fallen below 50%, meaning that more people and states see United States unfavorably than in positive perspective. Furthermore, alternative political-economic ideologies to free market capitalism arose outside United States.[42] Fourth, US relative wealth has decreased since 2008 (see Figure 1); moreover, the United States also has not agreed or voluntarily provided any new or additional public goods. If anything, the existing ones became questionable even for allied states.[43]

[41] E.g., Patrick, Stewart. 2010. Irresponsible stakeholders? The difficulty of integrating rising powers. *Foreign Affairs*, 89(6). Pp. 44–53; Acharya, Amitav. 2014b. *The end of American world order*. Cambridge: Polity Press; Flockhart, Trine. 2016. The coming multi-order world. *Contemporary Security Policy*, 37(1). Pp. 3–30; Wright, Thomas. 2017. *All measures short of war: the contest for the twenty-first century and the future of American power*. New Haven: Yale University Press; Mazarr, Michael J., et al. 2017. *Measuring the health of the liberal international order*. Santa Monica: Rand Corporation; Mearsheimer, John J. 2019. Bound to fail: The rise and fall of the liberal international order. *International Security*, 43(4). Pp. 7–50. On conceptual problems with liberal international order see Glaser, Charles L. 2019. A Flawed Framework: Why the Liberal International Order Concept Is Misguided. *International Security*, 43(4). Pp. 51–87.

[42] Zakaria, Fareed. 2007. *The future of freedom: illiberal democracy at home and abroad*. New York: WW Norton & Company; Makarychev, Andrey S. 2008. Russia's search for international identity through the sovereign democracy concept. *The International Spectator*, 43(2). Pp. 49–62; Levitsky, Steven, and Lucan A. Way. 2010. *Competitive authoritarianism: Hybrid regimes after the Cold War*. Cambridge: Cambridge University Press; Pelanda, Carlo. 2007. *The grand alliance.* Milano: FrancoAngeli; Durbin, Evan Frank Mottram. 2019. *The politics of democratic socialism: An essay on social policy*. London: Routledge.

[43] Kaufman, Joyce P. 2017. The US perspective on NATO under Trump: lessons of the past and prospects for the future. *International Affairs*, 93(2). Pp. 251–66; Tow, William T. 2017. President Trump and the Implications for the Australia–US Alliance and Australia's Role in Southeast Asia. *Contemporary Southeast Asia: A Journal of International and Strategic Affairs*, 39(1). Pp. 50–7; Knopf, Jeffrey W. 2017. Security assurances and proliferation

As such, there is a literature gap that this research project fills: presenting a new theory of hegemony that better explains the particularities of US hegemony, its underlying nature, functioning, and existential threats. Thus, the Pervasive Hegemony Theory should result in more accurate predictions. Furthermore, grand strategy and foreign policy recommendations that derive from it should not only be different than implications of existing theories, but also better suited for maintaining the hegemony. There is no doubt that the controversy over the nature of the contemporary global system is important, as the answer bears crucial policy implications for the United States and the rest of the world. The nature and the condition of the international system impacts states' world views and threat analysis. For example, if the US hegemony is in decline, then the United States will address the rise of China and the East Asia balance of power differently than it would if there was confidence about its preeminence in global politics.[44]

Therefore, Pervasive Hegemony Theory is different from the four-existing accounts of hegemony in all three dimensions—its nature, the functioning, and existential threat. Namely pervasive hegemony is reinforced by both—hegemon and non-hegemonic states. All countries

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risks in the Trump administration. *Contemporary Security Policy*, 38(1). Pp. 26–34; Amirfar, Catherine, and Ashika Singh. 2018. The Trump Administration and the Unmaking of International Agreements. *Harvard International Law Journal*, 59(2). Pp. 443–59.

[44] There is extensive literature on the matter of rise and fall of big powers, as well as on US-China dynamic, see e.g.: Lemke, Douglas, and Ronald L. Tammen. 2003. Power transition theory and the rise of China. *International Interactions*, 29(4). Pp. 269−271; Chan, Steve. 2005. Is there a power transition between the US and China? The different faces of national power. *Asian Survey*, 45(5). Pp. 687−701; Jeffery, Renée. 2009. Evaluating the 'China threat': power transition theory, the successor-state image and the dangers of historical analogies. *Australian Journal of International Affairs*, 63(2). Pp. 309–24; Lim, Yves-Heng. 2015. How (Dis)Satisfied is China? A power transition theory perspective. *Journal of Contemporary China*, 24(92). Pp. 280–97; Glaser, Charles L. 2015. A US-China grand bargain? The hard choice between military competition and accommodation. *International Security*, 39(4). Pp. 49−90; Cunningham, Fiona S., and M. Taylor Fravel. 2015. Assuring Assured Retaliation: China's Nuclear Posture and US-China Strategic Stability. *International Security*, 40(2). Pp. 7−50; Beckley. 2017; Allison, Graham. 2017. *Destined for war: can America and China escape Thucydides's trap?*. Boston: Houghton Mifflin Harcourt; Shambaugh. 2018.

continue to use the hegemon's monetary unit in their monetary relations which reproduces the global network centrality of the hegemon's monetary unit and thus, also the hegemony. I refer to such behavior as 'buy-in'. Even though non-hegemonic states may not prefer the imbalance of power, they can maximize their selfish interests and autonomy only through the buy-in and reinforcing the centrality of the hegemon's monetary unit. Conversely, the hegemon may not like the current monetary system rules and norms, but it can change those if it accepts the provision of the central monetary unit. Thus, the nature of pervasive hegemony is characterized by the hegemon's economic network centrality; and the functioning mechanism is the 'buy-in' dynamic. Subsequently, the existential threat to pervasive hegemony is an establishment of an alternative centrality in the global economy, particularly monetary relations, or diminishing the hegemon's centrality to a point where there is no clear global network centrality.

As such, there are five distinctive mechanisms and theories by which hegemony can endure for a considerable period. Yet, what classifies as enduring hegemony? A decade? Fifty years? A century? I define enduring hegemony using Kondratieff waves.[45] Borrowing from economic business cycle theory, there are four different cycle types that vary according to their temporal length.[46] Kondratiev waves are based on technological development and innovation. They last somewhere between 45 and 60 years.[47] Other three types of cycles are too short to

[45] Kondratieff, Nikolai D. 1984. *The Long Wave Cycle*. New York: Richardson and Snyder.
[46] There are numerus business cycle theories, which cut across paradigmatic divides in Economics. However, when it comes to temporal typology different economic schools of thought are in agreement. For more on this, see Glasner, David, Thomas F. Cooley, and Larry Murphy (eds.). 1997. *Business cycles and depressions: An encyclopedia*. London: Rutledge.
[47] Kondratieff. 1984. See also Kondratieff, Nikolai D. 1979. The long waves in economic life. *Review*, 2(4). Pp. 519–62; Garvy, George. 1943. Kondratieff's theory of long cycles. *The Review of Economic Statistics*, 25(4). Pp. 203–20; Tinbergen, Jan. 1981. Kondratiev cycles and so-called long waves: The early research. *Futures*, 13(4). Pp. 258–63; Ewijk, Casper van. 1982. A Spectral Analysis of the Kondratieff-Cycle. *Kyklos*, 35(3). Pp. 468–99; Metz, Rainer. 2011. Do Kondratieff waves exist? How time series techniques can help to solve the problem. *Cliometrica*, 5(3). Pp. 205–38. Out of the four temporal business cycles, International Relations has applied Kondratieff the most,

represent a benchmark for an enduring hegemony: Kuznets swings[48] (15-25 years) are based on demographics, land values, or infrastructural investments,[49] Juglar cycle[50] (7-11 years) is based on the price of fixed investments such as renovation or production machinery,[51] and Kitchen cycle[52] (approximately 40 months) is based on availability and information regarding commodities and their trade.[53] Thus, enduring hegemony is a hegemony that persists over at least two Kondratieff waves, which was also suggested by Modelski[54] and therefore means that the hegemony needs to last a minimum of 90 years to be classified as enduring. However, for the sake of clarity I use one century as the threshold.

Besides their temporal length, another reason why I use two Kondratiev waves in determining enduring hegemony is their nature. Namely, technological innovation and revolution

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see e.g., Wallerstein, Immanuel. 1979. Kondratieff up or Kondratieff down?. *Review*, 2(4). Pp. 663–73; Modelski, George. 1981. Long cycles, Kondratieffs, and alternating innovations: Implications for US foreign policy. In Kegly, Charles W. and Par McGovan (eds.), *The Political Economy of Foreign Policy Behavior.* Beverly Hills*:* Sage. Pp. 63–83; Thompson, William R., and L. Gary Zuk. 1982. War, inflation, and the Kondratieff long wave. *Journal of Conflict Resolution*, 26(4). Pp. 621–44; Goldstein, Joshua S. 1985. Kondratieff waves as war cycles. *International Studies Quarterly*, 29(4). Pp. 411−44; Devezas, Tessaleno C. (ed.). 2006. *Kondratieff Waves, Warfare and World Security*. Amsterdam: IOS Press.

[48] Kuznets, Simon S. 1930. *Secular movement in production and prices: Their nature and their bearing upon cyclical fluctuations*. Boston: Houghton Mifflin and Company.

[49] Forrester, Jay W. 1977. New Perspectives on Economic Growth. In Meadows, Dennis L. (ed.), *Alternatives to Growth, A Search for Sustainable Futures*. Cambridge: Ballinger. Pp. 107–21; Korotayev, Andrey V., and Sergey V. Tsirel. 2010. A spectral analysis of world GDP dynamics: Kondratieff waves, Kuznets swings, Juglar and Kitchin cycles in global economic development, and the 2008–2009 economic crisis. *Structure and Dynamics*, 4(1). Pp. 1–56. This cycle theory has been applied to International Relations, see e.g., Sayrs, Lois W. 1993. The long cycle in international relations: a Markov specification. *International Studies Quarterly*, 37(2). Pp. 215–37.

[50] Juglar, Clement. 1862. *Des Crises Commerciales et de leur retour périodique en France, en Angleterre et aux États-Unis*. Paris: Guillaumin.

[51] Niehans, Jurg. 1992. Juglar's credit cycles. *History of Political Economy*, 24(3). Pp. 545–69; Korotayev and Tsirel. 2010. This cycle theory has also been applied to International Relations, see e.g., Grinin, Leonid, Andrey Korotayev, and Arno Tausch. 2016. Interaction between Kondratieff waves and Juglar cycles. In Grinin, Leonid, Arno Tausch, and Andrey Korotayev (eds.), *Economic cycles, crises, and the global periphery*. New York: Springer. Pp. 55−109.

[52] Kitchin, Joseph. 1923. Cycles and trends in economic factors. *The Review of Economic Statistics*, 5(1). Pp. 10–6.

[53] Shiller, Robert J., and Jeremy J. Siegel. 1977. The Gibson paradox and historical movements in real interest rates. *Journal of Political Economy*, 85(5). Pp. 891–907; Korotayev and Tsirel (2010). International Relations has also applied this cycle theory, see e.g., Tylecote, Andrew. 1992. History as a forecasting tool: the future of the European economy in a long-wave/long-cycle perspective. *Review of Political Economy*, 4(2). Pp. 226–48.

[54] Modelski 1987.

is much more profound, in economic, as well as in political implications, than the nature of Kuznets swings – investments. The latter can of course cause recessions, but they do not change the nature of political-economic interaction. One such prominent example was the aforementioned 2008 global financial crisis, which was very severe in its economic dimensions, but not much has changed in the international system because of it. On the other hand, the 1971 Nixon Shock and the end of Bretton Woods although, not as economically severe, had important consequences for the nature of the international system as it brought financial economy to the forefront of international political-economic relations and pushed the real economy (trade) to the sides.[55] The latter crisis also aligns with Modelski's mapping Kondratiev waves onto global hegemonic changes and hence, predicted a decline of US hegemony.[56] However, as we have seen, this was not the case. Still, an important lesson here is that Kondratiev waves entail structural changes on how international relations are conducted. As such, if the hegemony can last over a deep structural political-economic change, this attests to its resilience and may be named enduring. Nevertheless, since the start of a hegemony may not be directly paralleled with the start of the Kondratiev wave, this means that it is very likely that the threshold of 100 years would encompass two profound crises and shifts in technological underpinnings in international political economy.[57] Thus, if the hegemony survives, it only strengthens its classification as enduring. Lastly, more shifts in Kondratiev waves means the greater likelihood that non-hegemonic balancing will be successful, which again fortifies the label, enduring hegemony.

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[55] As Cohen has pointed out, this was by and large a market-driven process and hence it arose organically (informal dollarization). See Cohen, Benjamin J. 1998. *The Geography of Money*. Ithaca: Cornell University Press.
[56] See Modelski. 1987.
[57] There is a debate about mapping Kondratiev waves onto hegemonic cycles, where Modelski argues in favor of this overlap, see Modelski, George. 2000. World system evolution. In Denemark, Robert Allen, Jonathan Friedman, Barry K. Gills, and George Modelski (eds.), *World system history: the social science of long-term change*. London: Routledge. Pp. 24−53. Yet, Goldstein (1985) points out that since 1945, war, prices and production, the variables by which Modelski measures long hegemonic cycles, have diverged.

Therefore, the contemporary US hegemony cannot be classified as enduring just yet. If we take the start of its hegemony 1945, we are now 75 years in; and if we take the starting point 1971, where this research project argues that US hegemony became a pervasive hegemony, then US hegemony is pushing 50 years. Nevertheless, the point of this dissertation is not about determining if US hegemony classifies as enduring, nor mapping it onto Kondratiev waves, but to identify causal mechanisms of its functioning. By understanding what those are, we can make more informed predictions about its future and its trajectory.

In sum, recent current events have driven the literature to argue again in favor of US hegemonic demise. Although ample evidence about shrinking the capabilities and power gap between the United States and other rising powers would support such a claim, there is an awkward lack of the ultimate feature of such argument—US hegemonic breakdown. Moreover, in monetary relations, the United States has enhanced its position relative to other global powers. Existing theories cannot fully explain these discrepancies: why would decline in relative capabilities not result in hegemonic decline, and why would monetary relations have the opposite trajectory as other issues? As such, the purpose of this dissertation is to make sense of these seemingly illogical occurrences by presenting a new theory of hegemony—Pervasive Hegemony. The latter explains a hegemony which is different in terms of its nature, underlying causal functioning, and existential threats than what existing four hegemonic theories assume – Coercive, Cooperative, Cultural, Opportunist. Namely, pervasive hegemony is characterized by hegemonic ownership of the central monetary unit of the international monetary system (IMS). Moreover, its fundamental mechanism is the 'buy-in' dynamic, where both hegemon and non-hegemonic states reinforce and reproduce the hegemony by continuing to use the central monetary unit in their monetary relations. Of course, they do so with different reasons, but both sides follow their selfish rational interests of preserving their autonomy and maximizing their national interests. Finally, in such a milieu the existential threat to hegemony are not the shrinking capabilities of the hegemony, erosion of international institutions, lack of common ideology or hegemonic appeal, nor staggering economy of the hegemony. Instead, it is the rising economic, especially monetary, centrality or diminishing hegemonic centrality in monetary relations that threatens the endurance of the hegemony and may cause its breakdown.

The dissertation precedes as follow. First, I will elaborate on Pervasive Hegemony Theory, its independent and dependent variables, causal mechanism, and outline my design of how (methods used) and where (which cases) I will test all five theories regarding US hegemony. Second, I empirically establish my explanatory variable—hegemonic ownership of the central monetary unit and elaborate how this characteristic draws fundamentally different type of hegemony – comparing hegemonies of United States and United Kingdom. Third, I process trace the breakdown of the Bretton Woods System, and the establishment of the post-Bretton Woods System. The latter two chapters compare the performance of all five theories of hegemony and establishes their respective explanatory power. Finally, I elaborate on policy and grand strategy implications that flow from my theory and the empirical evidence I presented.

2. PERVASIVE HEGEMONY THEORY

> "In /a/ sense, money and languages have similar characteristics, and the US dollar is the lingua franca for today's international monetary system."[58]

The crux of the Pervasive Hegemony Theory is the 'buy-in' dynamic, by which the hegemon and non-hegemonic states both reinforce the hegemony. Since the latter is defined as a set of rules, norms, and principles of how the hegemon centers the world economy around it. This means that the hegemon and non-hegemonic states either display their commitment to existing economic rules or consensually embrace new ones. Hence, assuming that monetary relations are the most important aspect of economics, and that politics and economics are not independent, the rules composing a monetary system is at the core of hegemony, and its change is my dependent variable. Being interested in enduring hegemony, I want to observe how a hegemony endures even when it must change this quintessential dimension—the monetary system. I operationalize the International Monetary System (IMS) and its rules through the monetary trilemma[59] and the manner of its functioning in terms of adjustment, liquidity, and confidence.[60]

Still, theoretically the more important question is why do non-hegemonic states and the hegemon alike 'buy-in'? I argue that it is due to the hegemonic ownership of the central monetary unit. Thus, this is my independent variable, which is composed of two elements: first, the central

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[58] Gourinchas, Rey and Sauzet. 2019. Pp. 862.
[59] A state can simultaneously pursue two out of three monetary policy options – free flow of capital, fixed exchange rates, and sovereign monetary policy, see Mundell, Robert. 1963. Capital Mobility and Stabilization Policy under Fixed and Flexible Exchange Rates. *Canadian Journal of Economics and Political Science*, 29(4). Pp. 475–85.
[60] See Willett, Thomas D. 1984. Functioning of the Current International Financial System: Strengths, Weaknesses and Criteria for Evaluation. In Von Furstenberg, George M. (ed.), *International Money and Credit: The Policy Roles*. Washington: International Monetary Fund. Pp. 5−44.

position—referring to the most important node in a network;[61] second, the ownership—meaning a control over the production of the monetary unit. Therefore, I operationalize this variable by measuring the network centrality of the hegemon's monetary unit over time (e.g., reserves, transactions).

As such, if the global centrality of the hegemon's currency is stationary (mean and variance do not change through time)[62] even in times of economic crises, and during a subsequent change in the IMS, we can talk about the presence of a 'buy-in' and this hegemony may be classified as a pervasive hegemony. Hence, the ownership of a central monetary unit creates a system where the non-hegemonic states can extract the benefits of using the hegemon's currency only if they 'buy-in' first, i.e., reproduce the IMS. The latter sequence is necessary as the hegemon may not be willing to procure its currency, particularly in times of crisis. Moreover, the ownership of the central monetary unit plugs into the risk-aversion of non-hegemonic states, so they do not seek an alternative monetary unit, as existing monetary centrality sufficiently generates the framework for their fulfillment of autonomy and maximizing national interests. Instead of seeking alternatives, they reinforce the new rules of hegemony, i.e., of the monetary system. Subsequently, the hegemon does not roll back its currency, and the non-hegemonic states may continue to reap benefits from using the hegemon's currency.

The hegemon reaches the same conclusion through an opposite perspective. Namely, the hegemon realizes that it is through the provision of a central monetary currency that it can generate

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[61] Newman, Mark. 2018. *Networks*. Oxford: Oxford University Press. Pp. 159.

[62] See Box-Steffensmeier, Janet M., John R. Freeman, Matthew P. Hitt and Jon C. W. Pevehouse. 2014. *Time series analysis for the social sciences*. Cambridge: Cambridge University Press. Pp. 125.

a new consensus on the rules, norms, and principles of the IMS that would reflect its own selfish interest better. Therefore, the hegemon is interested in securing such a new monetary system first, before making its currency available. Hence, both sides reinforce the hegemony, while at the same time both sides follow their selfish and rational national interests.

US pervasive hegemony, is therefore, the story of US dollar centrality.[63] Helleiner sums it up perfectly: "Washington has played little direct role in promoting dollarization abroad. Nevertheless, the United States has profited from this development."[64] For example, according to one estimate, the annual return on US investments overseas is 1.2% higher than its payments on overseas debt.[65] However, the literature[66] is divided along the fault line of US dollar persistence in its global dominance,[67] and an evolution away from US dollar-based system towards multi-

[63] In order to explain the unique position of the US dollar, economists have come up with a new paradigm – Dominant Currency Paradigm – with three key features: pricing in a dominant currency, pricing complementarities, and imported input use in production. See, Gopinath, Gita, Emine Boz, Camila Casas, Frederico J. Díez, Pierre-Oliver Gourinchas, and Mikkel Plagborg-Møller. 2019. *Dominant currency paradigm*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w22943/w22943.pdf (2 May 2020). Namely, through its dominance in the global economic network, a 1% appreciation of the US dollar results in a 0.6% decline in global trade outside United States, controlling for the global business cycle.
[64] Helleiner, Eric. 2006. Below the state: Micro-level monetary power. In Andrews, David M (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 72–90. At Pp. 88–9.
[65] Chinn, Menzie, and Jeffrey A. Frankel. 2007. Will the euro eventually surpass the dollar as leading international reserve currency?. In Clarida, Richard H. (ed.), *G7 Current account imbalances: sustainability and adjustment*. Chicago: University of Chicago Press. Pp. 283–338. At Pp. 289.
[66] A good overview is Helleiner, Eric, and Jonathan Kirshner (eds.). 2012a. *The future of the dollar*. Ithaca: Cornell University Press.
[67] Some recent literature includes: Gopinath. 2015; Gopinath, Gita. 2017. *Rethinking Macroeconomic Policy: International Economy Issues*. Washington: Peterson Institute for International Economics. Accessibility: https://www.piie.com/system/files/documents/gopinath20171012paper.pdf (31 May 2020); Farhi, Emmanuel, and Matteo Maggiori. 2018. A model of the international monetary system. *The Quarterly Journal of Economics*, 133(1). Pp. 295–355; Gopinath, Gita, and Jeremy C. Stein. 2018. *Banking, Trade, and the making of a Dominant Currency*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w24485.pdf (31 May 2020); Farhi, Emmanuel, and Matteo Maggiori. 2019. *China vs. US: IMS Meets IPS*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w25469.pdf (31 May 2020); Maggiori, Matteo, Brent Neiman, and Jesse Schreger. 2019. The Rise of the Dollar and Fall of the Euro as International Currencies. *AEA Papers and Proceedings*. 109. Pp. 521–26.

currency world.[68] Furthermore, it is also skeptical about US benefits from its hegemony.[69] Helleiner and Kirshner "argue that there are three distinct sets of /…/ assumptions that dominate the literature on the future of the dollar: those embodied in market-based, instrumental, and geopolitical approaches to the subject."[70] In all three of these approaches one finds scholars that support the decline of US hegemony and predict a bleak future for the US dollar, as well as those who predict the sustainable dominance of the US dollar and hence US hegemony.

A Market-based approach sees the future of the US dollar in the hands of market forces, where actors make judgements based on the attractiveness of the US dollar vs. other currencies through the prism of IMS confidence, liquidity, and adjustment.[71] An instrumental approach looks

[68] Some recent literature includes: Eichengreen, Barry. 2010. *Exorbitant privilege: The rise and fall of the dollar and the future of the international monetary system*. Oxford: Oxford University Press; Obstfeld, Maurice. 2011. *International liquidity: the fiscal dimension*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w17379.pdf (31 May 2020); Gourinchas, Pierre-Olivier, and Maurice Obstfeld. 2012. Stories of the twentieth century for the twenty-first. *American Economic Journal: Macroeconomics*, 4(1). Pp. 226–65; Gourinchas, Pierre-Olivier, and Olivier Jeanne. 2012. *Global safe assets*. BIS Working Paper. Accessibility: https://www.bis.org/publ/work399.pdf (31 May 2020); Eichengreen, Barry, Arnaud Mehl, and Livia Chitu. 2019. *How global currencies work: past, present, and future*. Princeton: Princeton University Press.

[69] A good counterargument to these prevailing notions in the literature is Norrlof, Carla. 2010. *America's global advantage: US hegemony and international cooperation*. Cambridge: Cambridge University Press.

[70] Helleiner, Eric, and Jonathan Kirshner. 2012b. The future of the Dollar: Whither the Key Currency?. In Helleiner, Eric, and Jonathan Kirshner (eds.), *The future of the dollar*. Ithaca: Cornell University Press. Pp. 1–23. At Pp. 7.

[71] Not all of these criteria are vectored universally. Namely, states want to postpone the adjustment as much as possible, therefore, they will want IMS to require the least amount of it from them. However, they can perform adjustment in an opposite direction, so that they enhance their relative monetary power and boost their exports, but at the same time cause problems for IMS. Thus, it is not only about the amount of adjustment, but is vector as well. Too much liquidity can also lead to inflation, but a deflation is also not good for generating economic growth, what states want from an IMS. Lastly, overconfidence can lead to carelessness, whereas not enough confidence will cripple investments, again resulting in a suboptimal performance of an IMS. Hence, the IMS that targets the right amount of each is ideal, but this is difficult to measure. Maybe the easiest golden objective to determine is liquidity – if prices rise and so does real income. Second, confidence is measured with consumer and business confidence index (for both see e.g., OECD. 2020a. *Data*. Accessibility: https://data.oecd.org/ (5 July 2020), if they stay the same through time, or rise, then IMS is performing well. Lastly, regarding the optimal adjustment, its vector and size is determined by balance of payments situation in IMS and specific states. Therefore, the post-Bretton Woods IMS generated a useful solution and 'outsourced' adjustment generation to the international financial markets, where official or public funds play a more indirect and minor role compared to private funds – particularly adjustment became subject of supply and demand forces. See Padoa-Schioppa, Tommaso, and Fabrizio Saccomanni. 1994. Managing a market-led global financial system. In Kenen, Peter B (ed.), *Managing the world economy: fifty years after Bretton Woods*. Washington: Peterson Institute for International Economics. Pp. 235–68.

at public authorities in determining the future of the US dollar—what will economic policies of the US and other non-hegemonic states be, e.g., exchange rates. A geopolitical approach looks at broader motivation, such as strategic and security concerns. Figure 11 displays a matrix of arguments and causes of a particular approach in relations to the future of the US dollar, while Figure 12 shows particular positions of scholars that contribute to that edited volume. Moreover, Figure 13 lists the arguments of these scholars regarding the future of the US dollar.

Figure 11: Contrasting Approaches to the US dollar's Future as an International Currency[72]

What future for the dollar's international role?	Determinants of international currency standing			
	Market-based	Instrumental		Geopolitical
		Bretton Woods II	Monetary anchor	
Sustainable	• Dollar still relatively more economically attractive vis-à-vis confidence, liquidity, transnational networks • Inertia	• Mutual gains from existing situation	• U.S. price stability	• U.S. power • Geopolitical rivalries in other regions
Decline	• U.S. deficits/debt • Euro's stability; size of eurozone economy and financial markets • tipping points	• Foreign de-coupling from U.S. economy • Foreign financial losses on dollar holdings • Risk of U.S. protectionism	• U.S. inflation and depreciation	• Loss of alliance glue • Growing political reaction against dollar hegemony

[72] Helleiner and Kirshner. 2012b. Pp. 18.

Figure 12: Expectation of Scholars about the Future of the US dollar[73]

What future for the dollar's international role?	Determinants of international currency standing		
	Market-based	Instrumental	Geopolitical
Sustainable	**James** Helleiner	**McKinnon** James	
Uncertain	**Schwartz** De Cecco McKinnon	Helleiner Schwartz	Helleiner De Cecco
Decline	**Cohen** Calleo Kirshner		Cohen **Calleo** **Kirshner**

Figure 13: Arguments of particular Scholars regarding the Future of the US dollar[74]

	Sustaining factors	Threats to the dollar's international role	Would-be anomalies
James	U.S. growth and attractiveness	Decoupling of global economy	Political balancing against the U.S.
McKinnon	Confidence in Federal Reserve	U.S. protectionism, inflation, or depreciation	Departure from dollar pegs in absence of U.S. policy mistakes
Helleiner	Liquidity of U.S. financial markets	Sudden withdrawal of foreign political support	Market shift away from dollar in absence of exchange rate crisis
Schwartz	Relatively higher U.S. growth rates	Relatively slower U.S. growth rates	Decline in dollar's role in absence of growth rate differentials
De Cecco	Inertia, U.S. global role	Dollar depreciation, financial instability, geopolitical uncertainty	Dollar endures as financial and geopolitical upheavals grow
Cohen	Distress in Europe, discord in Asia	Shift in 'battlegrounds" Mideast, Asia	Discontinuities in currency use
Calleo	U.S. policy reversals, 2010s like 1990s	More consumption, especially defense spending	Dollar stability in context of new military confrontation
Kirshner	International political conflict (non-U.S.)	Deterioration of U.S. fundamentals	Unmotivated bandwagoning with U.S.

[73] Helleiner and Kirshner. 2012b. Pp. 23.
[74] Helleiner and Kirshner. 2012b. Pp. 224.

My argument is rather eclectic when it comes to this typology. I claim that the US dollar leadership is based on its market credibility, reliability of US institutions, as well as geopolitical considerations of non-hegemonic states.[75]

Yet, Helleiner is also classified in all three approaches and furthermore also in two categories. Thus, one does question the usefulness of such taxonomy. Yet, it may just be an illustration of the complexity of the issue at hand. But this is not a new finding, since already Hirschman warned about the difficulty of measuring monetary leadership in 1945.[76] As such, if I had to position my argument in that taxonomy, I would list Pervasive Hegemony in all three approaches, yet, only in the category of the sustainable dominance of the US dollar.

The remainder of the chapter will be dedicated first to each of the theory's components – dependent variable (change in rules and norms of the IMS), independent variable (centrality of hegemon's currency), and the causal connections between the two under the new theory's assumptions. Lastly, I will elaborate how I will test my theory against four existing ones and justify my case selection (research design).

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[75] See also Walter, Andrew. 2006. Domestic Sources of International Monetary Leadership. In Andrews, David M. (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 51–71. At Pp. 51.
[76] See Hirschman, Albert O. 1945. *National power and the structure of foreign trade*. Berkeley: University of California Press.

2.1 INTERNATIONAL MONETARY SYSTEM

Monetary policy deals with issues related to money—interest rates, money supply and base, inflation, and exchange rates. "An international monetary system is a set of rules or conventions governing /related/ policies."[77] The objective of an IMS is to assure growth, price and financial stability, and facilitate trade.[78] The IMS comprises a set of official arrangements that regulate key dimensions of the balance of payments: exchange arrangements and exchange rates; international payments and transfers relating to current international transactions; international capital movements; and international reserves.[79] Some add also expectations to this definition.[80] Namely, by incorporating expectations about certain policies, the IMS differs from monetary standards, which refer to only institutions and arrangements of governance of the money supply.[81]

Thus, the notion of monetary trilemma comes in handy to operationalize the variation of such rules, norms, as well as expected behavior. Particularly as I am interested in the change of

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[77] Eichengreen, Barry. 1987. *Hegemonic stability theories of the international monetary system*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w2193.pdf (3 April 2020). Pp. 1.
[78] Mohan, Rakesh, Michael Debabrata Patra, and Muneesh Kapur. 2013. *The International Monetary System: Where Are We and Where Do We Need to Go?*. Washington: International Monetary Fund. Accessibility: https://www.imf.org/en/Publications/WP/Issues/2016/12/31/The-International-Monetary-System-Where-Are-We-and-Where-Do-We-Need-to-Go-41031 (11 May 2020). Pp. 4; Eichengreen, Barry J. 1998. *Globalizing capital: a history of the international monetary system*. Princeton: Princeton University Press. Pp. 1; see also Article IV in *Articles of Agreement of the International Monetary Fund*. 2016. Accessibility: https://www.imf.org/external/pubs/ft/aa/index.htm (15 February 2019).
[79] Lago y, Isabelle Mateos, Rupa Duttagupta, and Rishi Goya. 2009. *The Debate on the International Monetary System*. Washington: International Monetary Fund. Accessibility: https://www.imf.org/external/pubs/ft/spn/2009/spn0926.pdf (11 May 2020).
[80] See Leijonhufvud, Axel. 1984. Constitutional Constraints on the Monetary Power of government. In MacKenzie, Richard B. (ed.), C*onstitutional Economics, Containing the Economic Powers of Government*. Lexington: Lexington Books; Bordo, Michael D., and Lars Jonung. 1996. Monetary Regimes, Inflation and Monetary Reform. In Vaz, Daniel and Kumaraswamy Velupillai (eds.), *Inflation, Institutions and Information: Essays in Honour of Axel Leijonhufvud*. London: Macmillan Press.
[81] Bordo, Michael D., and Anna J. Schwartz. 1999. *Monetary policy regimes and economic performance: the historical record*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w6201.pdf (29 May 2020). Pp. 1.

those rules or change of the IMS. Monetary trilemma refers to a theoretical assumption that states can simultaneously pursue two out of three monetary policy options – free flow of capital, fixed exchange rates, and sovereign monetary policy.[82] In the post-Bretton Woods system we can see an agreement of state preferences for free flow of capital and sovereign monetary policy, while the Bretton Woods system was based on sovereign monetary policy and fixed exchange rates. Hence, the IMS represents an agreement on the state preferences within monetary trilemma and the rules and policies that flow from such an agreement to assure these choices.[83] Anthony Elson presents a useful summary:[84]

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[82] Mundell. 1963. Some argue that this ‘unholy trinity’ is a myth as you cannot have free flow of capital and political sovereignty (see Kirshner, Jonathan. 2018. The inescapable politics of money. In Kirshner, Jonathan (ed.), *Monetary orders: Ambiguous economics, ubiquitous politics*. Ithaca: Cornell University Press. Pp. 3–24. At Pp. 14). However, this argument claims that market economy overpowers politics. Yet, monetary relations may indeed impose environmental restrictions on state decisions, but the decision still resides within the state, which has multiple monetary options, as well as fiscal and other policies that can impact monetary situation and its relations. In other words, Kirshner is overselling the role of monetary markets and underestimates the role and the power of the state. Still, the word sovereignty may indeed paint the wrong picture here. In the time of complex interdependence, it may be better to talk about strategic autonomy, something what Cohen describes as “not allowing others to influence you” (Cohen, Benjamin J. 2006a. The Macrofoundations of Monetary Power. In Andrews, David M. (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 31–50. At Pp. 32). Furthermore, other scholars have posited that politics can affect monetary relations by impacting economic determinants through confidence (see Helleiner, Eric. 2008. Political Determinants of International Currencies: What Future for the US Dollar?. *Review of International Political Economy*, 15(3). Pp. 354–78; Walter. 2006. For a comparing IMS through history using monetary trilemma, see Obstfeld, Maurice, Jay C. Shambaugh, and Alan M. Taylor. 2005. The trilemma in history: tradeoffs among exchange rates, monetary policies, and capital mobility. *Review of economics and statistics*, 87(3). Pp. 423–38.

[83] The trilemma approach can be extended from its original conceptualization. First, s the incompatibility between financial stability, capital mobility and fixed exchange rates. Second, reconciling democratic politics with monetary autonomy and capital movements. Third, the interactions of democracy with capital flows and international order. See, Bordo, Michael, and Harold James. 2015. *Capital flows and domestic and international order: Trilemmas from macroeconomics to political economy and international relations*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w21017/w21017.pdf (2 May 2020). For visualization of these extensions, see Appendix 9. A different kind of extension of the monetary trilemma was also made. The ‘inconsistent quartet’ of policy objectives by bringing in commercial policy. Namely, free trade, capital mobility, fixed or managed exchange rates, and monetary policy independence. Yet, it is less clear which and why principles can be implemented together. See, Padoa-Schioppa, Tommaso. 2000. Capital Mobility: Why is the Treaty Not Implemented? In Padoa-Schioppa, Tommaso (ed.), *The Road to Monetary Union in Europe*. Oxford: Oxford University Press. Pp. 26–43. While some have reduced the trilemma into a dilemma. Due to the global financial economy, independent monetary policies are possible if and only if the capital account is managed – an ‘irreconcilable duo’. See, Rey, Hélène. 2018. *Dilemma not trilemma: the global financial cycle and monetary policy independence*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w21162/w21162.pdf (2 May 2020).

[84] Elson, Anthony. 2011. *Governing global finance: the evolution and reform of the international financial architecture*. London: Palgrave Macmillan. Pp. 29.

> Under Bretton Woods it was agreed that fixed exchange rates were necessary to support a revival of international trade, along with capital controls to maintain domestic policy autonomy in support of full employment. In this way, capital controls were viewed as essential to support a restoration of the exchange rate stability that had characterized the gold standard, while allowing domestic monetary and fiscal policy to support postwar recovery. With the growing force of international capital flows, the Bretton Woods system was abandoned in the mid-1970s in favor of a mix system in which the majority of countries have moved toward a regime of flexible exchange rates and capital account liberalization to allow for domestic monetary policy autonomy.

As an additional interlinked criteria assessing the functioning of a particular IMS, or the policies of assuring the monetary dilemma choice, I use: adjustment of international payments imbalances among states; liquidity generation to allow for trade and payments expansion; and confidence provided to assure stability.[85] These three criteria tell us how well an IMS is performing, or how much of its rules are obeyed, are states pursuing policies that reinforce the monetary trilemma choice and hence the IMS rules? They date back to 1960s Bellagio Group[86], led by Fritz Machlup.[87] Salvatore neatly explains the focal point that I am interested in[88]:

> A good international monetary system is one that maximizes the flow of international trade and investments and leads to an "equitable" distribution of the gains from trade among the nations of the world. /…/ Adjustment refers to the process by which balance-of-payments disequilibria are corrected. A good international monetary system is one that minimizes the cost of and the time

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[85] More on definitions of these three criteria see Cohen, Benjamin J. 1975. International Reserves and Liquidity. In Kenen, Peter B. (ed.), *International Trade and Finance: Frontiers for Research*. Cambridge: Cambridge University Press. Pp. 411−51; Gilpin, Robert. 2001. *Global political economy: Understanding the international economic order*. Princeton: Princeton University Press. Pp. 244−7.

[86] More on the Bellagio Group and Fritz Machlup, which have provided solutions to the problems of the international monetary system in 1960s, when the US dollar grew increasingly weaker, see Connell, Carol M. 2011. Framing world monetary system reform: Fritz Machlup and the Bellagio Group conferences. *PSL Quarterly Review*, 64(257). Pp. 143−66; Connell, Carol M. 2013. *Reforming the World Monetary System: Fritz Machlup and the Bellagio Group*. London: Pickering & Chatto.

[87] Machlup, Fritz. 1964. *Plans for reform of the international monetary system*. Princeton: Princeton University Press.

[88] Salvatore, Dominick. 2013. *International economics*. Hoboken: John Wiley & Sons. Pp. 668.

> required for adjustment. Liquidity refers to the amount of international reserve assets available to settle temporary balance-of-payments disequilibria. A good international monetary system is one that provides adequate international reserves so that nations can correct balance-of-payments deficits without deflating their own economies or being inflationary for the world as a whole. Confidence refers to the knowledge that the adjustment mechanism is working adequately and that international reserves will retain their absolute and relative values.

Similarly, to the monetary trilemma measure, here also different IMS performed differently according to them.[89] The Bretton Woods system performed poorly in adjustment and liquidity criteria, while maybe surprisingly displayed a high level of confidence; moreover, the post-Bretton Woods system guarantees all three[90]:

> The pre-1914 gold standard had generated a high degree of confidence and had operated on surprisingly low levels of reserves (liquidity), and it had required the political sacrifice of painful adjustment to deflation by its members in the 1870s and 1880s. After the First World War, the gold exchange standard had provided a greater degree of liquidity than the prewar system but had suffered and in the end collapsed because of confidence problems. After 1945, and particularly in the 1960s, the existence of confidence /and liquidity/ allowed the delaying of adjustment; as a result when adjustment was eventually required /its extent/ that would have been needed to return the system to smooth operation was too large to be acceptable to national policymakers.

Yet, state preferences regarding the IMS change over time and reflect their national interests and performance of a particular IMS. These preferences are summed up on Figure 14, which represents the monetary trilemma and subsequent policy preferences. As the figure portrays, the preference of increased capital mobility pushes states also towards floating exchange rates and autonomous monetary policy – the structure of post-Bretton Woods system.

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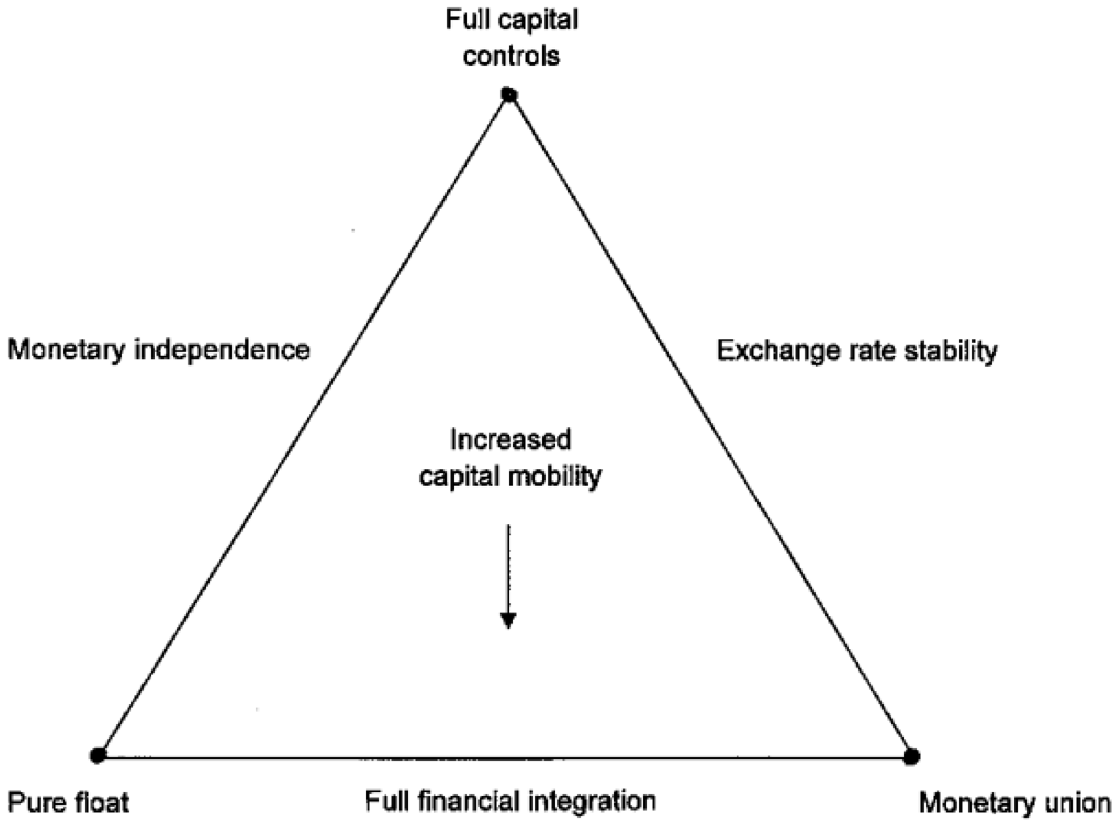
[89] For comparing different monetary systems in their performance based on these criteria, see James, Harold. 1996. *International monetary cooperation since Bretton Woods*. Washington: International Monetary Fund. Pp. 152.
[90] James. 1996. Pp. 152.

Figure 14: Monetary Trilemma and Consequential Policy Positions[91]



Furthermore, Cooper classifies 45 different potential types of IMS based on the monetary trilemma, with the caveat that he lists and operationalizes different options under each corner of the trilemma (see Figure 15).[92]

[91] Frankel, Jeffrey A. 1999. *No single currency regime is right for all countries or at all times*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w7338.pdf (27 May 2020). Pp. 8.
[92] Cooper, Richard N. 1975. Prolegomena to the choice of an international monetary system. *International Organization*, 29(1). Pp. 63–97.

Figure 15: Several Possible IMS[93]

Role of exchange rates in balance-of-payments adjustment	*Reserve asset*	*Degree of market convertibility for capital movements*
I. Fixed exchange rate	A. Gold	1. Full
II. Adjustable parities	B. SDRs*	2. Dual market
III. Gliding parities	C. US dollars and other national currencies	3. Controlled
IV. Managed float		
V. Free float		

*Refers to special drawing rights, first created in 1970 by the International Monetary Fund.

A logical consequence of these different options and natures of IMS begs the question of their appropriateness and quality – which one is the best? There is an extensive and inexhaustible debate on this manner.[94] However, one cannot make a normative claim about a theoretical structure of a particular IMS. We can only assess the empirical record of a particular type of IMS. Figure 16 compares performance of five different IMS with ten criteria.[95] Still, these empirical numbers do not tell us the causes of respective performances based on which we would be able to infer the normative judgment on them.

[93] Cooper. 1975. Pp. 67.
[94] E.g., Bordo, Michael D. 2017a. *An Historical Perspective on the Quest for Financial Stability and the Monetary Policy Regime*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w24154.pdf (31 May 2020).
[95] On this comparison see also Bordo, Michael D. 1993. The Bretton Woods international monetary system: a historical overview. In Bordo, Michael D., and Barry Eichengreen (eds.), *A retrospective on the Bretton Woods system: Lessons for international monetary reform*. Chicago: University of Chicago Press. Pp. 3–108. At Pp. 7–11; McKinnon, Ronald I. 1993. The Rules of the Game: International Money in Historical Perspective. *Journal of Economic Literature*, 31(1). Pp. 1–44. Overall, it seems that the Bretton Woods system performed best particularly between 1959 and 1970 (the so-called convertible period).

Figure 16: Comparing Performance of Different IMS[96]

		World GDP (per capita)[(b)]		World inflation[(c)]	
		Growth Annual average Per cent	Volatility Coefficient of variation	Average Per cent	Volatility Standard deviation Percentage points
Pre-Gold Standard	(1820-1869)	0.5	—	—	—
Gold Standard	**(1870-1913)[(d)]**	**1.3**	**1.2**	**0.6**	**3.0**
Interwar Period	**(1925-1939)[(d)]**	**1.2**	**3.3**	**0.0**	**4.6**
Bretton Woods	**(1948-1972)[(e)]**	**2.8**	**0.3**	**3.3**	**2.1**
memo:	*1948-1958* [(e)]	*2.7*	*0.4*	*3.1*	*2.9*
	1959-1972	*3.0*	*0.3*	*3.5*	*1.3*
Current	**(1973-2008)**	**1.8**	**0.7**	**4.8**	**3.5**
memo:	*1973-1989*	*1.4*	*0.8*	*7.5*	*3.4*
	1990-2008	*2.2*	*0.6*	*2.3*	*0.9*

PANEL B:

		Downturns		Current account balances
		Years of negative world GDP growth Share of period Per cent	Years of negative country GDP growth[(f)] Share of period, median country Per cent	Surpluses and deficits Per cent of world GDP[(g)]
Pre-Gold Standard	(1820-1869)	—	—	—
Gold Standard	**(1870-1913)[(d)]**	**7**	**19**	**2.4**
Interwar Period	**(1925-1939)[(d)]**	**21**	**27**	**1.2**
Bretton Woods	**(1948-1972)[(e)]**	**0**	**4**	**0.8**
memo:	*1948-1958* [(e)]	*0*	*0*	*0.8*
	1959-1972	*0*	*0*	*0.8*
Current	**(1973-2008)**	**0**	**13**	**2.2**
memo:	*1973-1989*	*0*	*18*	*1.6*
	1990-2008	*0*	*11*	*2.8*

PANEL C:

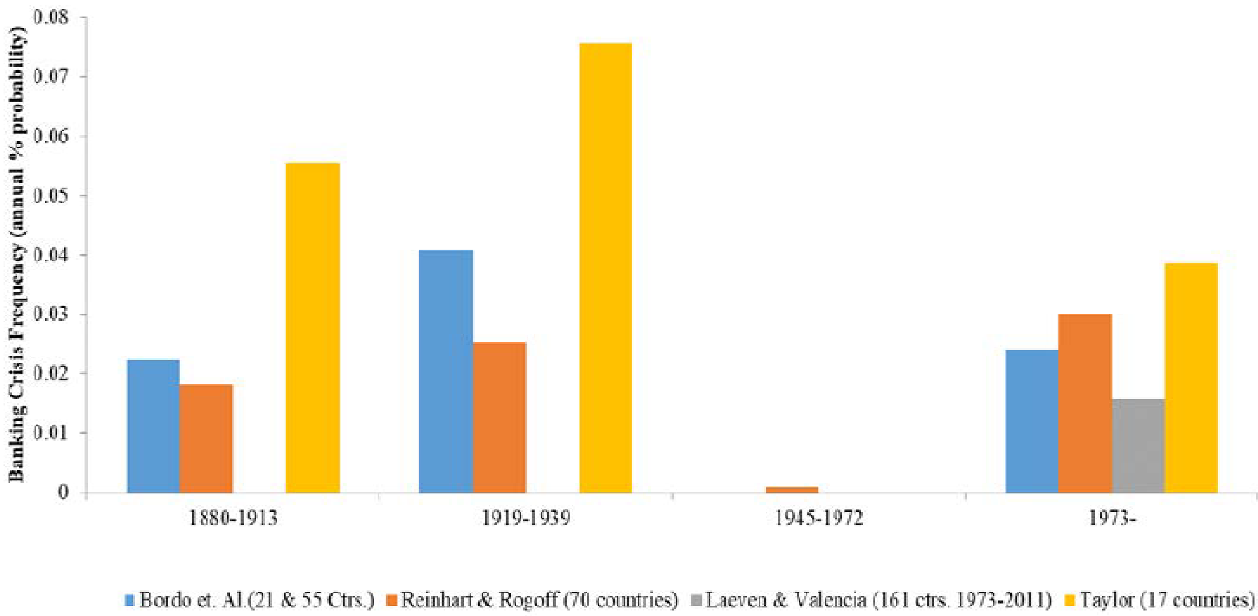
		Incidence of crises		
		Banking crises[(h)] Number per year	Currency crises[(i)] Number per year	External default[(j)] Number per year
Pre-Gold Standard	(1820-1869)	0.6	—	0.7
Gold Standard	**(1870-1913)[(k)]**	**1.3**	**0.6**	**0.9**
Interwar Period	**(1925-1939)**	**2.1**	**1.7**	**1.5**
Bretton Woods	**(1948-1972)**	**0.1**	**1.7**	**0.7**
memo:	*1948-1958*	*0.0*	*1.4*	*0.3*
	1959-1972	*0.1*	*1.9*	*1.1*
Current	**(1973-2009)**	**2.6**	**3.7**	**1.3**
memo:	*1973-1989*	*2.2*	*5.4*	*1.8*
	1990-2009	*3.0*	*2.4*	*0.8*

[96] Bush, Oliver, Katie Farrant, and Michelle Wright. 2011. *Reform of the international monetary and financial system*. London: Bank of England. Accessibility: https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2011/reform-of-the-international-monetary-and-financial-system.pdf?la=en&hash=61857A9CE1F0E8C6C604ECEE21E25758558AE4AF (31 May 2020). Pp. 7.

A potential drawback of the current IMS, which is not listed in the Figure 13, and which is often called upon is – volatility.[97] Namely, the volatility of capital flows would lead to credit booms and subsequently to financial crisis.[98] However, stability of IMS is not denoting the opposing end of a spectrum to volatility, but rather a different group of measures such as low inflation, smoothing the business cycles, and preventing recession. Hence, an in-depth analysis shows that financial crises have many different causes, where credit driven asset price booms are only one in a heterogeneous group of explanations.[99] Furthermore, "while greater volatility of underlying monetary and macroeconomic fundamentals tends to be associated with greater exchange rate volatility, such effects are weaker than one might have imagined. Even more surprising is the fact that the size of these effects does not depend very much on the degree of capital mobility."[100] This is supported also by a closer look for instance at the Banking crises – see Figure 17.

[97] E.g., Kenen, Peter B., and Dani Rodrik. 1986. Measuring and analyzing the effects of short-term volatility in real exchange rates. *The Review of Economics and Statistics*, 68(2). Pp. 311–15; Francis, Bill B., and Lori L. Leachman. 1996. The volatility and transmission of equity returns among the G-7 countries: the post-Bretton Woods experience. *International Review of Applied Economics*, 10(2). Pp. 289–303; Calvo-Gonzalez, Oscar, Rashmi Shankar, and Riccardo Trezzi. 2010. *Are commodity prices more volatile now? A long-run perspective*. Washington: The World Bank. Accessibility: https://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5460 (27 June 2020).
[98] Bordo. 2017a. Pp. 2.
[99] See Bordo. 2017a; Reinhart and Rogoff. 2009.
[100] Rose, Andrew K. 1996. Explaining exchange rate volatility: an empirical analysis of 'the holy trinity' of monetary independence, fixed exchange rates, and capital mobility. *Journal of International Money and Finance*, 15(6). Pp. 925–45. At Pp. 942.

Figure 17: Frequency of Banking Crises with Different Databases[101]



Another debate regarding the quality of IMS is political decision tangent to fixed or free-floating exchange rates and their advantages or disadvantages.[102] However, as there is no clear general economic advantage or benefit in favor of one or the other IMS decision within the monetary trilemma, we can only talk about the circumstantial empirical track record of such a political decision, there is also no clear economic advantage of a particular currency regime, or currency policy that favors strong or weak currency. Broz and Friedman explain:[103]

> There is no reigning economic argument as to the optimal national exchange rate policy. In this, international monetary policy differs from trade policy. There are powerful economic arguments for the welfare superiority of free trade, and free

[101] Bordo. 2017a. Pp. 59.
[102] For examples of two opposing views see Jeanne, Olivier, and Andrew K. Rose. 2002. Noise trading and exchange rate regimes. *The Quarterly Journal of Economics*, 117(2). Pp. 537–69; Obstfeld, Maurice, Jonathan D. Ostry, and Mahvash S. Qureshi. 2017. *A tie that binds: Revisiting the trilemma in emerging market economies*. IMF Working Paper. Accessibility: https://www.imf.org/en/Publications/WP/Issues/2017/06/08/A-Tie-That-Binds-Revisiting-the-Trilemma-in-Emerging-Market-Economies-44942 (31 May 2020).
[103] Broz, J. Lawrence, and Jeffry A. Frieden. 2011. The political economy of international monetary relations. *Annual Review of Political Science*, 4(1). Pp. 317–43. At Pp. 319.

> trade can usefully be considered a baseline from which national policies deviate /…/ In currency policy, there is no clear economic-efficiency argument for or against any particular level of the real exchange rate. A strong (appreciated) currency is one that is valuable relative to others; this gives national residents greater purchasing power. However, a strong currency also subjects national producers of tradable products (goods and services that enter into international trade) to more foreign competition, for the strong currency makes foreign products relatively cheaper. Although politicians certainly care about these effects—weighing the positive effects of increased mass incomes versus the negative effects of increased foreign competition—there is no purely economic reason to opt for one or the other.

Economic literature (e.g., rules versus discretion framework[104]) "says that fixed exchange rates provide valuable commitments to national monetary authorities. Governments abandon these commitments only when exogenous shocks make it too onerous to "tie the hands" of monetary authorities."[105] However, "fixed-rate systems may only be stable when governments actively choose to cooperate with one another. A fixed-rate system may, in fact, give governments incentives to cheat, such as to devalue for competitive purposes while taking advantage of other countries' commitment to monetary and currency stability."[106] And, the empirical record confirms this concern. A case in point is the Bretton Woods system that was based on fixed exchange rates, during which non-hegemonic states devalued their currencies several times repeatedly, and which ended when the hegemon became less concerned about the exchange rate volatility.[107] In other words, although fixed exchange rates have their advantage, it is difficult and costly, both

[104] For more on this approach which looks at the economic behavior in the light how strict the rules of behavior are, see Fischer, Stanley. 1988. *Rules versus discretion in monetary policy*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w2518.pdf (27 May 2020); Barro, Robert J. 1984. *Rules versus discretion*. National Bureau of Economic Research. Accessibility https://www.nber.org/papers/w1473.pdf (27 May 2020).

[105] Giovannini, Alberto. 1993. Bretton Woods and its precursors: rules versus discretion in the history of international monetary regimes. In Bordo, Michael D., and Barry Eichengreen (eds.), *A retrospective on the Bretton Woods system: Lessons for international monetary reform*. Chicago: University of Chicago Press. Pp. 109–54. At Pp. 109–10.

[106] Broz and Frieden. 2011. Pp. 337.

[107] Broz and Frieden. 2011. Pp. 338–9; Giovannini. 1993.

economically and politically, to maintain them, particularly in an uncertain environment. The disadvantage of fixed rates is that individual nations are exposed to both monetary and real shocks transmitted from the rest of the world via the balance of payments and other channels of transmission.[108]

The aforementioned empirical record has driven the literature to move away from this fix-vs-float dichotomy, and instead look at this topic in a rather continuous manner, where exchange rate regimes range from most rigid to most flexible: 1) Currency union, 2) Currency board, 3) 'Truly fixed' exchange rate, 4) Adjustable peg, 5) Crawling peg, 6) Basket peg, 7) Target zone or band, 8) Managed float, 9) Free float.[109] Frankel uses this classification to put to the test historical findings based on the dichotomous understanding of exchange rates – moving from fixed exchange rates towards flexible. Namely, Sussman and Eichengreen[110] have presented the argument that throughout the history fixed exchange rates were dominant, since they were linked to a particular specie (gold or silver), and that it was only after 1971 that we have seen an increased move towards free floating currencies – see Figure 18.[111]

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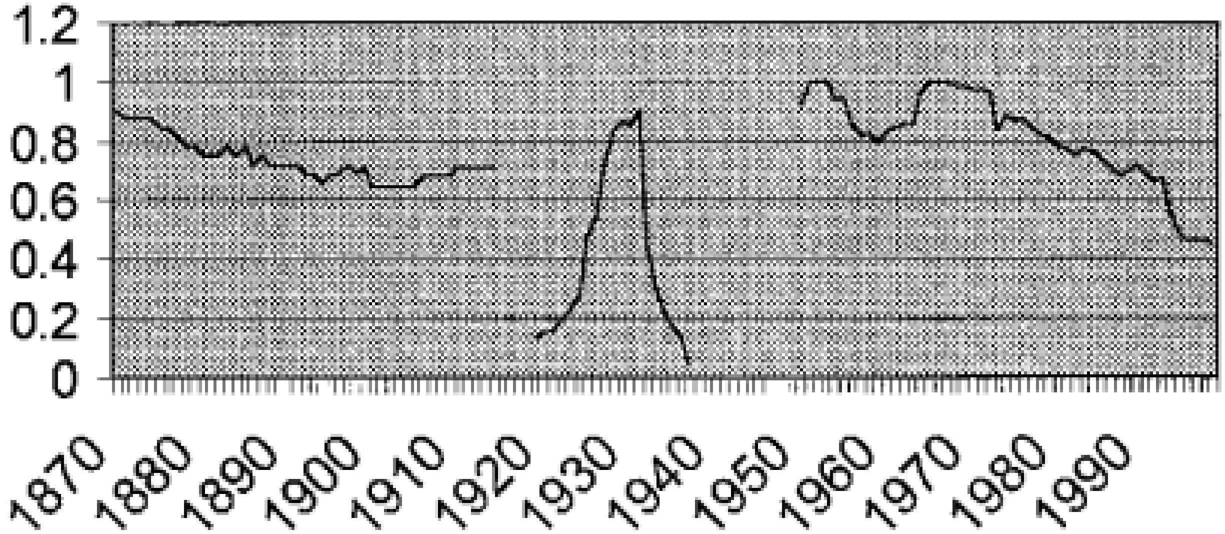
[108] Bordo, Michael D., and Anna J. Schwartz. 1989. Transmission of real and monetary disturbances under fixed and floating rates. In Dorn, James A., and William A. Niskanen (eds.), Dollars, Deficits and Trade. New York: Springer. Pp. 237–58.
[109] Frankel. 1999. Pp. 2–5.
[110] Sussman, Nathan, and Barry J. Eichengreen. 2000. *The international monetary system in the (very) long run*. Washington: International Monetary Fund. Accessibility: https://www.imf.org/external/pubs/ft/wp/2000/wp0043.pdf (27. June 2020).
[111] Free floating exchange rates are defined by the market forces of supply and demand.

Figure 18: Percentage of Countries with Pegged Exchange Rates[112]



The continuous approach of classification of exchange rates does not paint a different picture, but it does make this trend more granular. Frankel writes: "/…/ countries are increasingly finding the middle ground unsustainable – such intermediate regimes as adjustable pegs, crawling pegs, basket pegs and target zones – and are being forced toward either extreme, free float or rigid peg. The hypothesis of the missing middle has yet to be rationalized theoretically. Possibly a valid rationale is that complicated intermediate regimes are insufficiently verifiable or 'transparent' to satisfy hard-to-please global investors."[113] Hence, the finding partly corroborates the trend towards the free-floating exchange rates. Yet, the story is not the move away from fixed exchange rates regimes, amount of which in fact is also rising, if one uses continuous not dichotomous classification, but from the middle of the continuum towards both extreme ends. Nevertheless, such a finding is not as surprising as one would think at the first glance.

[112] Sussman and Eichengreen. 2000. Pp. 55.
[113] Frankel. 1999. Pp. 36.

Namely, with enhanced capital, financial, monetary, and trade interaction, an economic convergence occurs, particular in specific regions that are moving towards an optimum currency area.[114] As such, several regions have entered into monetary unions, most notably the Eurozone, where states let go of their sovereign monetary policies in order to seize greater potential and benefits from a common currency market area.[115] This move requires states to fix their exchange rates and exercise a coordinated monetary policy as a new sovereign monetary entity against other currencies.[116] Hence, European Central Bank is governed by representatives from Central banks of its member states.[117] However, the member states still have their political sovereignty and autonomy, as the Eurozone is only a political entity.[118] The strongest argument in favor of such

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[114] An optimum currency area is a region where states can maximize their economic efficiency and benefits by having a common currency, see Mundell, Robert A. 1961. A theory of optimum currency areas. *The American Economic Review*, 51(4). Pp. 657–65.

[115] On European Monetary Union see Verdun, Amy. 2002. *The euro: European integration theory and economic and monetary union*. Lanham: Rowman & Littlefield.

[116] There is a subtle difference between cooperation and coordination: "By cooperation we mean the sharing of information and techniques of central banking, the discussion of common problems and occasional/ad hoc emergency lending or other operations between central banks in periods of financial crisis. By coordination we mean policy actions formally agreed upon and taken by groups of policymakers (including finance ministers and central bankers) aimed at achieving beneficial outcomes for the international system as a whole." (Bordo, Michael D., and Catherine Schenk. 2016. Monetary policy cooperation and coordination: an historical perspective on the importance of rules. In Bordo, Michael D., and John B. Taylor, *Rules for International Monetary Stability: Past, Present, And Future.* Stanford: Hoover Institution Press. Pp. 205–61. At Pp. 206). "In principle, policy coordination might mean either of two different things: policies that are mutually established (co-ordained) or policies that are mutually appropriate (according to some set of welfare criteria). The first refers to process, the second to substance, and these are quite distinct. A jigsaw puzzle provides a useful metaphor. Did several players participate in its assembly, and what was the nature of their interaction? These are questions about procedural coordination. Do the pieces go together well? Do they fit? These are questions about substantive coordination." (Andrews, David M. 2006a. Monetary Policy Coordination and Hierarchy. In Andrews, David M (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 91–114. At Pp. 93). On the question if monetary coordination generates more gains than alternatives, see Obstfeld, Maurice, and Kenneth Rogoff. 2002. Global implications of self-oriented national monetary rules. *The Quarterly Journal of Economics*, 117(2). Pp. 503–35; Tchakarov, Ivan. 2004. *The gains from international monetary cooperation revisited*. Washington: International Monetary Fund. Accessibility: https://www.imf.org/en/Publications/WP/Issues/2016/12/30/The-Gains-From-International-Monetary-Cooperation-Revisited-17039 (26 June 2020). On historical analysis of central bank cooperation, see Borio, Claudio E. V., and Gianni Toniolo. 2006. *One hundred and thirty years of central bank cooperation: a BIS perspective*. Accessibility: https://www.bis.org/publ/work197.pdf (30 June 2020).

[117] On European Central Bank, see Scheller, Hanspeter K. 2004. *European Central Bank, History, Role and Functions.* Frankfurt am Main: European Central Bank. Accessibility: https://www.ecb.europa.eu/pub/pdf/other/ecbhistoryrolefunctions2004en.pdf (27. June 2020).

[118] Just recently this argument was reiterated by the European Court of Justice in a case against Cyprus, see *Opinion of Advocate General Pitruzzella*. 2020. 28 May. Accessibility: https://www.courthousenews.com/wp-content/uploads/2020/05/euro-group-ag.pdf (31 May 2020). "The opinion says that the European courts do not have

claim is the lack of so called Eurobonds – members of the Eurozone do not issue common bonds, but each state issues its own bonds.[119] Moreover, monetary regulation and oversight is by and large still in the jurisdiction of state Central Banks.[120] As such, member states still maintain their monetary autonomy.

A second explanation for these results is economic integration, which makes economic dependence more acute. Namely, states that gravely depend on another country benefit more if they completely peg their currency to their fountainhead country currency.[121] Therefore, they embrace the free flow of capital and want to seize as much benefits as they can, but still maintain monetary autonomy, as this peg is made by choice. Thus, the trend of moving towards extreme ends of the exchange rate continuum by no means contradicts the post-Bretton Woods IMS position within the monetary trilemma (sovereign monetary policy and free flow of capital).[122]

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jurisdiction to hear actions for damages brought against the Eurogroup /…/ Pitruzella argues that the Eurogroup cannot be officially classified as a body, office, or agency. An analysis of the Eurogroup's inception, function and *modus operandi* concluded that the Eurogroup was political and informal. It has no competences of its own and no power to penalize (See *Eurointelligence*. 2020a. Daily Brief, 29 May).

[119] On Eurozone bonds see Codogno, Lorenzo, Carlo Favero, and Alessandro Missale. 2003. Yield spreads on EMU government bonds. *Economic Policy*, 18(37). Pp. 503–32; Juncker, Jean-Claude, and Giulio Tremonti. 2010. E-bonds would end the crisis. *Financial Times*, .5 December. Accessed: http://www.astrid-online.it/static/upload/protected/Junc/Juncker-Tremonti.pdf (1 June 2020); Directorate General for Internal Policies Policy Department A: Economic And Scientific Policies. 2011. *Eurobonds: Concepts and Implications*. Accessibility: https://www.europarl.europa.eu/RegData/etudes/note/join/2011/457357/IPOL-ECON_NT(2011)457357_EN.pdf (2 June 2020).

[120] Gortsos, Christos V. 2020. *European Central Banking Law, The Role of the European Central Bank and National Central Banks under European Law*. London: Palgrave Macmillan.

[121] On this issue see Moon, Bruce E. 1982. Exchange rate system, policy distortions, and the maintenance of trade dependence. *International Organization*, 36(4). Pp. 715–39; Pitt, Alexander. 2001. *Sustaining fixed exchange rates: a model with debt and institutions*. Washington: International Monetary Fund. Accessibility: https://www.imf.org/external/pubs/ft/wp/2001/wp0127.pdf (27 June 2020); Blomberg, S. Brock, Jeffry Frieden, and Ernesto Stein. 2005. Sustaining fixed rates: The political economy of currency pegs in Latin America. *Journal of Applied Economics*, 8(2). Pp. 203–25.

[122] The recent rise of the fixed exchange rates in the post-Bretton Woods IMS opened a new line of research, where do these currencies anchor? Empirics show that "the US dollar scores (by a wide margin) as the world's dominant anchor currency and, by some metrics, its use is far wider today than 70 years ago. In contrast, the global role of the euro appears to have stalled in recent years." See, Ilzetzki, Ethan, Carmen M. Reinhart, and Kenneth S. Rogoff. 2017. *Exchange Arrangements Entering the 21st Century: Which Anchor will Hold?*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w23134 (27 May 2020).

What it does is presents a challenge to our unit of analysis – states or currencies? Nevertheless, as stated earlier, states still maintain their sovereignty, even if they are in a monetary union. As such, it may be better to refer to these cases as currency unions.[123]

Finally, based on the relations between different currencies, the literature also offers a typology of their international position. Namely, Susan Strange made a classification of international currencies comprised of what she called top, master, negotiated and neutral currencies, depending on the degree of political control involved in their creation and use.[124] Moreover, Cohen talks about international currency in terms of a two by three matrix that illustrates how public and private agents perform the three key roles of any currency (that is, to act as medium of exchange, unit of account and store of value).[125] However, this debate is again, as it is with IMS, political in its nature, and it is about the monetary power. Furthermore, when one talks about power, one also needs to talk about strategic interactions among states. In our case this is monetary statecraft – "efforts to influence the policies of other states by manipulating monetary conditions.[126]"

Therefore, the next section looks at these issues while elaborating my independent variable – ownership of the central monetary unit. To sum up, this section has defined and operationalized my dependent variable – the change in rules of an IMS. I observe the latter through the change in

[123] A monetary union assumes a unified and centralized monetary policy, whereas currency union only refers to a common currency without an assumption about the manner in which monetary policy of that union is conducted.
[124] Strange, Susan. 1971a. Sterling and British policy: A political view. *International Affairs*, 47(2). Pp. 302–15.
[125] Cohen, Benjamin J. 1971. *The Future of Sterling as an International Currency*. London: Macmillan.
[126] Henning, C. Randall. 2006. The exchange rate weapon and macroeconomic conflict. In Andrews, David M. (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp 117–38. At Pp. 117.

the monetary trilemma set up of an IMS, and adjustment, liquidity, and confidence policies that flow from a particular set up.

2.2 CENTRALITY OF THE HEGEMON'S CURRENCY

In monetary politics and monetary statecraft, economics and politics are not to be interpreted independent to each other, where one would present an exogenous shock to another.[127] The independence narrative is characteristic for economic literature, as well as a vast portion of International Relations, including a section of the International Political Economy[128] – the literature dealing with economics of war, allocation of resources during war, or how states finance wars.[129] Yet, such an assumption is in present research project inadequate. Monetary economics may not only be a cause of (political) statecraft, but an equal tool in general statecraft options of statesmen. Strategic interaction takes place not only in the realm of monetary politics, but with monetary politics, which is not only an epiphenomenal to military or general political balance of power.[130]

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[127] On this issue see Bordo, Michael D., and Olivier Jeanne. 2002. Monetary policy and asset prices: does 'benign neglect' make sense?. *International Finance*, 5(2). Pp. 139–64.

[128] For a historical overview of the term and the concept see Marlin-Bennett, Renée. 2010. International Political Economy: Overview and Conceptualization. In *Oxford Research Encyclopedia of International Studies*. Accessibility: https://oxfordre.com/internationalstudies/view/10.1093/acrefore/9780190846626.001.0001/acrefore-9780190846626-e-239 (6 June 2019); Cohen, Benjamin J. 2008. *International Political Economy*. Princeton: Princeton University Press.

[129] See Biddle, Jeff, and Warren Samuels. 1991. Thorstein Veblen on War, Peace and National Security. In Goodwin, Craufurd L. (ed.), *Economics and national security: a history of their interaction*. Durham: Duke University Press. Pp. 87–117. At Pp. 87.

[130] On the issue, see Luttwak, Edward N. 1990. From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce. *The National Interest*, 20. Pp. 17–23; Csurgai, Gyula. 2009. Sovereign Wealth Funds: Strategies of Geo-economic Power Projections. In Hieronymi, Otto (ed.), *Globalization and the Reform of the International Banking and Monetary System*. London: Palgrave. Pp. 209–27; Nitzan, Jonathan, and Shimshon Bichler. 2009. *Capital as power: A study of order and creorder*. London: Routledge; Zarate, Juan. 2013. *Treasury's War: The Unleashing of a New Era of Financial Warfare*. New York: PublicAffairs; Blackwill, Robert D., and Jennifer M. Harris. 2016. *War by Other Means: Geoeconomics and Statecraft*. Cambridge: Harvard University Press.

By and large the existing scholarship on relations between politics and monetary phenomena has not been explicitly focused on statecraft; still, it has been tangent to it in both of its research programs. First, approaches that study macro-economic interdependence (e.g. Optimum Currency Area, or monetary interdependence and war);[131] second, theories that look at domestic economic distribution and its relations to monetary politics.[132] However, when assuming a synthesis between politics and monetary affairs, the first research program presents structural, while the second is framed as domestic input into monetary statecraft.[133] Such a framework is more

[131] Mundell. 1961; McKinnon, Ronald. 1963. Optimum Currency Areas. *American Eco-nomic Review*, 53(4). Pp. 717–25; Kenen, Peter B. 1969. The Theory of Optimum Currency Areas: An Eclectic View. In Mundell, Robert, and Alexander Swoboda (eds.), *Monetary Problems of the International Economy*. Chicago: University of Chicago Press. Pp. 41–60; Keohane, Robert O., and Joseph S. Nye. 1977. *Power and Interdependence: World Politics in Transition*. Boston: Little, Brown and Company; Baldwin, David A. 1980. Interdependence and power: a conceptual analysis. *International Organization*, 34(4). Pp. 471–506; Koichi, Hamada. 1985. *The political economy of international monetary interdependence*. Cambridge: MIT Press; Andrews, David M., and Thomas D. Willett. 1997. Financial interdependence and the state: international monetary relations at century's end. *International Organization*, 51(3). Pp. 479–511; Kenen, Peter B. 2002a. Currency Unions and Policy Domains. In Andrews, David M., C. Randall Henning, and Louis W. Pauly (eds.), *Governing the World's Money*. Ithaca: Cornell University Press. Pp. 78–104; Willett, Thomas D. 2006. Optimum Currency Area and Political Economy Approaches to Exchange Rate Regimes: Towards an Analytical Synthesis. *Current Politics and Economics of Europe*, 17(1). Pp. 25– 52.

[132] Gowa, Joanne. 1983. *Closing the gold window: Domestic politics and the end of Bretton Woods*. Ithaca: Cornell University Press; Frieden, Jeffry A. 1991. Invested Interests: The Politics of National Eco-nomic Policies in a World of Global Finance. *International Organization*, 45(4). Pp. 425– 51; Henning, C. Randall. 1994. *Currencies and Politics in the United States, Germany, and Japan*. Washington: Peterson Institute for International Economics; Simmons, Beth. 1994. *Who Adjusts? Domestic Sources of Foreign Policy during the Interwar Years.* Princeton: Princeton University Press; Hefeker, Carsten. 1997. *Interest Groups and Monetary Integration: The Political Economy of Exchange Regime Choice*. Boulder: Westview Press; Oatley, Thomas H. 1997. *Monetary Politics: Exchange Rate Cooperation in the European Union*. Ann Arbor: University of Michigan Press; Bernhard, William, and David Leblang. 1999. Democratic Institutions and Exchange-Rate Commitments. *International Organization*, 53(1). Pp. 71– 97; Clark, William Roberts, and Mark Hallerberg. 2000. Mobile Capital, Domestic Institutions, and Electorally Induced Monetary and Fiscal Policy. *American Political Science Review*, 94(2). Pp. 323–46; Broz and Frieden. 2001; Streeck, Wolfgang, and Lea Elsässer. 2016. Monetary disunion: the domestic politics of Euroland. *Journal of European Public Policy*, 23(1). Pp. 1–24.

[133] Or in other words, one is situated in third image, and the other in the second (Waltz, Kenneth. 1959. *Man, the State, and War*. New York: Columbia University Press).

familiar to International Relations scholarship, where structural[134] and domestic[135] as respective explanatory images are common also when dealing with change in IMS. Yet, each of these two perspectives, which can be summed-up as either market of policy driving forces, alone presents an incomplete picture.[136] However, an assumption of fusing politics and monetary affairs brings about a two-sides-of-the-same-coin ontological position of monetary and political phenomena, and as such, elegantly and pragmatically circumvent a severe theoretical challenge of combining the two, what scholars have already experienced.[137] In other words, monetary policy is high politics.[138]

When talking about monetary statecraft, we immediately need to talk about monetary power, since power is the most fundamental concept in political science and also an important

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[134] Cohen, Stephen D. 1970. *International Monetary Reform, 1964-69: The Political Dimension*. New York: Praeger; Strange, Susan. 1976. International Monetary Relations. In Shonfield, Andrew (ed.), *International Economic Relations of the Western World 1959-1971 vol. 2*. Oxford: Oxford University Press. Pp. 18–359; Keohane and Nye. 1977; Solomon, Robert. 1977. The *International Monetary System, 1945-1976: An Insider's View*. New York: Harper and Row; Cohen, Benjamin J. Cohen. 1977. *Organizing the World's Money: The Political Economy of International Monetary Relations*. London: Palgrave; Williamson, John. 1977. *The Failure of World Monetary Reform, 1971-74*. London: Thomas Nelson and Sons.

[135] Strange, Susan. 1971b. *Sterling and British Policy: A Political Study of an International Currency in Decline*. Oxford: Oxford University Press; Calleo, David P., and Benjamin M. Rowland. 1973. *America and the World Political Economy: Atlantic Dreams and National Realities*. Bloomington: Indiana University Press; Morse, Edward L. 1973. *Foreign Policy and Interdependence in Gaullist France*. Princeton: Princeton University Press; Bergsten, C. Fred. 1975. *The Dilemmas of the Dollar: The Economics and Politics of United States International Monetary Policy*. New York: New York University Press; Katzenstein, Peter J. 1976. International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States. *International Organization*, 30(1). Pp. 1–46; Block, Fred L. 1977. *The Origins of International Economic Disorder: A Study of United States International Monetary Policy from World War II to the Present*. Berkeley: University of California Press; Krasner, Stephen D. 1978. *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy*. Princeton: Princeton University Press.

[136] Odell, John S. 1982. *US international monetary policy: Markets, power, and ideas as sources of change*. Princeton: Princeton University Press. Pp. 12.

[137] May, Ernest R. 1975. *The Making of the Monroe Doctrine*. Cambridge: Harvard University Press; May, Ernest R. 1973. *"Lessons" of the Past: The Use and Misuse of History in American Foreign Policy*. Oxford: Oxford University Press; Allison, Graham T. 1971. *Essence of Decision: Explaining the Cuban Missile Crisis*. Boston: Little, Brown; George, Alexander L., and Richard Smoke. 1974. *Deterrence in American Foreign Policy: Theory and Practice*. New York: Columbia University Press; Steinbruner, John D. 1974. *The Cybernetic Theory of Decision: New Dimensions of Political Analysis*. Princeton: Princeton University Press.

[138] Russell, Robert W. 1973. Transgovernmental interaction in the international monetary system, 1960–1972. *International Organization*, 27(4). Pp. 431–64. At Pp. 432.

factor for monetary statecraft.[139] Often scholars draw parallels between power in politics to money in the economy.[140] Moreover, Organski claims that economic power is a prerequisite for all other power capabilities, without a strong economy and good growth potential a dominant state stagnates and declines.[141] Yet, this approach again assumes the independence of the two, while in this particular research I am interested in monetary power. This fusion is supported by Keynes who explains that money links domestic politics with the international economy.[142] Moreover, money links images of analysis; and so, its significance cannot be partial – either political or economic, either domestic or international, structural or relational or agential.[143] Sensing this ontological challenge, scholars of monetary power have moved away from domestic-international frameworks and approached the issue from a different angle all together; one that integrates aforementioned ontological considerations; one that would be able to capture the nature of monetary power, particular capital mobility or capital markets;[144] one that would personify what Waltz argued:

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[139] Lasswell, Harold, and Abraham Kaplan. 1950. *Power and Society A Framework for Political Inquiry*. New Haven: Yale University Press. Pp. 75.

[140] On this issue see Baldwin, David A. 1971. Money and power. *The Journal of Politics*, 33(3). Pp. 578–614.

[141] Organski. 1958. Pp. 299–306.

[142] Keynes, John Maynard. 1934. *A Treatise on Money: Vol II The Applied Theory of Money*. London: Macmillan. Pp. 304.

[143] More on ontology see Hay, Colin. 2006. Political Ontology. In Goodin, Robert E. (ed.), *The Oxford handbook of contextual political analysis*. Accessibility: https://www.oxfordhandbooks.com/view/10.1093/oxfordhb/9780199604456.001.0001/oxfordhb-9780199604456-e-023 (6 June 2020); Jackson, Patrick Thaddeus. 2016. *The conduct of inquiry in international relations: Philosophy of science and its implications for the study of world politics*. London: Routledge; Marsh, David, Selen A. Ercan, and Paul Furlong. 2018. A skin not a sweater: Ontology and epistemology in political science. In Vivien Lowndes, David Marsh, and Gerry Stoker (eds.), *Theory and methods in political science*. London: Palgrave. Pp. 177–98. On ontology of power see Barnett, Michael, and Raymond Duvall. 2005. Power in international politics. *International Organization*, 59(1). Pp. 39–75; Baldwin, David A. 2016. *Power and international relations: A conceptual approach*. Princeton: Princeton University Press; Qin, Yaqing. 2018. *A relational theory of world politics*. Cambridge: Cambridge University Press.

[144] See Andrews, David M. 1994a. Capital mobility and state autonomy: toward a structural theory of international monetary relations. *International Studies Quarterly*, 38(2). Pp. 193–218; Andrews, David M. 1994b. Capital mobility and monetary adjustment in Western Europe, 1973–1991. *Policy Sciences*, 27(4). Pp. 425–45; Cohen, Benjamin J. 1993. The Triad and the Unholy Trinity: Lessons for the Pacific Region. In Higgott, Richard A., Richard Leaver, and John Ravenhill (eds.), *Pacific Economic Relations in the 1990s: Cooperation or Conflict?*. Boulder: Lynne Rienner. Pp. 133–58.

"Structure affects behavior within the system, but does so indirectly. The effects are produced in two ways: through socialization of the actors and through competition among them."[145]

A macro- and micro- foundations of monetary power approach has become the go-to starting point in monetary power scholarship. "At the macro-level, the key issue is who pays the costs of adjustment. /…/ Monetary power at the macro-level consists of the capacity either to delay payment of adjustment's continuing costs or to deflect its transitional costs on to others. /…/ At the micro-level, by contrast, the chief issue is who benefits from the organization of international monetary affairs."[146] Hence, monetary power refers to the notion of control over state autonomy, not to state influence over other states or outcomes in international affairs as generally in political science.[147] Moreover, linking monetary power to monetary statecraft, the relative position of a state towards other states is measured in terms of relative costs that a certain monetary policy will induce.[148] Since these costs fluctuate over time, a non-hegemonic state will seek a particular moment when its ability to bend the rules to its favor is higher than expected, and the hegemon will seek moments of higher vulnerability of non-hegemonic states when drafting those rules anew to reflect its interest better.[149]

Thus, what are specific monetary statecraft tools that states can use? The literature has by and large focused on currency coercion, which is based on the aforementioned asymmetric

[145] Waltz. 1979. Pp. 74.
[146] Andrews. 2006b. Monetary power and monetary statecraft. In Andrews, David M (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 7–28. At Pp. 11.
[147] Andrews. 2006b. Pp. 16. See also Hart. 1976.
[148] Cooper, Scott. 2006. The limits of monetary power: statecraft within currency areas. In Andrews, David M (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 162–83. At Pp. 168.
[149] Cooper. 2006. Pp. 176.

economic vulnerability.[150] However, currency coercion is only one type of seizing the opportunity that such a gap offers; moreover, it has several forms. Thus, it is a rather muddy concept. Figure 19 classifies several monetary statecraft tools that the states can mutually pursue in order to assure their autonomy.[151] Yet, choosing among these options depends on the monetary power a state has,[152] where within its macro-foundations Cohen distinguishes 'power to delay' and 'power to deflect.'[153] I differentiate between two micro-foundations of monetary power: 'power to generate financial regulation', and 'power to generate economic centrality'.

[150] Kirshner, Jonathan. 1997. *Currency and coercion: the political economy of international monetary power*. Princeton: Princeton University Press. Pp. 12–7.
[151] For example, during the Nixon shock, United States has used liquidity policy, as well as exchange rate policy, see Odell. 1982. Pp. 8.
[152] In fact, a state can choose several of these options at the same time, since they are not mutually exclusive, see Kindleberger. 1973; Kindleberger, Charles P. 1986. International public goods without international government. *The American Economic Review*, 76(1). Pp. 1–13; Lake, David A. 1993. Leadership, hegemony, and the international economy: Naked emperor or tattered monarch with potential?. *International Studies Quarterly*, 37(4). Pp. 459–89; Cohen, Benjamin J. 2006b. *The future of money*. Princeton: Princeton University Press.
[153] Cohen. 2006a.

Figure 19: Monetary Statecraft Options[154]

		Policy area			
		Currency relations		Financial relations	
		Currency value	Currency use	Payments financing	Liquidity provision
Immediate orientation of policy	Primary internal	Domestic policy insulation (e.g., via capital controls) Example: Malaysia following the Asian currency crisis	Restricting external employment of the currency Example: German policy under the EMS	Developing and maintaining access to external sources of payments financing with minimal policy constraints Example: IMF net reserve positions	Ensuring that domestic access to official liquidity is not a policy constraint Example: Creation of SDRs
	Primary external	External currency manipulation (e.g., talking the dollar down) Example: U.S. policy prior to Bonn summit	Promoting external employment of the currency Example: U.S. policy after World War II	Providing limited and conditional access to payments financing Example: Financial aspects of the Suez crisis	Exploiting others' reliance on official liquidity Example: U.S. opposition to the formation of an Asian Monetary Fund

For the state to have the Power to Delay, it needs a good international liquidity position – its international reserves and access to additional credit. For the state to have the Power to Deflect,

[154] Andrews. 2006b. Pp. 16.

it is necessary to have sound underlying real economic position – creating room for potential sacrifice.[155]

> On the one hand, states have the Power to Delay; on the other hand, they have the Power to Deflect. A two-fisted government prefers both. The continuing cost of adjustment, we shall see, may be defined as the cost of the new payments equilibrium prevailing after all change has occurred. The Power to Delay is the capacity to avoid the continuing cost of adjustment by *postponing* the process of adjustment. The transitional cost of adjustment, by contrast, may be defined as the cost of the change itself. When the process of adjustment cannot be put off, the Power to Deflect represents the capacity to avoid the transitional cost of adjustment by *diverting* as much as possible of that cost to others.[156]

The macro-fundaments of monetary power related to balance of payments or distribution of the burden of adjustment,[157] is in this classification partnered with the micro-level of monetary power, which is linked with issues that concern all actors, not only states.[158] "/…/ The micro-level considerations that characterize international monetary affairs, including especially the practices and institutions associated with money and finance at both the domestic and international levels" are:[159] centrality of a currency, which gives influence over regulatory trends and crisis management in financial markets; global reach of banking sector, which ensures the position of the lender of last resort and shaping global financial environment; currency blocks; financial or monetary entrapment or dependence if not even imperialism.[160] Figures 20 and 21 identify the mechanisms by which the macro- and micro- levels of monetary power work and what are their sources.

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155 Cohen. 2006a. Pp. 42.
156 Cohen. 2006a. Pp. 36.
157 Cohen. 2006a. Pp. 31.
158 Helleiner. 2006. Pp. 72.
159 Helleiner. 2006. Pp. 79.
160 Helleiner. 2006. Pp. 79–83.

Figure 20: Macro- and Micro- Levels of Monetary Power 1[161]

	Aspect of monetary power	Primary mechanisms
Macro-level	Extraction of wealth	Seignorage; devaluation / depreciation of currency
	Projection of macroeconomic preferences	"Pulling power" in global financial markets; use of exchange-rate weapon
Micro-level	Influence over financial regulation in other states	Regulation of financial markets employing core currency
	Influence over international financial crisis management	Public lender-of-last-resort activities; influence over private institutions lending in the core currency
	Reshaping of economic geography	Altering transaction costs to foster economic links with core economy
	Formation of identities	Creation of a common interest in value and stability of core currency; symbolic role of money; shared trust within the community using and issuing core currency; common "economic language"; collective monetary experiences

[161] Helleiner. 2006. Pp. 84.

Figure 21: Macro- and Micro- Levels of Monetary Power 2[162]

	Level of analysis			
	Macro-level		Micro-level	
Power to . . .	deflect the transitional costs of adjustment	delay the continuing costs of adjustment	rearticulate actor interests	reconstruct actor identities
Primary mechanisms	Passivity with respect to adjustment pressures, thus encouraging other states to bear the brunt of price and income changes required for mutual adjustment	Drawing down reserves or borrowing from abroad, thus postponing real adjustment	Adoption of an extraterritorial currency for at least some purposes, resulting in:	
			Reduction of mutual transaction costs; trade diversion; and formation of new private sector coalitions	Collective experience of monetary phenomena; symbolic role of money in identity formation
Principal sources	Fundamental economic characteristics (esp. relative economic size and openness)	Overall liquidity position (foreign reserves plus access to international credit)	Functional attractiveness of extra-territorial currencies; side payments from interested parties to key decision makers	
	Credibility of policy framework; quality of financial market institutions			

The taxonomy of micro- and macro- foundations of monetary power solves several ontological challenges in regard to monetary power – it encompasses structural, relational, and agential type of power, it includes all images of analysis, and fuses politics and economics. In this it surpasses earlier works on monetary power, which have aspired to overcome the same

[162] Andrews. 2006b. Pp. 12.

challenges.[163] Namely, Cohn dealt with two causal mechanisms of monetary power by distinguishing between 'structural power' as "the ability to gain by rewriting the rules of the game," even without such intention, whereas he saw 'process power' as "the ability to gain under the prevailing rules of the game.[164]" Furthermore, Strange picked up this distinction and argued that 'structural power' of money was becoming more important than what she called 'relational power'.[165] Hence, the structural monetary power is the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises.[166] Structural power is about the control of structures, not states.[167] While procedural power, which still is structural in nature, targets states directly (e.g. currency manipulation, monetary dependence).[168]

Thus, my explanatory variable stems from macro- and micro- foundation of monetary power, where I focus on one of the micro-foundations: economic centrality. I argue that ownership of the central monetary unit leads to general economic centrality and is as such quintessential for a pervasive hegemony. Moreover, it enhances both macro- and micro- foundations of monetary power. Such an argument has some hints in the literature. Namely, Cohen alluded to centrality

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[163] See Kirshner, Jonathan. 2008. Dollar Primacy and American Power: What's at Stake?. *Review of International Political Economy*, 15(3). Pp. 418–38.
[164] Cohen. 1977. Pp. 54, 56.
[165] Strange, Susan. 1982. Still an Extraordinary Power: America's Role in a Global Monetary System. In Lombra, Raymond E. and Willard E. Witte (eds.), *The Political Economy of International and Domestic Monetary Relations*. Ames: Iowa State University Press. Pp. 73–93; Strange, Susan. 1983. *Casino capitalism*. London: Blackwell; Strange, Susan. 1987. The persistent myth of lost hegemony. *International Organization*, 41(4). Pp. 551–74; Strange, Susan. 1988. *States and markets*. London: Continuum; Strange, Susan. 1989. Toward a Theory of Transnational Empire. In Czempiel, Ernst-Otto and James N. Rosenau (eds.), *Global Changes and Theoretical Challenges: approaches to world politics for the 1990s*. Lexington: Lexington Books. Pp. 161–76; Strange, Susan. 1990. Finance, information and power. *Review of International Studies*, 16(3). Pp. 259–74; Strange, Susan. 1998. *Mad money: when markets outgrow governments*. Ann Arbor: University of Michigan Press.
[166] Strange. 1998. Pp. 24–5.
[167] Strange, Susan. 1996. *The retreat of the state: The diffusion of power in the world economy*. Cambridge University Press. Pp. 26.
[168] See Kirshner. 1997.

when he stated that it is the acceptability of others that gives currency its power.[169] The latter comes from confidence in the currency, which comes with the assurance that it will be guided according to some predicted rules or strategies.[170] Thus, ownership over a central monetary unit would generate certain expected behavior (adjustment, liquidity, confidence) within a given IMS structure (monetary trilemma). This creates what the literature calls reliable monetary anchor.[171]

So, what does centrality mean? It derives from network analysis, and we can understand it as the level of importance of an individual unit or node within a network.[172] "A network is defined as a set of units (nerves, computers, individuals, organizations, states) and a rule that defines whether, how, in what way, and to what extent any two units are linked with each other."[173] As such, in my case I am interested in a network of states – states are nodes – and their economic connections that represent edges of such networks.[174] Yet, the edges can in theory also be

[169] Cohen, Benjamin J. 2012. *The future of global currency: the euro versus the dollar*. London: Routledge. Pp. 150.
[170] Cohen. 1998. Pp. 97, 122.
[171] Pauly, Louis. 2006. Monetary Statecraft in Follower States. In Andrews, David M. (ed.), *International monetary power*. Ithaca: Cornell University Press. Pp. 184-207.
[172] For a good overview of network analysis, see Wasserman, Stanley, and Katherine Faust. 1994. *Social Network Analysis: Methods and Applications*. Cambridge: Cambridge University Press; Freeman, Linton C. 2004. *The Development of Social Network Analysis: A Study in the Sociology of Science*. Vancouver: Empirical Press; Scott, John. 2012. *Social Network Analysis*. Thousand Oaks: Sage. For its application into International Relations see Hafner-Burton, Emilie M., Miles Kahler, and Alexander H. Montgomery. 2009. Network Analysis for International Relations. *International Organization*, 63(3). Pp. 559–92; Kahler, Miles (ed.). 2011a. *Networked politics: agency, power, and governance*. Ithaca: Cornell University Press; Avant, Deborah, and Oliver Westerwinter (eds.). 2016. *The new power politics: Networks and transnational security governance*. Oxford: Oxford University Press.
[173] Maoz, Zeev. 2012. How network analysis can inform the study of international relations. *Conflict Management and Peace Science*, 29(3). Pp. 247–56. At Pp. 248.
[174] My independent variable looks at monetary connections operationalized with international reserves and the amount of transactions denominated in US dollars. However, I also look at the trade relations to underline the difference that this variable makes in comparison to other central monetary units that were not owned by one entity – e.g., gold.

ideational or symbolic, not only material.[175] In a nutshell, centrality draws us a picture of the position that an actor has within a network, the latter can be enabling or constraining.[176]

Network centrality, relating to human interaction, was introduced to social science in 1948.[177] First studies[178] "concluded that centrality was related to group efficiency in problem-solving, perception of leadership and the personal satisfaction of participants."[179] This research paved the way for many experiments done in the 1950s and 1960s, which results were rather inconsistent and often contradictory.[180] It was also in the 1960s that International Relations first used network analysis, particularly in its graphic applications, and in regards to foreign policy decision making.[181] "These early studies generally stopped short of using network analysis to test theories or predict network effects on international politics. /Nevertheless, even the/ second wave of research based in sociology /which/ began in the late 1970s and used network analysis to investigate structural determinants of international inequality, drawing on dependency and world-

175 Montgomery, Alexander H. 2016. Centrality in transnational governance. In Avant, Deborah, and Oliver Westerwinter (eds.), *The new power politics: Networks and transnational security governance*. Oxford: Oxford University Press. Pp. 19–41.
176 Montgomery. 2016. Pp. 2.
177 Bavelas, Alex. 1948. A mathematical model for group structures. *Applied Anthropology*, 7(3). Pp. 16–30.
178 E.g., Bavelas, Alex. and Dermot Barrett. 1951. An experimental approach to organizational communication. *Personnel* 27. Pp. 386–97; Leavitt, Harold J. 1951. Some effects of certain communication patterns on group performance. *The Journal of Abnormal and Social Psychology*, 46(1). Pp. 38–50.
179 Freeman, Linton C. 1978. Centrality in social networks conceptual clarification. *Social networks*, 1(3). Pp. 215–39. At Pp. 215.
180 See Burgess, Robert L. 1969. Communication Networks and Behavioral Consequences. *Human Relations*, 22(2). Pp. 137–59.
181 E.g., Brams, Steven J. 1966. Transaction flows in the international system. *American Political Science Review,* 60(4). Pp. 880–98; Brams, Steven J. 1969. Search for structural order in the international system: Some models and preliminary results. *International Studies Quarterly*, 13(3). Pp. 254–80; Skjelsbaek, Kjell. 1972. Peace and the Structure of the International Organization Network. *Journal of Peace Research*, 9(4). Pp. 315–30; Axelrod, Robert (ed.). 1976. *Structure of Decision: The Cognitive Maps of Political Elites*. Princeton: Princeton University Press; Bonham, G. Matthew, Michael J. Shapiro, and George J. Nozicka. 1976. Cognitive process model of foreign-policy decision-making. *Simulation and Gaming*, 7(2). Pp. 123–52; Christopherson, Jon A. 1976. Structural Analysis of Transaction Systems: Vertical Fusion or Network Complexity?. *Journal of Conflict Resolution*, 20(4). Pp. 637–62; Bonham, G. Matthew, Michael J. Shapiro, and Thomas L. Trumble. 1979. The October war changes in cognitive orientation toward the Middle East conflict. *International Studies Quarterly*, 23(1). Pp. 3–44.

systems theory," had the same shortcoming.[182] Still, International Relations literature using network analysis continued to grow and went hand in hand with increased network scholarship in other fields.[183] Hence, it was only since 1990s that network analysis has been used to tackle unique and fundamental theoretical questions in International Relations.[184] Moreover, some have even

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[182] Hafner-Burton, Kahler and Montgomery. 2009. Pp. 562

[183] For the second wave of network analysis literature in International Relations see Moore, Michael. 1978. An international application of Heider's balance theory. *European Journal of Social Psychology*, 8(3). Pp. 401–5; Moore, Michael. 1979. Structural balance and international relations. *European Journal of Social Psychology*, 9(3). Pp. 323–6; McDonald, Brooke H., and Richard Rosecrance. 1985. Alliance and structural balance in the international system: A reinterpretation. *Journal of Conflict Resolution*, 29(1). Pp. 57–82; Snyder, David, and Edward L. Kick. 1979. Structural Position in the World System and Economic Growth, 1955–1970: A Multiple-Network Analysis of Transnational Interactions. *American Journal of Sociology*, 84(5). Pp. 1096–126; Breiger, Ronald L. 1981. Structures of Economic Interdependence Among Nations. In Blau, Peter Michael, and Robert King Merton (eds.), *Continuities in Structural Inquiry*. Beverly Hills: Sage. Pp. 353–80; Nemeth, Roger J., and David A. Smith. 1985. International Trade and World-System Structure: A Multiple Network Analysis. *Review (Fernand Braudel Center)*, 8(4). Pp. 517–60; Faber, Jan. 1987. Measuring Cooperation, Conflict, and the Social Network of Nations. *Journal of Conflict Resolution*, 31(3). Pp. 438–64; Peacock, Walter Gillis, Greg A. Hoover, and Charles D. Killian. 1988. Divergence and Convergence in International Development: A Decomposition Analysis of Inequality in the World System. *American Sociological Review*, 53(6). Pp. 838–52.

[184] E.g., Smith, David A., and Douglas R. White. 1992. Structure and dynamics of the global economy: Network analysis of international trade 1965–1980. *Social Forces*, 70(4). Pp. 857–93; Van Rossem, Ronan. 1996. The world systems paradigm as a general theory of development: A cross national test. *American Sociological Review*, 61(3). Pp. 508–27; Sacks, Michael Alan, Mark J. Ventresca, and Brian Uzzi. 2001. Global Institutions and Networks: Contingent Change in the Structure of World Trade Advantage, 1965–1980. *American Behavioral Scientist*, 44(10). Pp. 1579–601; Moore, Spencer, Eugenia Eng, and Mark Daniel. 2003. International NGOs and the Role of Network Centrality in Humanitarian Aid Operations: A Case Study of Coordination During the 2000 Mozambique Floods. *Disasters*, 27(4). Pp. 305–18; Ward, Michael D., Randolph M. Siverson, and Xun Cao. 2007. Disputes, Democracies, and Dependencies: A Reexamination of the Kantian Peace. *American Journal of Political Science*, 51(3). Pp. 583–601; Scheffran, Jurgen. 2008. The complexity of security. *Complexity*, 14(1). Pp. 13–21; Maoz, Zeev. 2010. *Networks of Nations: The Evolution, Structure, and Impact of International Networks, 1816–2001*. Cambridge: Cambridge University Press; Kim, Hyung Min. 2010. Comparing Measures of National Power. *International Political Science Review*, 31(4). Pp. 405–27; Corbetta, Renato. 2010. Determinants of Third Parties' Intervention and Alignment Choices in Ongoing Conflicts, 1946--2001. *Foreign Policy Analysis*, 6(1). Pp. 61–85; Ward, Michael D., Katherine Stovel, and Andrew Sacks. 2011. Network analysis and political science. *Annual Review of Political Science*, 14. Pp. 245–64; Van de Rijt, Arnout. 2011. The micro-macro link for the theory of structural balance. *Journal of Mathematical Sociology*, 35(1). Pp. 94–113; Carpenter, R. Charli. 2011. Vetting the Advocacy Agenda: Network Centrality and the Paradox of Weapons Norms. *International Organization*, 65(1). Pp. 69–102; Kinne, Brandon J. 2012. Multilateral Trade and Militarized Conflict: Centrality, Openness, and Asymmetry in the Global Trade Network. *The Journal of Politics*, 74(1). Pp. 308–22; Manger, Mark S., Mark A. Pickup, and Tom A. B. Snijders. 2012. A Hierarchy of Preferences: A Longitudinal Network Analysis Approach to PTA Formation. *Journal of Conflict Resolution*, 56(5). Pp. 853–78; Cranmer, Skyler J., Bruce A. Desmarais, and Elizabeth J. Menninga. 2012. Complex Dependencies in the Alliance Network. *Conflict Management and Peace Science*, 29(3). Pp. 279–313; Kinne, Brandon J. 2013. Network Dynamics and the Evolution of International Cooperation. *American Political Science Review*, 107(4). Pp. 766–85; Oatley, Thomas, William Winecoff, Andrew Pennock, and Sarah Bauerle Danzman. 2013. The Political Economy of Global Finance: A Network Model. *Perspectives on Politics*, 11(1). Pp. 133–53; Böhmelt, Tobias, Vally Koubi, and Thomas Bernauer. 2014. Civil Society Participation in Global Governance: Insights from Climate Politics. *European Journal of Political Research*, 53(1). Pp. 18–36; Murdie, Amanda. 2014. The Ties that Bind: A Network Analysis of Human Rights International Nongovernmental Organizations. *British Journal of Political Science*, 44(1). Pp. 1–27; Carpenter, Charli. 2014.

touched upon the same question as the present research is – enduring US hegemony.[185] Still, skepticism among general International Relations scholars regarding the usefulness and added value of network analysis persists. The latter is rather surprising as the aforementioned literature has shown how network analysis is applicable also for interdisciplinary studies, which is one of the contemporary buzzwords in International Relations.[186] Moreover, a similar sentiment may be detected also in Economics, where network analysis is considered as 'fancy descriptive statistics'.[187]

The advantage of network analysis and the reason why I use it for my operationalization of my explanatory variable, is that networks have been interpreted as structures, relations, and agents.[188] However, one can also take an eclectic approach and treat networks holistically, what would reflect the described characteristic of monetary power. Namely, network analysis is grounded in three principles that all reflect the need when talking about monetary power: First, nodes and their behaviors are mutually dependent (recalling the linkage between domestic and

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"Lost" Causes: Agenda Vetting in Global Issue Networks and the Shaping of Human Security. Ithaca: Cornell University Press; Carpenter, Charli, Sirin Duygulu, Alexander H. Montgomery, and Anna Rapp. 2014. Explaining the Advocacy Agenda: Insights from the Human Security Network. *International Organization*, 68(2). Pp. 449–70; Kinne, Brandon J. 2014. Dependent Diplomacy: Signaling, Strategy, and Prestige in the Diplomatic Network. *International Studies Quarterly*, 58(2). Pp. 247–59; Wilson, Maya, David R. Davis, and Amanda Murdie. 2016. The view from the bottom: Networks of conflict resolution organizations and international peace. *Journal of Peace Research*, 53(3). Pp. 442–58.

185 Winecoff, William Kindred. 2020. "The persistent myth of lost hegemony," revisited: structural power as a complex network phenomenon. *European Journal of International Relations*, 26(1). Pp. 209–52; Oatley, Thomas. 2017. The political economy of hegemony: the (surprising) persistence of American hegemony. *Oxford Research Encyclopedia of Politics*. Accessibility: https://oxfordre.com/politics/view/10.1093/acrefore/9780190228637.001.0001/acrefore-9780190228637-e-284 (20 April 2020); Fichtner, Jan. 2017. Perpetual decline or persistent dominance? Uncovering Anglo-America's true structural power in global finance. *Review of International Studies*, 43(1). Pp. 3–28.

186 Maoz. 2012. Pp. 249.

187 This phrase was used in two separate conversations with economists – one academic and one from banking.

188 Kahler, Miles. 2011b. Networked politics: agency, power, and governance. In Kahler, Miles (ed.), *Networked politics: agency, power, and governance*. Ithaca: Cornell University Press. Pp. 1–20; Hafner-Burton, Emilie M., and Alexander H. Montgomery. 2009. Globalization and the social power politics of international economic networks. In Kahler, Miles (ed.), *Networked politics: agency, power, and governance*. Ithaca: Cornell University Press. Pp. 23–42.

international politics when it comes to money and monetary power); Second, ties between nodes can be material or nonmaterial (recalling that micro foundation of monetary power also has an ideational component); Third, patterns of association can be enabling or restrictive (recalling the very nature of power).[189] There is "no assumption about the homogeneity or other characteristics of the nodes or ties. Consequently, network analysis can be used to analyze any kind of ties, including market or hierarchical transactions.[190]"

When it comes to power, network analysis generates three general findings about the nature and role of power.[191] First, the formation of networks is associated with concentrations of power. It reflects my assumption of initial imbalance of power, which I will elaborate in the next section. Namely, ownership of the central monetary unit can be generated only if there is a prerequisite of an initial imbalance of power. Second, the distribution of ties in networks is a function of power differentials. This point is a classification of the mechanism of how my explanation works; namely, the 'buy-in' mechanism, the more a monetary unit is central to the network, the more power the hegemon has. Third, networks also redistribute power within the unit – again reflecting the nature of monetary power. However, the issue is that there are several concepts by which to measure power and centrality in a network. Kahler distinguishes bargaining power, social power, and the power of exit.[192] The unit increases its bargaining power when it increases the size of its ties to other units. Social power is enhanced when unit increases the number of ties and units it is

[189] Wasserman and Katherine. 1994. Pp. 4. See also Hafner-Burton, Kahler, and Montgomery. 2009.
[190] Montgomery. 2016. Pp. 3
[191] See Eilstrup-Sangiovanni, Mette. 2016. Power and Purpose in Transgovernmental Networks. In Avant, Deborah, and Oliver Westerwinter (eds.), *The new power politics: Networks and transnational security governance*. Oxford: Oxford University Press. Pp. 131–68.
[192] Kahler. 2011b. Pp. 12–3.

connected to. Finally, the power to exit means if a unit has the capacity to leave a network. Thus, the existence of outside options becomes critical in assessing network power of this kind.[193]

All three forms are relevant and included in this analysis. The first two are merged in the type of centrality measure I use – weighted degree. Namely, it is a measure that combines the two – the number of ties that a node has, as well as their respective sizes. Furthermore, assuming that there is always an alternative outside a particular monetary system, and that states are autonomous, then each state has the power to exit. Of course, the consequences and costs of such exit will be disproportionate and subject to particular macro-foundations of monetary power.

Regarding centrality assessments, network analysis includes a panoply of different measurements of centrality:[194] i.e., degree, betweenness, closeness, flow, power, and eigenvector.[195] Each reflects a different characteristic of a node within a network, as well as the nature of their ties. As such, not every measure is appropriate for each network.[196] Based on Borgatti degree, centrality is appropriate for trade and money exchange process.[197] Namely, he

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[193] A related clarification regarding relations between power and network has been made by Castells who distinguishes: "1. Networking Power: the power of the actors and organizations included in the networks that constitute the core of the global network society over /others/ who are not included in these global networks. 2. Network Power: the power resulting from the standards required to coordinate social interaction in the networks. In this case, power is exercised not by exclusion from the networks but by the imposition of the rules of inclusion. 3. Networked Power: the power of social actors over other social actors in the network. /…/ 4. Network-making Power: the power to program specific networks according to the interests and values of the programmers, and the power to switch different networks following the strategic alliances between the dominant actors of various networks." (Castells, Manuel. 2011. A network theory of power. *International Journal of Communication*, 5. Pp. 773–87).
[194] Montgomery. 2016. Pp. 6.
[195] See Hanneman, Robert A., and Mark Riddle. 2005. *Introduction to social network methods*. Riverside: University of California. Accessibility: http://faculty.ucr.edu/~hanneman/ (9 June 2020). See Ch. 10. See also Borgatti, Stephen P. 2005. Centrality and network flow. *Social Networks*, 27(1). Pp. 55–71.
[196] For their detailed definitions descriptions see Freeman. 1979; Hanneman and Riddle. 2005: Cook, Karen S., Richard M. Emerson, Mary R. Gillmore, and Toshio Yamagishi. 1983. The distribution of power in exchange networks: Theory and experimental results. *American Journal of Sociology*, 89(2). Pp. 275–305.
[197] Borgatti. 2005. Pp. 62.

presents a typology of network flows based on two dimensions: the kinds of trajectories a traffic follows (geodesics, paths, trails, or walks) and the method of spread (broadcast, serial replication, or transfer). Therefore, different things travel differently: "used goods (trail – sequence of incident links in which no link is repeated), money (walks – it could easily move from A to B, B back to A, A to B again, then B to C, and so on), gossip (traces – trails through the network rather than walks, be in several places at once, one person at a time), e-mail (from one person to multiple people, and multiple places at the same time), attitudes (spread from person to person, replication – I do not lose my attitude the moment I infect you with it), infection (spreads from person to person by duplication, like gossip, but does not re-infect anyone who already has had it because they become immune), and packages (package's trajectory follows shortest geodesic paths through a network of roads and intersections)."[198] Hence, "the choice of which metric to use will depend on the particular type of power process – whether it is through access to other important actors (e.g., degree and eigenvector), brokerage between unconnected groups (e.g., betweenness and flow), or speed of diffusion through a network (e.g., closeness and power)."[199]

As stated, I will use weighted degree centrality, which assures to capture the transfers I am interested in.[200] Freeman notes: "The degree of a point is viewed as an index of its potential communication activity."[201] This approach has a virtue, since it takes "the structure of an entire network into account in specifying /power level/ for every position in that structure."[202] The degree centrality is "the sum of the value of the ties between /a/ node and every other node in the network.

[198] Borgatti. 2005. Pp. 57.
[199] Montgomery. 2016. Pp. 6.
[200] A degree-based measure of centrality is a count of the number of adjacencies for a point, see Nieminen, Juhani. 1974. On the centrality in a graph. *Scandinavian Journal of Psychology*, 15(1). Pp. 332–6.
[201] Freeman. 1979. Pp. 221.
[202] Cook, Emerson, Gillmore, and Yamagishi. 1983. Pp. 289.

This measure tells us how much access a particular node has to the other nodes."[203] Actors that have more ties have greater opportunities because they have choices. This autonomy makes them less dependent on any specific other actor, and hence more powerful.[204] Yet, the size of a particular tie also matters for the same reason – it enhances options or more specifically in my case generates macro-foundation of monetary power.[205] Thicker and multiple ties give the node alternative ways to satisfy their interests and needs, and subsequently are less dependent on others and as such more autonomous.[206] "Because they have many ties, they may have access to, and be able to call on more of the resources of the network as a whole. Because they have many ties, they are often third-parties and deal makers in exchanges among others, and are able to benefit from this brokerage."[207] Therefore, the micro-foundation of centrality in a monetary network is a prerequisite for macro-foundations, as I have described in the previous section. Namely, the centrality of the US dollar also gives the United States the power to delay and power to defect. In fact, United State has more power to delay than anyone else. As Cohen puts it:

> Global popularity translates directly into a sustained demand for the dollar or dollar-denominated claims, which in turn enables the United States to finance deficits, in effect, with its own money. /…/ But there is also a downside to this privilege. Dollar accumulation around the world is no more than a form of external

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[203] Hafner-Burton, Kahler, and Montgomery. 2009. Pp. 563. To make matters more complicated, there are several ways how to interpret degree centrality as a proxy measure of power. Although I will be traditional in using and interpreting degree centrality as power, I will add weights to those ties. Yet, some other measures include e.g., Bonacich degree centrality, who differentiated between power centrality and degree centrality. Namely, nodes that are well connected with nodes that do not have many connections also are powerful. As such, an actor may be central (many ties), but not powerful (some nodes are not part of his centrality score), and vice-versa (Bonacich, Phillip. 1987. Power and centrality: A family of measures. *American Journal of Sociology*, 92(5). Pp. 1170–82). See also Rodan, Simon. 2011. Choosing the 'β' parameter when using the Bonacich power measure. *Journal of Social Structure*, 12(4). Pp. 1–23. On limits of centrality power measures see Cook, Emerson, Gillmore, and Yamagishi. 1983.

[204] Hanneman and Riddle. 2005.

[205] Montgomery. 2016.

[206] My argument runs also in reverse order in that non-hegemonic states want to maintain certain centrality and therefore, reinforce the existing ties and enhance their size. Thus, reproducing hegemony. I will elaborate this in the next section.

[207] Hanneman and Riddle. 2005.

> borrowing by the United States. In acquiring dollars or dollar-denominated claims, foreigners automatically extend credit to the U.S. economy; in the case of greenback notes, the credit is even interest-free. As with all external borrowing, therefore, there is a potential limit, set by the willingness of foreigners to go on lending. The ability of the United States to postpone adjustment ultimately rests on that same perpetual opinion poll, that is, on the judgments of agents elsewhere, including not only private-market actors using the dollar for investment purposes but also foreign central banks using the dollar for their reserves.[208]

In sum, my explanatory variable derives from a network perspective of micro-foundation of monetary power: ownership of the central monetary unit. The next section outlines the causal path by which the variation of my explanatory variable leads to a particular outcome – change in the IMS.[209]

2.3 'BUY-IN' MECHANISM AND ASSUMPTIONS OF PERVASIVE HEGEMONY THEORY

Linking my independent variable (ownership of the central monetary unit) with my dependent variable (change in IMS) in Pervasive Hegemony Theory is a causal mechanism which I refer to as 'buy in'. I will elaborate by starting with assumptions and then explain how the mechanism works for non-hegemonic states and the hegemon.

First, international relations are anarchic. Although hegemony entails a notion of hierarchy,[210] the latter is a consequence of a specific distribution of power. As such, anarchy relates to supremacy of the state as an institution over all other agents in international affairs, where there is no entity above the state that can resolve disputes, enforce rules, and assure guiding principles

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[208] Cohen. 2006a. Pp. 45.

[209] A network perspective to power has been applied already in 1960s, see Emerson, Richard M. 1962. Power-dependence relations. *American Sociological Review*, 27(1). Pp. 31-41.

[210] See e.g., Lake, David A. 2011. *Hierarchy in international relations*. Ithaca: Cornell University Press.

of behavior in international relations.[211] Therefore, it relates to a type of constitutive element of the structure of international relations, whereas hierarchy refers to a particular distribution of power within a set structure.[212] Hence, the two elements refer to two separate issues in international affairs and are not contradicting one another. Moreover, I assume both – anarchic relations and an initial imbalance of power (hierarchical distribution of power).

The next assumption flows from the first – the key actors in this system are states. And when it comes to states, they are selfish, which is the fourth assumption. Lumping together the latter two and adding anarchy assumption it then follows that states live under a sword of Damocles – uncertainty. As such, they can rely only on themselves – a fifth basic assumption.

Furthermore, alongside these traditional realist assumptions,[213] there are also some more specific. Namely, states are rational, but also risk averse – they have a concave utility function for a particular goal.[214] "Attitude to risk—a taste for it or an aversion to it—is an attractive way to

[211] Milner, Helen. 1991. The assumption of anarchy in international relations theory: a critique. *Review of International Studies*, 17(1). Pp. 67–85. On further debate on anarchy see, Powell, Robert. 1994. Anarchy in international relations theory: the neorealist-neoliberal debate. *International Organization*, 48(2). Pp. 313–44; Donnelly, Jack. 2011. The discourse of anarchy in IR. *International Theory*, 7(3). Pp. 393–425; Fiammenghi, Davide. 2019. Anarchy is what states make of it": true in a trivial sense; otherwise, wrong. *International Politics*, 56(1). Pp. 17–32.

[212] Pervasive Hegemony Theory stresses centrality of the hegemon in economic relations. Thus, hierarchy in this theory may relate also to relations, not only distribution of power. Yet, this is the case only regarding one issue among numerus in international affairs – centrality. Furthermore, other hegemonies are not characterized by this feature. Therefore, as I want to compare explanatory power of different theories of hegemony, it would be wrong to assume hierarchy of relations. As such, I only assume an initial imbalance of power – hierarchical distribution of power.

[213] On realist ontological assumptions see e.g., Donnelly, Jack. 2000. *Realism and international relations*. Cambridge: Cambridge University Press; James, Patrick. 2002. *International relations and scientific progress: Structural realism reconsidered*. Columbus: Ohio State University Press; Randall, Schweller. 2003. The Progressiveness of Neoclassical Realism. In Elman, Colin, and Miriam Fendius Elman (eds.), *Progress in International Relations Theory*. Cambridge: MIT Press. Pp. 311–48.

[214] On this assumption, which is close to Prospect Theory (Kahneman Daniel Tversky, Amos, and Daniel Kahneman. 1979. Prospect theory: An analysis of decision under risk. *Econometrica*, 47(2). Pp. 263–91), see De Mesquita, Bruce Bueno. 1980. An expected utility theory of international conflict. *American Political Science Review*, 74(4). Pp. 917–31; Morrow, James D. 1987. On the theoretical basis of a measure of national risk attitudes.

explain decision-making. It links the strategic and the psychological conceptions of choice, portraying leaders as calculating goal-seekers while allowing them to have different personal decision-making styles."[215] What this means is that in cases where states may get greater benefits, but the benefits are uncertain, they will likely opt for smaller benefits, which are certain.

The next assumption is that along survival, states want to maximize their interest through maximizing their autonomous behavior.[216] There is a long debate in International Relations literature whether states seek power, security, autonomy, to fulfill their interests.[217] Yet, as Fiammenghi has shown, a synthesis of these seemingly opposing arguments is possible.[218] Thus, my assumption is a synthesis—I claim that these axioms are not mutually exclusive. I posit that states seek to maximize interests; and their first and foremost interest is their survival. Moreover, the way they can maximize their other interests is through assuring their autonomy. States want to choose their preferred policies independent of other states, broader environment, and issues at stake. Some may want to prioritize security, and some may want to obtain power in order to suffice

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International Studies Quarterly, 31(4). Pp. 423–38; Huth, Paul, D. Scott Bennett, and Christopher Gelpi. 1992. System uncertainty, risk propensity, and international conflict among the great powers. *Journal of Conflict Resolution*, 36(3). Pp. 478–517; Farnham, Barbara (ed.). 1994. *Avoiding losses/taking risks: Prospect theory and international conflict*. Ann Arbor: University of Michigan Press; Fearon, James D. 1995. Rationalist explanations for war. *International organization*, 49(3). Pp. 379–414; Geva, Nehemia, and Alex Mintz (eds.). 1997. *Decisionmaking on war and peace: The cognitive-rational debate*. Boulder: Lynne Rienner; Kowert, Paul A., and Margaret G. Hermann. 1997. Who takes risks? Daring and caution in foreign policy making. *Journal of Conflict Resolution*, 41(5). Pp. 611–37; Berejekian, Jeffrey. 1997. The gains debate: Framing state choice. *American Political Science Review*, 91(4). Pp. 789–805; Lau, Richard R., and Jack S. Levy. 1998. Contributions of behavioural decision theory to research in political science. *Applied Psychology*, 47(1). Pp. 29–44; McDermott, Rose. 2001. *Risk-taking in international politics: Prospect theory in American foreign policy*. Ann Arbor: University of Michigan Press; Boettcher III, William A. 2004. The prospects for prospect theory: An empirical evaluation of international relations applications of framing and loss aversion. *Political Psychology*, 25(3). Pp. 331–62.

[215] O'Neill, Barry. 2001. Risk aversion in international relations theory. *International Studies Quarterly*, 45(4). Pp. 617–40. At Pp. 617.

[216] See Schweller. 1994; Harknett, Richard J., and Hasan B. Yalcin. 2012. The struggle for autonomy: a realist structural theory of international relations. *International Studies Review*, 14(4). Pp. 499−521.

[217] On this debate see: Walt. 1987; Schweller. 1994; Mearsheimer. 2001; Harknett and Yalcin. 2012.

[218] Fiammenghi, Davide. 2011. The security curve and the structure of international politics: A neorealist synthesis. *International Security*, 35(4). Pp. 126–54.

their ultimate interest of survival. This is a particular foreign policy choice, which depends on different factors that we can neatly classify within three frameworks: the individual (profile of state leaders or elites), the state (bureaucratic process, or state regime), the international structure (geography, technology).[219] Still, every state wants to decide what to do autonomously. Hence, autonomy presents a primary motivation.[220] Pervasive Hegemony Theory facilitates an opportunity for states to maximize their interests to 'n-1'; where 'n' refers to the number of issues in international affairs at any given point in time, and '-1' refers to the issue of 'buy-in'—reproducing centrality of the hegemon's monetary unit in the global economy. Thus, non-hegemonic states are autonomous on all issues, but when it comes to 'the one crucial' – monetary centrality – their autonomy is constrained. Pervasive hegemony is a system that imposes a severe constraint on the autonomy of non-hegemonic states whereby not 'buying in' the monetary centrality of the hegemon and not following the structural imperative, the non-hegemonic states bear severe costs – economic, political, and security.

Subsequently, next to reinforcing hegemony, non-hegemonic states are free to pursue any policy in all other issues. As such, under pervasive hegemony there is a bifurcation of issues and types of relations in them, which is not the case in other hegemonic theories. First, there is a hegemony-relevant monetary centrality of the hegemon's currency issue, which is characterized only by the 'buy-in' dynamic. Second, are all other issues, which are not relevant for the functioning and persistence of hegemony; and so, states are autonomous in all those issues. This is where multiple other factors determine state motivations and ultimately state action.[221] Hence,

[219] See Waltz. 1959; Ripsman, Taliaferro, Lobell. 2016.
[220] Harknett and Yalcin. 2012. Pp. 506.
[221] On the topic of diverse behavior of states see Lobell, Steven E. 2018. A Granular Theory of Balancing. *International Studies Quarterly*, 62(3). Pp. 593−605.

the same states compete and cooperate at the same time. The most striking feature of recent international monetary relations is that part of the time the game resembles a classic power confrontation, but another part of the time it resembles a cooperative venture to improve the general welfare.[222] This is the realm where balancing and bandwagoning behavior take place. Yet, from the perspective of Pervasive Hegemony Theory, it is less important.

I also assume that economics and politics are not independent of one another. Namely, I understand them as 'two-sides-of-the-same-coin', and I have elaborated this position in the subchapter dedicated to my independent variable – ownership of the central monetary unit. Kissinger said that the "key economic policy decisions are not technical, but political."[223] Finally, an assumption about monetary economics as the most important part of the economy. Specifically, monetary economy is more important than real economy. Trade and other forms of economy are by-and-large impacted if not determined by monetary economics.[224] The role of money is often paralleled to the role of blood in an organism,[225] or to a foundation of a tall building.[226] Although one can explain economic events using long-term 'real economics' only,[227] this is suboptimal for the purpose of this project. As Gilpin notes:

> International financial flows have /…/ become an important determinant, and many economists believe they are the most important determinant of exchange rates (at

[222] Hoffmann, Stanley. 1972. Weighing the Balance of Power. *Foreign Affairs*, 50(4). Pp. 618–43.
[223] Kissinger, Henry. 1979. *White house years*. New York: Simon and Schuster. Pp. 950.
[224] See for example: Rose, Andrew, and Tom D. Stanley. 2005. A Meta-Analysis Of The Effect Of Common Currencies On International Trade. *Journal of Economic Surveys*, 19(3). Pp. 347−65.
[225] One of the first such references date back to early 20th century, see Riesser, Jacob. 1910. *Die Deutschen Großbanken und ihre Konzentration*. Jena: Verlag von Gustav Fischer. Pp. 186.
[226] Odell. 1982. Pp. 5.
[227] A formal distinction between real and monetary economic analysis was only made by Schumpeter (see Schumpeter, Joseph Alois. 1954. *History of economic analysis*. London: Routledge). Furthermore, the first theoretical alternative to real economics was done by Keynes (see Keynes, John Maynard. 1936. *The general theory of employment, interest, and money*. London: Macmillan).

> least in the short term) and a cause of erratic movements in currency values. Movement toward a single, globally integrated market for corporation ownership has resulted from increased financial flows, and this has greatly facilitated corporate mergers and takeovers across national boundaries and the integration of the world economy by multinational firms. Altogether, the reemergence of international finance has increased interdependence of trade, monetary, and other aspects of the international economy. The need to mesh these formerly separate domains of international economic affairs has complicated the task of managing the world economy.[228]

An analysis based on 'real economics' is situated within the logic of barter, which is not applicable to the nature of the contemporary financial economy, where the same agent makes multiple transactions within seconds. As such, money has greater fluctuation and fungibility[229] than physical goods and affects output, inflation, interest rates, employment, as well as exchange rates with its distinct logic in a very short term, as well as in the long run.[230] Yet, it is the first that is profound, and means that risks of severe losses are considered also on the very short term, not only in the long run. This bears important consequences for Pervasive Hegemony Theory as even revisionist states (wolves)[231] are reluctant to contest the centrality of the hegemon's currency since the risks are immediate and severe. Hence, they 'buy-in'.

An analysis based on 'real economics' would not capture this (very) short-term aspect of economic relations; however, in the long run both analyses – real and monetary – reach the same end point.[232] As such, the 'real economy' can serve as an additional proxy measurement of the hegemon's economic centrality, namely, US centrality in global trade relations can strengthen the

[228] Gilpin. 2001. Pp. 277.
[229] See e.g., Baldwin, David A. 1989. *Paradoxes of Power*. New York: Basil Blackwell. Pp. 134–5.
[230] For more see Krugman, Paul R., and Maurice Obstfeld. 2008. *International economics: Theory and policy*. Boston: Pearson. Ch 12 and 14.
[231] Schweller. 1994. Pp. 100.
[232] More on classical dichotomy see Akhtar, M. A. 1975. The "Classical Dichotomy" in Ricardian Economics. *History of Political Economy*, 7(3). Pp. 299–311.

claim of hegemon's centrality and persistent imbalance of power. Furthermore, due to monetary data shortage, we can compare different hegemonies throughout history using these proxy measures (particularly trade data) in order to determine uniqueness of US hegemony.

This nature (financial) of the economy became prevalent after the end of the Bretton Woods IMS. Therefore, observing monetary relations under the Bretton Woods system as well as in the post-1971 IMS contributes to clarifying how two very different systems of monetary rules, norms and principles are encompassed within the same hegemony. Hence, it allows me to identify and explain the logic of the 'buy-in' dynamic. Lastly, money assures three basic functions for every agent in the market economy (medium of exchange, unit of account, and store of value).[233] It is through these functions that I also operationalize my independent variable: transactions made in hegemon's currency, and international reserves denominated in hegemon's currency.

Based on these assumptions, Pervasive Hegemony Theory has a condition that the hegemon needs to decide to pursue policies to make its currency central to the IMS. This process takes time, so pervasive hegemony needs a period of maturity. The sheer imbalance of power is not sufficient for pervasive hegemony; however, it is necessary for establishing the centrality of the hegemon's currency. Once this is reached, the explanatory setting is in place for the 'buy-in' mechanism. Namely, when the hegemon asserted its currency as central to the international monetary relations, now the non-hegemonic states can 'buy-in' and maintain this centrality. Different types of hegemony differ when it comes to time required to establish a hegemony. The imbalance of power is sufficient for Coercive and Opportunist hegemony to take shape. Therefore,

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[233] Mankiw, N. Gregory. 2010. M*acroeconomics*. New York: Worth Publishers. Pp. 80−1.

they are the easiest to be created. Cooperative hegemony needs some time to be set up, and so too, Cultural hegemony. Moreover, any of these four hegemonies may have a central monetary unit which is not the hegemon's currency. Yet, this fact does not result in the 'buy-in' mechanism.[234] Thus, such a centrality is not a crucial feature for functioning and maintaining a hegemony. It is the hegemon's ownership of the central monetary unit that makes the difference and generates a particular behavior of non-hegemonic states – 'buy-in'.

Once the hegemon's currency is central in international monetary relations, the non-hegemonic states can fulfill their selfish interests (e.g., generate economic growth) only if they continue to use that currency in their economic activities. The alternatives are simply too risky and too costly. "The costs of switching are especially high if there are large asymmetries in financial development that favors the currency leader. This consideration helps to explain why, despite the large fluctuations in the value of the dollar since 1973, there has been only a minor erosion of its position as the lead currency in the contemporary system. Network externalities compound the advantages that accrue to the lead currency, not least because its use by specialized private financial intermediaries is likely to deepen the existing cost advantages of transacting in this currency."[235]

[234] Case in point here is 19th century United Kingdom, and the Gold standard international monetary system, which I will touch upon in the quantitative empirical chapter. The classical gold standard system may have been coordinated in London, but Britain was no monetary hegemon, nor did it behave as such, nor did other states 'buy-in'. See Gallarotti, Giulio M. 1995. *The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880-1914*. Oxford: Oxford University Press.
[235] Walter. 2006. Pp. 66.

Ownership of the central monetary unit gives the hegemon a sort of monopoly power.[236] As such, it is more costly for the hegemon to achieve such a position than it is to maintain it.[237] Non-hegemonic states will under this condition engage in enhancing their macro-foundations of their respective monetary power (power to delay and power to defect), but the bottom line is that they do not want to endanger the micro-foundation of the IMS – centrality of hegemon's currency. Hence, non-hegemonic states have a vested interest in maintaining this micro-foundation, as they benefit from it. Even if they do not approve of the hegemon, or they do not like the imbalance of power, in such a setting they can only maximize their autonomy and pursue their national interest if they are ready to continue to use the hegemon's currency. The benefits are material (markets access, lower transaction costs, generating economic growth, cheaper borrowing of money), ideational (clear rules and norms), as well as strategic or political (assuring autonomy in their foreign policy decisions).[238] Thus, they are ready also to accept a change in IMS rules and norms (my dependent variable), so long as the central monetary unit is preserved and their path of autonomous fulfilling of national interest remains clear.

In this process, the hegemon's ownership of the central monetary unit is crucial, as the hegemon controls the monetary production and availability. Other regimes, such as centrality of a specie standard, does not have the same effect as the specie is disbursed across the globe, its resources uncertain and unclear. Therefore, the hegemon does not have the micro-foundational centrality power as the latter is diffused. Whereas when the hegemon owns the central currency, it is clear who the hegemon is, what its currency is, who produces it, as well as whom to address

[236] Walter. 2006. Pp. 52.
[237] Walter. 2006. Pp. 66.
[238] See Walter. 2006; and also, Polanyi, Karl. 1944. *The great transformation*. Boston: Beacon press.

when fundamental monetary issues are at stake. Basket of currencies, a non-hegemonic currency, or even a digital currency, may be attractive when it comes to generating yields, but they are characterized by higher uncertainty, and states are risk averse. Namely, basket of currencies suffers from the same problem as a specie standard – diffused micro-foundational centrality power and therefore increased risk and uncertainty. A non-hegemonic currency as a central monetary unit in IMS is an oxymoron. If the hegemon releases the central position in the IMS to a different state, this means that it is the other state that determines the rules and norms, and therefore, is the hegemon. Digital currency lacks trust among states to base their IMS on it.

Thus, even when states do not approve of the hegemon, or they do not like the imbalance of power, or they would prefer a different IMS, they are still willing to support their 'second best option' (centrality of the hegemon's currency), since benefits deriving from it are still great, but most importantly they are certain. Monetary centrality generates pervasive hegemony. The ownership of the central monetary unit generates predictability what states in monetary relations seek. The hegemonic ownership of the central monetary unit generates trust and stability, which alternatives to this monetary unit do not have. Lastly, the hegemon's behavior when it comes to centrality of its currency, generates certainty or its commitment to such a position.

All this is best observed in a time of crisis. States may indeed seek higher yields with riskier investments in financial (monetary) markets; however, when international monetary crises hit, they rapidly return to the safe haven of the hegemon's central monetary unit. We have seen this in the 2008 global financial crisis and most recently with the COVID-19 crisis.[239] Moreover, in times of

[239] For an early analysis of the impact of COVID-19 on US hegemony see Norrlöf, Carla. 2020. Is COVID-19 the end of US hegemony? Public bads, leadership failures and monetary hegemony. *International Affairs*, 96(5). Pp.

crises, IMS rules and norms are most likely to be changed. Doing so, non-hegemonic states not only accept the change, but also reinforce and reproduce it, and so they strengthen the centrality of the hegemon's currency in IMS and hence, also its hegemony. In other words, they 'buy-in'. Non-hegemonic states want to preserve the hegemon's currency centrality, so that they can successfully maximize their autonomy and interests. Since the alternatives are deleterious, they are willing to accept a change in the rules of the IMS, if this is a condition for the continuation of the hegemon's procurement of the central monetary unit. If there is no hegemon's ownership, then the system is unstable, and uncertainty looms large. The latter is even more undesirable than living with the imbalance of power. Furthermore, in cases other than the hegemonic ownership of the central monetary unit, the alternatives do not come with as high price, and the system itself is dubious, so non-hegemonic states do not 'buy-in'. Hegemony may still be maintained, but not through the mechanism characteristic for pervasive hegemony – 'buy-in'.

Hence, compared to the Opportunist Hegemony logic of 'buy-out', here the order is reversed. The non-hegemonic states need to 'buy-in' first before they get access or obtain the benefits for such behavior. Whereas in 'buy-out' they get paid first and then they behave accordingly. Moreover, the root cause of 'buy-in' behavior is not the hegemon and its policies, but selfish national interests of non-hegemonic states. So pervasive hegemony spurs more organically, while opportunist hegemony is more hegemon-made. Conversely, 'buy-out' is a consequence of a specific hegemon's policy. Thus, under pervasive hegemony non-hegemonic states are not only simply passively satisfied with the status quo or not, as Power Transition Theory would argue,[240]

1281–1303. She claims that even though the hegemon politically mismanaged the pandemic, it has strengthened its monetary leadership, which is for its hegemony more relevant, but should not be taken for granted.

[240] See DiCicco, Jonathan M., and Jack S. Levy. 1999. Power shifts and problem shifts: The evolution of the power transition research program. *Journal of Conflict Resolution*, 43(6). Pp. 675−704.

but they in fact actively reproduce the centrality of the hegemon and therefore, they also assure the endurance of a pervasive hegemony.

Moreover, it follows from the Pervasive Hegemony Theory that preferred Grand Strategy for such a hegemon is restraint. There are two rationales for this. First, when the hegemon acts only when its vital interests of maintaining the hegemony are at stake, it signals to the non-hegemonic states what these crucial interests are. Moreover, in doing so it also (re)assures non-hegemonic states to maximize their autonomy – one of the benefits of pervasive hegemony and general aspirations of each state. First you 'buy-in', then you get all else. Second, with restraint the hegemon puts the ball on the non-hegemonic court and allows the consensus on the international monetary architecture to arise organically. It gives time and the initiative to the non-hegemonic states to come to terms with hegemon's interests.[241]

A similar analysis happens with the hegemon, namely, the hegemon reaps benefits with its currency being in the center of global monetary relations – it determines rules of the IMS, which are bent in hegemon's favor. Yet, the monetary centrality in such a system also trickles-up also into the real economy, and the hegemon maintains a central position also in trade and other economic activities. The latter is not the case with other aforementioned monetary units' centrality. However, increased macro-foundations of non-hegemonic monetary power leads to diminishing benefits for the hegemon. Or the burden of procurement of the central monetary unit may become too costly for the hegemon. "The benefits of issuing an international currency are likely to decline

[241] During the Nixon Shock, one can argue that United States followed this strategy. After a change in their international monetary policy, they have exercised restrained, and waited for European partners and Japan to do their bidding first. See Odell. 1982. Pp. 5–8.

over time, while its costs are likely to increase."[242] "Historical experience suggests that the hegemon's willingness to act in a stabilizing capacity at a single point tends to undermine its continued capacity to do so over time."[243] The non-hegemonic states' strive to rise behavior derives from my assumptions and it is shared by other theories of hegemony and general International Relations theories. Where my theory differs is how the hegemon deals with the problem of rising powers.

As such, a change in the IMS rules and norms is desired by the hegemon and its leverage to do so in pervasive hegemony is its ownership of the central monetary unit in the IMS. Moreover, bending the rules in its favor and maintaining its central position has another benefit for the hegemon – seigniorage ("the difference between the face value of a currency and its production", or more broadly "gains due to the difference between the interest paid on foreign assets acquired by the issuing country and that on assets denominated in its own currency acquired by foreigners").[244] This means that balance of payments deficits are easily financed by the hegemony and hence domestic financial institutions, companies, and consumers also benefit from it.[245]

Since the non-hegemonic states desire hegemon's currency to continue to be central, the hegemon can condition that with a certain behavior or acceptance of new rules and norms of IMS. If it does not possess that it does not have the pervasive hegemony leverage, but it can use other measures that are underlined by other theories of hegemony. Namely, the hegemon conditions the

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[242] Mundell, Robert A. 1993. *EMU and the International Monetary System: A Transatlantic Perspective*. Wien: Oesterreichische Nationalbank. Pp. 17.
[243] Eichengreen. 1987. Pp. 6.
[244] Chey, Hyoung-kyu. 2012. Theories of international currencies and the future of the world monetary order. *International Studies Review*, 14(1). Pp. 51–77. At Pp. 54. See also Aliber, Robert Z. 1964. The costs and benefits of the US role as a reserve currency country. *The Quarterly Journal of Economics*, 78(3). Pp. 442–56.
[245] Chey. 2012. Pp. 55.

procurement of its currency with the non-hegemonic acceptance of the new rules and norms of monetary relations, that would also assure the hegemon greater benefits than those of the previous system. The non-hegemonic states will accept this change if the hegemon assures a continuation of the procurement of its currency also under the new IMS rules and norms. Thus, the hegemon accepts the provision of the centrality currency, as it understands that through it, it will be able to change the rules of IMS. Therefore, the hegemon displays a 'buy-in' as it assures centrality even if that might not be its immediate number one policy choice.

2.4 RESEARCH DESIGN

In conducting my empirical inquiry, I will focus on the US hegemony, as my argument is that Pervasive Hegemony Theory better explains the latter than existing theories of hegemony. It is therefore logical that the focal point of my empirical work will be the period after the Second World War, when US preeminence was apparent, and one can speak of US hegemony. However, I will also make a brief comparison with 19th century UK hegemony in order to point out the difference that the ownership of the central monetary unit (my independent variable) does and to underline the unique category of US hegemony.[246]

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[246] Still, the notion of British hegemony in 19th century is disputed by some. Calleo argues that under the gold standard United Kingdom did not in fact exercise monetary hegemony outside her own empire (Calleo, David P. 1976. The Historiography of the Interwar Period: Reconsiderations. In Rowland, Benjamin M. (ed.), *Balance of Power or Hegemony: The Interwar Monetary System*. New York: New Yok University Press. Pp. 225–60). Moreover, Waltz (1959) furthers this argument by saying that the gold standard period was a stable one, since states balanced against each another with tariff wars.

As I define hegemony as a set of rules, norms, and principles of the game that the hegemon sets for the region it dominates[247] to center the economy around it,[248] the change in IMS is the outcome I am interested in, as it embodies rules as well as economic centrality. Namely, as I assume that monetary relations are the most important part of economic interactions, and that politics and money are not independent of each other, then the architecture of an IMS – its rules and norms – become the quintessential aspect of hegemony. The hegemon needs to control the rules and norms of the IMS as well its potential change, if it can do that, it can endure.

This sets the stage for observing competing mechanisms for achieving hegemonic endurance. A change in the IMS rules and norms is normally associated with a change in the hegemony. Usually, a change in IMS would mean a breakdown of the hegemony and would reflect the end of an imbalance of power. This is the premise of existing theories of hegemony. They explain the hegemonic endurance by the capacity of the hegemon to put this change at bay. Therefore, observing a change in IMS, while a hegemony endures, is a difficult case to explain for hegemonic theories, or a least likely case for such theories.[249] Odell also observes this: "When the monetary system performs its functions effectively, it remains unnoticed by most of the inhabitants. But when the foundation begins to crumble or shake, it sends reverberations throughout the structure. The analogy is imperfect, since the monetary foundations of the world may be shifted substantially without destroying the structure, at least in principle."[250]

[247] Lobell. 2003. Pp. 8.
[248] Goldstein. 1988. Pp. 281.
[249] Bennett, Andrew, and Colin Elman. 2007. Case study methods in the international relations subfield. *Comparative Political Studies*, 40(2). Pp. 170–95; Levy, Jack S. 2008. Case studies: Types, designs, and logics of inference. *Conflict Management and Peace Science*, 25(1). Pp. 1–18; Rapport, Aaron. 2015. Hard thinking about hard and easy cases in security studies. *Security Studies*, 24(3). Pp. 431–65.
[250] Odell 1982. Pp. 5.

If existing theories of hegemony would claim that the hegemon needs to push away or postpone the change in IMS so that its hegemony can endure and would therefore also not expect the hegemony to survive such a fundamental change in IMS rules and norms, then Pervasive Hegemony Theory offers an explanation of how a hegemony may survive and embrace a change in IMS. This is the fundamentally different mechanism of enduring hegemony.

Hence, I have picked my cases (Bretton Woods IMS, and post-Bretton Woods IMS) for several reasons. First, it captures the core of my puzzle: following existing International Relations literature, we would expect that a profound monetary crisis like the one in 1971 would be the beginning of US hegemonic demise, as balancing against the United States and a push for an alternative international power architecture would emerge. But this is not what occurred. Second, the existing theories can all be observed with these two case studies, and their explanatory power compared to my theory. Third, the Nixon shock of 1971 that led to the end of Bretton Woods IMS was severe in both political and economic measures. Economic criteria for crisis are either quantitative (e.g., inflation, currency crash, currency debasement, asset price), or based on economic events (banking crisis, external or domestic default).[251] With such criteria the end of Bretton Woods would come in as third biggest crisis – after 2008, and the end of the Cold War.[252] Nevertheless, there are also political dimensions to these crises, which are not captured by the aforementioned economic criteria. Moreover, the end of the Cold War was not a crisis for the hegemon, as US hegemony actually expanded its scope. The issue with 2008 is that it does not present a difficult case: there was no change in IMS and there was no change in hegemony. Furthermore, a detailed process tracing may be impossible to conduct, as some materials (e.g.,

[251] Reinhart and Rogoff. 2009. Ch. 1.
[252] Reinhart and Rogoff. 2009. Pp. 253. As well as Ch. 16.

minutes of meetings) are still not accessible for the general public. Fourth, the two case studies allow me to clearly identify and isolate the impact of my independent variable (ownership of the central monetary unit) from its inception onwards on the change in IMS. Overall, the selected case studies represent the best heuristic opportunity to rigorously test a new theory of hegemony and reveal with some analytical clarity how its causal mechanism differs from existing theories.

In the first quantitative empirical section I will elaborate on my independent variable (ownership of the central monetary unit) which I have also outlined in the introduction. I will show how this variable is correlated with trickled-up onto the trade relations. This section will hence display a crucial difference in characteristic feature of US hegemony and other hegemonies – proxy for which I will use 19th century United Kingdom. Thus, setting up the second stage for the second empirical part – comparing different theories of hegemony.

Therefore, I will use time series and network analysis methods. There have been recent methodological developments in network analysis, where models can capture the endogenous dynamics of a network, how its properties move through time, and so enhance our inference from them.[253] Although such methods that fuse network analysis and endogenous time series – e.g., vector autoregression (VAR) – which would be ideal for my research project, they come with a cost.

[253] On a great overview of these recent developments see Desmarais, Bruce A., and Skyler J. Cranmer. 2017. Statistical inference in political networks research. In Victor, Jennifer Nicoll, Alexander H. Montgomery, and Mark Lubell (eds.), *The Oxford handbook of political networks*. Oxford: Oxford University Press. Pp. 203–19.

One of such recent developments are Temporal Exponential Random Graph Models (TERGM).[254] An "ERGM models a network as a single multivariate observation in which the components of the network depend on covariates as well as endogenous dependencies among the ties."[255] "The temporal exponential random graph model, usually called TERGM, is an extension of the ERGM designed to accommodate inter-temporal dependence in longitudinally observed networks. The extension is accomplished by incorporating parameters into an ERGM specification that reflect the ways in which previous realizations of the network determine current features of the network."[256] Yet, mathematics behind TERGM do not allow to put weights on the edges of the network, hence, I cannot use it for my model. Some studies have tackled this issue, by collapsing each year-network into one network. Yet, such an approach would not capture the temporal dynamic I am interested in.[257] Moreover, TERGM only provide inferences at the network level; but I am also interested in actor-specifies.[258]

Other possibilities would be to use relational event model (REM)[259] or the dynamic network actor model (DyNAM),[260] however they are not applicable for panel network data, which

[254] *Temporal Exponential Random Graph Models (TERGMs) for dynamic network modeling in statnet*. 2019. Accessibility: http://statnet.org/Workshops/tergm_tutorial.html (3 July 2020).
[255] Desmarais, Bruce A., and Skyler J. Cranmer. 2012a. Micro-level interpretation of exponential random graph models with application to estuary networks. *Policy Studies Journal*, 40(3). Pp. 402–34. At Pp. 403.
[256] Leifeld, Philip, Skyler J. Cranmer, and Bruce A. Desmarais. 2018. Temporal exponential random graph models with btergm: Estimation and bootstrap confidence intervals. *Journal of Statistical Software*, 83(6). Pp. At 1–36. At Pp. 2.
[257] Desmarais, Bruce A., and Skyler J. Cranmer. 2012b. Statistical inference for valued-edge networks: The generalized exponential random graph model. *PloS one*, 7(1). e30136.
[258] Desmarais and Cranmer. 2012a. Pp. 404.
[259] Butts, Carter T. 2008. A relational event framework for social action. *Sociological Methodology*, 38(1). Pp. 155–200.
[260] Stadtfeld, Christoph, and Per Block. 2017. Interactions, actors, and time: Dynamic network actor models for relational events. *Sociological Science*, 4(14). Pp. 318–52.

I have.[261] Moreover, I could also use one of the stochastic actor-based models or stochastic actor-oriented models (SABM) as they allow to extrapolate actor particularities.[262] But, SABM begins by assuming that ties in the network change one at a time.[263] This means that the change cannot happen simultaneously and sporadically, and that the process of network dynamics is broken down into infinite small sequential steps. Therefore, it is a poor model for multilateral events that have instant impact on all agents, and an agreement on IMS is such a multilateral event. Lastly, there are network autoregressive (integrated) moving average (NARIMA) models, which treat the network as a multivariate time series and so they are set to transform the complex data into simpler time series for data analysis (dimension reduction) with lifting schemes (i.e., simulating node removal).[264] Due to this characteristic, this group of methods takes away the essence I am interested in – network position.

As such, I have opted for a third way, and conduct my analysis in two steps – applying network analysis and time series in each, respectively. First, for each year of my observation, I will construct a network and calculate weighted degree centrality for each node. I will be interested in the scores for United States and other great powers. Then, I will treat these scores as time series and plot them to look at their dynamic over time. Is centrality of United States rising, diminishing, or is it stationary? The latter means that for each time series, the mean and variance do not change

[261] See Leifeld, Philip, and Skyler J. Cranmer. 2019. A theoretical and empirical comparison of the temporal exponential random graph model and the stochastic actor-oriented model. *Network Science*, 7(1). Pp. 20–51. At Pp. 21–2.
[262] See Desmarais, and Cranmer. 2012a; Leifeld, and Cranmer. 2019.
[263] Desmarais, and Cranmer. 2012a. Pp. 408.
[264] Knight, Marina, Matt Nunes, and Guy Nason. 2016. *Modelling, detrending and decorrelation of network time series*. arXiv preprint arXiv:1603.03221. Accessibility: https://arxiv.org/pdf/1603.03221.pdf (7 July 2020).

through time.[265] To test this I will use several unit root tests – Dickey-Fuller, Phillips-Perron, and modified Dickey-Fuller.[266]

The second empirical section will be a qualitative process tracing of two case studies. First, the Bretton Woods IMS and the post-Bretton Woods IMS. The two IMS are delineated with the Nixon shock in 1971. The primary focus in examination of the 1971 crisis will be monetary politics of different great powers– United States, France, Germany, United Kingdom, and Japan.

In process tracing the change of the IMS, I will be interested in causal 'smoking gun' evidence.[267] Namely, I will compare the overlap of the expectations of the five different causal mechanisms regarding the change in IMS with the historical record. As such, I will use disciplined configurative approach to case study research.[268] "The disciplined interpretive case study interprets or explains an event by applying a known theory to the new terrain. /…/ Although this method may not test a theory, the case study shows that one or more known theories can be extended to account for a new event."[269] Thus, I am not testing these theories, I am only determining their explanatory power when it comes to a particular case – US hegemony. Such a method has been used in IPE as well as on the 1971 crisis before, although with different objective and hence different theories in mind.[270] To control for my potential bias regarding the strength of a particular fact and theory, I will make three efforts.

[265] See Box-Steffensmeier, Freeman, Hitt and Pevehouse. 2014. Pp. 125.
[266] See Zivot, Eric, and Jiahui Wang. 2007. *Modeling financial time series with S-Plus®*. New York: Springer. Ch. 4.
[267] Collier, David. 2011. Understanding process tracing. *PS: Political Science & Politics*, 44(4). Pp. 823−30.
[268] Verba, Sidney. 1967. Some Dilemmas in Comparative Research. *World Politics*, 20(1). Pp. 111–27.
[269] Odell, John S. 2001. Case study methods in international political economy. *International Studies Perspectives*, 2(2). Pp. 161–76. At Pp. 163.
[270] E.g., Odell (1982, Ch 2) speaks of five alternative perspectives for explaining foreign economic policy shifts: security and power, international market, domestic politics, internal organizational structure of the government, and

First, I will use three different measures to assess the explanatory power of different theories. Namely, I will break down the two case studies into two separate components (Bretton Woods IMS creation, Functioning of the Bretton Woods IMS, 1971 Nixon Shock, and Creation of the post-Bretton Woods IMS), respectively. This will generate four sections or outcomes, in which theories will compete against. I will measure their performance with a simple affirmative or negative score, indicating if they can explain that particular section or not. Furthermore, I will then rank the quality of those explanations, and finally, I will look at these scores separately for the two case studies and in an alternative reductive timeframe (omitting the first section). Second, I will be intentionally biased against my Pervasive Hegemony Theory in that when in doubt of ranking or assessing its performance, I will preference skepticism. Finally, I will use counterfactual mental experiments, questions, and statements during the course of my case studies.[271] This will enable me to better assess the quality and the power of a particular explanation.

So, what will I be looking for when it comes to particular theories? Coercive Hegemony would seek instances of United States threatening or even actually using force to align non-hegemonic states into a new post-Bretton Woods system. Alternatively, proof for Cooperative Hegemony at work would be that the International Monetary Fund (IMF) would facilitate an agreement on the new monetary relations. If pro-American sentiment would be on the rise in the crisis period and if the non-hegemonic states would echo the ideology and positions of the United

cognitive perspective. However, none of them meets the more rigorous definitions of 'theory', they are more akin to 'research programs'. But each provides a set of questions, hypotheses, and expectations that can guide one's research.

[271] On counterfactuals see, Fearon, James D. 1991. Counterfactuals and hypothesis testing in political science. *World Politics* 43(2). Pp. 169–95; Tetlock, Philip E., and Aaron Belkin (eds.). 1996. *Counterfactual thought experiments in world politics: Logical, methodological, and psychological perspectives*. Princeton: Princeton University Press; Levy, Jack S. 2015. Counterfactuals, causal inference, and historical analysis. *Security Studies*, 24(3). Pp. 378–402.

States, then this would be a confirmation of Cultural Hegemony. A fourth group of evidence – Opportunist Hegemony – would seek new commitments for producing and providing public goods by the United States arising in times of crisis. Lastly, for Pervasive Hegemony I will need to find evidence of hegemonic conditioning the provision of its central monetary unit with non-hegemonic acceptance of new IMS rules and norms; and conversely non-hegemonic desire for US dollars to overshadow other interests.

By comparing different theories and presenting a new theory of hegemony enables us to look at the past in different way and consequently better understand our history.[272] This subsequently leads to better awareness of the contemporary and better foresight of future challenges. I now turn to the empirical part of this dissertation, where the following chapter will quantitively assess the centrality of the US dollar in global finance.

[272] Trachtenberg, Mark. 2006. *The Craft of International History: A Guide to Method*. Princeton: Princeton University Press. Ch. 2.

3. US ECONOMIC CENTRALITY AND OWNERSHIP OF THE CENTRAL MONETARY UNIT

> "Operation Twist: while it reinforced foreigners' desire to hold dollars at short term, it also increased their desire to borrow them at long term. /…/ By pegging long-term interest rates, the American authorities were inducing New York financial institutions to become short-term borrowers and long-term lenders. This was indeed a traditional pattern for the centre of the international credit system.[273]"

Recalling the introduction, I have established a contemporary centrality of the US dollar in global financial and monetary affairs using two measures – international reserves and the amount of transactions made in US dollars, as well as the shrinking power gap between the United States and China. This finding personifies my puzzle: When rising states decrease the power gap in comparison to the hegemon, one would expect that this would be reflected in their central position in the global monetary politics. However, this is not the case when it comes to the US hegemony.

Furthermore, Figure 8: International Reserves – Relative Amount, goes all the way back to 1947 and can hence also present a dynamic of centrality of US dollar as a reserve currency. We can observe when this centrality emerged. Moreover, looking at alternative measures[274] of the same variable – international monetary reserves (Figure 22)[275] – as a robustness check, we reach the same conclusion as with Figure 8.[276]

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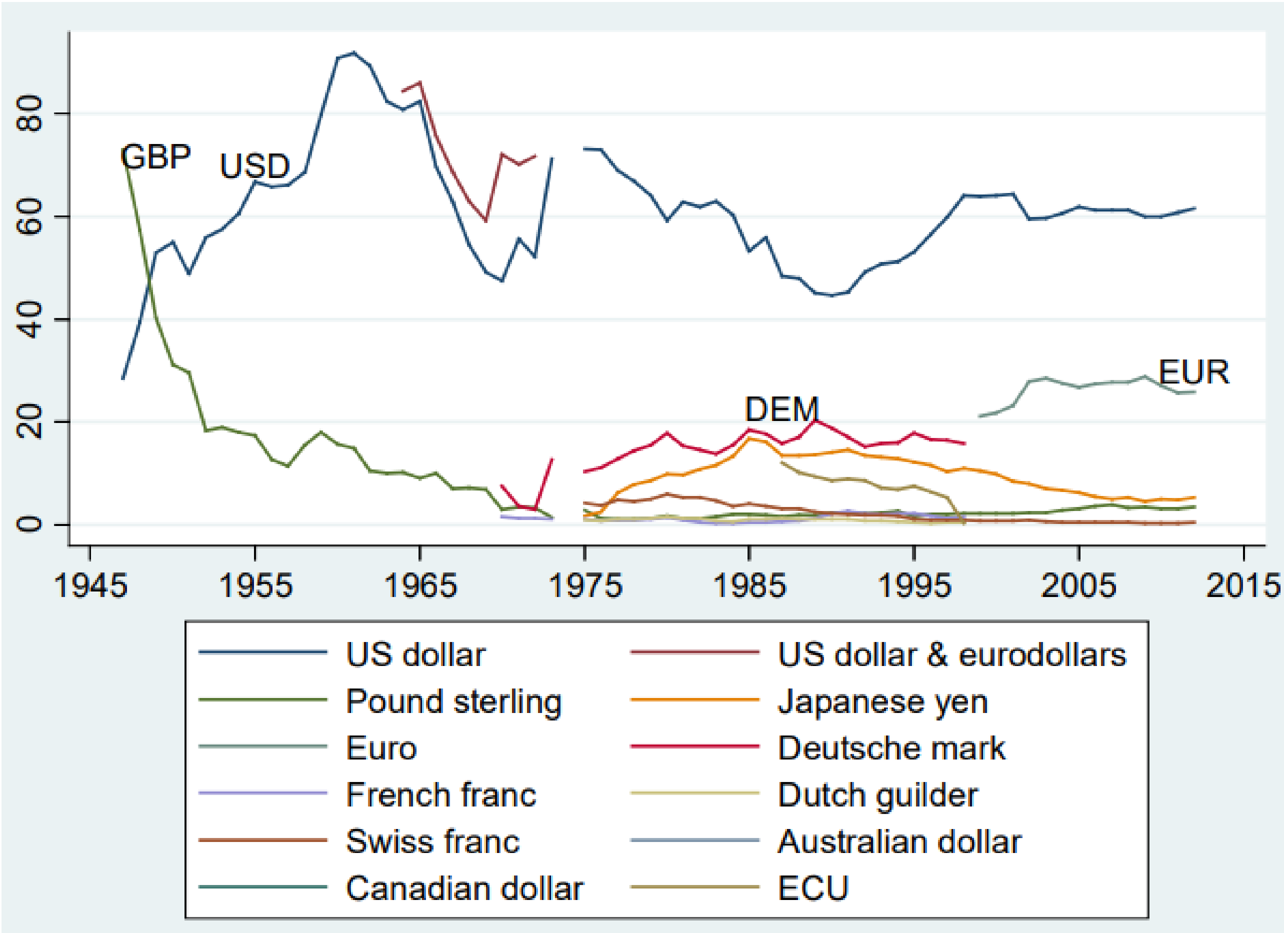
[273] De Cecco, Marcello. 1976. International financial markets and US domestic policy since 1945. *International Affairs*, 52(3). Pp. 381–99. At Pp. 392.
[274] Figure 22 is based on constant exchange rates.
[275] Eichengreen, Chiţu, and Mehl. 2014. Pp. 26.
[276] See Appendix 2 for details regarding the unit root tests. The results are similar than with Figure 8, only the statistical significance is slightly lower (e.g., not at 1% level, but at 5% level). Still, we can confirm that the time series is stationary.

Figure 22: International Reserves – at Constant Exchange Rates

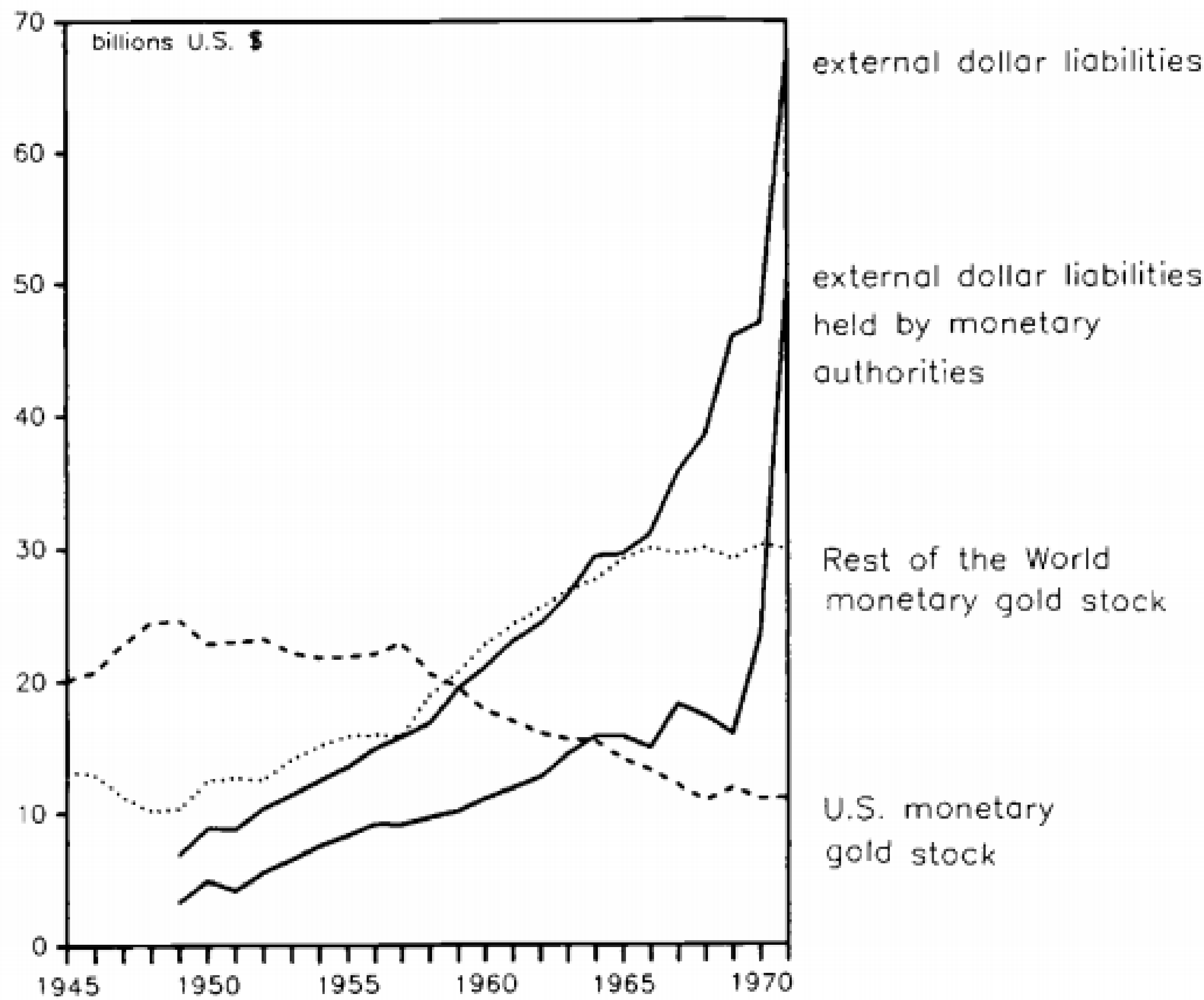


As said establishing the timing of US dollar centrality in global reserves, depends on these different measures. Hence, looking at Figure 22 and Figure 8 this can be either 1950 or 1955. Yet, regardless of the exact date, the story is again the same: a rapid decline of the British Pound and rise of the US dollar. Hence, this indicates a maturity period of establishing centrality of the US dollar, which I have mentioned in the theory section. Nevertheless, since the Bretton Woods system was a gold exchange standard, we need to also look at the relationship between the US dollar and gold. This is done in Figure 23.[277] The latter shows that US took over as the main reserve

[277] Bordo. 1993. Pp. 39.

unit in the late 1960s. Therefore, we can only speak of US ownership of the central monetary unit in Bretton Woods IMS after 1969 (see exponential growth of the external dollar liabilities held by monetary authorities on Figure 23). Therefore, the maturity period of US pervasive hegemony lasted from 1945 through 1969. This is necessary for the second half of my empirics – looking at the change in IMS under the framework of hegemonic ownership of the central monetary unit.

Figure 23: US dollar and Gold as Global Reserves from 1945 through 1971



The second variable by which I measure centrality – amount of transactions – presents itself with a data challenge. As I have already displayed in the introduction the contemporary time span of this variable is tri-annual from 1989. Although, there is some scattered and partial data about the years prior to that available, it is not enough to create a time series variable. Thus, I have decided to use proxy measures. Two come to mind – international trade and foreign direct investments (FDI). I have decided to opt for the former for two reasons.

First, as shown on Figure 24[278] international trade presents a much higher share of global GDP than global FDI. Although one might not be surprised by this, one is astonished by the gap between the two. Namely, since 1980s multinational corporations grew vastly in numbers on the global stage, and consequently in 1990s the absolute number of FDI increased dramatically due to liberalization of the investment criteria, increase in gross savings, rise of bilateral investment treaties, and opening up domestic markets of many countries.[279] However, international trade still presents around 50% of global GDP, and FDIs are below 10%. This does not come without a great share variance, for example United States trade exposure is 26%, while China's is 40%.[280]

Second, FDI data is highly problematic. One reason is that there is no common definition what classifies as an FDI and so states' reports are difficult to compare. Furthermore, this also allows states to manipulate those numbers as well as their origin to suit their public diplomacy objectives.[281] Moreover, dyadic FDI data is scares. The United Nations Conference on Trade and

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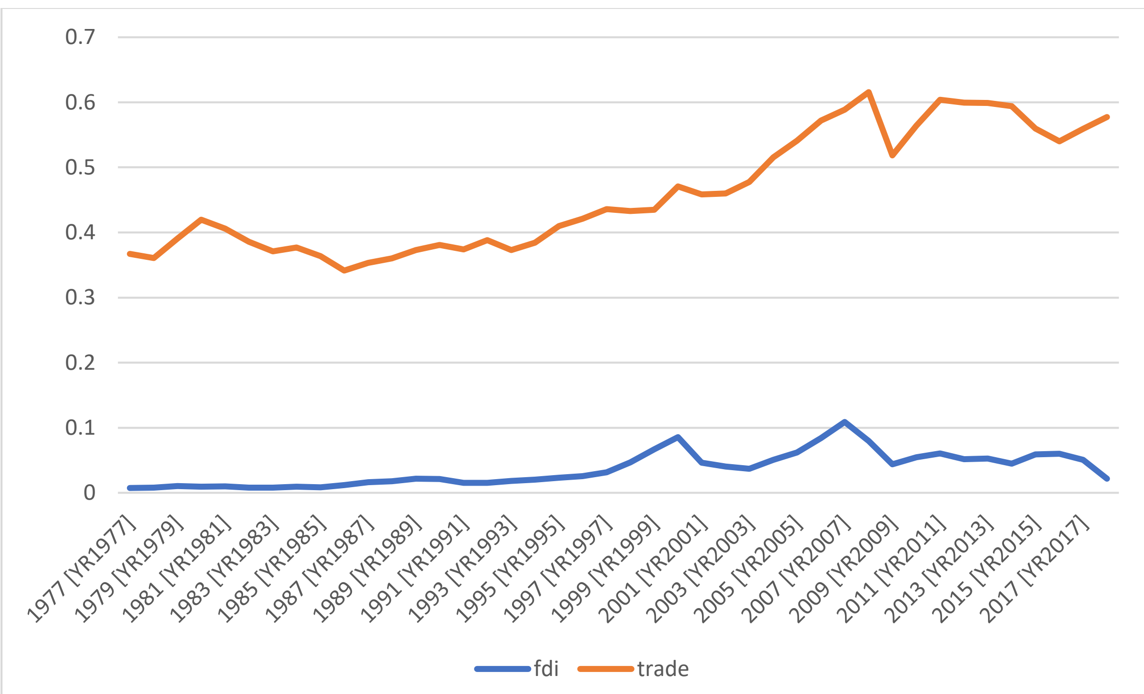
[278] Data from World Bank data base: *The World Bank Data*. 2020. Accessibility: https://data.worldbank.org/ (10 July 2020).
[279] Kenwood, Albert George, and Alan Leslie Lougheed. 1999. *The Growth of the International Economy 1820-2000*. London: Routledge. Pp. 254.
[280] *The World Bank Data*. 2020.
[281] See Amighini, Alessia, Claudio Cozza, Roberta Rabellotti, and Marco Sanfilippo. 2014. Investigating Chinese outward foreign direct investments: How can firm-level data help?. *China & World Economy*, 22(6). Pp. 44–63.

Development (UNCTAD) led an ambitious project of presenting dyadic bilateral FDI, which is appropriate for network analysis and centrality calculation.[282] Yet, the project has stalled. Therefore, their data is severely undernourished – it spreads only for about a decade, and the number of states with relatively good scope of data is stunningly small. Thus, the dataset is not appropriate for my analysis. Another possibility would be OECD data, but longitudinal spread of this dataset is even shorter.[283] Finally, there is IMF Coordinated Direct Investment Survey, which suffers from the same vices as the previous two databases.[284] Nevertheless, in the Appendix 5 I use the latter to show the dynamic of US and China FDI trends.

Figure 24: Share of Global Trade and Global FDI of Global GDP



[282] UNCTAD. 2018. *Bilateral FDI Statistics*. Accessibility: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx (18 August 2018).
[283] OECD. 2020b *FDI income payments by partner country*. Accessibility: https://data.oecd.org/fdi/fdi-income-payments-by-partner-country.htm#indicator-chart (10 July 2020).
[284] International Monetary Fund. 2021a. *Coordinated Direct Investment Survey*. Accessibility: https://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5 (20 April 2021). In fact, this database even has a special code 'C', indicating that this is a severe issue, for data that was suppressed by the reporting economy.

This situation is in stark contrast with availability of trade data, where several datasets offer dyadic trade data for substantive period of time. Namely, the Correlates of War (COW) Trade database,[285] IMF Direction of Trade Statistics (DOTS),[286] World Integrated Trade Solutions (WITS),[287] and Gleditsch dataset.[288] Nevertheless, these datasets have several deficiencies of their own, and require substantive polishing before one can use them in a network analysis. For example, there are not few but several examples in all four datasets where bilateral trade of state A and B is higher than global trade of state A or B. Yet, this is theoretically impossible.

Figure 25 shows the number of countries included in a particular dataset through time. However, in order to have more reliable results, I need to apply several polishing criteria. Figure 26 presents the diminishing scope of all four datasets when simple polishing criteria are applied: bilateral exports as share of total exports of a country in a dyad cannot be higher than 1, bilateral imports as share of total imports of a country in a dyad cannot be higher than 1, bilateral imports cannot be 0 and bilateral exports cannot be 0.[289]

Thus, I have calculated weighted degree centrality for each network in each year in each dataset for each country. Here I will focus on and show the results of the COW dataset, others are

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[285] Barbieri, Keshk, and Pollins. 2009.
[286] *Direction of Trade Statistics (DOTS)*. 2020. Accessibility: https://data.imf.org/?sk=9D6028D4-F14A-464C-A2F2-59B2CD424B85 (10 July 2020).
[287] *World Integrated Trade Solutions (WITS)*. 2020. https://wits.worldbank.org/Default.aspx?lang=en (10 July 2020).
[288] Gleditsch, Kristian Skrede. 2002. Expanded trade and GDP data. *Journal of Conflict Resolution*, 46(5). Pp. 712–24.
[289] Although I have my empirical reservations regarding '0' values in that I do not think they are accurate, I treat these values methodologically the same as NA values for a different reason. Namely, I need a balanced network to perform my analysis, and so each dyad needs a value.

available in Appendix 3. I have chosen to do so because the results of different databases are ultimately the same – United States maintains dominance in network centrality, although its absolute trade advantage over China is disappearing. Also, I can only use the COW dataset to look at the same dynamics during the Gold Standard IMS and compare US hegemony with UK hegemony.

Figure 25: Number of Countries Included in a Particular Bilateral Trade Dataset

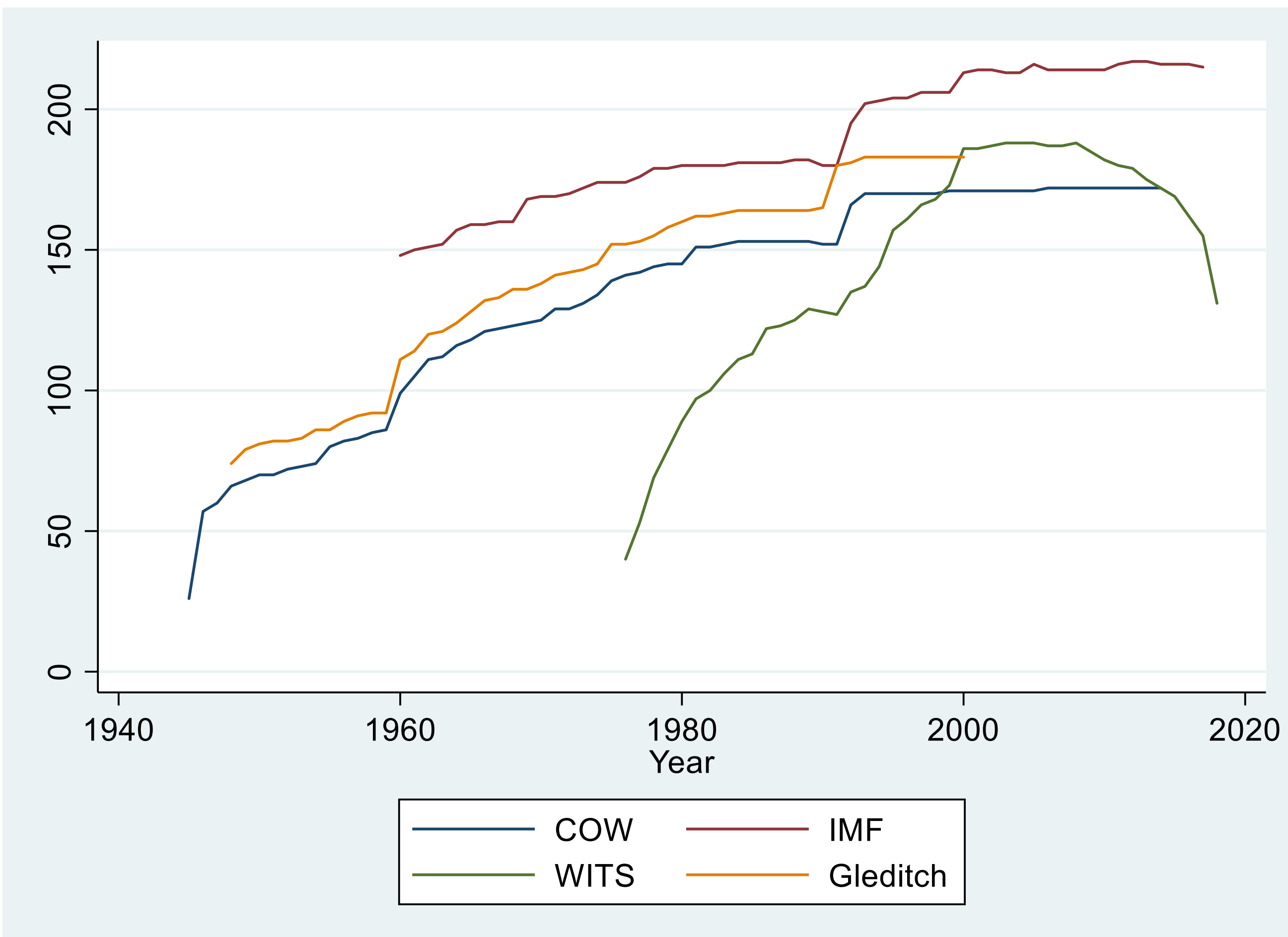


Figure 26: Amount of Data in a Particular Bilateral Trade Dataset after Sequential Application of Polishing Criteria[290]

		Gleditsch Dataset			
		Individual Application of Criteria		Sequential Application of Criteria	
		frequency	*%*	*frequency*	*%*
1948-1971	Initial full data	151823	100.0	151823	100.0
	After merging 1	151823	100.0	151823	100.0
	Afret merging 2	151823	100.0	151823	100.0
	1. criteria	146275	96.3	146275	96.3
	2. criteria	151410	99.7	146220	96.3
	3. criteria	151181	99.6	145617	95.9
	4. criteria	148525	97.8	142938	94.1
	5. criteria	63827	42.0	63226	41.6
	6. criteria	63514	41.8	53394	35.2
1972-1990	Initial full data	249359	100.0	249359	100.0
	After merging 1	249359	100.0	249359	100.0
	Afret merging 2	249359	100.0	249359	100.0
	1. criteria	245166	98.3	245166	98.3
	2. criteria	249302	100.0	245114	98.3
	3. criteria	247254	99.2	243030	97.5
	4. criteria	245625	98.5	241321	96.8
	5. criteria	118003	47.3	117401	47.1
	6. criteria	117302	47.0	101068	40.5
1991-2000	Initial full data	178047	100.0	178047	100.0
	After merging 1	178047	100.0	178047	100.0
	Afret merging 2	178047	100.0	178047	100.0
	1. criteria	176959	99.4	176959	99.4
	2. criteria	177990	100.0	176926	99.4
	3. criteria	172944	97.1	171867	96.5
	4. criteria	172473	96.9	171360	96.2
	5. criteria	91948	51.6	91621	51.5
	6. criteria	91489	51.4	86236	48.4

[290] Details about the six criteria related to each dataset separately are available in the Appendix 3.

		BILATERAL TRADE DATA SETS											
		Correlates of War				International Monetary Fund				UN COMTRADE			
		Individual Application of Criteria		Sequential Application of Criteria		Individual Application of Criteria		Sequential Application of Criteria		Individual Application of Criteria		Sequential Application of Criteria	
		frequency	*%*	*frequency*	*%*	*frequency*	*%*	*frequency*	*%*	*frequency*	*%*	*frequency*	*%*
1945-1971	Initial full data	139337	100.0	139337	100.0	860148*	100.0	860148*	100.0				
	After merging 1	139337	100.0	139337	100.0	860148	100.0	860148	100.0				
	Afret merging 2	139337	100.0	139337	100.0	860148	100.0	860148	100.0				
	1. criteria	132371	95.0	132371	95.0	100319	11.7	100319	11.7				
	2. criteria	137478	98.7	132344	95.0	90244	10.5	57813	6.7				
	3. criteria	134234	96.3	127572	91.6	102291	11.9	57537	6.7				
	4. criteria	122609	88.0	116700	83.8	91449	10.6	57182	6.6				
	5. criteria	55131	39.6	52424	37.6	102690	11.9	57182	6.6				
	6. criteria	55802	40.0	43706	31.4	92224	10.7	57182	6.6				
1972-1990	Initial full data	228342	100.0	228342	100.0	1361901	100.0	1361901	100.0	154870**	100.0	154870**	100.0
	After merging 1	228306	99.98	228306	99.98	1361901	100.0	1361901	100.0	154870	100.0	154870	100.0
	Afret merging 2	228178	99.9	228178	99.9	1361901	100.0	1361901	100.0	85653	55.3	85653	55.3
	1. criteria	215145	94.2	215145	94.2	279764	20.5	279764	20.5	78453	50.7	78453	50.7
	2. criteria	223673	98.0	215118	94.2	249843	18.3	159470	11.7	69117	44.6	61917	40.0
	3. criteria	222835	97.6	210078	92.0	282003	20.7	158508	11.6	77397	50.0	61050	39.4
	4. criteria	207042	90.7	195160	85.5	251386	18.5	157770	11.6	68528	44.2	60633	39.2
	5. criteria	107721	47.2	101517	44.5	283778	20.8	157770	11.6	78453	50.7	60663	38.7
	6. criteria	106481	46.6	83449	36.5	253468	18.6	157770	11.6	68387	44.2	60003	38.7
1991-2008	Initial full data	319392	100.0	319392	100.0	1290222	100.0	1290222	100.0	409015	100.0	409015	100.0
	After merging 1	317829	99.5	317829	99.5	1290222	100.0	1290222	100.0	409015	100.0	409015	100.0
	Afret merging 2	315449	98.8	315449	98.8	1290222	100.0	1290222	100.0	320551	78.4	320551	78.4
	1. criteria	290734	91.0	290734	91.0	491166	38.1	491166	38.1	297843	72.8	297843	72.8
	2. criteria	299801	93.9	290694	91.0	442807	34.3	296727	23.0	258124	63.1	235416	57.6
	3. criteria	295469	92.5	272377	85.3	494442	38.3	295085	22.9	294275	71.9	232785	56.9
	4. criteria	277736	87.0	255936	80.1	445668	34.5	294161	22.8	255687	62.5	230924	56.5
	5. criteria	174249	54.6	163350	51.1	497010	38.5	294161	22.8	297625	72.8	230920	56.5
	6. criteria	169685	53.1	141066	44.2	448582	34.8	294161	22.8	253316	61.9	227039	55.5
2009-2014	Initial full data	113102	100.0	113102	100.0	645111***	100.0	645111***	100.0	284972****	100.0	284972****	100.0
	After merging 1	106525	94.2	106525	94.2	645111	100.0	645111	100.0	284972	100.0	284972	100.0
	Afret merging 2	98103	86.7	98103	86.7	645111	100.0	645111	100.0	219218	76.9	219218	76.9
	1. criteria	95081	84.1	95081	84.1	324639	50.3	324639	50.3	208316	73.1	208316	73.1
	2. criteria	97860	86.5	95068	84.1	288566	44.7	199626	30.9	179851	63.1	168949	59.3
	3. criteria	97954	86.6	94922	83.9	326132	50.6	198734	30.8	207154	72.7	168054	59.0
	4. criteria	91023	80.5	88208	78.0	289023	44.8	197969	30.7	178613	62.7	167019	58.6
	3. criteria	66442	58.7	62445	55.2	327502	50.8	197969	30.7	207963	73.0	166984	58.6
	4. criteria	65620	58.0	55296	48.9	290943	45.1	197969	30.7	176886	62.1	164598	57.8

* from 1960 to 1971; Bilateral trade data is available from 1948, but the overall trade data that we need to perform our network analysis is available only from 1960. The initial number of data points from 1948 would hence be 1720296.

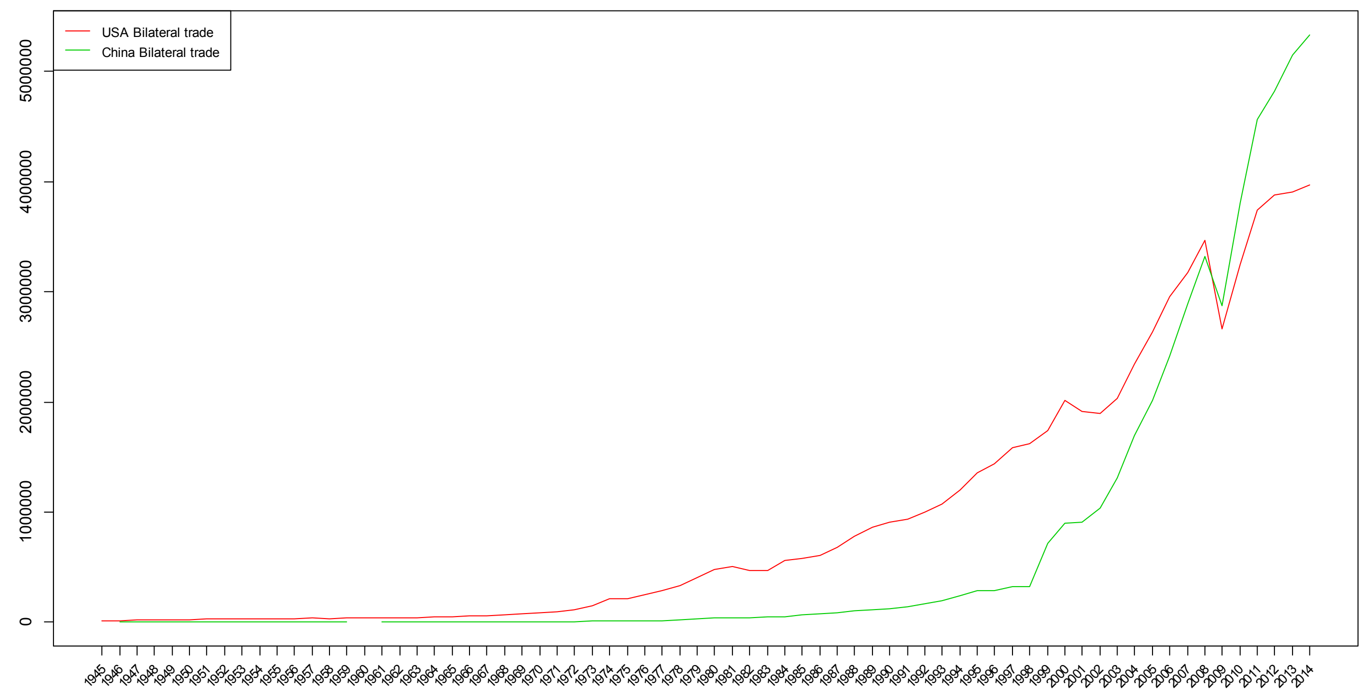
** from 1976

*** through 2017

**** through 2018

In order to further my claim about uniqueness of US hegemony, let us look first at the augmented trade data for the United States and China – see Figure 27.[291] It displays a dynamic that together with other indicators mentioned in the introduction (e.g., CINC scores, GDP PPP) drives existing theories of hegemony to claim that US capacities are shrinking. Thus, their expectation is that also US hegemony will demise.

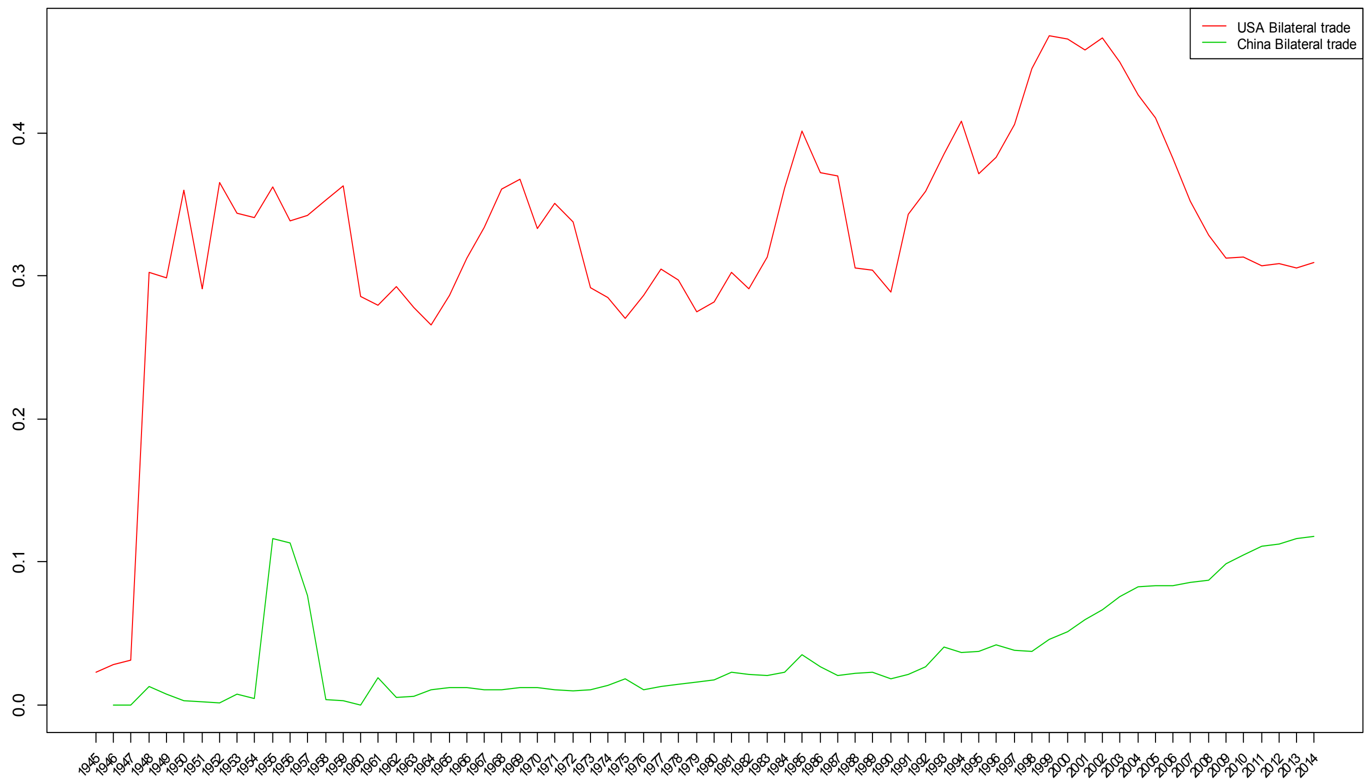
Figure 27: Absolute Trade of United States and China



However, when one looks at the same data from a network perspective – see Figure 28 – one gets a different picture. Namely, the graphs portray weighted degree network centrality for the United States and China, and there is no diminishing centrality that one would expect based on the previous graph.

[291] Data from Barbieri, Keshk, and Pollins. 2009.

Figure 28: Weighted Degree Network Centrality for United States and China[292]



Moreover, unit root tests confirm that this time series is stationary, so it does not have a (downward) trend – See Figures 29, 30, and 31.[293]

[292] Data from Barbieri, Keshk, and Pollins. 2009.
[293] Two out of three such tests confirm this at 1% level, while the third test is close to being significant at 10% level.

Figure 29: Dicky-Fuller Test for US Global Trade Weighted Degree Centrality

Dickey-Fuller test for unit root Number of obs = 69

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-4.140	-3.553	-2.915	-2.592

MacKinnon approximate p-value for Z(t) = 0.0008

Figure 30: Phillips-Perron Test for US Global Trade Weighted Degree Centrality

Phillips-Perron test for unit root Number of obs = 69
Newey-West lags = 3

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-15.664	-19.242	-13.452	-10.814
Z(t)	-4.148	-3.553	-2.915	-2.592

MacKinnon approximate p-value for Z(t) = 0.0008

Figure 31: Modified Dickey–Fuller Test for US Global Trade Weighted Degree Centrality

```
DF-GLS for usa                                        Number of obs =    59
Maxlag = 10 chosen by Schwert criterion
```

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
10	-1.858	-3.694	-2.749	-2.472
9	-1.883	-3.694	-2.796	-2.518
8	-1.493	-3.694	-2.843	-2.564
7	-2.018	-3.694	-2.889	-2.609
6	-1.910	-3.694	-2.935	-2.652
5	-1.929	-3.694	-2.979	-2.693
4	-2.001	-3.694	-3.020	-2.732
3	-2.080	-3.694	-3.058	-2.767
2	-2.118	-3.694	-3.093	-2.798
1	-2.052	-3.694	-3.122	-2.825

```
Opt Lag (Ng-Perron seq t) =  9 with RMSE  .0223212
Min SC   = -7.307883 at lag  1 with RMSE  .0241601
Min MAIC = -7.251976 at lag  1 with RMSE  .0241601
```

Looking at the Figure 28 again, one also notices the increase in Chinese centrality towards the end of the series. Therefore, one could conclude that China will eventually overtake the United States. Nevertheless, when we perform the Granger causality test, we get a different view of the data. Namely, this test tells us, if one series anticipates another. In other words, is Chinese rise a consequence of US decline, or is Chinese rise generating US decline? In fact, both series are independent of one another. Therefore, neither anticipates the movement of the other, and so Chinese rise cannot be linked in any way with the recent downward variation of US centrality. Moreover, when we include a dummy variable for Chinese membership in the World Trade Organization (WTO), it becomes clear that it is the latter that generates the rise of Chinese weighted degree centrality, while it is insignificant for the US centrality.[294] These results bear important policy implications, where dismantling the free trade agreements where China is a part of would result in Chinese decrease in global trade network centrality.

Performing this test, I had to first determine the lag order of the two series in a vector autoregression model, using VARSOC operation. Figure 32 shows the result, where lag of 2 and 4 are significant.[295] Moreover, Figure 33 shows results of the Granger causality test.

Figure 32: VARSOC for United States and China Trade Centrality

```
Selection-order criteria
Sample:  1950 - 2014                         Number of obs      =        65
```

lag	LL	LR	df	p	FPE	AIC	HQIC	SBIC
0	223.914				3.7e-06	-6.82812	-6.80172	-6.76122
1	312.578	177.33	4	0.000	2.7e-07	-9.43315	-9.35396*	-9.23244*
2	314.117	3.0787	4	0.545	3.0e-07	-9.35744	-9.22545	-9.02292
3	319.941	11.649	4	0.020	2.8e-07	-9.41357	-9.22879	-8.94525
4	329.51	19.138*	4	0.001	2.4e-07*	-9.58493*	-9.34735	-8.9828

```
Endogenous:  usa chn
 Exogenous:  _cons
```

[294] Results of this test are available in Appendix 3.
[295] Since VARSOC operation is very sensitive to lag selection, I have run a robustness check and allow it to perform an analysis for maximum of 10 lags. The results are reported in Appendix 3 and show that in that case lag selection is 9; still the Granger causality test is not impacted – the series remain independent also in that case.

Figure 33: Granger Causality Test for United States and China Trade Centrality

Granger causality Wald tests

Equation	Excluded	chi2	df	Prob > chi2
usa	chn	3.778	2	0.151
usa	ALL	3.778	2	0.151
chn	usa	2.8435	2	0.241
chn	ALL	2.8435	2	0.241

If we take a closer look at the period from 1945 until the Nixon shock in 1971, we see that the US relative advantage in aggregate trade was stable (Figure 34)[296]; however, its network weighted degree centrality became dominant from 1950s and was steadily increasing until 1971 (Figure 35).[297]

As such, these proxy measures lead me to conclude that the US dollar was the main currency in which transactions were conducted before 1971, and so the hegemonic ownership of the central monetary unit was established before the change in IMS. However, this centrality was established gradually. Through a maturity period from 1945 through 1969. Such a time frame corroborates the conclusions deriving from the reserve currency measure of US dollar network centrality. Hence, the US dollar was established as central monetary unit during the Bretton Woods IMS. I claim that this was the maturity period of US pervasive hegemony, which reached its full fruition after the Nixon shock in 1971 and the creation of the post-Bretton Woods IMS.

[296] Data from Barbieri, Keshk, and Pollins. 2009.
[297] Data from Barbieri, Keshk, and Pollins. 2009.

Figure 34: Aggregate Trade from 1945 through 1971

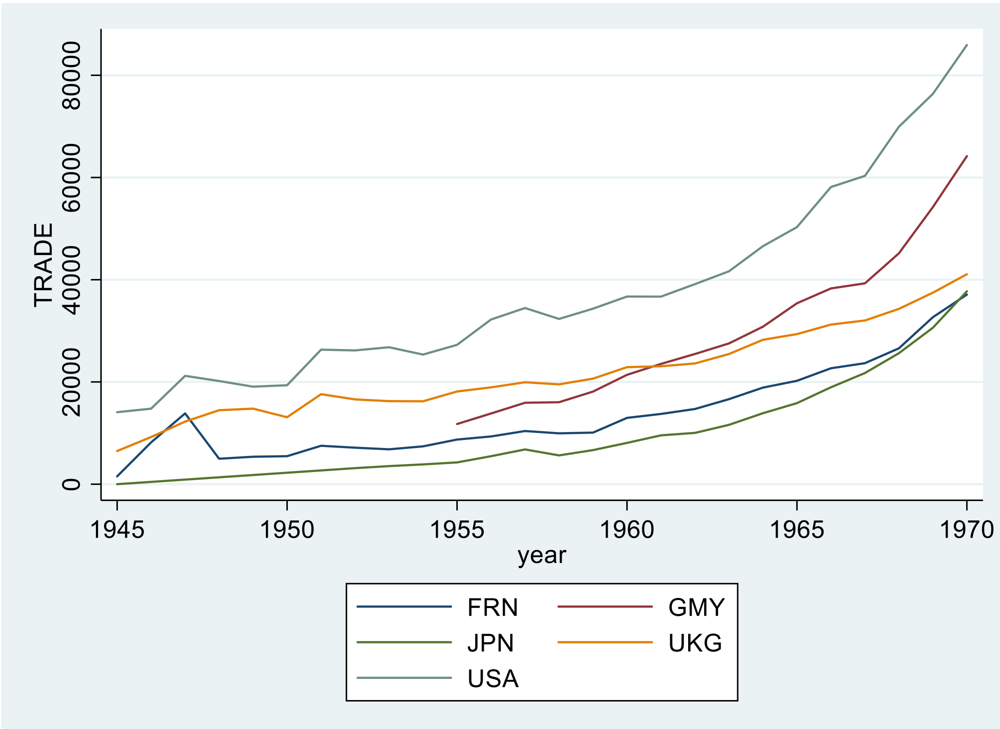
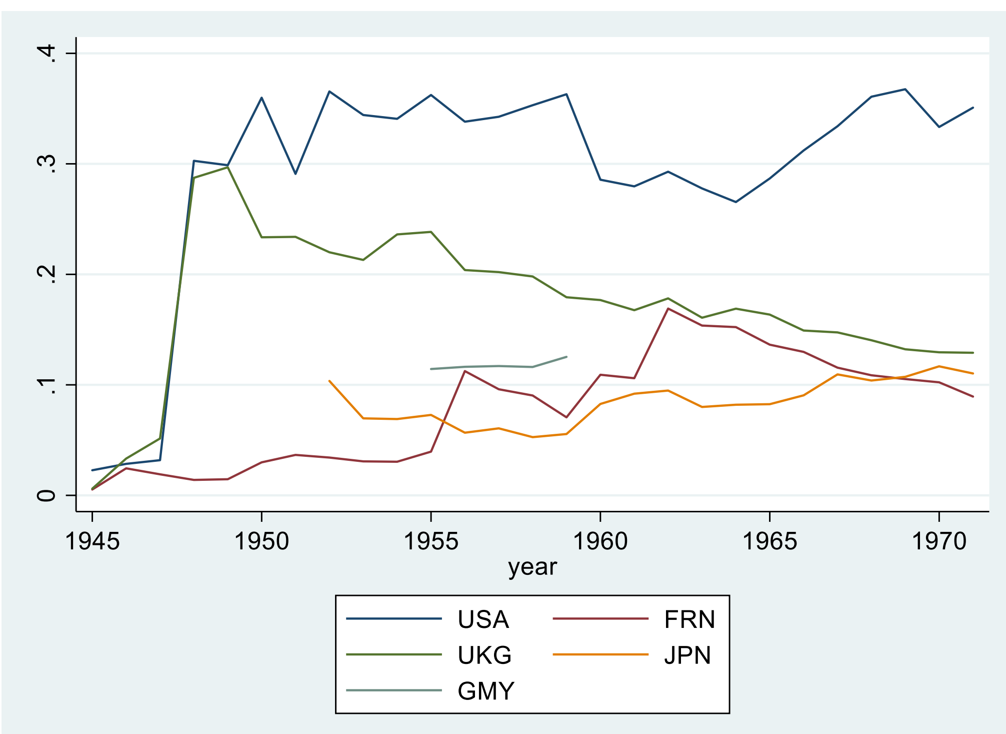


Figure 35: Weighted Degree Centrality in Global Trade Network from 1945 through 1971



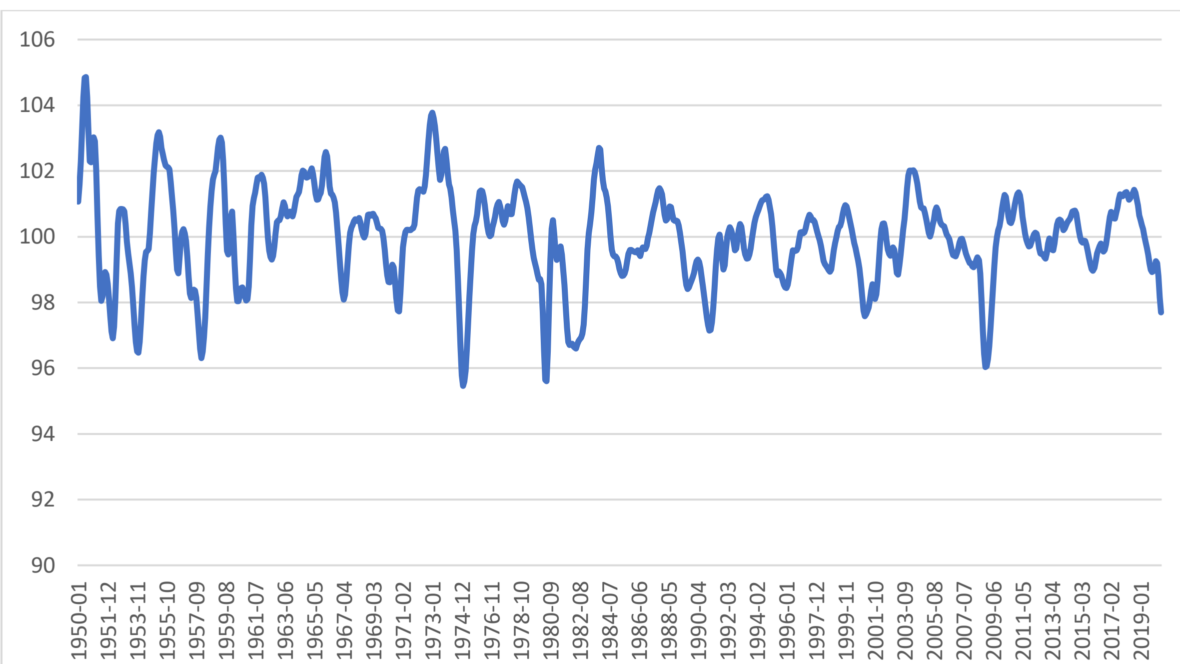
If the liquidity role of the US dollar has been steadily enhanced from 1945, can we say anything about the confidence that economic actors had in US dollar in this period? There are two proxy measures again that we can apply here – Business Confidence Index (BCI) and Consumer Confidence Index (CCI).[298] Both are available in the OECD database.[299]

The "business confidence indicator provides information on future developments, based upon opinion surveys on developments in production, orders and stocks of finished goods in the industry sector. It can be used to monitor output growth and anticipate turning points in economic activity. Numbers above 100 suggest an increased confidence in near future business performance, and numbers below 100 indicate pessimism towards future performance.[300]" The "consumer confidence indicator provides an indication of future developments of households' consumption and saving, based upon answers regarding their expected financial situation, their sentiment about the general economic situation, unemployment, and capability of savings. An indicator above 100 signals a boost in the consumers' confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to spend money on major purchases in the next 12 months. Values below 100 indicate a pessimistic attitude towards future developments in the economy, possibly resulting in a tendency to save more and consume less.[301]"

[298] There are also other proxy measures that one could use, which are available in the Appendix 6. However, BCI and CCI both directly measure economic confidence in particular states and subsequently one can make calculate a global average which is the case in the data bellow. The data in Appendix 6 on the other hand, more or less uses event data or other measures to determine an economic sentiment. As such, BCI and CCI are ontologically closer to the measure one desires here.
[299] OECD. 2020a.
[300] OECD. 2020a.
[301] OECD. 2020a.

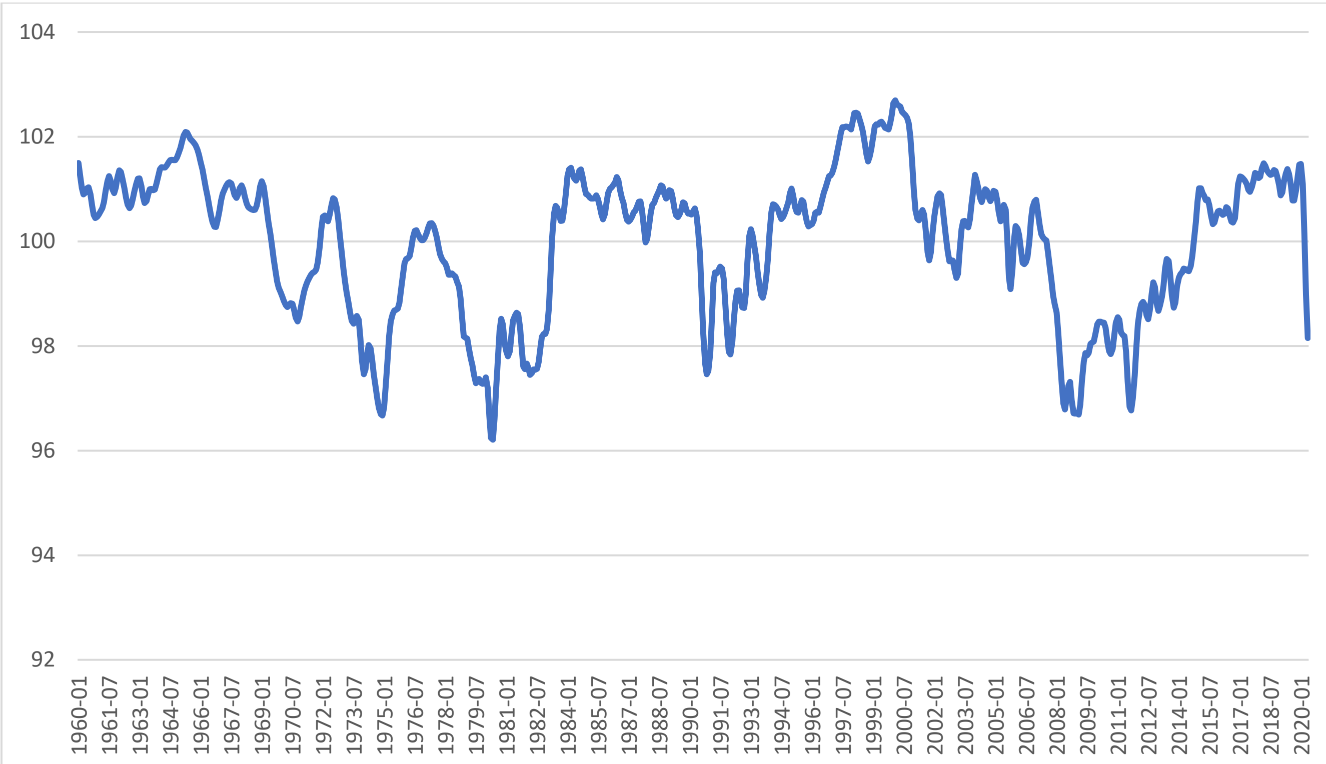
Unfortunately, the number of states included before 1974 in both databases is quite low. Furthermore, for those few the data is available from 1950 for BCI and 1960 for CCI, respectively. The particularity of these two measures (100 as a base line), which indicate either optimism or pessimism actors have about the future economic stance, requires several different approaches to facilitate inference from it. Namely, these variables do not directly measure confidence or contempt with the US dollar, but the vision of the future in each particular country. Only if we aggregate all data and create an OECD average, which can serve as a proxy for global measurement, may be interpreted as global confidence level. And since the US dollar is the cornerstone of the global economy, we can make the next step of claiming that such a measure indicates confidence in the US dollar. Figure 36 portrays Global Business Confidence Index, while Figure 37 displays Global Consumer Confidence Index.

Figure 36: Global Business Confidence Index[302]



[302] Data from OECD. 2020a.

Figure 37: Global Consumer Confidence Index[303]



Another important clarification when analyzing these variables is that we need to be cognizant that people and business value their losses more than gains. As such, we can expect that the dips will be sever, but short lived, while ups will have lesser amplitude, but they will be more constant. Indeed, just below 54% of the time the BCI index is slightly above 100 – indicating optimism and confidence. Moreover, its long year average is also slightly above 100 – demonstrating confidence. Lastly, in Appendix 4 I report unit root tests scores for BCI and CCI. The results confirm that the BCI series is stationary, which means that there is no (downward) trend, and we can deduct that aforementioned numbers do illustrate genuine confidence.

[303] Data from OECD. 2020a.

Similar inference is reached also with CCI. More than 54% of the time CCI scores are above 100; however, its long-time mean is 99.993, therefore just below 100. Moreover, in Appendix 4 I report the unit root tests for CCI, which confirm that the series is stationary. Hence, put together these number suggest that there is a genuine confidence particularly for the post Bretton Woods IMS.[304] Still, how is the position of US dollar different or what difference does it cause in comparison to alternatives? The only empirical contrast may be shown with the Gold Standard in 19th century and UK hegemony.

3.1 US DOLLAR VS. GOLD STANDARD

Comparing[305] US hegemony characteristics with hegemony of the United Kingdom, there is no difference in terms of the centrality of the monetary unit, as Figure 38[306] clearly displays that gold was a central reserve unit during the Gold Standard IMS.[307] However, a notable difference is in the ownership. Namely, the United Kingdom, as the hegemon nor any other state for that matter,

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[304] The of states included for the years prior to 1971 is extremely small, so a generalization about global confidence level is rather dubious.
[305] I will do so by using most similar case method, where two cases are similar in most of the characteristic but lead to different outcomes. Hence, one can attribute this variation to the things which are distinct. See Seawright, Jason, and John Gerring. 2008. Case selection techniques in case study research: A menu of qualitative and quantitative options. *Political Research Quarterly*, 61(2). Pp. 294–308.
[306] Lindert, Peter H. 1969. *Key currencies and gold, 1900-1913*. Princeton: International Finance Section, Department of economics, Princeton University. Pp. 24.
[307] Gold Standard refers to a unique IMS created as an outcome of nations unilaterally adopting a gold standard throughout 1870s. Gallarotti explains Gold Standard with 7 characteristics: nation's money is strictly defined with respect to some fixed amount of gold, there is perfect interconvertibility between notes (i.e., paper money) and gold at legally determined rates, coins other than the central monetary metal under a monometallist regime (i.e., a regime that confers central status to one rather than several metals) can only circulate as token money (i.e., can only liquidate debts and make purchases up to limited amounts), reserves in the public and private banking systems must have a disproportionate gold component, private citizens are free to hold gold in whatever form they wish: coin or bullion, whatever metal citizens possess is normally free of international restrictions, and authorities institute some rule linking the creation of paper money to a. nation's gold stock (Gallarotti, Giulio M. 1995. *The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880-1914*. Oxford: Oxford University Press. Pp. 21–3.).

did not own the global gold supplies, nor did it control them, or was fully aware of their scope and whereabouts.[308] Nations scrambled for gold.[309] Chevalier argued that just as Rome stopped using bronze when silver became sufficiently abundant, gold came to displace silver when it became available in sufficient amounts in the 1850s.[310] Hence, such a system operated within a framework of low liquidity, since states were bound by gold supply they had and which limited its monetization. Moreover, even when we look at the ownership of the gold stock in 1913 the Bank of England owned the least amount of it out of 7 great powers (England, France, Germany, United States, Russia, Italy, Austro-Hungary).[311]

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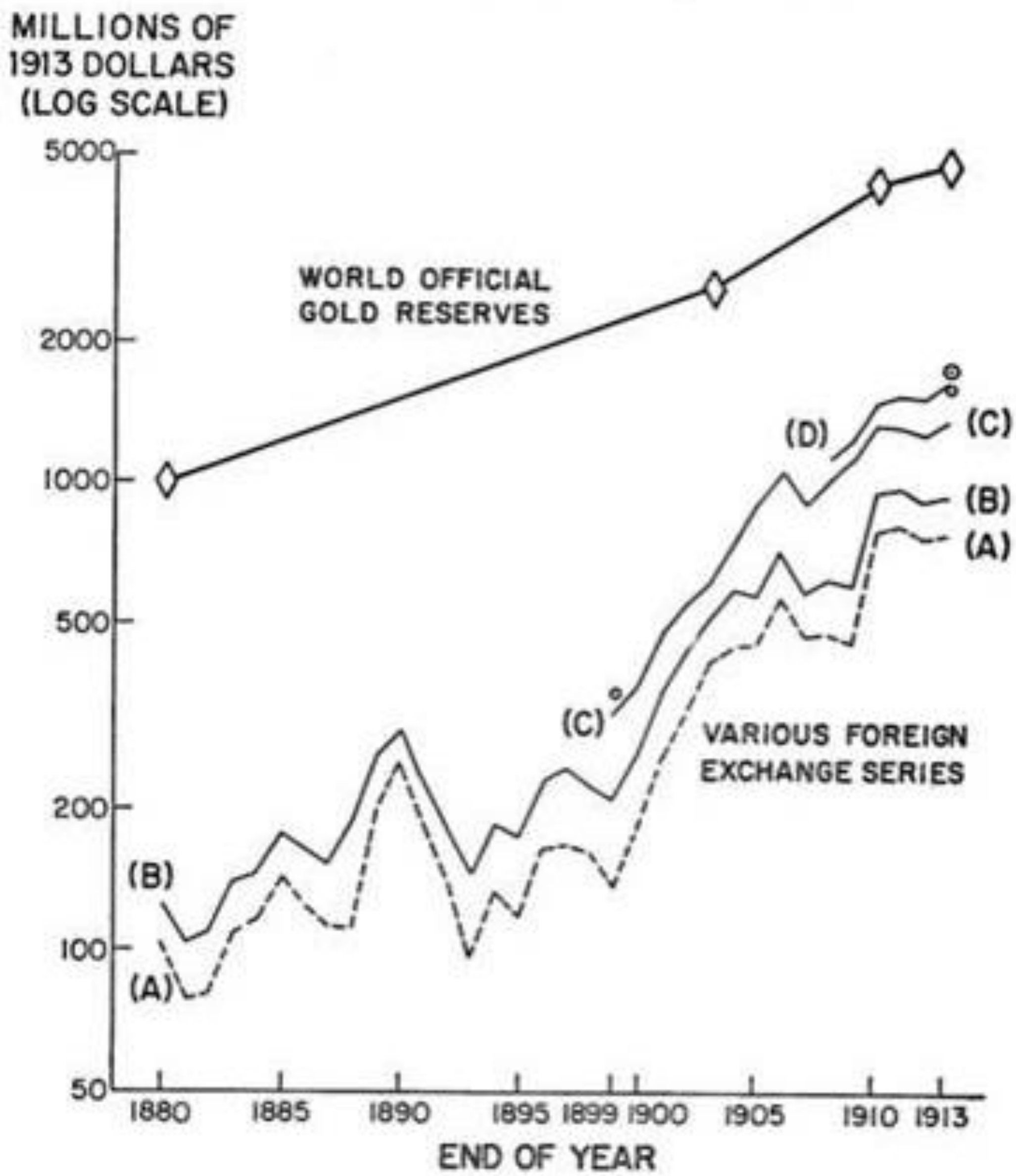
[308] On the origins of the Gold Standard see Gallarotti. 1995. Ch. 6.
[309] White, Horace. 1893. *The gold standard*. New York: Evening Post Publishing. Pp. 27.
[310] Chevalier, Michel. 1859. *On the Probable Fall in the Value of Gold*. New York: Appleton. Pp. 39, 40, 94, 95.
[311] Lindert. 1969. Pp. 10.

Figure 38: Global Reserve Composition between 1880 and 1913[312]



[312] I would like to draw attention to the atypical scaling of both axes. Furthermore, Series A is constructed from 18 individual series; Series B, from 26; Series C. from 39; and Series D, from 52. As such, 52 other currencies or store of value substances (e.g., silver) account for only at about 10% of gold reserves and until 1913 moved up to about 20%. However, when looking at 35 leading nations of the period show that even by 1913 gold still made up 68.1% of official reserves, with foreign exchange making up just 15.9%. In fact, silver was more abundant in official reserve pools than foreign exchange (1,132.5 to 1,132.1 million dollars). Looking at the British Pound, in 1913, of the 7,110.8 million dollars in official reserve holdings of the 35 leading countries of the period, only 431.6 million was being held in Pound Sterling (6%). Even as a proportion of foreign exchange reserves (1,132.1 million), Pound Sterling did not make up a majority (only 38%). The other two most abundantly held currencies, French Francs (275.1 million dollars) and German Marks (152.3 million), together made up almost as much as British Pound (427.4 million dollars in francs and marks versus 431.6 million dollars in Pound Sterling). These three currencies added u 76% of all foreign exchange reserve currencies of the 35 leading countries (See Lindert 1969. Pp. 10–2, 18–9).

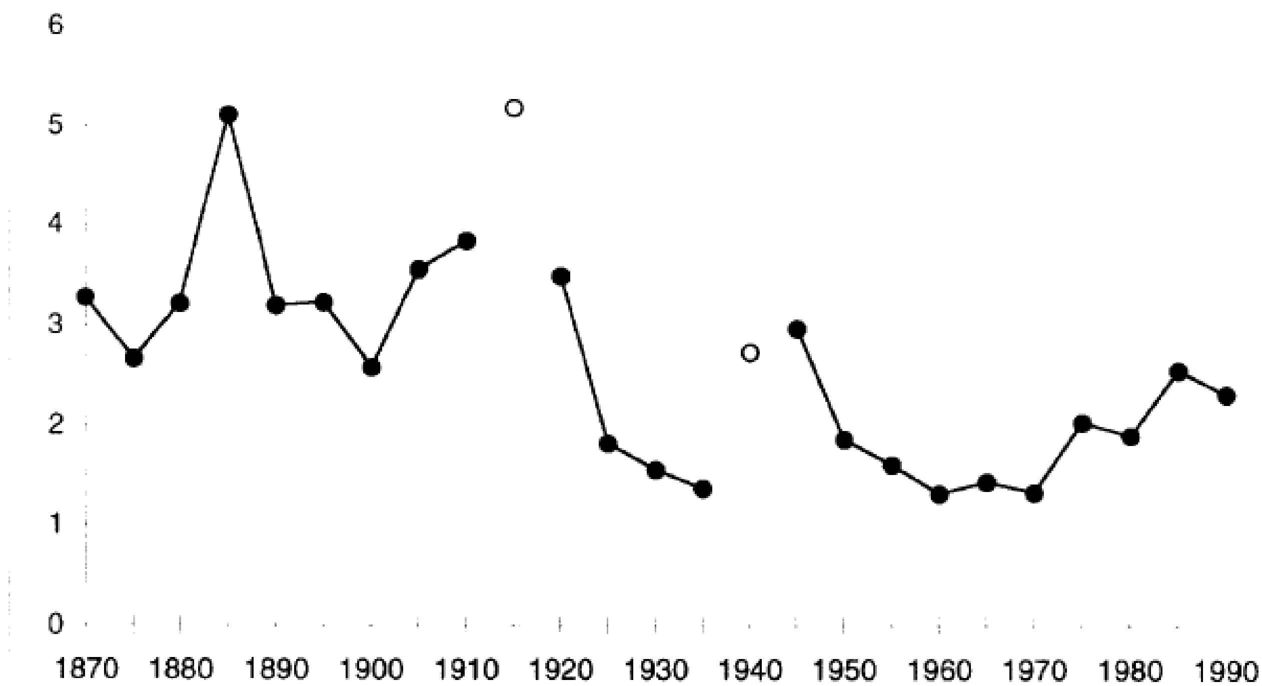
Also, when it comes to transactions, gold was dominant as all currencies were pegged to it. London indeed controlled over 60% of those transactions, and often served as a clearinghouse for exchanges between gold and other currencies.[313] Still, British Central Bank played a minute role in controlling or facilitating these flows.[314] Gold served as a reference point, and was the ultimate foundation for real (i.e., trade) and financial transactions. "Even by 1909, in only four of the 12 leading financial powers of the period was there more paper than gold in circulation (Germany, Belgium, Sweden, Finland). Of the four core nations, in only Germany was the amount of paper greater than the amount of monetary gold.[315]" This meant that gold played the role of a principal international money.[316] As such, gold was the central monetary unit of the Gold Standard, however, it was not controlled by the hegemon. The United Kingdom did not have monopoly over its production and distribution. Thus, such hegemony cannot be classified as a pervasive hegemony. Furthermore, analyzing the mechanism how UK hegemony functioned, it may come a bit unexpected that it does not fit coercive hegemony, opportunist hegemony, nor cooperative hegemony narrative.[317] Instead, UK hegemony was a cultural hegemony, where the hegemon desired to create a system around the philosophy of *laissez-faire*, free trade, freedom of capital movements.[318]

Recalling the monetary trilemma, the Gold Standard IMS was based on fixed exchange rates (towards the gold), and free flow of capital, while post-Bretton Woods system is situated in

[313] Eichengreen. 1987. Pp. 29–30.
[314] See Gallarotti. 1995. Ch. 5.
[315] Gallarotti. 1995. 149.
[316] Gallarotti. 1995. Pp. 26.
[317] See Gallarotti. 1995. Ch. 4.
[318] See Gilpin. 1981. Pp. 138; Cohen. 1977. Pp. 81; Krasner. 1976. Pp. 338.

free flow of capital and sovereign monetary policy. In both cases, there is ample evidence for free flow of capital, which is displayed on Figure 39.[319] Yet, there is some arguable data regarding the fix exchange rates during the Gold Standard. Namely, central banks as well as private banks constantly intervened and violated the rules.[320]

Figure 39: Free Flow of Capital from 1870 through 1990[321]



[319] Obstfeld, Maurice, and Alan M. Taylor. 1998. The great depression as a watershed: international capital mobility over the long run. In Bordo, Michael D., Claudia Goldin, and Eugene N. White (eds.), *The Defining Moment: The Great Depression and the American Economy in the Twentieth Century*. Chicago: University of Chicago Press. Pp. 353-402. At Pp. 360.

[320] See Bordo, Michael D., and Ronald MacDonald. 1997. *Violations of the Rules of the Game and the Credibility of the Classical Gold Standard, 1880-1914*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w6115.pdf (1 August 2019); Hinderliter, Roger H., and Hugh Rockoff. 1976. Banking Under the Gold Standard: An Analysis of Liquidity Management in the Leading Financial Centers. *The Journal of Economic History*, 36(2). Pp. 379−98; Triffin, Robert. 1964. *The evolution of the international monetary system: Historical reappraisal and future perspectives*. Princeton: Princeton University.

[321] The numbers present as a mean absolute value of current account of 12 countries as percent of GDP.

Still, such constant adjustment took place principally through short-term capital flows that were driven by interest rate differentials across nations not by violating fixed exchange rates.[322] Furthermore, it did not undermine the gold standard, Gallarotti explains[323]:

> "/…/ the process of adjustment under the gold standard was actually quite different from conventional visions of trade flows shifting according to the effects of gold flows on prices (inflation/deflation). What in fact we witnessed, within the gold club specifically, was a group of nations with fairly strong long-term external positions (i.e., current accounts) that were easily able to adjust for temporary disequilibria in their international exchanges by attracting short-term capital. Hence, the principal means of adjustment under the gold standard were short-term capital flows rather than shifts in trade (i.e., adjustment was a monetary rather than real phenomenon in the short run). Nations over the entire international monetary system showed quite different capacities to attract these funds, and these differences allowed more developed nations to redistribute some of the burden of adjustment to less developed nations in the system. But this potential to shift the burden of adjustment did not lead to outcomes that were fully commensurate with differential capacities to influence the movement of international investment, a condition which rendered the process of adjustment under the gold standard much less skewed than the literature on the period suggests."

Thus, these short-term capital flows were an effective tool for adjustment. Moreover, long term (gold) flows moved in the direction required by these short-term flows. Hence, this dynamic did not present a break from the rule, but rather a specific mechanism of rule efficacy.[324] These

[322] See Nurske, Ragnar. 1944. *International Currency Experience in the Interwar Period*. Genève: League of Nations; Ford, Alec George. 1962. *The Gold Standard, 1880-1914: Britain and Argentina*. Oxford: Clarendon; Bloomfield, Arthur Irving. 1963. *Short-term Capital Movements under the pre-1914 Gold Standard*. Princeton: International Finance Section, Department of economics, Princeton University; Grubel, Herbert G. 1969. *The International Monetary System: Efficiency and Practical Alternatives*. New York: Penguin; Goodhart, Charles A. E. 1972. *The business of banking, 1891-1914*. London: London School of Economics and Political Science.

[323] Gallarotti. 1995. Pp. 41.

[324] Scammell, William M. 1965. The working of the gold standard. *Bulletin of Economic Research*, 17(1). Pp. 32–45; Bloomfield, Arthur Irving. 1968. *Patterns of fluctuation in international investment before 1914*. Princeton: International Finance Section, Department of economics, Princeton University; Jonung, Lars. 1984. Swedish Experience under the Classical Gold Standard, 1873-1914. In Bordo, Michael D., and Anna J. Schwartz (eds.), *A Retrospective on the Classical Gold Standard, 1821-1931*. Chicago: University of Chicago Press. Pp. 361–404.

movements supported the fix exchange rates objective – parities of the key currencies were basically immovable over the period 1879-1914.[325]

An additional issue regarding the exchange rates was that several states[326] and group of states[327] were only *de facto* on the gold standard, while normatively they were bimetallic (gold and silver).[328] "Only Britain maintained a full-fledged gold standard for anything approaching the century preceding 1913.[329]" One can understand this duality as a political means of assuring liquidity and hedging against potential disruption when new sources of either metal is found.[330] Elson claims that this system continuously struggled to assure enough supply or demand for liquidity.[331] But, if that were the case, then we would have to see enhanced inflation when a supply

325 Gallarotti. 1995. Pp. 42. He continues: "The small standard deviations attest to the proximity of average movements to par, and the fact that the differences between mean and par rates tended to be significantly less than standard deviations suggests that average deviations tended to be fairly symmetrically distributed around par" (Gallarotti. 1995. Pp. 42).

326 Even United States, see Elwell, Craig Kent. 2011. *Brief History of the Gold Standard (GS) in the United States*. Congressional Research Service. Accessibility: https://fas.org/sgp/crs/misc/R41887.pdf (5 July 2020). Friedman and Schwartz elaborate that abandoning the gold standard might well have been preferable for United States in 1890s. However, this was not feasible as the fear that silver would produce inflation drove states to have a severe deflation in order to stay on the gold standard (Friedman, Milton, and Anna J. Schwartz. 1963. *A Monetary history of the US 1867-1960*. Princeton: Princeton University Press. Pp. 111, 133).

327 For example: Latin Monetary Union, and Scandinavian Monetary Union. For more on the two see, Einaudi, Luca L. 2000. From the Franc to the 'Europe': The Attempted Transformation of the Latin Monetary Union into a European Monetary Union, 1865-1873. *Economic History Review*, 53(2). Pp. 284–308; Timini, Jacopo. 2018. Currency unions and heterogeneous trade effects: the case of the Latin Monetary Union. *European Review of Economic History*, 22(3). Pp. 322–48; Bergman, Michael, Stefan Gerlach, and Lars Jonung. 1993. The Rise and Fall of the Scandinavian Currency Union 1873-1920. *European Economic Review,* 37(2–3). Pp. 507–17; Grytten, Ola Honningdal, and Arngrim Hunnes. 2012. Price Stability in the Periphery during the International Gold Standard: Scandinavia. In Ögren, Anders, and Lars Fredrik Øksendal (eds.), *The Gold Standard Peripheries: Monetary Policy, Adjustment and Flexibility in a Global Setting*. London: Palgrave Macmillan. Pp. 58–80.

328 On bimetallism in general see Bordo, Michael D., Christopher M. Meissner, and Marc D. Weidenmier. 2006. *Currency Mismatches, Default Risk, and Exchange Rate Depreciation: Evidence from the End of Bimetallism*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w12299.pdf (5 July 2020); Diebolt, Claude, and Antoine Parent. 2008. Bimetallism: The "rules of the game". *Explorations in Economic History*, 45(3). Pp. 288–302; Meissner, Christopher M. 2015. *The Limits of Bimetallism*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w20852.pdf (5 July 2015).

329 Eichengreen. 1987. Pp. 16.

330 See Oppers, Stefan E. 2000. *Dual Currency Boards: A Proposal for Currency Stability*. International Monetary Fund. Accessibility: https://www.elibrary.imf.org/doc/IMF001/01907-9781451860108/01907-9781451860108/Other_formats/Source_PDF/01907-9781451905465.pdf (5 July 2020).

331 Elson. 2011. Pp. 31.

shock of new gold discoveries (gold rushes were common throughout 19th century) appeared, but we have not. In fact, inflation levels were constantly low throughout the 19th century.[332] Instead, one can claim that the system also performed well with regard to liquidity criteria – money supply was rising, but so was the real income.[333] The latter may be attributed to the will of states to perform adjustments as their interest rates were stable and they assured free flow of capital. Nevertheless, the last third of the 19th century is referred to as long depression, so enhanced liquidity may come in handy in tackling this issue and generating economic growth.[334]

As such, the aforementioned interventions, should be understood in the light of commitment and confidence in the IMS and the wish of maintaining it. Namely, when confidence is high, other attributes of the IMS are easier to conduct. So, absence of confidence indexes for the Gold Standard period may not be tragic, as we can treat other described measures as epiphenomenal or interlinked with confidence. Although there were some issues with economic growth and liquidity, actors supported such an IMS, which attests to their confidence in this system. Moreover, since the number of nations pegged to gold was steadily increasing, this also indicates that the confidence level was stable, if not increasing as well. And since other measures

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[332] See Bordo, Michael D. 1981. The classical gold standard: Some lessons for today. *Federal Reserve Bank of St. Louis Review*, 63(5). Pp. 2−17.

[333] See Bordo. 1981.

[334] On the Long Depression from 1873-1896 see Rosenberg, Hans. 1943. Political and social consequences of the great depression of 1873-1896 in Central Europe. *The Economic History Review*, 13(1/2). Pp. 58–73; Musson, Alfred E. 1959. The great depression in Britain, 1873–1896: a reappraisal. *The Journal of Economic History*, 19(2). Pp. 199–228; Coppock, Dennis John. 1961. The Causes of the Great Depression, 1873-96. *The Manchester School*, 29(3). Pp. 205–32; Musson, Alfred E. 1963. British industrial growth during the 'Great Depression (1873-96): some comments. *The Economic History Review*, 15(3). Pp. 529–33; Coppock, Dennis John. 1964. British Industrial Growth during the 'Great Depression' (1873-96): A Pessimist's View. *The Economic History Review*, 17(2). Pp. 389–96; Gourevitch, Peter Alexis. 1977. International trade, domestic coalitions, and liberty: Comparative responses to the crisis of 1873-1896. *The Journal of Interdisciplinary History*, 8(2). Pp. 281–313; Hobsbawm, Eric. 1987. *Age of empire: 1875-1914*. London: Weidenfeld & Nicolson; Park, Y. Goo. 1997. Depression and Capital Formation: the United Kingdom and Germany, 1873-1896. *Journal of European Economic History*, 26(3). Pp. 511–34.

are high, one can infer that the confidence was high as well.[335] Lastly, we also did not see bank rushes or gold rushes (in financial meaning), but we did see a silver rush. Eichengreen elaborates[336]:

> "Hence the plausible explanation for the contrast between the 1870s and earlier years is the danger of exceptionally rapid inflation due to the magnitude of post-1870 silver discoveries. Between 1814 and 1870, the sterling price of silver, of which so much was written, remained within 2 percentage points of its 1814 value, alternatively driving gold or silver from circulation in bimetallic countries but fluctuating insufficiently to raise the specter of significant price level changes. Then between 1871 and 1881 the London price of silver fell by 15 percent, and by 1891 the cumulative fall had reached 25 percent. Gold convertibility was the only alternative to continued silver coinage that was judged both respectable and viable. The only significant resistance to the adoption of gold convertibility emanated from silver-mining regions and from agricultural areas like the American West, populated by proprietors of encumbered land who might benefit from inflation. Seen from this perspective, the impetus for adopting the gold standard existed independently of Britain's rapid industrialization, dominance of international finance, and preeminence in trade."

Another important difference in international markets and transactions during the Gold Standard IMS and contemporary IMS is that in the 19th century the transactions were done more or less between private citizens and banks, while transactions between nations and banks, contemporary common practice, has been unthinkable. Therefore, international liquidity was epiphenomenal to domestic liquidity, where banks had greater leverage than states.[337] Thus, as

[335] Gallarotti (1995. Pp. 51) explains: "The whole short-term adjustment process under the gold standard was dependent upon perceptions of convertibility and exchange risk. On a public level, monetary authorities were comfortable clearing payments through shifting claims on foreign exchange. This comfort level was linked to expectations that the foreign exchange would maintain its value and remain convertible. On a private level, since returns to investments were limited because of the limited spread in interest rates and limited movement of exchange rates, the perceptions of such risk had to be small indeed in order to encourage foreign investment. Hence, private actors, like monetary officials holding foreign fiduciary assets, had to be certain that currencies in which they took positions would maintain their international purchasing power as well as remain convertible into gold."
[336] Eichengreen. 1987. Pp. 17–8.
[337] See Gallarotti. 1995. Pp. 27–34.

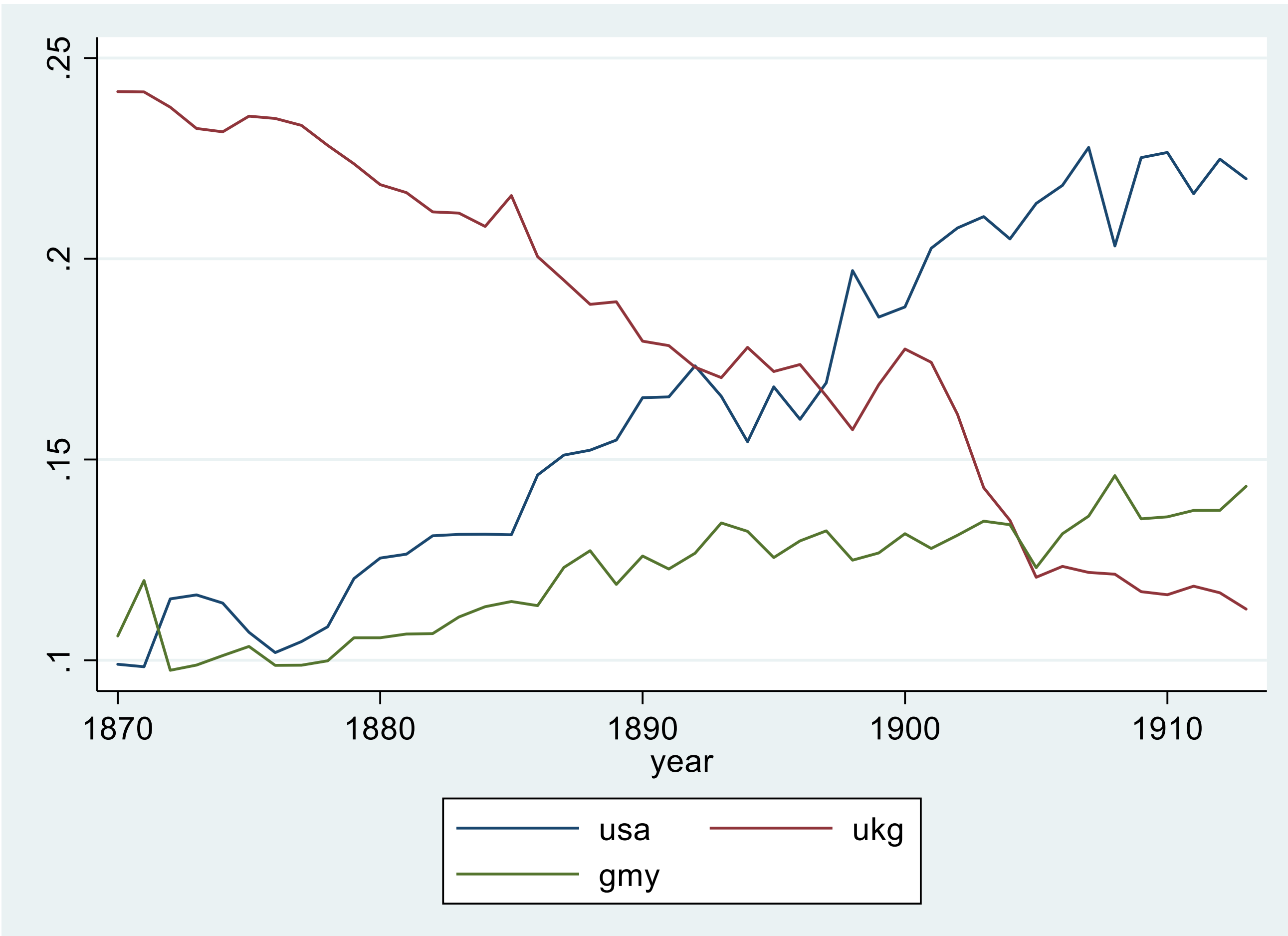
adjustment was outsourced to the markets in the post-Bretton Woods IMS, liquidity was done so under the Gold Standard IMS.

In a nutshell, although both systems were set in different monetary frameworks, their performance is comparable. While the Gold Standard might have some issues with liquidity, both systems were characterized by a central monetary unit, which under the Gold Standard was not owned by the hegemon. Furthermore, one would expect that an empire, how UK hegemony or dominance has been described, would have an advantage in generating trade relations and positioning itself in the center of the global trade network. Namely, the United Kingdom had greater trade exposure than the United States – 49%t of GDP in 1877–85 and 52% in 1909–13.[338] Furthermore, financial instruments, although rapidly growing towards the end of 19th century, were not as dominant as in the post-Bretton woods period. International transfers were more or less linked to the real economy – trade. Hence, it is expected that if dominating in aggregate trade, British hegemony would maintain trade centrality and economic centrality. Still, as shown below, the results are staggering. On the other hand, United States had more regimes to assist its hegemony, while United Kingdom had few only implicit regimes. And another difference was in the nature of trade, where under the Gold Standard IMS trade was inter-industry, while post 1945 trade increasingly became intra-industry.[339]

[338] Lake, David. 2014. British and American hegemony compared: lessons for the current era of decline. In Frieden, Jeffry A., and David A. Lake (eds.), *International political economy: perspectives on global power and wealth*. London: Rutledge. Pp. 127–40.
[339] See Lake. 2014.

Therefore, Figure 40 portrays the CINC scores for the United Kingdom, the United States, and Germany.[340] As expected, the British scores are through the years declining, while the scores for United States and Germany are rising. UK dominance has according to this data ended in 1890.

Figure 40: 19th Century CINC Scores of United Kingdom, United States and Germany

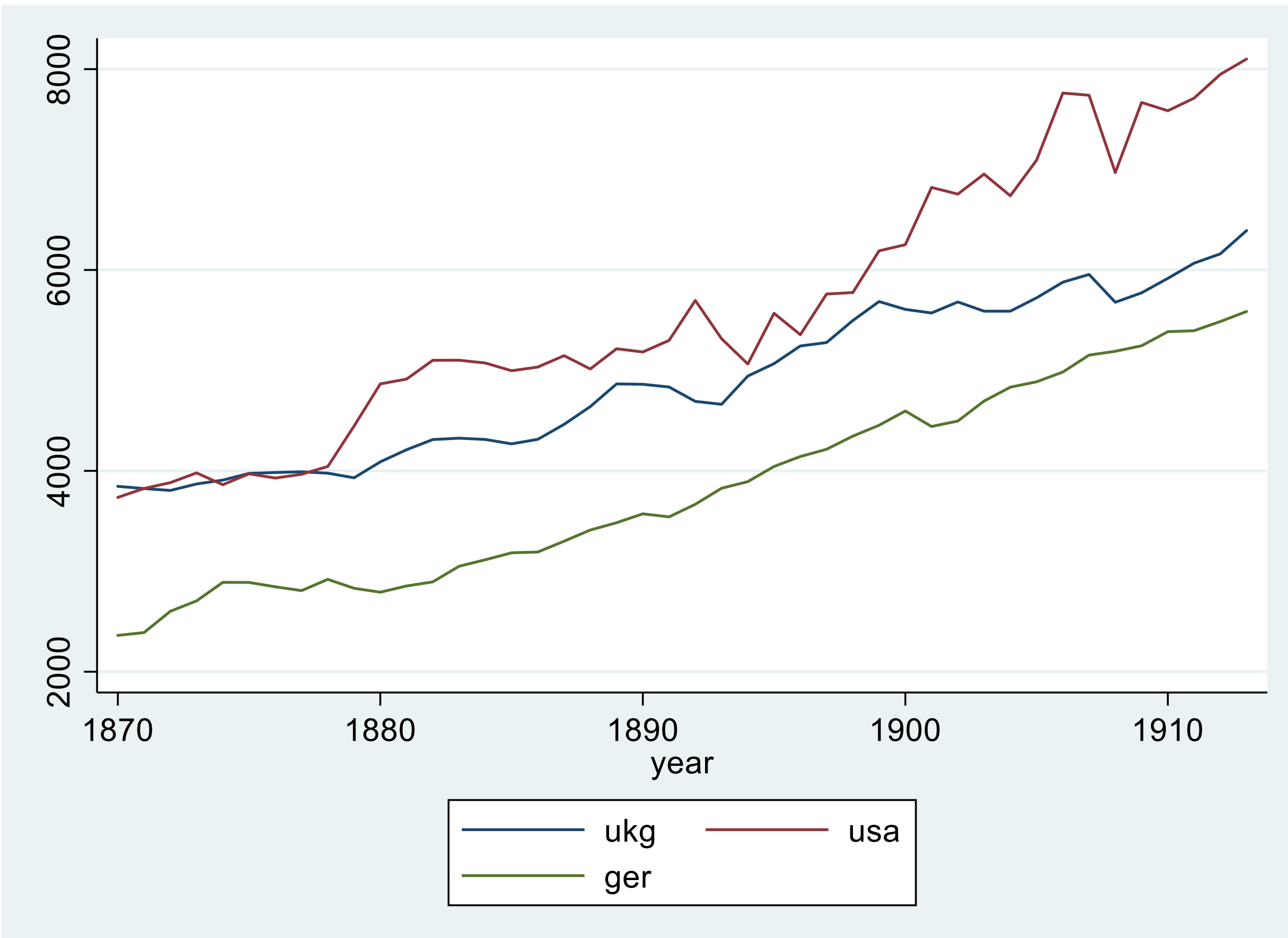


Similarly, the GDP data of the same countries tell us the same story: United States and Germany are rising faster than United Kingdom. Figures 41 and 42 employ two different measures

[340] Data from Singer. 1987.

for real GDP per capita.[341] According to the first, the United States overtook the United Kingdom in 1880, while according to the second, the dominance of the United Kingdom lasted well into the 20th century.

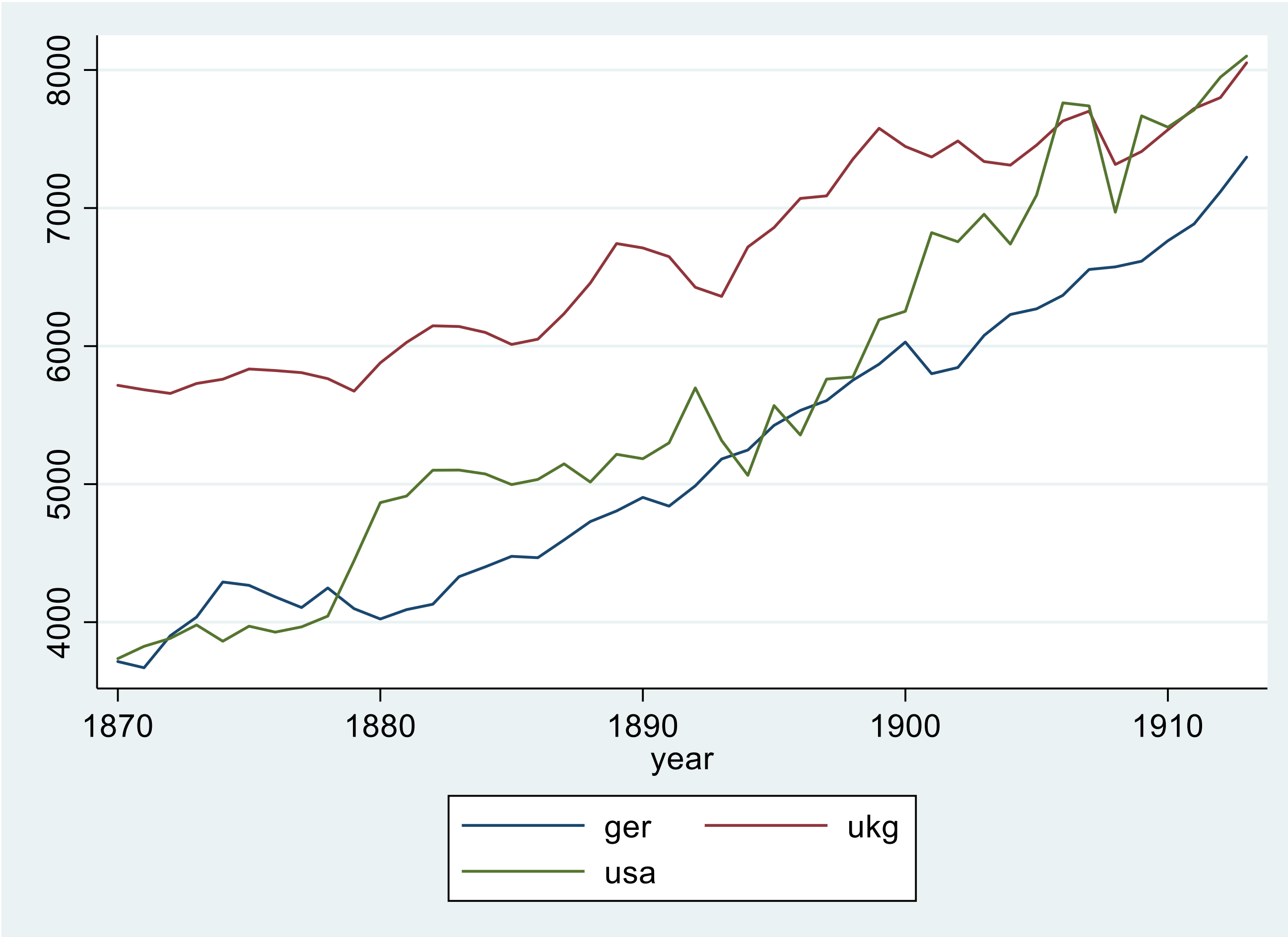
Figure 41: 19th Century Real GDP per capita for United Kingdom, United States and Germany 1[342]



[341] Data from: *Maddison Project Database, version 2018*. 2018. Bolt, Jutta, Robert Inklaar, Herman de Jong, and Jan Luiten van Zanden. "Rebasing 'Maddison': new income comparisons and the shape of long-run economic development. Accessible: https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2018 (12 July 2020).

[342] Data in 2011 US dollars. The method is suitable for cross-country income comparisons.

Figure 42: 19th Century Real GDP per capita for United Kingdom, United States and Germany 2[343]

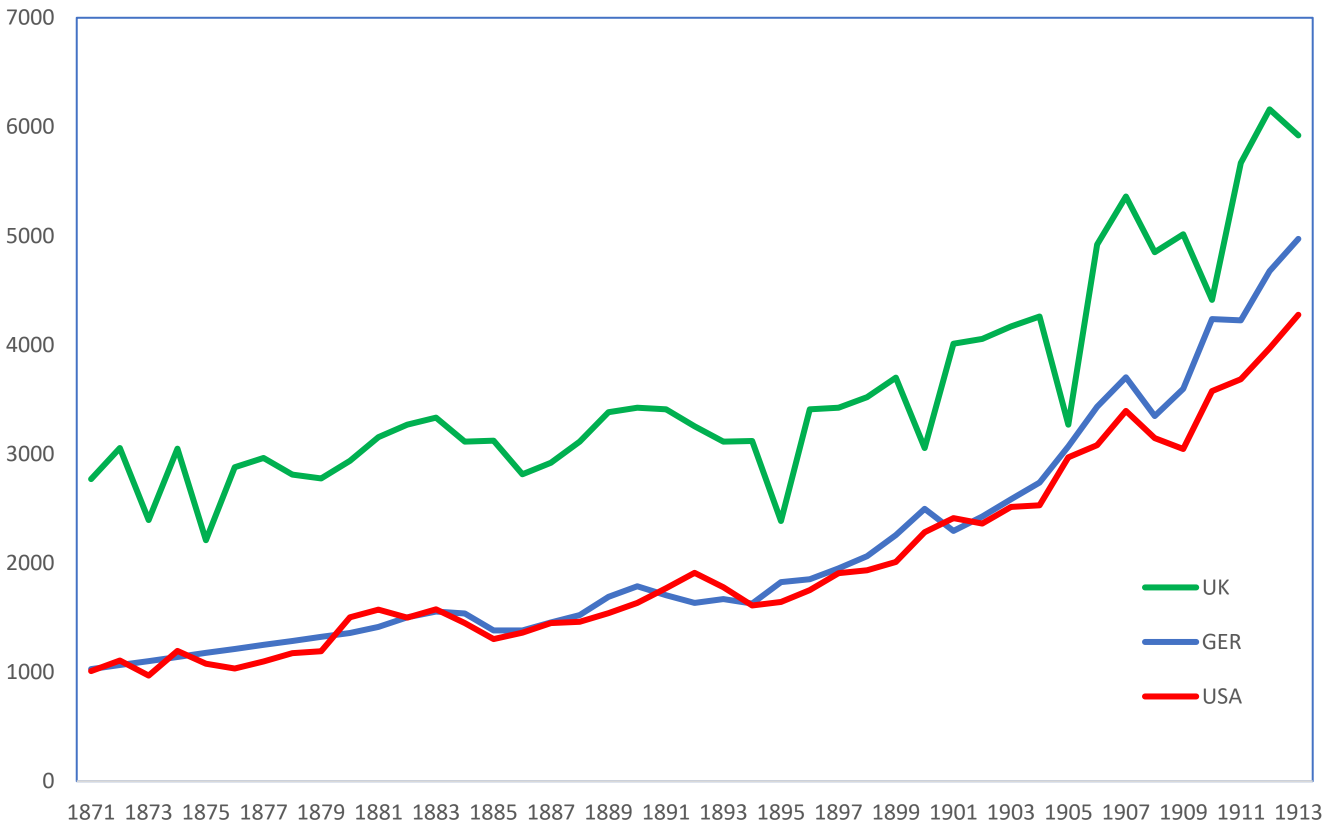


Finally, moving to trade data as a proxy measure of centrality of a state in the global economy, Figure 43 shows aggregate trade. And again, the story is the same. The United States and Germany are playing catch-up with the United Kingdom. All these figures are what general International Relations scholarship and existing theories of hegemony would expect – a rising states vs. (relatively) a declining hegemon. When one rises the other declines. As such, these numbers and graphs tell us that the American and British stories are the same, with a slight caveat that the United Kingdom "continued to dominate and manage the international economy until the

343 Data in 2011 US dollar, 2011 benchmark. The method is suitable for cross-country growth comparisons.

outbreak of the First World War. With its industrial base slipping, Britain moved into services—relying on shipping, insurance, and international finance to offset its increasing trade deficits.[344]" Hence, the United Kingdom maintained the lead in aggregate trade although its relative position was challenged, whereas as depicted in Figure 27, the United States has been already overtaken by China in aggregate trade.

Figure 43: United Kingdom, United States and Germany Global Aggregate Trade[345]

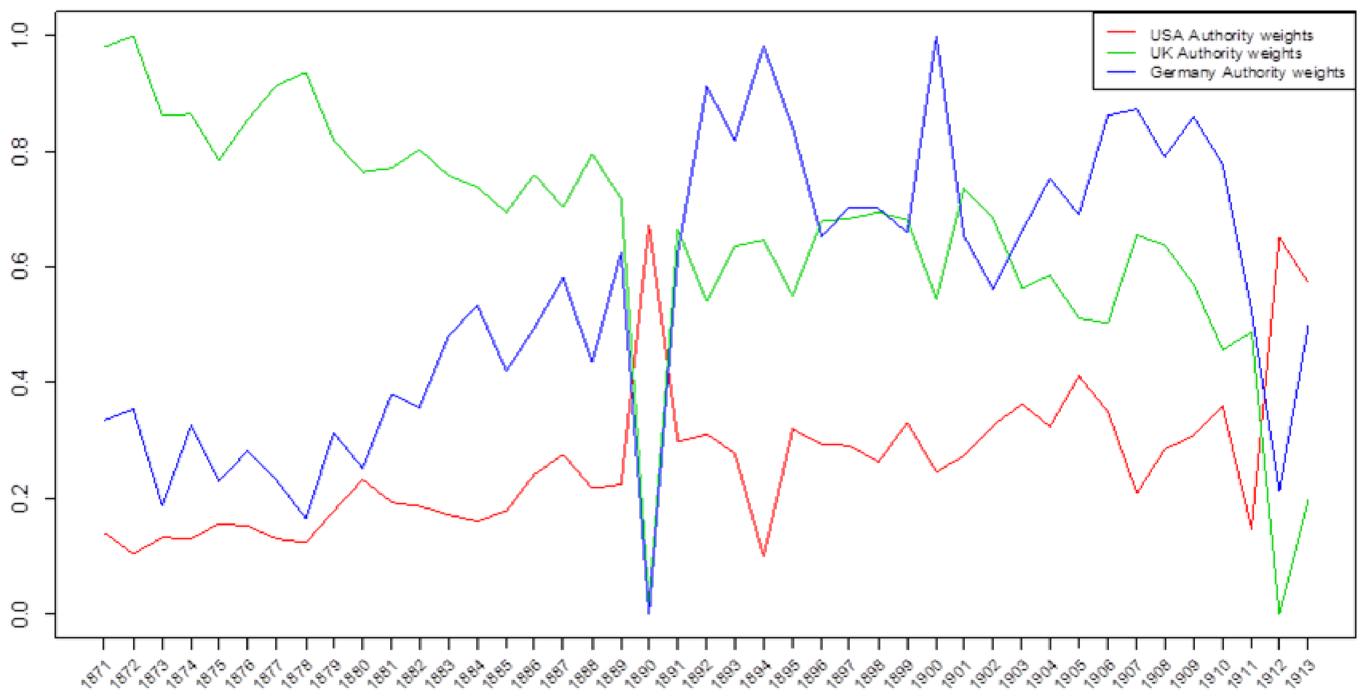


As such, Figure 44, which shows a network centrality of the three analyzed countries in 19th century, is unexpected and telling. Namely, existing theories, presented date on aggregate

[344] Lake. 2014. Pp. 129.
[345] Data in current millions of US Dollars taken from Barbieri, Keshk, and Pollins. 2009.

trade of the United Kingdom, as well as the US experience shown on Figure 28, would have us suppose that the weighted degree centrality gap between the United Kingdom and the other two rising countries, would be diminishing, but not gone. However, the United Kingdom lost this position in 1889, when its aggregate trade advantage was still substantive.

Figure 44: UK, US, and German Centrality in Global Trade Relations[346]



Hence, this is a puzzle that Pervasive Hegemony Theory resolves. Namely, the trajectories of US and UK hegemony were similar according to many criteria. Yet, in one fundamental aspect they differ – centrality in global trade. The only substantive difference that this result can be attributed to is the ownership of the central monetary unit, which the United Kingdom lacked. Furthermore, these facts would make us believe that UK hegemony was even in a better position than current US hegemony. Yet, the network perspective shows an important difference. London

[346] Data from Barbieri, Keshk, and Pollins. 2009.

might have been the location where business was done; however, this has not trickled up into the UK's centrality in the global economy. Most of the gold was indeed exchanged in London, but this fact has not attributed to further UK hegemony. Applying the economic theory of John Henry Williams,[347] which states that any international system composed of unequal partners will be regulated more by the domestic policies of the larger partners than by any specific foreign policy of any of the partners, De Cecco[348] claims that Gold Standard IMS gradually did adapt to Britain's gradual loss of weight in the international economy. Namely, Britain did try to position the Pound Sterling as a reserve currency, and its rate grew exponentially in 1890s.[349] But it was too little too late and an uneasy modus vivendi was characterized by constant commotions and crises of increasing intensity, and so the crisis of 1907 and the final crisis of August 1914 brought this IMS down as well as its hegemon. Eichengreen explains the functioning of Gold Standard IMS:[350]

> "Since fiscal harmonization requires no discussion in an era of balanced budgets, the stability of the classical gold standard can be explained by the desire and ability of central banks to harmonize their monetary policies in the interest of external balance. External balance, or maintaining gold reserves adequate to defend the established gold parity, was the foremost target of monetary policy in the period preceding World War I. In the absence of a coherent theory of unemployment, much less a consensus on its relation to monetary policy, there was relatively little pressure for central banks to accommodate domestic needs. External balance was not the sole target of policy, but when internal and external balance came into conflict, the latter took precedence. Viewed from an international perspective, British leadership played a role in this process of harmonization insofar as the market power and prominence of the Bank of England served as a focal point for policy coordination."

[347] Williams, John Henry. 1920. *Argentine international trade under inconvertible paper money, 1880-1900*. Cambridge: Harvard University Press.
[348] De Cecco, Marcello. 1975. *Money and empire: the international gold standard, 1890-1914*. Oxford: Blackwell.
[349] Eichengreen. 1987. Pp. 36.
[350] Eichengreen. 1987. Pp. 31–2.

On the other hand, the ownership of the US dollar as the central monetary unit in contemporary post-Bretton Woods IMS gives the United States a unique central position in the global economy, as well as generates a different kind of hegemony. Its underlying principle is not the capacity of the hegemon by which it makes efforts to postpone successful balancing against it, instead it lies in the ability due to the position of its currency to generate a 'buy-in' dynamic, where all states reproduce and reinforce this position of the US dollar and hence also of the hegemony. Moreover, the centrality of hegemon's currency also enables the hegemon to facilitate a change in IMS without endangering its hegemony. As such, ownership of the central monetary unit explains a change in IMS while hegemony endures. And this is the crux of Pervasive Hegemony Theory, which personifies the case of US hegemony.

The next two chapters are dedicated to testing its explanatory power against four other hegemonic theories. Furthermore, they will also elaborate and isolate the 'buy-in' mechanism, which is characteristic for pervasive hegemony.

4. BRETTON WOODS SYSTEM

"It's a great spot for a murder."[351]

In 1944, 44 countries signed an agreement establishing the International Monetary Fund (IMF) in Bretton Woods, New Hampshire. It was a part of a series of agreements establishing global governance, and facilitating international trade after the end of the Second World War[352] (other examples include, the United Nations (UN),[353] World Bank (WB),[354] and the General Agreement on Tariffs and Trade [GATT]).[355] The Bretton Woods agreement established an IMS with fixed exchange rates and based on sovereign monetary policy in terms of monetary trilemma.[356] All the currencies were fixed against the US dollar, which in turn was fixed to gold at $35 an ounce. As such, the system may be labelled as a gold exchange standard, where through the US dollar all currencies were able to be exchanged.[357] This architecture was a result of "the /passion/ and sincere belief of all participants that the postwar economic order should represent a new beginning."[358] While the Nurkse's quote personifies the zeitgeist: "If there is anything that inter-war experience has clearly demonstrated, it is that paper currency exchanges cannot be left free to fluctuate from day to day under the influence of market supply and demand /…/ If currencies are left free to fluctuate, speculation in the widest sense is likely to play havoc with

[351] This was a comment of one of the journalists regarding the venue place of the conference that designed a new post-World War Two IMS, see 378 Envoys, 500 Newsmen Due at Monetary Parley. 1944. *Boston Globe*, 2 June.
[352] See James. 1996. Chs. 2–5.
[353] Agreed in 1944 at Dumbarton Oaks Conference in Washington DC.
[354] Its first institution – International Bank for Reconstruction and Development – was established also at Bretton Woods conference.
[355] An outcome of the failed negotiations over International Trade Organization, GATT was signed in Geneva in 1947.
[356] Elson. 2011. Pp. 29.
[357] Krugman and Obstfeld. 2008. Pp. 515.
[358] James. 1996. Pp. 56.

exchange rates-speculation not only in foreign exchanges but also, as a result, in commodities entering into foreign trade."[359]

Yet, due to limited amount of gold, increased capital flows resulting from the non-hegemonic states' changing preferences, as well as the will of the United States to supply these flows, and the tolerance of the United States for the lack of adjustment of non-hegemonic states, the US dollar gradually began to serve as the main reserve currency and established itself as a central international monetary unit.[360] The manner in which this was done also alludes to my argument that the Bretton Woods IMS should be interpreted as a maturity period for US pervasive hegemony. Non-hegemonic states settled for US dollars once it became obvious, they could not guarantee their interests with gold. Furthermore, the United States was willing to tolerate the delay of adjustment by the non-hegemonic states as long as their interests were not endangered, and non-hegemonic states were willing to accept the US dollar. Yet, once the US vital domestic interests were at stake, the United States acted and conditioned the provision of the US dollar with a new IMS.

4.1 CREATION OF THE BRETTON WOODS SYSTEM

Lessons from 1930s drove the IMF agreement in creating fixed exchange rates to prevent beggar thy neighbor policies and trade discrimination.[361] Although there were alternative models

[359] Nurske. 1944. Pp. 137–8.
[360] Eichengreen, Chiţu, and Mehl. 2014.
[361] Frankel, Jeffrey A. 2003. *Experience of and lessons from exchange rate regime in emerging economies*. Cambridge: National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w10032.pdf (3 August 2019). Pp. 10. See also Article IV in the *Articles of Agreement of the International Monetary Fund*. 2016.

– e.g. free flows of capital of the gold standard era – government intervention and control of capital flows were preferred,[362] since the states saw free flow of capital and free floating exchange rates as speculative and harmful for international trade.[363] Moreover, states wanted to stay in full control over economic affairs, hence the IMS was also designed with the objective of states maintaining their individual monetary policies. Yet, there was some level of flexibility. The states "contributed their currencies and gold to the IMF to form a financial pool that the IMF could lend to countries in need.[364]" Furthermore, IMF rules allowed countries to adjust their exchange rates in the case of a fundamental economic disequilibrium, which was never clearly defined.[365] Therefore, this IMS was created by design, but never fully operated in the manner in which it was conceptualized.[366]

Bretton Woods IMS suffered from two important flaws. First, the agreement itself was poorly designed for the nature of the economy where it operated. Enhanced capital flows, which the agreement wanted to prevent, were a personification of that problem. Still, such IMS would be able to survive if the states were willing to adjust, but this was unfeasible due to the second deficiency of the Bretton Woods IMS – the architecture of the agreement prompted different solutions at different times. It was too vague, and states would easily take advantage and exercise their power to delay.[367]

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[362] Elson. 2011. Pp. 27.
[363] Krugman and Obstfeld. 2008. Pp. 516.
[364] Krugman and Obstfeld. 2008. Pp. 516.
[365] Krugman and Obstfeld. 2008. Pp. 516.
[366] For detailed account of the establishment of Bretton Woods IMS see: Van Dormael, Armand. 1978. *Bretton Woods: Birth of a Monetary System*. London: Macmillan; Eckes, Alfred E. 2012. *A Search for Solvency: Bretton Woods and the International Monetary System, 1941-1971*. Austin: University of Texas Press; Rofe, J. Simon. 2017. *Global perspectives on the Bretton Woods conference and the post-war world order*. London: Palgrave Macmillan.
[367] More on these two deficiencies of the Bretton Woods IMS see Andrews, David M. 2005. The Bretton Woods agreement as an invitation to struggle. In Joerges, Christian, Bo Stråth, and Peter Wagner (eds.) *The economy as a polity: The political constitution of contemporary capitalism*. London: UCL Press. Pp. 77–98; Bordo. 1993.

The inception of such IMS took place at a conference in the Mount Washington Hotel from July 1st to 22nd.[368] This event was a crucial step in demising UK global leadership and facilitating US hegemony.[369] Financial Times chief foreign affairs commentator recalls: "At the time, one senior official at the Bank of England described the deal reached at Bretton Woods as 'the greatest blow to Britain next to the war', largely because it underlined the way in which financial power had moved from the UK to the US."[370] The struggle between two negotiation leaders at the Bretton Woods conference has become rather legendary: John Maynard Keynes for United Kingdom and Harry Dexter White for the United States.[371]

Although there were other delegations, whose members played a role in crafting the final agreement,[372] it was the push and pull between these two individuals and their plans that is most significant.[373] "American and British officials offered different plans for postwar monetary reconstruction because they had different views of the problem of international economic adjustment and because they represented economies with different strengths and weaknesses.

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[368] Amusing fact is that the end date of the conference was forced by the hotel owner, David Stoneman, who was hosting another conference after this one – American Banker's Association, which in fact was working against the Bretton Woods agreement (Conway, Edmund. 2014. Seeing the Woods for the Trees – Preconceptions and Misconceptions about Bretton Woods. In Nauschnigg, Franz, and Sandra Dvorsky (eds.), *Bretton Woods @ 70: Regaining Control of the. International Monetary System*. Vienna: Oesterreichische Nationalbank. Pp. 41–9. At Pp. 44).

[369] More on the peaceful transition between UK and US hegemony see Schake, Kori. 2017. *Safe Passage: The Transition from British to American Hegemony*. Cambridge: Harvard University Press; Yongping, Feng. 2006. The Peaceful Transition of Power from the UK to the US. *The Chinese Journal of International Politics*, 1(1). Pp. 83–108.

[370] Rachman, Gideon. 2008. The Bretton Woods sequel will flop. *Financial Times*, November 11. Accessibility: https://web.archive.org/web/20140116085300/http:/www.relooney.info/0_New_3860.pdf (11 July 2018).

[371] See Steil, Benn. 2013. *The battle of Bretton Woods: John Maynard Keynes, Harry Dexter White, and the making of a new world order*. Princeton: Princeton University Press.

[372] See Conway. 2014. In fact, it was a Brit, Dennis Robertson, who proposed to include the US dollar in the agreement. For a detailed overview of negotiations see Schuler, Kurt, and Andrew Rosenberg, (eds.). 2012. *The Bretton Woods Transcripts*. New York: Center for Financial Stability. Ch. 5.

[373] Alongside United States and United Kingdom, also France and Canada presented their own plans, while economist John Williams had his own idea of a key-currencies (US dollar and Pound Sterling). See Horsefield, J. Keith (ed.). 1969. *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Co-Operation. Vol. 3, Documents*. Washington: International Monetary Fund.

British officials were preoccupied by two weaknesses of their economic position. First was the specter of widespread unemployment. /…/ Second was the problem of sterling balances. /…/ U.S. concerns centered on the growth of preferential trading systems from which its exports were excluded, notably the sterling bloc."[374]

Keynes and White indeed agreed on many things, most importantly they were both Keynesians in terms of their macroeconomic worldview.[375] Yet, this tells us very little, as there are many flavors of Keynesianism, which is a big and diverse tent of economists and theories. They both believed:

> "/…/ the key to an open multilateral trading system was to get the international financial system working properly. They viewed the protectionism of the 1930s as essentially a product of currency problems. Essentially, the trade wars were the consequence of currency wars. Secondly, both believed that the excessively free capital flows of the 1920s and 1930s had been destabilizing. And so both endorsed some form of controls on short-term capital flows. Thirdly, both recognized that some mechanism for providing temporary financing to countries running balance of payments deficits – was necessary. And it was necessary because in the 1930s, countries had not had access to short-term assistance and therefore had to impose highly deflationary policies on themselves. [376]"

This commonality is stressed by authors that claim that it is in this common theoretical position that we need to look for the reasons why Bretton Woods conference was successful. As such, Ikenberry argues:

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[374] Eichengreen. 1987. Pp. 23–4.

[375] More on their commonalities see Ikenberry, G. John. 1992. A world economy restored: expert consensus and the Anglo-American postwar settlement. *International organization*. 46(1). Pp. 289–321. Ikenberry, G. John. 1993. The political origins of Bretton Woods. In Bordo, Michael D., and Barry Eichengreen (eds.), *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*. Chicago: University of Chicago Press. Pp. 155–98.

[376] Ahamed, Liaquat. 2014. Bretton Woods: Keynes versus White. In Nauschnigg, Franz, and Sandra Dvorsky (eds.), *Bretton Woods @ 70: Regaining Control of the. International Monetary System*. Vienna: Oesterreichische Nationalbank. Pp. 38–40. At Pp. 38.

> "/…/ ideas inspired by Keynesianism and embraced by a group of well-placed British and American economists and policy specialists was crucial in defining government conceptions of postwar interests, building coalitions in support of the postwar settlement, and legitimating the exercise of American power, particularly as these experts engineered a shift from the contentious trade issues to the monetary issues where there was an emerging "middle ground" created by Keynesian ideas. These experts and their 'new thinking' were important in overcoming political stalemate both within and between the two governments. Put simply, this group of British and American experts intervened at a particularly fluid moment in history to help the British and American political establishments identify their interests, thereby creating the bases of postwar economic cooperation.[377]"

Nevertheless, both chief negotiators also had substantive differences deriving from their different experiences both personally and from their respective nations. First, Keynes was from

> "a privileged Imperial British family, sent to Eton and Cambridge, inculcated from pretty early on in life to believe that he could have and achieve anything he wanted. White was the absolute inverse: short and stocky where Keynes was tall, Jewish where Keynes was anti-Semitic, self-made while Keynes had it all. Keynes had refused to fight in the Great War. White had signed up at the first possible opportunity.[378]"

Second, "The U.K. was a deficit country and a major international debtor after the Second World War; the U.S.A. was a surplus country and the biggest creditor in the world. But it also, I think, emerged from their different experiences. Keynes had been deeply affected by the problems of the 1920s for United Kingdom. By contrast, White was more concerned about the problems of the 1930s."[379]

[377] Ikenberry. 1993. Pp. 157
[378] Conway. 2014. Pp. 42.
[379] Ahamed. 2014. Pp. 38.

Overall, the US plan[380] was targeting price stability, while UK[381] wanted a system that would encourage economic growth. More specifically, White's position was to ensure the stability of currencies and prevent the repetition of competitive devaluations and the restrictions on payments as well as the setting up a bank for reconstruction and development. Keynes's plan was to form an International Clearing Union and to create a large amount of credit to be distributed among all trading countries.[382] "White's plan, which was the more conservative, won out – not because it was intellectually superior, but because the United States had more money and power and US congressmen wanted to see a plan that looked like it was more sparing of American resources. The White plan did not survive – in 1947, the international monetary system became more Keynesian, with the Marshall Plan, and in 1969 more Keynesian still, with the introduction of Special Drawing Rights as a reserve asset.[383]" Finally, even Milton Friedman and Richard Nixon are associated with the phase "We are all Keynesians now."[384]

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[380] See White, Harry D. 1969. *Preliminary draft outline of a Proposal for an International Stabilization Fund of the United and Associated Nations. Rev. 10 July 1943*. In Horsefield, J. Keith (ed.), The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Co-Operation. Vol. 3, Documents. Washington: International Monetary Fund. Pp. 83–96. More on the White plan see Oliver, Robert. 1975. International Economic Co-operation and the World Bank. London: Macmillan.

[381] See Keynes, John M. 1969. Proposals for an International Clearing Union (April 1943). In Horsefield, J. Keith (ed.), The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Co-Operation. Vol. 3, Documents. Washington: International Monetary Fund. Pp. 19–36. More on the Keynes plan see Moggridge, Donald E. 1986. Keynes and the international monetary system, 1909-1946. In Cohen, Jon S., and Gregory C. Harcourt (eds.), *International Monetary Problems and Supply Side Economics*. London: Macmillan. Pp. 56–83.

[382] More on comparing these respective plans see Boughton, James M. 2001. *Why White, not Keynes? Inventing the post-war International Monetary System.* Washington. International Monetary Fund. Accessibility: https://www.imf.org/external/pubs/ft/wp/2002/wp0252.pdf (22 July 2020).

[383] Rauchway, Eric. 2014. Growth as a Means to Stability: The Consensus of Bretton Woods. In Nauschnigg, Franz, and Sandra Dvorsky (eds.), *Bretton Woods @ 70: Regaining Control of the. International Monetary System*. Vienna: Oesterreichische Nationalbank. Pp. 55–65. At Pp. 55-6.

[384] Milton Friedman used this phrase in the middle of 1960s in Time magazine interviews (We Are All Keynesians Now. 1965. *Time*, 31 December 31. Accessibility: http://content.time.com/time/magazine/article/0,9171,842353,00.html (22 July 2020); Letter: Friedman & Keynes. 1966. *Time*. 4 February. Accessibility: http://content.time.com/time/subscriber/article/0,33009,898916-2,00.html (22 July 2020)). President Nixon made it to Howard K. Smith of ABC News on January 4, 1971, off camera no less (Snider, Jeffrey. 2016. We're All Keynesians Now Because We Have No Choice. *Real Clear Markets*, 8 July. Accessibility: https://www.realclearmarkets.com/articles/2016/07/08/were_all_keynesians_now_because_we_have_no_choice_102254.html (22 July 2020)). It was published in The New York Times on January 7 (Nixon Reportedly Says He Is

The US delegation managed, surreptitiously, to insert the US dollar into the official Bretton Woods agreement.[385] Hence, they have taken favorable imbalance of power and the wish and need of everyone to reach an agreement to their advantage. One of the best examples of such a conclusion was the crucial British position and support for the International Clearing Union that would look after the global imbalances, and international currency named 'Bancor'. The United States opposed both vehemently and ultimately prevailed. Diaries of Henry Morgenthau, the US Secretary of Treasury, offer additional vivid descriptions of US behavior and objective. For instance, he states:

> "Whether it is done between governments or whether it is done here, this thing is a matter of postponing the day of reckoning ... the financial center of the world is going to be New York and we don't want to postpone this thing until another day where we may not be in as advantageous a position and maybe have then to get in a horse-trading position and maybe end up by having it in London. Now the advantage is ours here, and I personally think we should take it."[386]

Conway explains[387] that the US objective and strategy was to:

> "keep the Articles of Agreement as vague as possible. Time and time again, Keynes attempted to get White and his assistant Eddie Bernstein to be more specific about what their system would involve. He accused them of writing the whole thing in what he called "Cherokee" – an opaque kind of legal jargon. But the "Cherokee" wasn't purely a hallmark of the strong American legal tradition – it also served a purpose. White and Bernstein were well aware that the more specifics there were in the Articles, the more pinch points there would be which could serve to undermine the stability of the system."

Now a Keynesian. 1971. *The New York Times*, 7 January. Accessibility: https://www.nytimes.com/1971/01/07/archives/nixon-reportedly-says-he-is-now-a-keynesian.html (22 July 2020)).

[385] See Schuler and Rosenberg, (eds.). 2012.

[386] *Diaries of Henry Morgenthau, Jr., April 27, 1933-July 27, 1945*. Vol 753. Accessibility: http://www.fdrlibrary.marist.edu/_resources/images/morg/md1043.pdf (22 July 2020). Pp. 162.

[387] Conway. 2014. Pp. 47.

Subsequently, United States wanted to avoid specifics that would allow non-hegemonic states to have greater leverage. Nevertheless, United States genuinely wanted a new IMS that would facilitate international trade.[388] Hence, under this objective, the United States managed to include the US dollar in the agreement, a move, which in fact was incited by a British economist.[389]

As such, I agree with Block's account of events,[390] who argues that the US position in the creation of the Bretton Woods system may be attributed to the expectation that a decline in spending would return the unemployment of the 1930s, and so the United States wanted everyone to import US goods, thereby keeping their full employment. Therefore, it was in the US interest to financially assist others in their reconstruction, so that they could purchase US goods through free trade arrangements, since no state had any industrial alternative to that of the United States, as well as to facilitate international convertibility of currencies into gold or the US dollar.[391] All this would lead to the centrality of the US dollar. Hence, there is evidence that United States wanted to preserve its dominant economic position.[392] Moreover, there is also evidence that at least part of the US elites had the will and objective to position the US dollar in the center of the monetary and economic relations. The latter argument was made explicit by John Williams – two key currencies (US dollar and British Pound). White disagreed with Williams on geopolitical grounds, as he saw it as a gift to the United Kingdom. He adapted Williams's proposal into his negotiating positions

[388] See National Archives. Record Group 59, Pasvolsky Papers, Office files of Leo Pasvolsky, February-March 1944, Memorandum from Gordon Leddy to Leo Pasvolsky, 16 February 1944.
[389] See Schuler and Rosenberg, (eds.). 2012.
[390] Block. 1977. Pp. 82.
[391] Block. 1977. Chs. 3 and 4.
[392] More on this see Steil. 2013; James, Harold. 2012a. The multiple contexts of Bretton Woods. *Oxford Review of Economic Policy*, 28(3). Pp. 411−30.

(only one key currency – US dollar).[393] As such, preserving US power dominance was lined to economic strength, which in turn to US exports, which could not be expanded if others would not hold US dollars.[394]

As such, the notion of the global centrality of the US dollar had theoretical as well as empirical history in United States. Figure 45 portrays that throughout the 1920s and 1930s gold maintained its dominant position as an international reserve unit.[395] However, more fascinating is to look at the reserves held in currencies, albeit smaller part of international reserves. Here, the US dollar obtained its primacy already in 1920s (see Figure 46).[396] Still, this is an incomplete picture of the monetary relations of that period as Figure 46 only considered third countries, but not the two issuance states – the United Kingdom and the United States.

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[393] More on this see Eichengreen, Barry. 2019a. The Monetary Role of Gold as the Original Sin of Bretton Woods. In Lamoreaux, Naomi, and Ian Shapiro (eds.), *The Bretton Woods Agreements: Together with Scholarly Commentaries and Essential Historical Documents*. New Heaven: Yale University Press. Pp. 38−55; Bernstein, Edward M. 1984. Reflections on Bretton Woods. In *The International Monetary System: Ferry Years After Bretton Woods*. Boston: Federal Reserve Board of Boston, Conference Series No. 28. Pp. 15−20; Asso, Pier Francesco, and Luca Fiorito. 2009. A scholar in action in interwar America: John H. Williams on trade theory and Bretton Woods. In Leeson, Robert (ed.), *American Power and Policy*. London: Palgrave Macmillan. Pp. 180–242.

[394] This causal step was made explicit by James F. Byrnes (director of the Office of Demobilization and Reconversion) on January 2nd, 1945, to US Congress (*New York Times*, 2nd January, 1945. Pp. 12).

[395] Eichengreen, Barry, and Marc Flandreau. 2008. *The rise and fall of the dollar, or when did the dollar replace sterling as the leading international currency?*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w14154.pdf (20 July 2020). Pp. 6.

[396] Farhi, Emmanuel, and Matteo Maggiori. 2016. *A model of the international monetary system*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w22295.pdf (20 July 2020). Pp. 60.

Figure 45: Composition of international reserves from 1924 through 1939

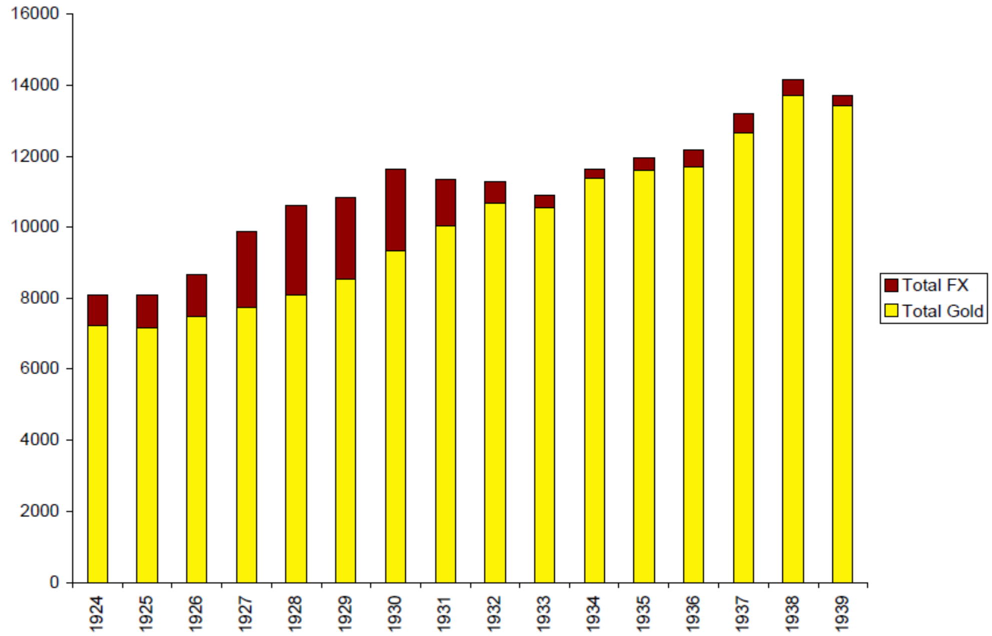
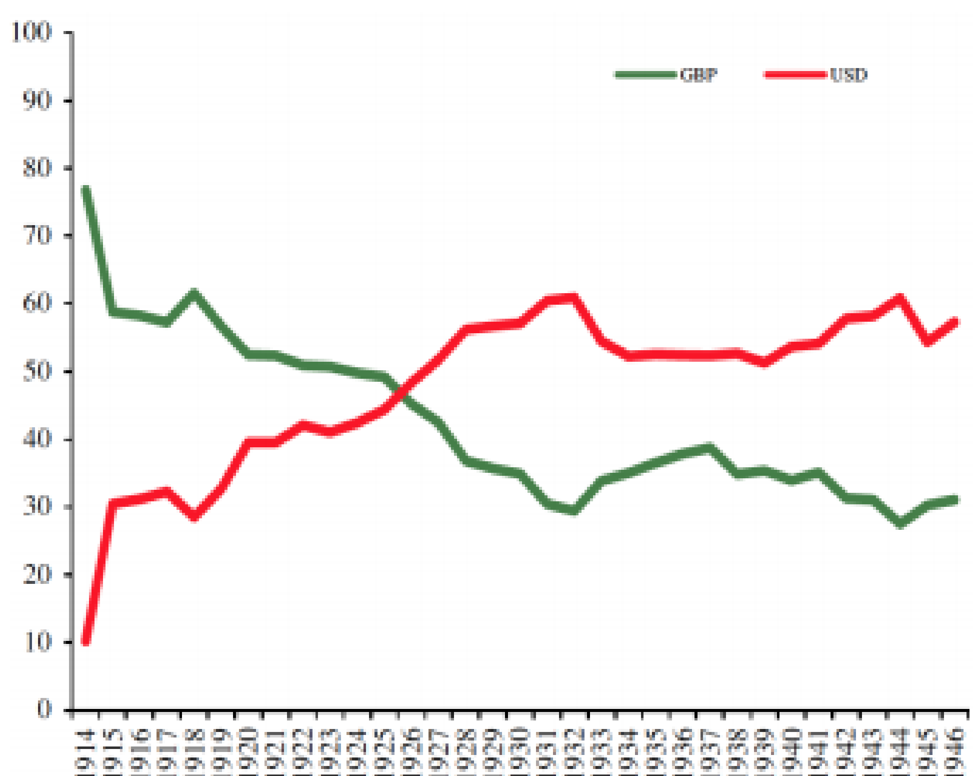
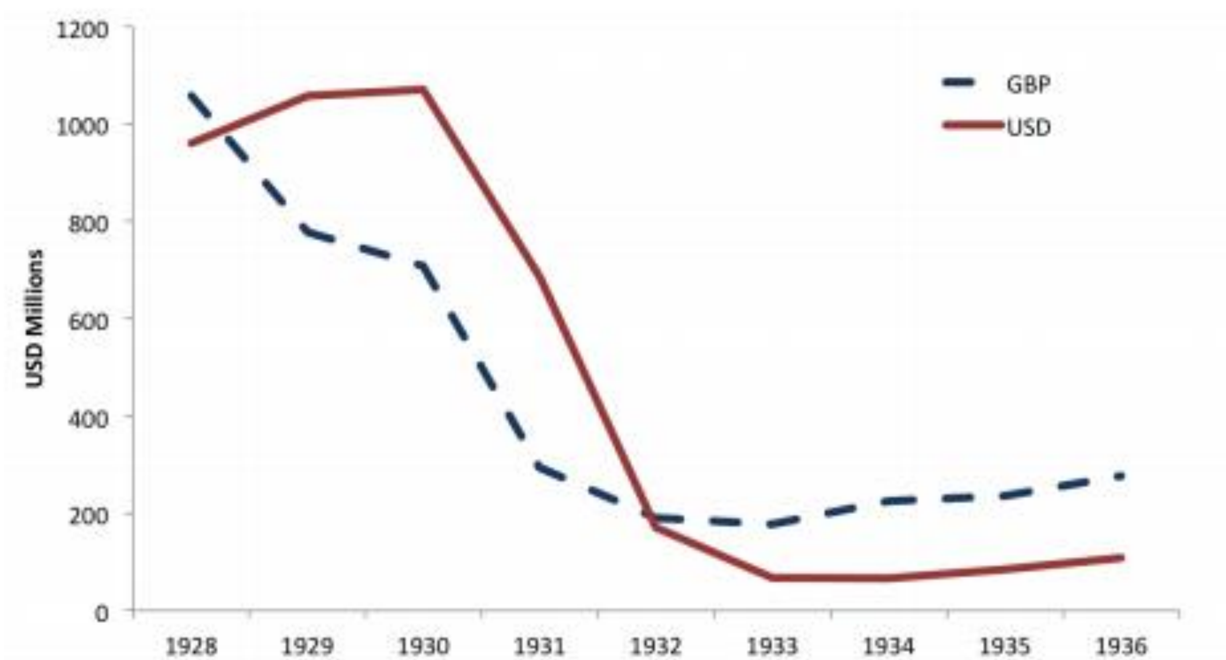


Figure 46: Third party Issuance in Reserve Currency



As such, Figure 47 and Figure 48 are indicative. First, Figure 47 shows all reserves in British Pound and in the US dollar, including the United Kingdom and the United States. We see that the Pound Sterling was hit first and hard by the financial collapse in 1929, followed by the decline of the US dollar only in 1931. Yet, the US dollar actually dropped more than British Pound and lost its dominant position in the global economy.

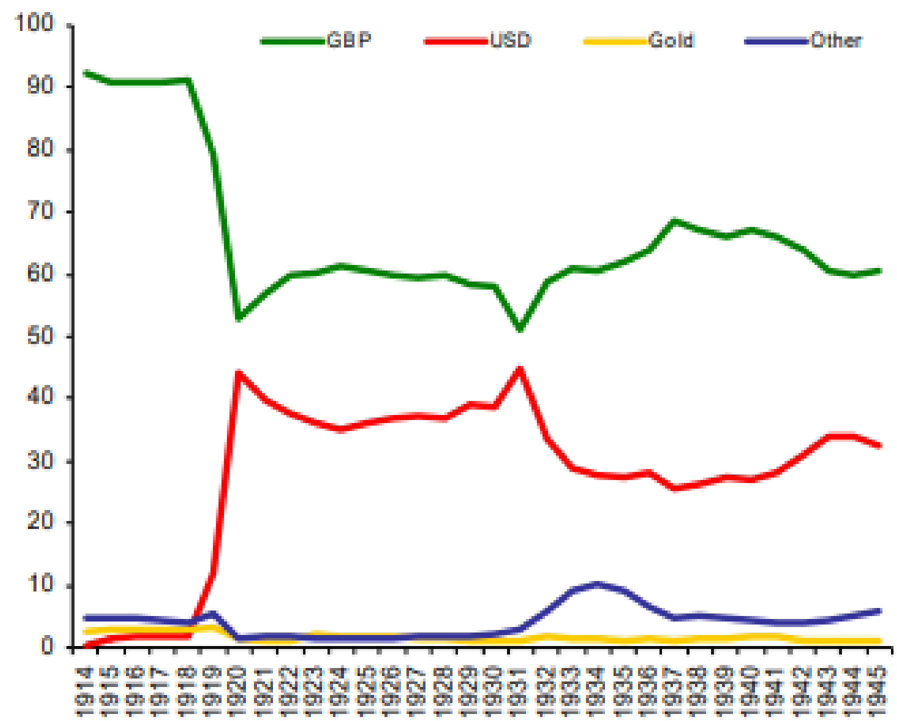
Figure 47: Collapse of international reserves denominated in US dollar and British Pound[397]



[397] Farhi and Maggiori. 2018. Pp. 299.

Second, Figure 48[398] shows global public debt, where British Pound maintained its dominant position throughout 1920s and 1930s. Although both of these Figures paint a more complex picture of the period leading to the Bretton Woods agreement, we can make a deduction that the global position of the British Pound was diminishing throughout this period, and that the US dollar had the opposite trend. Another indication for such a conclusion is the fact that the key area for the British Pound was the Commonwealth, therefore British colonies, whereas the US dollar was gaining traction among nations of Europe, (i.e., other states in the international system).[399]

Figure 48: Global Foreign Public Debt by Selected Currencies



[398] Chiţu, Livia, Barry Eichengreen, and Arnaud Mehl. 2012. *When did the dollar overtake sterling as the leading international currency? Evidence from the bond markets*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w18097.pdf (20 July 2020). Pp. 25.
[399] Chiţu, Eichengreen, and Mehl. 2012. Pp. 24–6. See Eichengreen and Flandreau (2008) for detailed view of individual countries.

Still, the Bretton Woods agreement did not simply cement the centrality of the US dollar – as shown in the previous chapter. This was a process that was generated on both ends – hegemonic (United States) and non-hegemonic. The best example of both were the repeated Pound Sterling crises throughout the Bretton Woods period that asserted the US dollar as the vehicle of the international monetary system.[400] The United States wanted to increase access in trade and finances to the British Empire. Moreover, British colonies wanted their political independence and monetary autonomy. Thus, both sides saw the US dollar as a tool in the service of their deeper national interests. Hence, step by step the British Empire broke down, and the US dollar took the role of the key currency in global monetary relations.[401]

In looking at the trade data, as a proxy measure of the usage of a currency, the conclusion about this dynamic stands. Figure 49 shows aggregate trade data for the United Kingdom and the United States in-between the two World Wars they moved hand in hand. The Second World War expediated the US dominance in international trade. Furthermore, Figure 50 shows the same data in a network perspective, where leading to the Second World War, the United Kingdom maintains a lead in trade centrality; yet the war tanks its dominance and puts it at par with United States.[402]

Finally, one of the aforementioned reasons for the successful creation of the Bretton Woods IMS and a condition for a pervasive hegemony is the imbalance of power. The United States was

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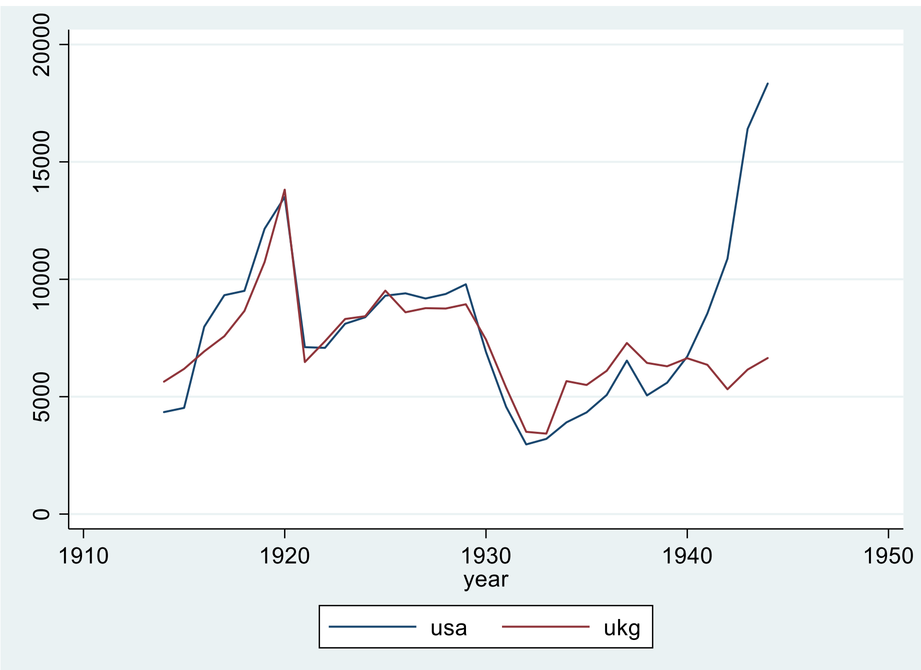
[400] See Gardner, Richard N. 1956. *Sterling-dollar diplomacy*. New York: McGraw-Hill; Gardner, Richard N. 1985. Sterling-dollar diplomacy in current perspective. *International Affairs*, 62(1). Pp. 21–33.
[401] Lundestad, Geir. 1986. Empire by Invitation? The United States and Western Europe, 1945-1952. *Journal of peace research*, 23(3). Pp. 263–77.
[402] *Barbieri, Keshk, and Pollins. 2009*.

clearly the most powerful country, and so "ultimately was able to impose its will on the others, including an often-dismayed Britain."[403] Looking empirically at this issue, CINC scores show a constant gap throughout the inter-war period between the United States and the United Kingdom. Moreover, it is again the Second World War that contributes exponentially to the imbalance of power (See Figure 51).[404] Moreover, Figure 52[405] and figure 53[406] each show a different measure of GDP of these two countries and display the same story: initial gap after World War one was filled by the United Kingdom after the financial crisis of 1929. Still, after 1940, the gap again raises rapidly.

Figure 49: Aggregate trade of United Kingdom and United States[407]



[403] Fitz-Gerald, Keith. 2010. *Fiscal hangover: how to profit from the new global economy*. Hoboken: John Wiley and Sons. Pp. 46.
[404] *Singer. 1987.*
[405] Data in 2011 US dollars. The method is suitable for cross-country income comparisons. See Maddison Project Database, version 2018.
[406] Data in 2011 US dollar, 2011 benchmark. The method is suitable for cross-country growth comparisons. See Maddison Project Database, version 2018.
[407] *Barbieri, Keshk, and Pollins. 2009*.

Figure 50: Network centrality in international trade of United Kingdom and United States

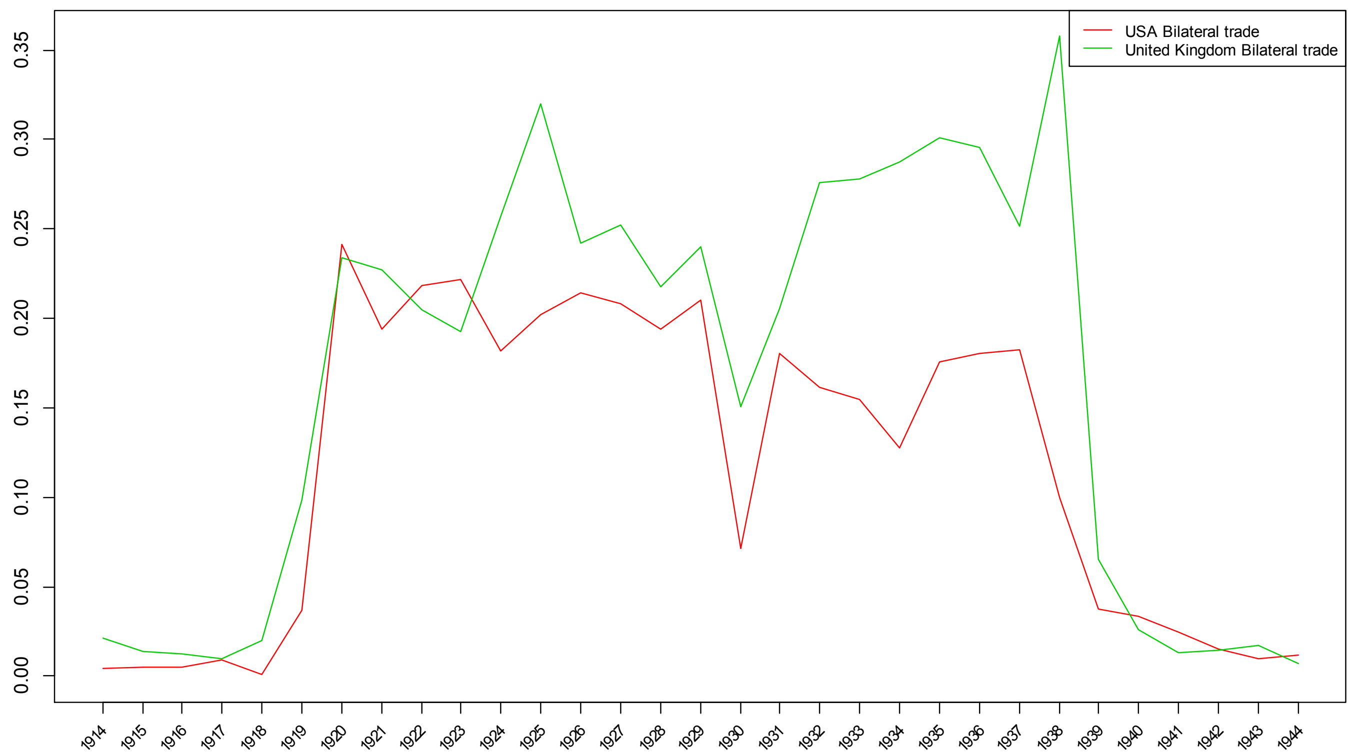


Figure 51: CINC scores of United States and United Kingdom

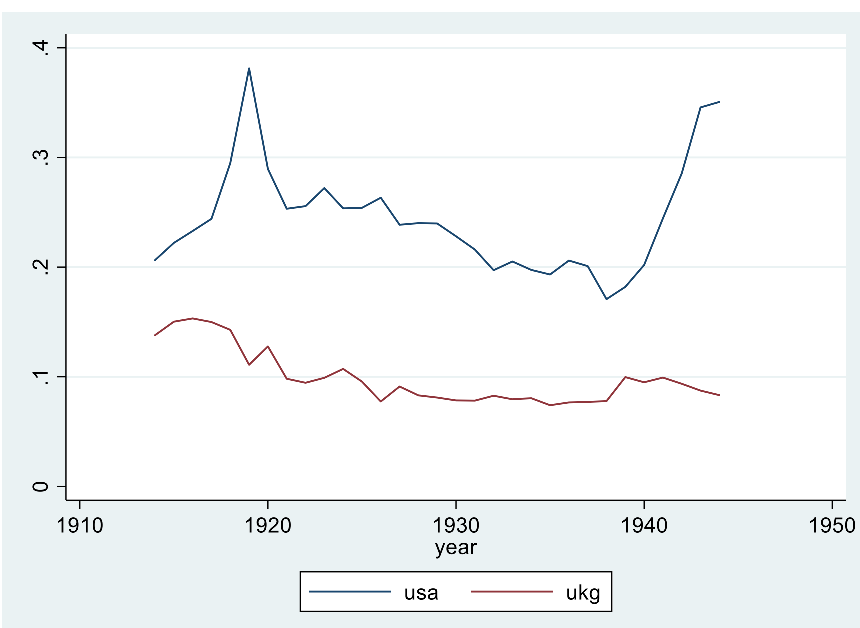


Figure 52: Real GDP per capita for United States and United Kingdom 1

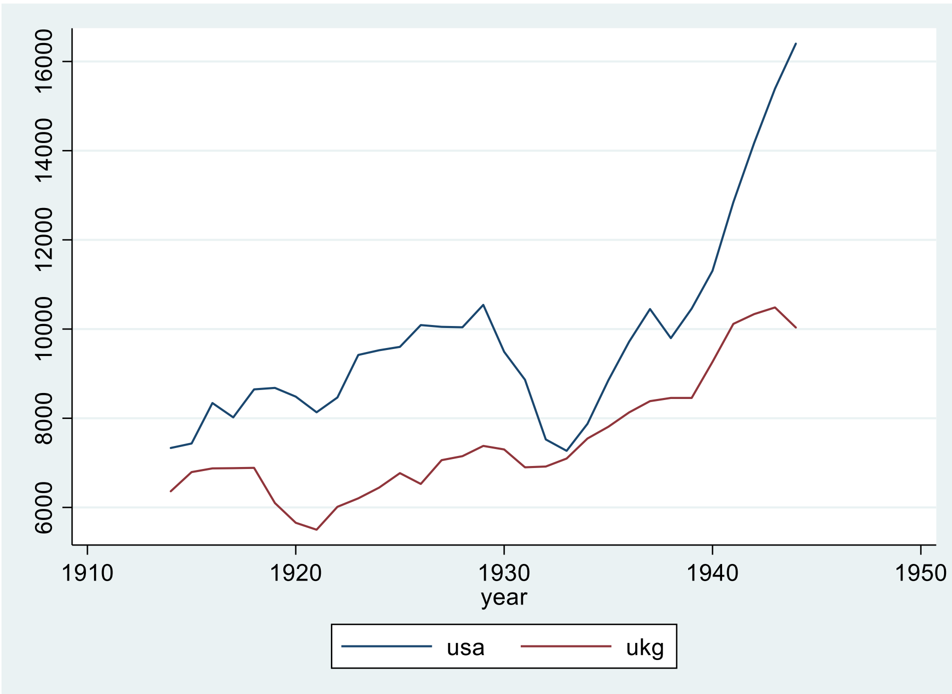
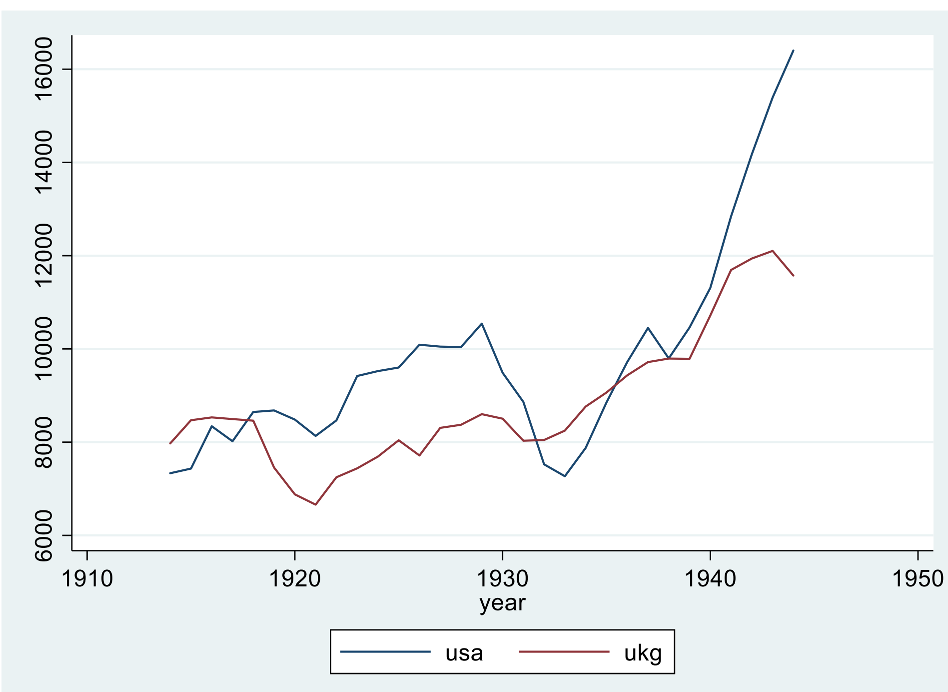


Figure 53: Real GDP per capita for United States and United Kingdom 2



Thus, the post-1945 IMS was born out of American strength. The United States replaced the United Kingdom on the hegemonic throne. This was done in accordance with other states, which wanted to accept the Bretton Woods agreement that they thought will benefit them. Namely, the US industry and economy was the only one not affected by the material destruction of the World War II. Hence, the United States wanted to preserve such a situation, and the Coercive Hegemony explanation draws a good account of these events – forcing other states into a new system.

Yet, as it turned out, it was not the Bretton Woods IMS that was most significant, since it did not reflect the needs of the economic environment, but it was the centrality of the US dollar that was the long-term benefit for United States and for its hegemony. Furthermore, the US wish for centrality of New York as the global financial center, and the US dollar as the central currency in the monetary and trade relations, were crucial objectives and interests not only for United States, but also for other countries. Hence, (diplomatic) coercion is not the only story here. Thus, also Pervasive Hegemony can explain the creation of the Bretton Woods IMS. The United States opted for it because through it, it could maintain its economic advantages, as well as facilitate its international monetary centrality. Yet, it was not fully aware of the economic environment it was entering in, and these two objectives came into contradiction as time and the Bretton Woods IMS advanced. Interestingly, also non-hegemonic states needed time to fully understand the economic environment in which they operated. The Bretton Woods IMS provided leadership, financial stability, and generated economic recovery. That is why they supported it and accepted the US dollar as the key currency in such an IMS. However, all features of the Bretton Woods IMS turned out to be epiphenomenal to the US dollar, which was the only vehicle non-hegemonic states could operate within an increasing interconnected economy. Thus, non-hegemonic craving for the US dollars, contributed to its centrality and willingly undermined the Bretton Woods IMS. Both sides supported the creation of the Bretton Woods IMS and the position of the US dollar in it due to their selfish national interests. The United States wanted to preserve the imbalance of power, while non-hegemonic states wanted to generate economic growth.

An alternative interpretation of these events is stressed by Cooperative Hegemony, which sees the creation of the Bretton Woods international institutions as a means to create an order more durable and stable than previous orders, where the benign hegemon would be bound by and into the multilateral network of international regimes. In such a perspective, the system was created to advance US interests and power by assuring long-lasting stability and peace.[408] In the words of William L. Clayton (Assistant Secretary of State): "Nations which act as enemies in the marketplace cannot long be friends at the council table."[409] However, these theoretical assumptions and rhetoric lack empirical evidence, as I have previously shown. "Bretton Woods system was not driven by some grand idealistic purpose on the part of its founders, but by considerations of national interest."[410] The US objectives and motives were linked to its domestic audiences (assuring its trade dominance), through which the US wanted to assure its power dominance. United States needed to take the lead in creating an IMS to facilitate that – stabilize currencies, ease financial crises, promote world commerce, all of this is to be facilitated by the centrality of

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[408] See Ikenberry, G. John. 1989. Rethinking the origins of American hegemony. *Political Science Quarterly*, 104(3). Pp. 375–400; Ikenberry. 2001; Ikenberry. 2011.
[409] Clayton, William L. 1945. Address before Economic Club of Detroit, Michigan, 21st May. Department of State Bulletin 12(309), 27th May 1945. Pp. 979–82.
[410] Gavin, Francis J. 1996. The legends of Bretton Woods. *Orbis*, 40(2). Pp. 183–99. At. Pp. 185.

the US dollar in global economic relations. Hence, the international institutions created for global governance were in place for enhancing US power, not to tame it. The next chapters will deal with the issue of stickiness of the Bretton Woods institutions that somehow survived the end of their initial IMS.[411]

Furthermore, gradually a liberal-free-market economic ideology was put at the vanguard against the competing communist ideology and so the idealist account of the Bretton Woods system (universality, equality, liberalization) fade with the outbreak of the Cold War.[412] As such, Cultural Hegemony may have something to say about the creation of the Bretton Woods system. Yet, this narrative clarifies the role of the Bretton Woods system in the broader Cold War context, not its inception as the time frame does not add up – Bretton Woods was created in 1944 and the Cold War broke out later (1947 Truman doctrine was adopted). Soviet Union even had a third largest voting power in the IMF; therefore, the Bretton Woods IMS was not an early Cold War product.[413] An argument relevant for the Bretton Woods IMS inception is the ideological commonality between negotiators of the agreement.[414] However, as previously shown, such commonality tells us very little how the negotiators behaved and what were their positions. Broad theoretical or ideological common denominators are thus not a good explanation for the Bretton Woods IMS. Nevertheless, the communism-capitalism divide and its role in the functioning of the Bretton Woods IMS will be addressed in the next subchapter.

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[411] Ikenberry. 1993. Pp. 155.
[412] See Engerman, David. 2010. Ideology and the Origins of the Cold War, 1917–1962. In Leffler, Melvyn P. and Odd Arne Westad (eds.), *The Cambridge History of the Cold War Vol 1*. Cambridge: Cambridge University Press. Pp. 20−43.
[413] Pollard, Robert A. 1985. Economic Security and the Origins of the Cold War: Bretton Woods, the Marshall Plan, and American Rearmament, 1944–50. *Diplomatic History*, 9(3). Pp. 271–89.
[414] Ikenberry. 1992; Ikenberry. 1993.

Lastly, in line with the latter consideration, is also the argument for providing public goods – the Opportunist Hegemony account for creating Bretton Woods IMS. The gradually increased US current account deficits are a consequence of the will to provide public goods and satisfaction among non-hegemonic states so that they would not switch sides in the bipolar Cold War system, or that they would be able to withstand attacks from the adversary. However, this explains how the Bretton Woods system was used, not why it was set up as it was. Moreover, the fact that such 'buy-out' began in 1948 (introduction of the Marshall Plan) not together with the creation of the Bretton Woods system immediately after the war in 1945, raises concerns that Opportunist Hegemony does not fully capture the creation of the Bretton Woods system. The logic of the US delegation was rather mercantilist – the motivation was to secure the level of exports to other countries and the position of US industry, not generating support from other non-hegemonic states. Still, this explanation becomes very powerful in the next sub-chapter, which deals with the performance of the Bretton Woods IMS.

4.2 (NOT)FUNCTIONING OF THE BRETTON WOODS MONETARY SYSTEM

As stated in the previous chapter, the changed nature of the economy and lack of adjustment are the essential reasons for the downfall of the Bretton Woods IMS. Both reasons generated lust for more liquidity that put pressure on the US gold reserves. However, the United States was willing to replace gold with US dollars, and the non-hegemonic states were willing to accept it. Still, that did not solve the US Triffin dilemma[415] within a dysfunctional international monetary

[415] Illustrating contradicting domestic and international interests of a hegemon.

architecture.[416] Ultimately, this dilemma could not be otherwise resolved but by building a different IMS that would better assure US interest, hence the 1971 Nixon shock.

By and large the Bretton Woods IMS provided economic results that states desired: materially states grew at a higher rate than ever before,[417] inflation was low, real long-term interest rates were low, growth was evenly distributed (developed vs. developing nations), international trade expanded even faster than global productivity, trade liberalization reproduced additional trade growth, which in turn reinforced liberalization.[418] Yet, this was a façade, as the architectural fundaments of the IMS were slowly, but surely crumbling.

The unsound constellation worked for two interlinked reasons – economic and political[419] − which one can synthesize into a simple political-economy reason that advanced the central position of the US dollar in the global economy.[420] Namely, the "expansion of international credit /printing US dollar/ during the 1960s provided means of establishing larger reserves and of postponing adjustment /…/ US dollar /…/ became the world's major reserve /…/ Reserves outside the United States were stocked up, as the counterpart of the outflow of dollars from the United States (largely for investment) in practice filled the 'reserve gap'."[421] This reinforcing of the

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[416] See Bordo. 1993. Pp. 80; Cooper, Richard N. 1984. Is there a need for reform? In *The International Monetary System: Ferry Years After Bretton Woods*. Boston: Federal Reserve Board of Boston, Conference Series No. 28. Pp. 21–39.
[417] Kuznets, Simon. 1977. Two Centuries of Economic Growth: Reflections of U.S. Experience. *American Economic Review*, 67(1). Pp. 1−14.
[418] James. 1996. Pp. 148.
[419] James. 1996. Pp. 153.
[420] While I present a structural argument for Bretton Woods IMS survival curve – its relevance and utility for states to further their interests, Bordo (1993) makes a different argument: sound economic policies of states, which in his account declined in late 1960s and generated different rates of inflation across the system. The latter, combined also with speculative capital transactions (the new nature of the economy), brought the end of Bretton Woods IMS. My argument includes the last point as a reflection of the changing nature of the economy, while Bordo's unsound economic policies may be paralleled with the lack of adjustment in my argument.
[421] James. 1996. Pp. 153.

centrality of the US dollar and United States in the global economy was accompanied with political dynamics of alliances and security considerations. Perhaps the most obvious examples are the Cuban missile crisis and the Vietnam war, where European states, particularly France – a vocal economic adversary of the United States, which even withdrew from military structures of NATO − helped the United States.[422] Moreover, they also received a free security umbrella.[423] As such, this dynamic was in the interests of both the hegemon and the non-hegemonic states. Therefore, the Bretton Woods IMS assured vital interests of both sides and it survived until it was able to perform such a role.

The 1960s were labeled as the golden age of capitalism.[424] For the United States, it was hegemony on the cheap, since it could print money without any costs, and it could spend as much as it wanted. For European countries and Japan, it was economic growth on the cheap. It effected the US exports negatively and boosted theirs. However, although the US exports fell in relative terms to other sates', the United States was able to 'export' its inflation by providing the global central monetary unit – the US dollar. Since other non-hegemonic states wanted to maintain their currency values and keep their exports high as well as generate their economic growth and full employment, they wanted to purchase these dollars. By the 1970s, the US dollar reserves far exceeded gold reserves and the need for revaluing currencies became crystal clear.[425] Yet, adjustment was something that non-hegemonic states were reluctant to perform. Instead, they have

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[422] See Kissinger, Henry. 1994. *Diplomacy*. New York: Simon and Shuster. Pp. 605; Kissinger, Henry. 1982. *Years of upheaval*. New York: Simon & Schuster. Pp. 129.
[423] More on the political considerations of relations between security and economic issues during the Bretton Woods IMS see, Gavin, Francis J. 2002. The Gold Battles within the Cold War: American Monetary Policy and the Defense of Europe, 1960–1963. *Diplomatic History*, 26(1). Pp. 61–94.
[424] Fletcher, Gordon. 1989. *The Keynesian Revolution and Its Critics: Issues of Theory and Policy for the Monetary Production Economy*. New York: Palgrave Macmillan. Pp. XX.
[425] Balaam, David N., and Michael Veseth. 2008. *Introduction to international political economy*. Upper Saddle River: Pearson. Pp. 138−9.

craved more liquidity to offset for that – creating constant dollar shortages. This hypocrisy may be most evident in France, which obtained US dollars for their reconstruction and growth, while at the same time complaining about American 'exorbitant privilege'.[426]

Moreover, the situation where adjustment was not happening, the effects of the changing nature of the economy was amplified. Paradoxically, the very thing that the Bretton Woods system facilitated – expanding international trade and generating economic growth – was also what caused increased capital flows and subsequently contributed to the creation of the financial economy we know today. This turn of events attests to a different kind of economy, which the makers of the Bretton Woods IMS did not foresee. First, exponential growth of international transactions led to a high level of monetary interdependence (Eurodollars, and Petrodollars).[427] Second, the creation of international banking consortia: by 1971 90% of 50 world's biggest banks had become a part of broader and larger conglomerates.[428] This trend reinforced the first one.[429] Third, the

[426] The words of French economic minister Valery Giscard d'Estaing, which were echoed by French President De Gaul on February 4th, 1965. See Lacouture, Jean. 1993. *De Gaul the Ruler, 1945-1970*. New York: WW Norton. Pp. 381.

[427] The term Eurodollars describes the US dollar deposits outside United States; thus, not under jurisdiction of the Federal Reserve. The term Petrodollars refers to international investments of oil producing countries, see Kim, Kenneth A., and Suk H. Kim. 2011. *Global Corporate Finance: A Focused Approach*. London: World Scientific. Ch. 9.

[428] Ganoe, Charles. 1972. Banking Consortia: are they here to stay?. *Columbia Journal of World Business*, 7(4). Pp. 51−7.

[429] "Between 1955 and 1960, the New York banking scene witnessed a wave of mergers between large banks. The Chase National Bank merged with the Bank of Manhattan Co., and the Bronx County Trust Co., to establish the Chase Manhattan Bank. The National City Bank of New York, previously the second largest bank in the country, took over the First National Bank of New York. Soon after that, the Bankers' Trust Co., acquired the Public Bank and Trust Co. of New York; during the previous five years the same bank had absorbed the Title Guarantee & Trust Co., the Lawyers Trust Co., the Flushing National Bank, the Commercial National Bank and the Bayside National Bank. Also in the mid-1950s the Chemical Bank and Trust Co. was merged with the Corn Exchange Bank and Trust Co., to form the Chemical Corn Exchange Bank. This was followed by another huge merger in 1959, with the New York Trust Co., establishing the Chemical Bank New York Trust Co. as New York's third largest bank. In the same year the Morgan Guaranty Trust Co. emerged as the fifth largest New York bank after the merger of the Guaranty Trust Co. and J. P. Morgan and Co. Inc. Finally, in 1961, the Manufacturing Trust Co. merged with the Hanover Bank, to form the Manufacturers Hanover Trust, the third largest bank in New York, and the fourth largest in the world (the first being the Bank of America, based in California). The combined consequences of the five mergers were dramatic. By 1961, the Department of Justice noted-in the course of an anti-trust suit brought and lost against

consequence of the first two reasons was that the financial-economic sector started to outgrow the real-economic sector.[430] "By the end of the 1970s, financial flow size dwarfed trade flows by 25:1 and they were much more volatile."[431] Today, 99% of all financial transactions are short term-speculative transactions. Eichengreen puts it simply: "It became easier to over or under-invoice trade and to spirit funds abroad."[432]

4.2.1 The New Economy Problem

The ease and speed of financial transactions became unprecedented and put pressure on the Bretton Woods IMS which was based on controlling capital flows and fixed exchange rates. The latter were the first to feel the pressure as speculations about the value of the US dollar and other currencies pegged to it, arose in the international markets and international banks. The separation of the gold market to an official state-run with fixed exchange rate and private free-market-run markets, only enhanced speculations about devaluing of the US dollar and appreciation of other currencies.[433] Namely, alongside official (state to state) gold market, where states would exchange gold to pay off their debts and where the price of gold was fixed (35 US dollars an ounce), an unofficial private-non-state-related market for gold arose, where private entities would buy and sell gold independent of the fixed US dollar price of gold.[434] Furthermore, the first bonds

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the last-mentioned merger that the concentration of deposits in the five largest banks in New York City was 75 per cent of all bank deposits, while the same five banks were responsible for 77 per cent of total commercial bank loans in the same area" (de Cecco. 1976. Pp. 385–6).

430 See Menkhoff, Lukas, and Norbert Tolksdorf. 2000. *Financial market drift: Decoupling of the financial sector from the real economy?*. New York: Springer.

431 Gilpin. 2001. Pp. 240.

432 Eichengreen. 1998. Pp. 119.

433 De Vries, Margaret Garritsen. 1976. *The International Monetary Fund, 1966-1971, Vol I: Narrative*. Washington: International Monetary Fund. Pp. 405−9.

434 See Krugman and Obstfeld. 2008. Pp. 523.

denominated in US dollars issued outside the United States appeared in 1963 giving rise to the Eurobond market. This meant that the United States could not alone control the global money supply.[435] Subsequently, it was in Europe where the financial earthquake of the early 1970s originated.[436] The latter interconnectedness is also displayed by the internationalization of banks. Figure 56 shows how the exposure of US banks to foreign markets grew through the 1960s.

Another simple illustration of this new nature of the economy is the measurement of velocity of money (how fast does the unit of money change possession within a given period of time).[437] Figure 57 displays a stationary velocity of money in the period between the World Wars, while Figure 58 shows a rising level of velocity of money during the Bretton Woods IMS.[438] These two figures do not only tell us that the velocity of money in mid 1950s reached the levels of pre-Second World War economy, but also that money changed hands in accelerating pace even after that level. Therefore, indicating that something fundamentally has changed in the way the economy functions – a different nature of the economy.

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[435] See He, Dong, and Robert N. McCauley. 2010. *Offshore Markets for the Domestic Currency: Monetary and Financial Stability Issues*. Basel: Bank of International Settlements. Accessibility: https://www.bis.org/publ/work320.pdf (11 July 2019).

[436] de Cecco. 1976. Pp. 398.

[437] More on velocity of money see Garvy, George, and Martin R. Blyn. 1970. *The Velocity of Money*. New York: Federal Reserve Bank of New York.

[438] The ratio is GNP to the money stock. Subsequently one would get different ratio based on the type of measurement of money stock – M1, M2, MZM, etc. M1 is the narrowest definition, while MZM is the broadest. More on these measures, see Federal Reserve Bank of New York. 2008. *The Money Supply*. Accessibility: https://www.newyorkfed.org/aboutthefed/fedpoint/fed49.html (2 July 2020). However, regardless of the money supply measure used, the story in regard to the Bretton Woods IMS is the same – money velocity was rising, while between the two World Wars it stayed the same. I think that M1 is the most appropriate definition and the supply of money, which we would be most interested in the process of calculating money velocity. "M1 is the money supply of currency in circulation (notes and coins, demand deposits, and other liquid deposits). A decreasing velocity of M1 might indicate fewer short- term consumption transactions are taking place. We can think of shorter- term transactions as consumption we might make on an everyday basis" (FRED. 2021b. *Velocity of M1 Money Stock*. Accessibility: https://fred.stlouisfed.org/series/M1V (1 May 2021)).

Figure 56: International Operations of US Banks 1960-1974 (billions of US dollars)[439]

Category	1960	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974 (Sept.)
I. U.S. Offices[1]												
Bank Credit to Foreigners[2]	$4.2	9.4	9.7	9.6	9.8	9.2	9.3	9.7	12.1	13.4	17.2	26.5
Foreign Deposits[2,3] (other than Due to Foreign Branches)	$9.1	13.4	13.6	12.6	14.4	14.7	16.5	16.5	17.1	17.4	21.8	28.6
Due to Foreign Branches[4]	—	1.2	1.3	4.0	4.2	6.0	12.8	7.7	0.9	1.4	2.5	2.9
II. Overseas Branches of Banks[5]												
Number of Banks with Overseas Branches	8	11	13	13	15	26	53	79	91	108	125	129
Number of Overseas Branches	131	181	211	244	295	375	459	536	583	627	699	737
Assets of Overseas Branches[6]	$3.5	6.9	9.1	12.4	15.7	23.0	41.1	52.6	67.1	77.4	118.0	155.0 p.e.
III. Edge and Agreement Corporations												
Number	15	38	42	49	53	63	71	77	85	92	104	114
Assets	0.6	0.9	1.0	1.4	1.5	2.5	3.5	4.6	5.5	6.0	6.9	NA
Memorandum:												
All Commercial Banks in U.S.												
Total Assets	$255.7	343.9	374.1	401.4	448.9	498.1	527.6	576.2	640.3	732.5	827.1	872.0[J]
Total Deposits	228.4	305.1	330.3	351.4	394.1	432.7	434.1	480.9	537.9	612.8	677.4	703.8[J]

NOTE: Data are for end of year through 1973. Data for 1974 are for September (except where footnoted J—end of June). p.e. Partly Estimated.
1. All data for U.S. offices are on a balance of payments basis.
2. Bank credit to foreigners and foreign deposits relate to all commercial banks reporting on the Treasury foreign exchange forms, and include credits and deposits of branches and agencies of foreign banks as well as U.S. banks. Bank credit includes short- and long-term loans and acceptance credits denominated in dollars; for 1960, some other short- and long-term claims are also included. Data for 1972 through 1974 do not include claims on U.S. banks or their foreign branches or claims of U.S. agencies and branches of foreign banks on their head offices.
3. Foreign deposits include demand and time deposits of one-year or less maturity, and beginning in 1964, include negotiable certificates of deposit issued to foreigners and international institutions.
4. Due to branches refers to the gross liabilities due to foreign branches of large U.S. weekly-reporting banks.
5. Overseas branches include branches of member banks in U.S. possessions and territories as well as in foreign countries.
6. Branch assets include interbranch balances.

Sources: Treasury Forms B-2 and B-3; Federal Reserve Board.

439 Brimmer, Andrew F., and Frederick R. Dahl. 1975. Growth of American international banking: implications for public policy. *The Journal of Finance*, 30(2). Pp. 341–63. At Pp. 345.

Figure 57: Money Velocity from 1921 and 1931[440]

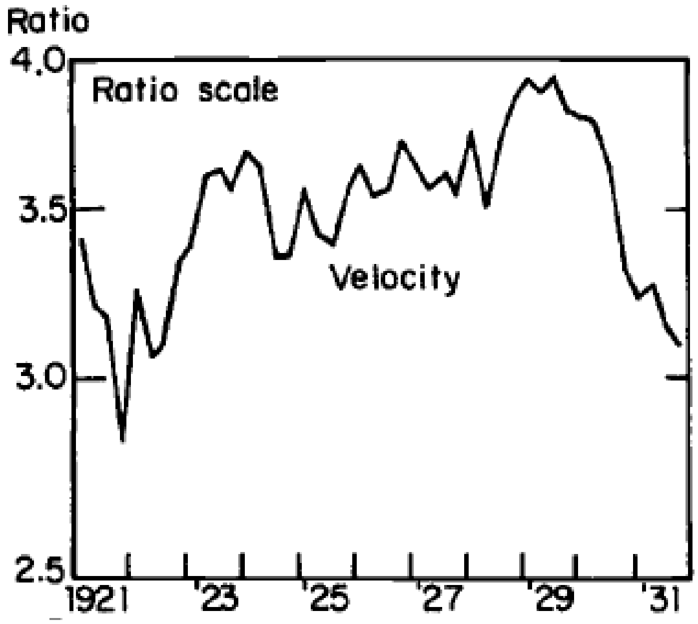
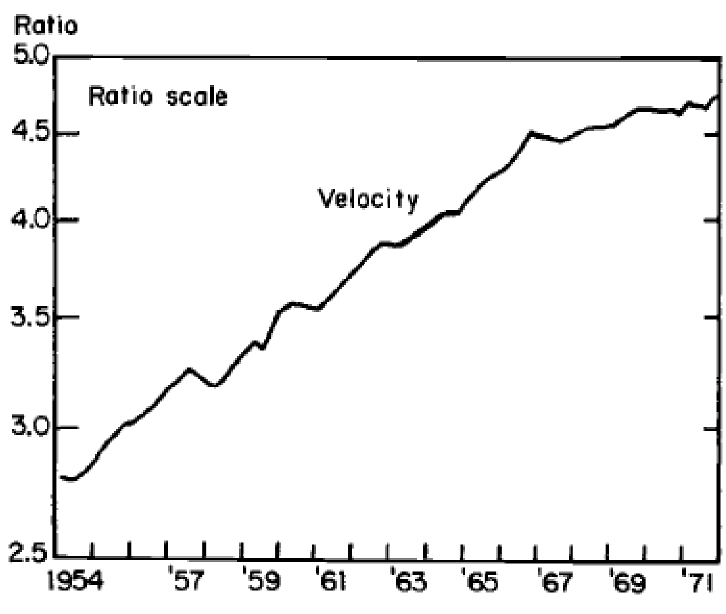


Figure 58: Money Velocity from 1954 and 1971[441]



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[440] Cagan, Phillip, and Anna J. Schwartz. 1987. Has the growth of money substitutes hindered monetary policy?. In Anna J. Schwartz (ed.), *Money in Historical Perspective*. Chicago: University of Chicago Press, 1987. Pp. 209–33. At Pp. 215.

[441] Cagan and Schwartz. 1987. Pp. 216.

As such, with the changing nature of the economy, state behavior was also different than what the architects of the Bretton Woods IMS envisioned. First, the “transition period from war to peace was much longer and more painful than was anticipated. Full convertibility of the major industrial countries was not achieved until the end of 1958.”[442] This means that until 1958 there were exchange controls even for current account transactions (international trade).[443], The IMF articles of Agreement[444] called the states to make their currencies convertible as soon as possible, as this would promote international trade. The US and Canadian dollars became convertible in 1945.[445] European currencies did so by the end of 1958[446] and Japan only in 1964. Since the US dollar was the only global convertible currency, this generated denomination of international reserves and international trade in US dollars, not in local currencies. Furthermore, entities wanted to hold US dollars as their reserves. As foreign exchange markets grew, so did the financial integration and the desire to move funds across borders. Enhanced global capital flows created pressures on the Bretton Woods IMS that was set to hamper and control it. Furthermore, it was only in the 1950s that West European countries and Japan obtained a current account surplus (1954).[447] Therefore, the first 9 years of the Bretton Woods IMS may be labelled as a period of Leontief paradox, where a country (e.g., United States) has a surplus in both labor- and capital-

[442] Bordo. 1993. Pp. 37.
[443] More on this see Tew, Brian. 1988. *The Evolution of the International Monetary System*. London: Hutchinson; Mckinnon, Ronald. 1979. *Money in International Exchange: The Convertible Currency System*. Oxford: Oxford University Press; Black, Stanley W. 1987. International monetary institutions. In Eatwell, John, Murray Milgate, and Peter Newman (eds.), *New Palgrave Dictionary of Economics*. London: Macmillan. Pp. 917–20.
[444] *Articles of Agreement of the International Monetary Fund*. 2016.
[445] Krugman and Obstfeld. 2008. Pp. 516.
[446] For more on the issue of EU currency convertibility and the success and traps of EU payments union see Kaplan, Jacub and Günther Schleiminger. 1989. *The European payments union: Financial diplomacy in the 1950s*. Oxford: Oxford University Press.
[447] See Triffin, Robert. 1957. *Europe and the Money Muddle*. New Haven: Yale University Press. Ch. 2.

intensive goods.[448] With the benefit of the hindsight, it is logical for us today to argue that states devastated by the Second World War, would not have the infrastructure necessary to actually start rebuilding, and would depend on labor intensive goods from states whose infrastructure was not affected by war. Thus, only once they manage to recover the fundamental infrastructure, they would be able to develop their own industry and take advantage of their abundance of labor force and hence generate labor intensive goods. Yet, such a situation was unknown to the founders of the Bretton Woods IMS. Furthermore, since true development of these countries only began in the mid-1950s, once they grasped their manufacturing potential, these states would be obsessed with these policies for years to come, which led to their particular international monetary behavior in the 1960s.[449]

Second, although the Articles establishing the IMF and Bretton Woods IMS treated currencies as equals, the fact that the US dollar was directly pegged to gold and other currencies to the US dollar, created a hierarchy. In fact, this was not a gold standard, but a gold exchange standard. Moreover, there was a 1% parity zone fluctuation established when it comes to fixed exchange rates of other currencies to the US dollar. Thus, the exchange rates were not in an adjustable peg (adjustment happens when there are severe balance of payments imbalances), but in a peg with a band. Since capital controls were put in place to assist in preventing the need for peg adjustment, there was also no incentive from states' perspective to subscribe to these controls. Namely, their exchange rate was de facto in a peg, and they did not want to adjust so they did not need the help of capital controls, so they took advantage of free(er) flow of capital to compensate

[448] Leontief, Wassily. 1953. Domestic Production and Foreign Trade; The American Capital Position Re-Examined. *Proceedings of the American Philosophical Society*, 97(4). Pp. 332–49.
[449] See also Bordo. 1993.

for that decision. States also did not desire to adjust their exchange rates due to an economic competitiveness factor – keeping their exports attractive, there were risks associated with loss of prestige when one changes its parity, the shadow of interwar 'beggar thy neighbor' policies, as well as the pressure from speculative capital flows when a hint of a potential parity change occurred. In fact, there were incentives coming from the private sector not to adjust, since private (financial) businesses benefited from enhanced capital transactions,[450] which in fact led to higher yields for both a company and a state. These developments were not in the economic playbook that the founders of Bretton Woods IMS have had when creating the system.

Third, a decline of Sterling and the rise of the US dollar was another, symbolic, indication of a different economy than what the founders of the Bretton Woods IMS envisioned. Through the first decade of the Bretton Woods IMF, the US dollar rose as the key reserve currency. Figures 8 and 22 from previous chapters display this dynamic, together with a sharp decline in Sterling's position, which was equally important in the global economy as the US dollar at the end of the Second World War.[451] Moreover, in the 1960s, the US dollar also overtook gold as the crucial reserve unit. Although the founders of the Bretton Woods IMS intended that the US dollar would have a special role in a new IMS (fixed parties of other currencies to it), they envisioned and built the IMS around a different role of the US dollar, which in fact the latter obtained. Furthermore, they definitely did not plan or foresee a rapid sharp Sterling decline starting in the late 1940s. Namely, the Bretton Woods IMS was initially tested with micro-crises.[452] These events began in

[450] See Bordo. 1993. Pp. 36–50.
[451] Schenk, Catherine R. 2010. *The decline of sterling: managing the retreat of an international currency, 1945–1992*. Cambridge: Cambridge University Press.
[452] See Milward, Alan S. 1984. *The reconstruction of western Europe, 1945-51*. Berkeley: University of California Press.

1947 and continued in 1949 with continuous Sterling crises,[453] which derived from states switching their currency camps. They are often referred to as 'Sterling overhang' problem,[454] which is: what happens with a former global currency and countries formerly bound to it, when it is abruptly replaced by another?[455] Making Sterling convertible to the US dollar in 1947 meant that the United Kingdom lost its reserves, as well as global reserves denominated in Sterling decreased since British colonies wanted goods from United States not United Kingdom. This contributed to an ever more pressing dollar shortage. Additionally, in order to finance and enhance its loan for reconstruction, the United Kingdom needed more US dollars.[456] To facilitate the latter, the Sterling devalued in 1949, which was followed by other European nations and further contributed to the global currency switch, trade liberalization, although it generated growth as well.[457] However, this again contributed and pointed to the US dollar shortage problem.[458] As such, there was a snowball effect with the US dollar during the Bretton Woods IMS – its initial key position was being constantly enhanced by states abandoning other currencies and eventually also gold – something that the Bretton Woods IMS architecture was not equipped to deal with.

Fourth aspect of the emerging new nature of the economy was the shrinking availability of United States to provide gold reserves. By 1970s the global share of the US gold reserves fell

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453 For more on these crises see Newton, Scott. 1984. The sterling crisis of 1947 and the British response to the Marshall plan. *The Economic History Review*, 37(3). Pp. 391−408; Newton, Scott. 1985. The 1949 sterling crisis and British policy towards European integration. *Review of International Studies*, 11(3). Pp. 169−82; Hinds, Allister E. 1987. Sterling and imperial policy, 1945–1951. *The Journal of Imperial and Commonwealth History*, 15(2). Pp. 148−69.
454 Bergsten. 1975. Pp. 110.
455 See Gardner. 1956. This 'overhang' consideration was repeated after 1971, this time in the light of a would-be US dollar decline; however, these fears did not materialize, since non-hegemonic states continued to prefer using US dollars, that gradually morphed into a 'buy-in' behavior, see Bergsten. 1975. Ch. 8.
456 Eichengreen. 1998. Pp. 100−4.
457 James. 1996. 95.
458 See Leffler, Melvyn P. 1992. *A preponderance of power: National security, the Truman administration, and the Cold War*. Stanford: Stanford University Press. Ch. 8; Cardwell, Curt Michael. 2011. *NSC 68 and the Political Economy of the Early Cold War*. Cambridge: Cambridge University Press. Ch. 5.

significantly: between 1957 and 1968 its share dropped from 62 to 28 per cent.[459] Figure 59 shows the global distribution of gold reserves from 1948 through 2014. It is quite telling in that after this rapid fall, the US gold reserves are the same today as in 1968 and by far leading all other countries. "United States owned half of the world's official gold reserves (574 million ounces) at the end of the Second World War,"[460] and so at that point, the system appeared secure and stable. But in 1968, only 25% of US gold reserves were able to cover foreign holdings, the rest was to cover US domestic needs.[461] The Bretton Woods IMS did not anticipate that United States would start running out of gold to satisfy the global demand. The United States was solving this liquidity problem by printing US dollars, which states accepted as their second-best option. Subsequently, French economic minister, d'Estaing labelled the Bretton Woods system as 'America's exorbitant privilege' − an asymmetric financial system where non-US citizens "see themselves supporting American living standards and subsidizing American multinationals."[462] However, the non-hegemonic states accepted the new role of the US dollar, even France. Figure 60[463] shows that with the declining amount of available gold reserves, the reserves in US dollars grew exponentially, what subsequently contributed to the establishing of the US dollar centrality in international reserves and ultimately the centrality of the US dollar in global monetary affairs.

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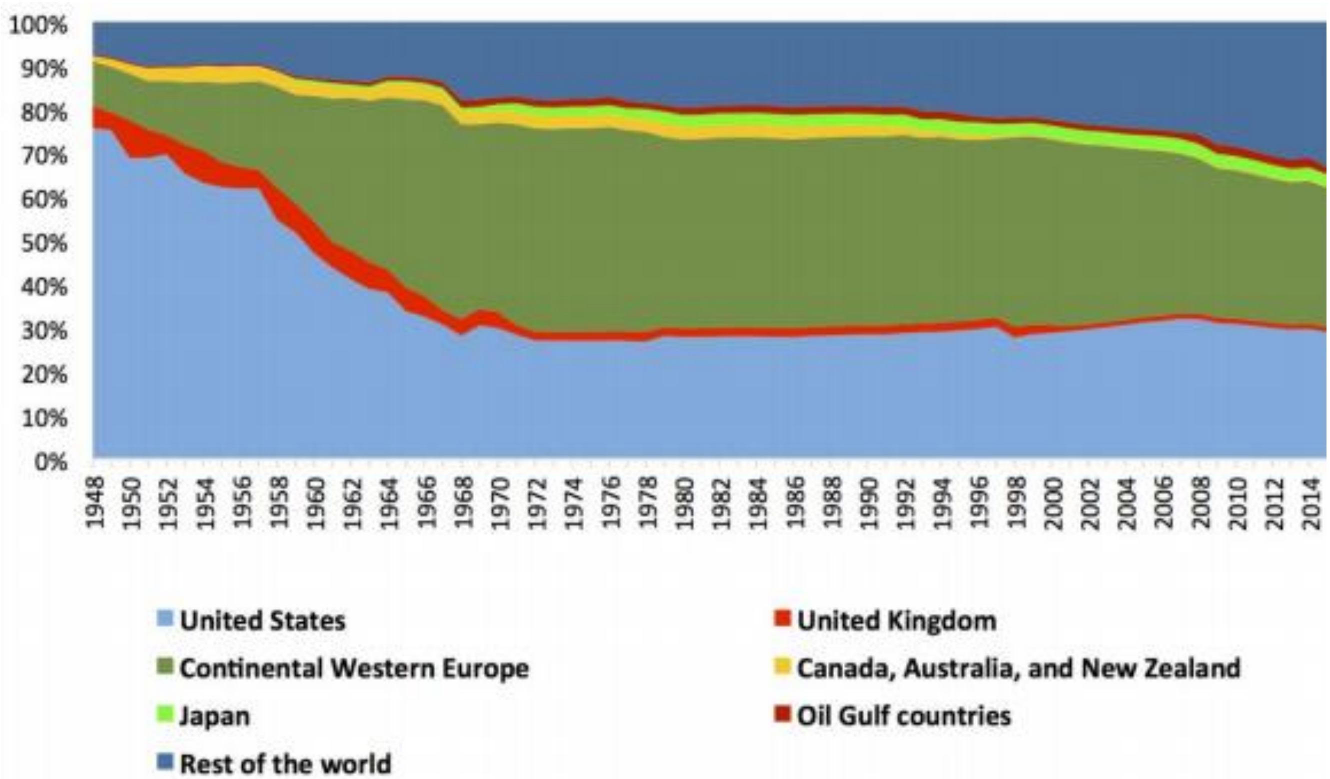
[459] Ocampo, José Antonio. 2016. *A brief history of the international monetary system since Bretton Woods*. Helsinki: United Nations University World Institute for Development Economics Research. Accessibility: https://www.wider.unu.edu/sites/default/files/wp2016-97.pdf (8 June 2019). Pp. 8.
[460] Lubin Alex and Marwan M. Kraidy, 2016. Introduction. In Lubin Alex and Marwan M. Kraidy (eds.), *American Studies Encounters the Middle East*. Chapel Hill: University of North Carolina Press. Pp 1−28. At Pp. 13.
[461] International Monetary Fund. 2018. Money Matters, System in Crisis (1959-1971). Accessibility: https://www.imf.org/external/np/exr/center/mm/eng/sc_sub_3.htm (12 July 2018).
[462] Eichengreen. 2010. Pp. 4.
[463] Meltzer, Allan H. 1991. US policy in the Bretton Woods era. *Federal Reserve Bank of St. Louis Review*, 73(3). Pp. 54−83. At Pp. 57.

Furthermore, Figure 61 shows the composition of French international reserves, where by 1971 foreign exchange reserves are as big as their gold reserves.[464]

Figure 59: Global Distribution of Gold Reserves[465]



Therefore, the rules of Bretton Woods IMS did not equip states for the new type of the economy, and so have behaved in opposition what those rules required, which ultimately led to the downfall of the Bretton Woods IMS.

[464] Bordo, Michael D., Dominique Simard, and Eugene N. White. 1994. *France and the Bretton Woods International Monetary System:1960 to 1968*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w4642/w4642.pdf (10 October 2020). Pp. 41.
[465] Ocampo. 2016. Pp. 7.

Figure 60: US Gold Reserves and US dollar Liabilities by Foreign Central Banks and Governments

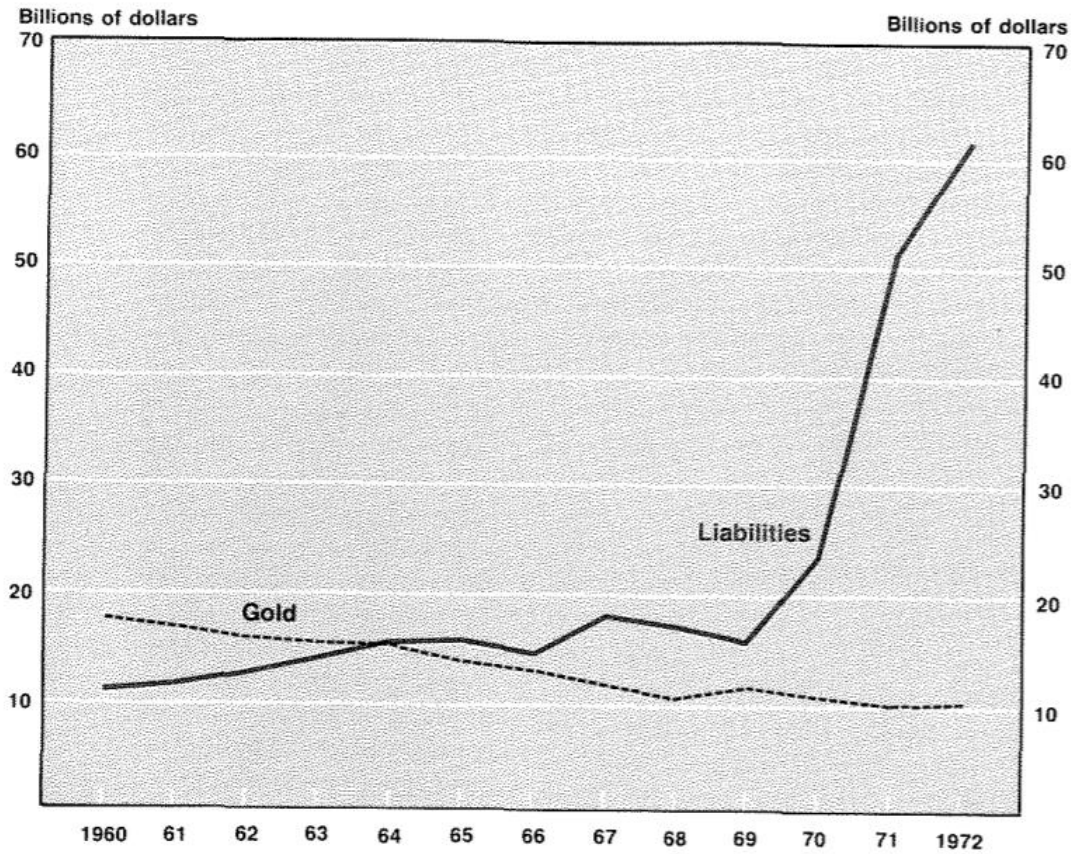
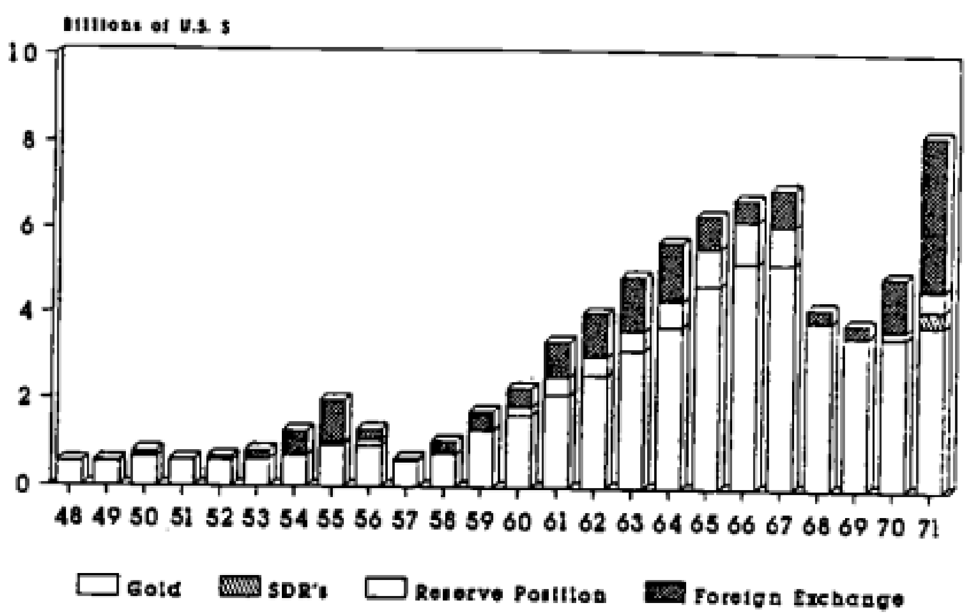


Figure 61: France International Reserves Composition



Lastly, a reduced prestige of the IMF. Bretton Woods IMS envisioned a big role for the IMF – it was supposed to determine fundamental disequilibrium of states, allow them to devalue their currency, and financially assist them in such an adjustment. But whenever a crisis occurred, states preferred ad hoc solutions and settings, or establishing bilateral agreements rather than resolving the problem through the IMF. Thus, the mechanisms designed for the functioning of the Bretton Woods IMS were not sought. Furthermore, the IMF lost its initial systemic prominence, which was later displayed in dealing with the 1971 Nixon Shock, and particularly in setting up the post-Bretton Woods IMS.

4.2.2 Adjustment Problem

Deriving from the first reasons why the Bretton Woods IMS did not function properly – the new nature of the economy – is the second reason: the lack of adjustment. Yet, I treat this reason separately because of its importance, since it was the main characteristic of state behavior leading to 1971 Nixon Shock and the end of the Bretton Woods IMS.

As stated before, the non-hegemonic states were reluctant to adjust their exchange rates because that would have a direct negative impact on their domestic audiences. Thus, by not adjusting they were helping their exports, reconstruction, economic growth, and assured full employment.[466] However, they also repeatedly ignored the US calls for appropriate adjustment.[467]

[466] See De Vries, Margaret Garritsen. 1986. *The IMF in a changing world, 1945−85*. Washington: International Monetary Fund. Pp. 59−61.
[467] Pelanda. 2007. Pp. 20−3.

European states did not want to adjust until they would be leveled with the United States. Subsequently, they required more and more liquidity, and since gold amount was limited, they did settle for US dollars, which generated a dollar shortage,[468] but also allowed United States to continue printing US dollars and position itself in the center of the global economy.[469] Although I will deal with the liquidity issue in the next sub-chapter, it is worth noting here that the non-hegemonic states were reluctant to adjust, but they were on board with establishing any type of mechanism that would increase liquidity to offset for that.

The adjustment problem had two parts: "The asymmetry of adjustment between deficit and surplus countries and the asymmetry of adjustment between the United States as the center of the system and the rest of the world."[470] Consequently, the lack of adjustment led to discrepancy in the markets, where official exchange rates were unrealistic.[471] With the rise of the new financial economy, this opened a window of opportunity for speculations, which further increased the amount of capital transactions and put pressure on states to adjust.[472] These private incentives to follow yields and profits had significance for current account deficits and surpluses as a country might be labeled as being in a fundamental disequilibrium.[473] "Such suspicion could in turn spark balance of payments crisis" analyze Krugman and Obstfeld.[474] For example, anyone who holds a great amount of a currency that is devalued, will lose a great amount of net worth. Thus, selling

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468 Bordo, Michael D. 2017b. *The Operation and Demise of the Bretton Woods System; 1958 to 1971.*: National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w23189.pdf (11 July 2019). Pp. 15.
469 Eichengreen. 1998. Pp. 92−3.
470 Bordo. 1993. Pp. 5–12.
471 See Elson. 2011. Pp. 49−50.
472 For more on this see Gavin, Francis J. 2004. *Gold, dollars, and power: the politics of international monetary relations, 1958-1971*. Chapel Hill: The University of North Carolina Press; Copeland, Laurence S. 2008. *Exchange rates and international finance*. London: Pearson. Ch. 1; De Vries. 1986; Kenwood and Lougheed. 1999. Part III.
473 Krugman and Obstfeld. 2008. Pp. 516−7.
474 Krugman and Obstfeld. 2008. Pp. 517.

this currency before the devaluation makes sense. However, in order to maintain a fixed exchange rate to the US dollar, a country would have to purchase an excessive amount of its currency from the market, thus losing its reserves. The latter, if big enough, can also force a devaluation, or at least present additional risk, as a state may run out of its reserves to reinforce the exchange rate. Such balance of payment crises became frequent in the 1960s.[475] To tackle this issue, states craved for more liquidity. As such, different mechanisms within the Bretton Woods IMS and outside of it arose: Gold Pool, two tier gold market, a change in IMF quotas,[476] special funding increases were made for Canada, Germany, and Japan,[477] and Special Drawing Rights (SDR)[478] were created.

Still, these initiatives were not enough to save the Bretton Woods IMS, since the adjustment problem was too profound to be dealt with only with enhanced liquidity. The system was in a negative spiral with a negative feedback loop, where the relaxation of capital controls led to a greater need of finance to offset speculative capital transfers.[479] Therefore, the nature of the new economy amplified the problems arising from the lack of adjustment, which in turn led to the greater need for liquidity, which further pushed states to derail from capital controls and embrace the free flow of capital. The new surplus countries did however perform ad hoc adjustments, but

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[475] Krugman and Obstfeld. 2008. Pp. 516−7.

[476] A system that determines voting power in IMF, but more importantly also how much money a state needs to contribute to the IMF and how much money it can ask for form the IMF (Fritz-Krockow, Bernhard and Parmeshwar Ramlogan. 2007. *International Monetary Fund Handbook: its functions, policies, and operations*. Washington: International Monetary Fund. Pp. 6).

[477] James. 1996. Pp. 118.

[478] IMF defines the SDR as "an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves" (International Monetary Fund. 2019. Special Drawing Rights. Accessibility: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR (6 June 2019)). For more on SDR see Wilkie, Christopher. 2012. *Special drawing rights (SDRs): The first international money*. Oxford: Oxford University Press.

[479] Eichengreen. 1998. Pp. 112.

it was not to improve the imbalances in the system, instead to enhance their relative positions in relations to other competitors, which made things worse for the international monetary system.[480] Thus, they sacrificed the Bretton Woods IMS for their own relative gains.

The US dollar was under pressure to depreciate, while other currencies were pressured to appreciate. Yet, the latter often did the opposite. Although surplus states were not allowed to devalue their currencies, they did so on multiple occasions in order to maintain their competitiveness in the international trade and maintain their surplus. Consequently, US imports grew compared to exports, resulting in a first trade deficit in 20th Century in 1971.[481] Subsequently, also United States was reluctant to devalue. Figure 62 displays the frequency of exchange rates and their magnitude and regional distribution. As one can see from the table, from the industrial countries only Japan and Switzerland appreciated their currencies. It is important to stress that adjustment became harder and harder to do as the 1960-decade unfolded. The states were 'digging their heels in' – the more they postponed the adjustment, the harder it became to do it. Moreover, economic growth was taken for granted since the states were able to grow on the cheap by having access to liquidity. Hence, the governments brushed aside adjustment policies because they were able to be successful without them. Furthermore, recent experience told them that they could do so – they were always able to leverage the United Sates to issue more US dollars. Another reason for not adjusting properly was economic crisis that many non-hegemonic states found themselves in at the end of 1960s. Under pressure of repeated labor union strikes and growing unemployment, adjustment became a political suicide, which no one wanted to undertake.[482] Finally, the non-

[480] James. 1996. Pp. 157.
[481] O'Malley, Chris. 2014. *Bonds without borders: A history of the eurobond market*. Chichester: John Wiley & Sons. Pp. 51.
[482] James. 1996. Pp. 200.

hegemonic states (ministers and officials) also lacked conceptual apparatus of understanding monetary policy and their country's external position. Therefore, the will for performing adjustment was diminishing over time, while the urgency for it only grew.[483]

Figure 62: Devaluations under the Bretton Woods System until 1967[484]

Percentage Devaluation	Total	Industrial Countries	Developing Countries: Africa	Asia	Europe	Latin America	Middle East
No devaluation or appreciation	13[1]	3	2	0	0	7	1
Less than 30 percent	12[2]	6	0	0	1	3	2
30–39 percent	22[3]	5	9	4	0	1	3
40–75 percent	39[4]	6	18	6	2	5	2
More than 75 percent	23[5]	2	6	4	2	7	2
Total	109	22	35	14	5	23	10

Note: Industrial countries followed by developing countries; within each group, countries are listed in order of increasing depreciation.

[1] Japan, Switzerland, the United States; Lebanon, Cuba, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Liberia, Panama, Ethiopia.

[2] Canada, Italy, Belgium, Luxembourg, the Federal Republic of Germany, the Netherlands; Costa Rica, the Syrian Arab Republic, Saudi Arabia, Portugal, Venezuela, Nicaragua.

[3] Australia, Norway, South Africa, Sweden, Denmark, Burma, Iraq, Jordan, Kenya, Kuwait, Libya, Malaysia, Nigeria, Pakistan, Sierra Leone, Singapore, Somalia, Sudan, Tanzania, Uganda, Zambia, Ecuador.

[4] Ireland, United Kingdom, New Zealand, France, Austria, Finland; Cyprus, The Gambia, Jamaica, Malawi, Trinidad and Tobago, Guyana, Burundi, Egypt, Sri Lanka (Ceylon), Philippines, Thailand, India, Rwanda, Peru, the Islamic Republic of Iran, Mexico, Nepal, Turkey, China, Cameroon, Central African Republic, Chad, Benin (Dahomey), Gabon, Guinea, Côte d'Ivoire (Ivory Coast), Madagascar (Malagasy Republic), Mali, Mauritania, Niger, Senegal, Togo, Burkina Faso (Upper Volta).

[5] Iceland, Spain; Ghana, Algeria, Tunisia, Morocco, Congo (Brazzaville), Colombia, Greece, Lao People's Democratic Republic (Laos), Viet Nam, Israel, Yugoslavia, Paraguay, Argentina, Chile, Congo (Democratic Republic of), Uruguay, Bolivia, Afghanistan, Brazil, Indonesia, Korea.

[483] James. 1996. Pp. 177.
[484] De Vries. 1986. Pp. 59.

The circumstances under which adjustment was understood as taboo for the non-hegemonic states, is best displayed by France. Under de Gaulle's leadership, France used conversions of its dollar reserves into gold as tactical threats to induce the United States to initiate the reform of the international monetary system towards a more symmetrical and cooperative gold-exchange standard regime.[485] For example, in February 1965 de Gaulle proposed to move away from the gold exchange standard of Bretton Woods system to a gold standard, where the balance of payments would be settled only in gold.[486] However, the French did not find support in other European countries nor Japan for their attempt to restructure the system.[487] As displayed in the previous chapters (e.g., Figure 23), from 1964 onwards states usage of the US dollar was higher than gold. Therefore, the states did not think such a move would contribute to assuring their interests. Moreover, during the economic downturn in the second half of the 1960s, this initiative was finally dropped as the Gold Pool collapsed, and two-tier gold marked arose, what terminated the leverage non-hegemonic states had over United States.[488] Specifically, on November 28, 1968, France announced that it will devalue the franc – a move that would benefit its exports and hurt the Bretton Woods IMS.[489] Yet, De Gaulle changed his mind the day after, and opted for fiscal austerity.[490] Thus, France postponed its adjustment even when it would favor its terms of trade.

[485] Bordo, Simard, and White. 1994.
[486] De Vries. 1976. Pp. 61.
[487] This initiative was in line with the broader French strategy of geopolitical independence from the United States – 1963 Franco-German Elysée treaty, de Gaulle's establishment of diplomatic relations with communist China in 1964, and its withdrawal from NATO integrated military command in 1966. However, just as in the security realm, so too was in the economic – France was alone. See Chivvis, Christopher S. 2006. Charles de Gaulle, Jacques Rueff and French International Monetary Policy under Bretton Woods. *Journal of Contemporary History*, 41(4). Pp: 701–20. At Pp. 712–7. Moreover, as Figure 68 clearly shoe, at the end of 1960s even France was on board with the US dollar centrality and displayed 'buy-in' behavior.
[488] Bordo, Simard, and White. 1994. Pp. 16–7.
[489] Although to be fair, French current account balance was negative in 1968 and 1969 as a consequence of a short recession. Therefore, the depreciation of the Frank may be somewhat justified from the national perspective, but not from the broader systemic perspective, as its current account was generally in a surplus and France had a nice economic growth until 1968.
[490] Prate, Alain. 1978. *Les Batailles économiques du général de Gaulle*. Paris: Plon. Pp. 270.

Moreover, France experienced a problem common across European states: it is difficult to implement austerity measures in a welfare state. Finally, France changed its mind again in August and devalued the Frank for 11%.[491] It is important to stress that the austerity measures are not a synonym for structural reforms and adjustments. Austerity means only cutting a budget deficit, not conducting painful political-economic reforms with regard to the labor market, retirement legislation, health care, education and innovation, other welfare expenditures, taxation reform, creating a business-friendly environment, smart investments. It also does not mean adjusting exchange rates and monetary policy (money supply, interest rates, inflation) to satisfy the needs of state's balance of payments. Therefore, austerity without reform, as the French did, was doomed to fail. Hence, it does not come as a surprise that the economic situation in France worsened from 1968 to 1969 – its otherwise positive trade balance became negative[492] − so devaluing became somewhat reasonable. Nevertheless, the story here is that exchange rate adjustment had a negative connotation, even when the economic recovery was at stake.

Similar stories regarding the aversion to adjustment during the late 1960s recession are observed also in other European countries. For example, the United Kingdom was not willing to adjust its Sterling. Yet, it did so only after it ran out of all other options in 1967, when the IMF rejected its proposal to increase its quota for loans after it has used all alternatives.[493] Furthermore, another interesting case was West Germany, whose rhetoric was that it is willing to adjust. Although one country could not solve the entire global monetary system, this was indeed an

[491] James. 1996. Pp. 196.
[492] Global Economy. 2019. *France*. Accessibility: https://www.theglobaleconomy.com/France/Trade_balance/ (12 July 2019).
[493] See Clift, Ben, and Jim Tomlinson. 2008. Negotiating Credibility: Britain and the International Monetary Fund, 1956–1976. *Contemporary European History*, 17(4). Pp. 545−66.

encouraging moment.[494] Germany gave assurances in 1967 to the United States that due to their current account surplus, they would not be purchasing gold, promote capital outflows, and hinder inflows (so called Blessing letter).[495] Of course one cannot separate this commitment from the German offsetting for the military spending and security that the United States provided West Germany. However, it was really only political rhetoric, because German gold reserves grew and its commitment to adjustment was dubious.[496] Its competition with France drove its policy to argue that the Franc should depreciate, instead of appreciation of the German Mark. This indicated that there is more to the German policy than its declaratory commitment to the stability of the international monetary system.[497] As such, West Germany also proposed a border tax of 4% on exports to France, which would have had the same bilateral effect as revaluation.[498] Yet, companies could easily find loopholes in such a measure, so the problem was not solved. Hence, Germany did adjust its exchange rate only in October 1969.

On the other side was the United States, which was also reluctant to depreciate. Its balance of payment problem was "caused by inadequate international competitiveness, /which/ was solvable by /either/ devaluation of the dollar, revaluation of foreign currencies, or the adoption of more restrictive domestic policies."[499] The United States did not want to devalue as there was no guarantee that others would not do the same to neutralize such a US policy. Moreover, devaluing

[494] Eichengreen, Barry. 2000. *From benign neglect to malignant preoccupation: US balance-of-payments policy in the 1960s*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w7630.pdf (3 August 2019). Pp. 30.
[495] See *Blessing letter*. 1967. Accessibility: http://www.gata.org/files/BundesbankLetter-03-30-1967.pdf (12 July 2019).
[496] See Ocampo. 2016. Pp. 8.
[497] See Bordo, Michael D. 2007. The Bretton Woods International Monetary System: A Historical Overview. In Bordo, Michael D., and Barry Eichengreen (eds.), A retrospective on the Bretton Woods system: lessons for international monetary reform. Chicago: University of Chicago Press. Pp. 3−108. At Pp. 78.
[498] James. 1996. Pp. 194−5.
[499] Eichengreen. 2000. Pp. 30.

could also have a negative impact on the international position of the US dollar, because increasing the size of the foreign reserves and trade denominated in US dollars could be threatened. Thus, its path to centrality endangered – reserves would be worth less and so non-hegemonic states may consider abandoning the US dollar. Since the United States could not count on other states to appreciate, it was left with domestic measures to assure its balance of payments (limit capital outflows) and interests. Namely, to contain the growth of its foreign liabilities abroad, the United States designed several capital controls: imposition of interest equalization tax in 1963, voluntary guidelines to limit the growth of foreign assets in commercial banks in 1965, and in 1968, direct investment by multinational corporations.[500]

As such, the lack of adjustment, on both ends – hegemonic and non-hegemonic – generated additional state behavior that was not in accordance with the Bretton Woods IMS architecture. Furthermore, together with the new type of the economy it also opened another frontier for states to tackle – liquidity problem. The latter is not a source for non-functioning of the Bretton Woods IMS, but rather an epiphenomenon to such behavior.

4.2.3 Liquidity Problem

Explaining the liquidity – dollar shortage – problem, De Vries argues that the European states were ready to compensate the lack of adjustment by constantly asking for more liquidity, since they valued their economic growth, full employment, and reconstruction more than the question with what they will be paying for it: "/T/he inability of the system to provide adequate

[500] Elson. 2011. Pp. 52.

world reserves as the volume of international trade and financial transactions grew, /…/ meant that countries turned to using the US dollar for the bulk of their reserves which, subsequently, put the United States in a position of having to run, or of being able to run, continuous balance of payments deficits. Reliance on the dollar also encourage the risk that the par value system could unravel at any time if the monetary authorities of other countries lost their confidence in the dollar and decided to convert their holdings into gold."[501]

"The perceived liquidity problem in the Bretton Woods system was that the various sources of liquidity were not adequate or reliable enough to finance the growth of output and trade. The world's monetary gold stock was insufficient by the late 1950s, IMF unconditional drawing rights were meager, and the supply of U.S. dollars depended on the U.S. balance of payments, which in turn was related to the vagaries of government policy and the confidence problem."[502] Hence, the liquidity problem also caused the confidence in reserve media to be constantly at stake. An example of such confidence crisis was the fall of 1960, when concerns over a Democratic victory in the US presidential election sparked unrest in financial markets. Kennedy's pledge 'to get America moving again' after a short recession at the end of 1950s, was interpreted as an inflationary policy that might force the United States to devalue its currency, which would mean unilaterally raise the price of gold in terms of dollars.[503]

[501] De Vries. 1986. Pp. 73.
[502] Bordo 1993. Pp. 51.
[503] Solomon. 1977. Pp. 35; Bordo. 1993. Pp. 69.

Yet, United States was time and again willing to supply the required liquidity without devaluing its currency and therefore, generate confidence in the US dollar.[504] Instead of buying gold, the non-hegemonic states did not mind holding US dollars as a reserve currency.

> "/…/ main responsibility /of the United States/ was to hold the dollar price of gold at $35 an ounce and, in particular to guarantee that foreign central banks could convert their dollar holdings into gold at that price. /…/ However, the foreign central banks were willing to hold on to the dollars, /.../ as they paid interest. /Moreover, since the/ gold supplies were not growing quickly enough to keep up with the economic growth /and the demand it generated, this created additional incentive to hold US dollar as a reserve currency/."[505]

However, such turn of events created a different problem for the United States. The United States was in fact a bank for the rest of the non-hegemonic states that borrowed short and lent long.[506] As such, providing liquidity generated a deficit in the capital account of the United States, and since the goods from reconstruction countries were cheap, the United States also gradually ran a current account deficit (falling surplus to a negative balance in 1970).[507] "The /US/ balance of payments deficit under Bretton Woods arose because capital outflows exceeded the current account surplus. In the early postwar years, the capital outflow consisted largely of foreign aid. By the end of the 1950s, private long-term investment abroad (mainly direct investment) exceeded military expenditures abroad and other official transfers."[508] This imbalance or mismatch came to be named the Triffin dilemma. In 1960, the Belgian economist Robert Triffin, published a book

[504] James. 1996. Pp. 155.
[505] Krugman and Obstfeld. 2008. Pp. 522.
[506] Despres, Emile, Charles Poor Kindleberger, and Walter S. Salant. 1966. The dollar and world liquidity: a minority view. *The Economist*, February 5.
[507] Germany, Japan, and other rebuilding countries were growing faster than United States due to their lower technological position and productivity growth. Therefore, post war reconstruction generated export-led economies, for more on this issue see Smolny, Werner. 2000. Post-War Growth, Productivity Convergence and Reconstruction. *Oxford Bulletin of Economics and Statistics*, 62(5). Pp. 589−606.
[508] Bordo. 1993. Pp. 55; see also Eichengreen, Barry, and Marc Uzan. 1992. The Marshall Plan: Economic Effects and Implications for Eastern Europe and the Former USSR. *Economic Policy*, 7(14). Pp. 14–75.

where he argued that the Bretton Woods system suffered from a built-in deficiency.[509] He argued that once US dollar reserves held by other countries outgrew the US gold reserves, a confidence crisis could emerge, as the United States would no longer be able to assure the exchange of US dollars for gold at the fixed price of $35 an ounce. In other words, this dilemma represented how domestic monetary policy has a direct impact on the international monetary system. In order to amend the current account deficit, the United States would have to reduce liquidity in the international system, which it was not inclined to do as that would jeopardize its central position in the global economy.[510] Thus, the political dilemma arises where domestic and international interests of the hegemon are at odds (Triffin dilemma).

Triffin's own solution to the problem was to return to the original Keynesian International Clearing Union plan, which meant converting all existing reserves into international money and have the IMF to serve as the world's central bank, to provide generous liquidity. Yet, the United States went a different route – trying to ad hoc patch the system until the unavoidable happened, namely, a crisis that enabled a structural reform of the whole IMS. Such an ad hoc moves and avoidance of official Bretton Woods institutions was made for three interlinked reasons. First, it was easier for the United States to secure its interests through bilateral and ad hoc groupings. Second, its interests were conflicting with existing IMS – centrality of the US dollar. Third, official Bretton Woods institutions were in denial of the liquidity problem. The first IMF report in 1953 argued that reserves are adequate,[511] while the second report in 1958 claimed that they were

[509] Triffin, Robert. 1960a. *Gold and the dollar crisis: yesterday and tomorrow*. New Haven: Yale University Press.
[510] For more on the Triffin dilemma see Bordo, Michael D., and Robert N. McCauley. 2017. *Triffin: dilemma or myth?* Basel: Bank of International Settlements. Accessibility: https://www.bis.org/publ/work684.pdf (15 March 2019).
[511] International Monetary Fund. 1953. Adequacy of Monetary Reserves. In Horsefield, Keith (ed.), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Co-Operation. Vol. 3, Documents.* Washington: International Monetary Fund. Pp. 311–48.

adequate for the time being and should be sufficient for the next decade.[512] Both of these reports, came after the Sterling crisis of late 1940s and 1953 recession, which were the first clear signals of the liquidity problem.[513] Moreover, another short but deep recession in 1958 highlighted the liquidity problem of the Bretton Woods IMS.[514] The Federal Reserve raised interest rates that resulted in a US recession echoed by Nixon a decade later in his justification for putting the domestic interests of the United States first.[515] Yet, this recession became a global phenomenon – displaying the system effects of the US monetary policy decision. Higher interest rates mean lower amounts of US dollars available to other states, which caused a dollar shortage and generated a liquidity problem for the IMS (dollar shortage).

Furthermore, the bigger the shortage, the greater the will of other states for gold became, and subsequently greater pressure on the United States. Still, it took a decade for the IMF to make its first reform – creation of SDR and new IMF quotas, which tackled the issue of liquidity.[516] Yet, by then it was too little too late to save the Bretton Woods IMS. On the other hand, these two events did have an academic impact, since a group of academics and public officials formed the impactful and already mentioned Bellagio group.[517]

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[512] International Monetary Fund. 1958. International Reserves and Liquidity. In Horsefield, Keith (ed.), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Co-Operation. Vol. 3*, *Documents.* Washington: International Monetary Fund. Pp. 349–420.
[513] Both were also criticized by Triffin (1960a), who clearly stated that there are not enough gold reserves in the IMS.
[514] For more on this crisis see: McClenahan, William M. and William H. Becker. 2011. *Eisenhower and the Cold War Economy*. Baltimore: The Johns Hopkins University Press.
[515] Frieden, Jeffry A. 2007. *Global capitalism: Its fall and rise in the twentieth century*. New York: WW Norton. Pp. 344.
[516] In 1969 First Amendment to Articles of Agreement were adopted.
[517] De Vries. 1987. Pp. 80.

Thus, the main challenge for the United States during the Bretton Woods IMS was how to cope with the Triffin dilemma. The institutionalist narrative that “once Europe completed its recovery, IMF quotas were supposed to satisfy the world’s demand for liquidity,”[518] was empirically simply wrong. Non-hegemonic states did not behave in such a manner. The issue had to be tackled on domestic and international front, as the challenge itself merges both levels. However, the objective on both ends was to try to limit capital outflows, as this was considered as the most prudent way to deal with it. Kennedy and Johnson administrations did just that.[519] Furthermore, several initiatives were pursued also to secure liquidity in the system with the aspiration not to put additional burden on the United States.[520]

On the domestic front, alongside the aforementioned capital controls, the U.S. monetary authorities designed measures to improve the balance of trade (reduction in defense and nondefense government purchases abroad, expansion of Export-Import Bank lending in 1960, and tying development aid to dollar purchases in 1961) and altered the monetary fiscal policy mix (investment tax credit, accelerated depreciation allowances).[521]

A special initiative, which had domestic and international dimension, was the so called ‘Operation Twist’. The Federal Reserve designed it “to twist the yield curve and raise short-term rates, thereby encouraging a capital inflow while simultaneously reducing long-term rates to stimulate the economy.”[522] It did so by buying (long-term) and selling (short-term) bonds. An

[518] Eichengreen. 1998. Pp. 113.
[519] See Solomon. 1977; Meltzer. 1991.
[520] Gilpin. 2001. Pp. 237.
[521] Bordo. 1993. Pp. 58–9.
[522] Bordo. 1993. Pp. 59.

important thing to stress, is that the process uses the money obtained from selling for the buying. Therefore, the Federal Reserve does not print money to do so, unlike quantitative easing.[523] As such, the idea was to stimulate industry into building new economic capacity on one hand, and on the other, to generate a foreign desire to hold US dollars.[524]

On the international level, the United States initiated a number of "arrangements to prevent foreign monetary authorities from converting outstanding dollar liabilities into gold."[525] These included swap arrangements with other central banks, and Rossa bonds (long-term bonds denominated in foreign currencies), however, they were also institutional or structural, such as establishing the Gold Pool and General Arrangements to Borrow. Moreover, developing countries addressed the liquidity problem with reforming the IMF and creating SDR.

In 1961, the United States facilitated the establishing the Gold Pool in London.[526] Together with seven European countries, the US began to coordinate their gold stocks to maintain agreed upon exchange rates, particularly the US dollar towards gold. The Bank of International Settlements (BIS), an institution outside the Bretton Woods arrangement, facilitated such a coordination.[527] The gold pool lasted until 1968 when the two-tier gold market arose. The idea was that if states pool and funnel their joint gold reserves, this would alleviate demand for US dollars

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523 More on Quantitative Easing see Ashworth, Jonathan. 2020. *Quantitative Easing, The Great Central Bank Experiment*. Newcastle: Agenda Publishing.
524 See de Cecco. 1976.
525 Bordo. 1993. Pp. 59.
526 For details on the gold pool see Bordo, Michael, Eric Monnet, and Alain Naef. 2017. *The Gold Pool (1961-1968) and the Fall of the Bretton Woods System. Lessons for Central Bank Cooperation*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w24016.pdf (11 July 2019).
527 Elson. 2011. Pp. 51−2.

and capital outflow from United States. However, during its period, it sold 2.5 billion US dollars' worth of gold, of which 1.6 billion US dollars was provided by the United States.[528]

In 1962, The General Arrangements to Borrow (GAB) were agreed upon, and was another system designed outside the Bretton Woods institutions (G-10) but tasked the IMF with its bidding.[529] A group of the ten wealthiest counties decided to form an additional track aside from the IMF for borrowing and lending. Additionally, this G-10 became the principal forum where the IMF reform was negotiated. The G-10 and GAB enabled Central Banks to establish 'track two' cooperation through currency swaps mechanisms. The agreement was alive until the assent of the two-tier gold market, although it was rarely used.[530] Another similarity with the gold pool was that BIS provided secretariat for G-10 as well.[531]

Since both of these initiatives were perceived as elitist and not looked at fondly by developing states in Africa, Asia, and Latin America, since it drew a fault line between haves and have-nots, the latter created the United Nations Conference on Trade and Development (UNCTAD) in 1964 to help them with their economic endeavors.[532] As such, in order to bridge this newly created divide, developed states picked up a French proposal regarding the creation of

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[528] Schwartz, Anna J. 1989. The postwar institutional evolution of the international monetary system. In Schwartz, Anna J. (ed.), *Money in Historical Perspective.* Chicago: University of Chicago Press. Pp. 333–63. At Pp. 342.
[529] For more on GAB see Ainley, Michael. 1985. Supplementing the Fund's lending capacity. *Finance and Development*, 22(2). Pp. 41−5. More on G-10 see IMF. 2018. *A Guide To Committees, Groups, and Clubs*. Accessibility: https://www.imf.org/en/About/Factsheets/A-Guide-to-Committees-Groups-and-Clubs#G10 (5 July 2018). The members included: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, United Kingdom, and United States.
[530] Bordo, Michael D., and Harold James. 2000. *The International Monetary Fund: its present role in historical perspective*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w7724.pdf (11 July 2019).
[531] Elson. 2011. Pp. 50−1.
[532] Horsefield, J. Keith, and Margaret G. De Vries. 1981. *The International Monetary Fund: 1945-1965*, vol II *Analysis*. Washington: International Monetary Fund. Pp. 109.

a collective reserve unit, which ultimately led to the IMF reform and creation of SDR.[533] Thus, the First Amendment to Articles of Agreement was adopted in 1969.[534] "The SDR was created as a supplementary international reserve asset in the context of the Bretton Woods fixed exchange rate system."[535] It still serves to this day as the unit of account of the IMF and some other international organizations.

> "/However/ the SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. SDRs can be exchanged for these currencies. It was initially defined as equivalent to 0.888671 grams of fine gold − which, at the time, was also equivalent to one US dollar. After the collapse of the Bretton Woods system, the SDR was redefined as a basket of currencies /…/ Under the Articles of Agreement, when certain conditions are met, the IMF may allocate SDRs to members participating in the SDR Department in proportion to their quotas (known as a general allocation) /.../ The SDR mechanism is self-financing and levies charges on allocations which are then used to pay interest on SDR holdings. Members can buy and sell SDRs in the voluntary market."[536]

SDR were agreed at the 1967 IMF meeting in Rio de Janeiro. They were designed for transactions between the banks and the IMF.[537] The rationale was that the SDR system was to prevent countries from buying gold at the fixed official price and selling it at the free-market price, and to hold US dollars.[538] However, at the same time (end of 1960s), the United States increased the US dollar liquidity tremendously (see Figure 60). As such, the task of the SDR had become redundant. Moreover, institution of the SDR has raised several issues. First, its acceptability, which

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[533] See Bordo, Michael D., Dominique Simard, and Eugene N. White. 1994. *France and the Bretton Woods International Monetary System 1960 to 1968*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w4642.pdf (25 July 2019).
[534] For more on SDR see Wilkie. 2012.
[535] International Monetary Fund. 2019.
[536] International Monetary Fund. 2019.
[537] Gavin. 2004. Ch 1.
[538] Kenwood and Lougheed. 1999. Pp. 273.

was lesser than the dollar and gold.[539] Second, the SDR expanded the scope and sources for growing international reserves, but it did not include measures or conditions regarding such reserve growth (e.g., through deficits), hence contributing a great amount to inflation growth.[540] Third, seigniorage: "By economizing on gold reserves, the issue of SDRs created a social saving. To the extent that competitive interest was not paid on SDR balances, the social saving was distributed as seigniorage. Moreover, to the extent that seigniorage was allocated in proportion to members' quotas, it was distributionally neutral."[541] Lastly, SDRs rose confidence concerns, since states preferred gold and US dollar and did not perceive SDR as their substitute.

"It was widely believed that solving the liquidity problem would also solve the adjustment problem and thereby, preserve the Bretton Woods system. What the reformers did not pay adequate attention to, was the buildup in world inflation after 1965, in turn considerably aggravated by a vast surplus of international liquidity."[542] Therefore, all these initiatives allowed the Bretton Woods IMS to survive, but made its recovery impossible. The system was bended to the point where it broke.

Although all the aforementioned initiatives and actions in early 1960s were initially successful,[543] by 1965 liquidity concerns reoccurred.[544] The United States had several policy

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539 See McKinnon, Ronald I. 1988. An international gold standard without gold. *Cato Journal*, 8(2). Pp. 351–73; Meltzer. 1991.
540 See Williamson. 1977. Pp. 23.
541 Bordo. 1993. Pp. 68; see also Williamson. 1977. Pp. 24; Mundell, Robert A, and Alexander K. Swoboda (eds.). 1969. *Monetary Problems of the International Economy.* Chicago: University of Chicago Press.
542 Bordo. 1993. Pp. 68.
543 See Bordo, Monnet, and Naef. 2017. Pp. 2; Truman, Edwin M. 2017. *The End of the Bretton Woods International Monetary System*. Washington: Peterson Institute for International Economics. Pp. 13.
544 International Monetary Fund. 1964. *Annual Report*. Washington: International Monetary Fund. Pp. 29; Group of Ten. 1965. *Report of the Study Group on the Creation of Reserve Assets: Report to the Deputies of the Group of Ten*. Rome: Bank of Italy Press. Pp. 17.

options, such as protectionist measures, travel taxes, export subsidies, and slashing the budget. However, they were not pursued as the United States was afraid of a run on gold.[545] President Johnson recalls: "The world supply of gold is insufficient to make the present system workable – particularly as the use of the dollar as a reserve currency is essential to create the required international liquidity to sustain world trade and growth."[546] Furthermore, even suspending governments to trade in gold on private markets did not help, as the private markets expanded and consequently the price of gold rose even higher.[547] Therefore, the collapse of the Gold Pool and the creation of the two-tier gold market happened in 1968. From December 1967 to March 1968, the Gold Pool lost 3 billion US dollars in gold, with the US share at 2.2 billion US dollars.[548] Hence, to avoid speculations on devaluing the US dollar, the Gold Pool was dissolved on 17 March and a two-tier arrangement put in its place. This converted the Bretton Woods system into an enforcement mechanism of floating the gold peg and collapsed the aforementioned regimes.[549] The fall of the Gold Pool was logically followed by the breakdown of GAB. However, the real problem was the gold scarcity.[550] Thus, US Congress repealed the 25% requirement of gold backing of the dollar – in order to enhance US exports and prevent gold outflows.[551] As it turned out, the non-hegemonic states were ready and willing to offset the gold scarcity with US dollars.

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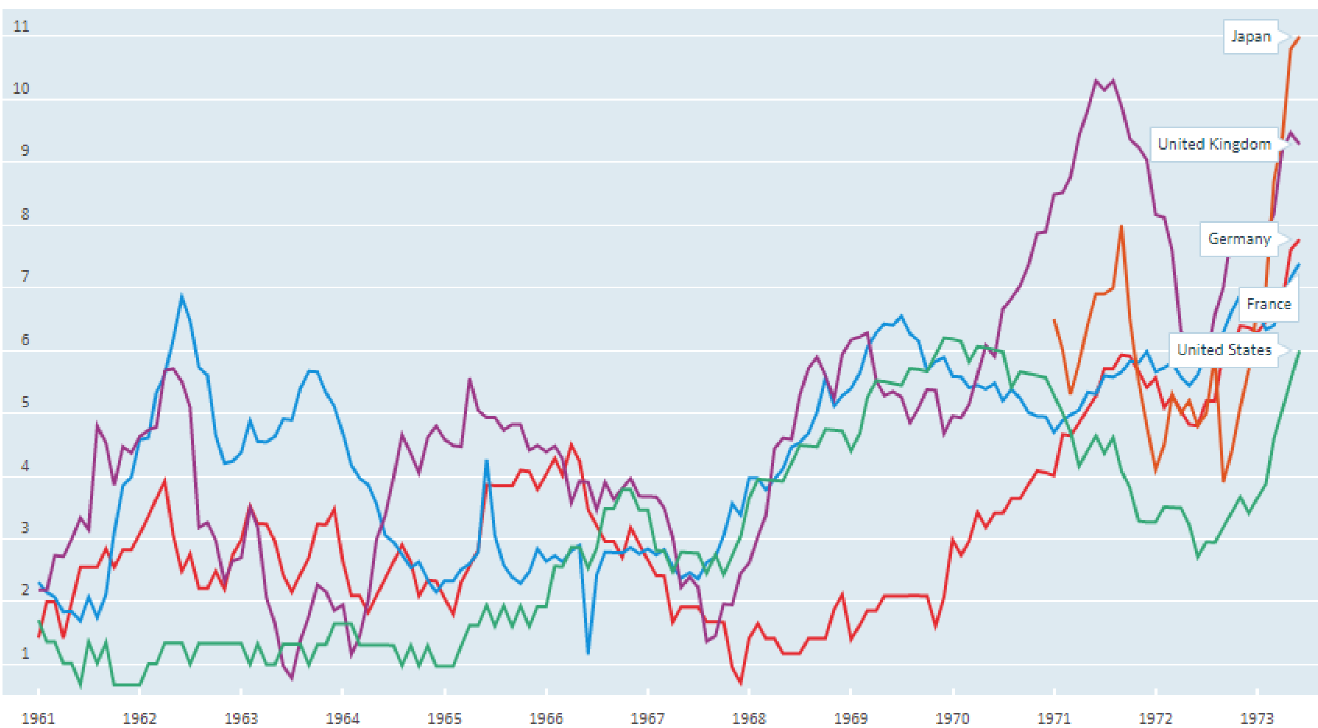
[545] Sercu, Piet. 2009. *International finance: Theory into practice*. Princeton: Princeton University Press. Pp. 45−7.
[546] Lyndon B. Johnson Library, National Security Files, National Security Council History, Box 54, The 1968 Balance of Payments Program, Minutes of the Cabinet Committee on Balance of Payments, 21 December 1967.
[547] Francis, Darryl. 1968. *The Balance of Payments, the Dollar, and Gold*. Speech delivered at a Rotary Inter City Meeting, Webster Groves, MO. July 12. Accessibility: https://fraser.stlouisfed.org/title/481/item/18575 (6 January 2018).
[548] Solomon. 1977. Pp. 119.
[549] De Vries. 1986. Ch. 8.
[550] See Gilbert, Milton. 1968. *The Gold-Dollar System: Conditions of Equilibrium and the Price of Gold*. Princeton: International Finance Section, Department of economics, Princeton University; Johnson, Harry G. 1968. The sterling crisis of 1967 and the gold rush of 1968. *Nebraska Journal of Economics and Business*, 7(2). Pp. 3–17.
[551] United States Congress, Public Law 90-269. 1968, March 18.

The end-result of political economic behavior of the hegemon and the non-hegemonic states was three-fold. First, as the saying goes – what goes around, comes around; increased liquidity resulted in increased inflation that plagued the international economic system the whole of next decade (see Figure 63). Second, the US dollar became a well-established central currency in the international economic relations. Third, the stage was set for the final break-down of the Bretton Woods IMS.

Figure 63: Inflation (CPI) of Major Economies from 1961 to 1973[552]



[552] Data from OECD. 2020a.

Although economic science nowadays lacks a clear theory of inflation,[553] there is a general tendency to believe that the rise of money supply in the long run leads to inflation.[554] Furthermore, views differ also on the 'export' of inflation.[555] When it comes to the Bretton Woods IMS, a correlation was established that it was not the increase of money supply in the United States that contributed to the global inflation, but rather in other non-hegemonic states.[556] For example, Germany increased its money supply growth rate from 6.4% in 1968 to 12.3 % in 1971. The reason was to hedge from potential US dollar devaluation.[557] The United States increased its money supply only to maintain the liquidity need of the IMS; as such, it was this extra non-hegemonic monetary expansion that mostly caused increased inflation. Figure 64 displays monetary growth in Japan, Germany and United States, where the levels of the first two far exceed the US levels. Figure 65 shows monetary growth rates in G7 countries, where it becomes obvious that the

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[553] See Perry, George L. 1980. Inflation in Theory and Practice. *Brookings Papers on Economic Activity*, 11(1). Pp. 207–60; Tarullo, Daniel K. 2017. *Monetary Policy without a working Theory of Inflation*. Hutchins Center Working Papers. Accessibility: https://www.brookings.edu/wp-content/uploads/2017/10/es_wp33_tarullo.pdf (20 October 2020).

[554] E.g., Hallman, Jeffrey J., Richard D. Porter, and David H. Small. 1991. Is the price level tied to the M2 monetary aggregate in the long run?. *The American Economic Review*, 81(4). Pp. 841–58; Grauwe, Paul De, and Magdalena Polan. 2005. Is inflation always and everywhere a monetary phenomenon?. *Scandinavian Journal of Economics*, 107(2). Pp. 239–59.

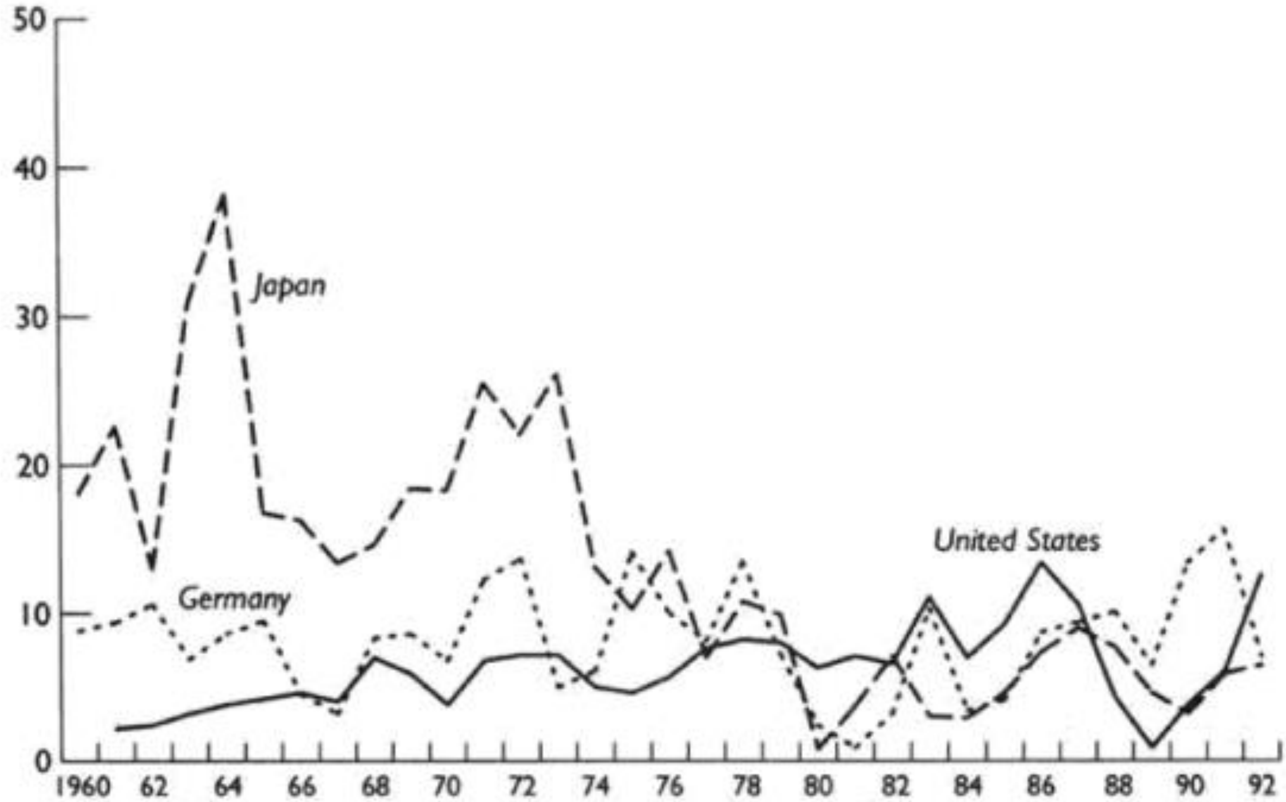
[555] Monetarist claim is that the price level is a consequence of supply and demand. Thus, inflation levels converge across the world via market arbitrage. Since United States could sterilize the reserve flows, whereas the rest of the could not, this resulted in higher inflation across the globe, but not in the United States (see Swoboda, Alexander K., and Hans Genberg. 1982. Gold and the Dollar: Asymmetries in World Money Stock Determination, 1959-1971. In Richard N. Cooper et al. (eds.), *The International Monetary System under Flexible Exchange Rates: Global, Regional and National: Essays in Honor of Robert Triffin*. Cambridge: Ballinger. Pp. 235–59). An alternative account follows Balassa-Samuelson effect (Balassa, Bela. 1964. The Purchasing Power Parity Doctrine: A reappraisal. *Journal of Political Economy*, 72(6). Pp. 584–96; Samuelson, Paul A. 1964. Theoretical Notes on Trade Problems. *Review of Economics and Statistics*, 46(2). Pp. 145–54), where states differ in their productivity trends in tradable and non-tradable goods. Namely, rapid growth of productivity in the traded goods (compared to non-tradable goods) in surplus countries leads to higher inflation (see Marston, Richard. 1987. Real exchange rates and productivity growth in the United States and Japan. In Arndt, Sven W., and J. David Richardson (eds.), *Real-Financial Linkages among Open Economies*, ed. Sven Arndt. Cambridge: MIT Press. Pp. 71–96).

[556] First, US inflation was caused by US money growth. Second, US money growth was independent of changes in international reserves. Third, US money growth had strong and significant effects on money growth in seven major countries. The lags reflect the fact that central banks in the seven countries partially sterilized reserve flows. Fourth, money growth in the seven countries explained inflation in these countries. (See Darby, Michael R., James R. Lothian, Arthur E. Gandolfi, Anna J. Schwartz, and Alan C. Stockman. 1983. *The International Transmission of Inflation*. Chicago: University of Chicago Press).

[557] Krugman and Obstfeld. 2008. Pp. 527−8.

excessive liquidity came from the non-hegemonic states. The difference still holds when we control for the real output of those states (Figure 66).

Figure 64: Money Growth, Annual Change in Percent[558]



[558] James. 1996. Pp. 199. See also Pp. 197–8.

Figure 65: Money (M1) Growth Rates in the G7 Countries, 1951-73[559]

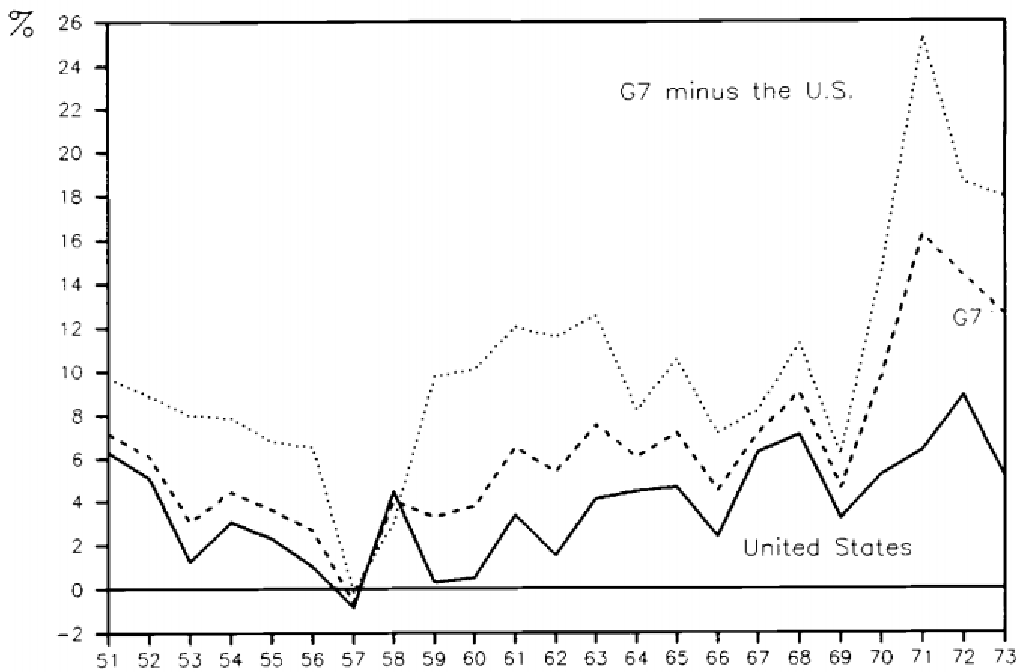
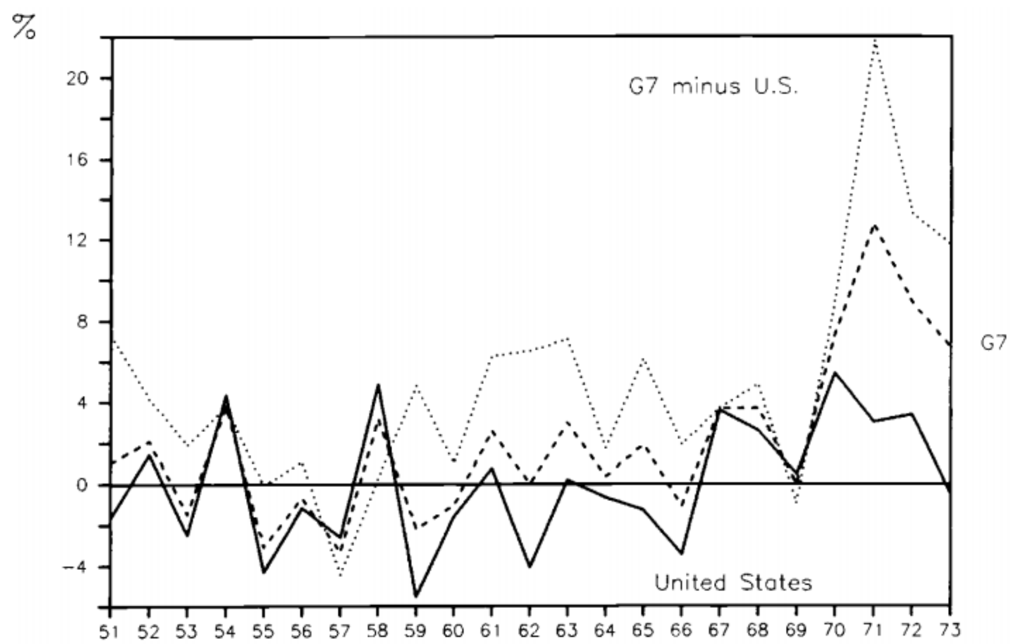


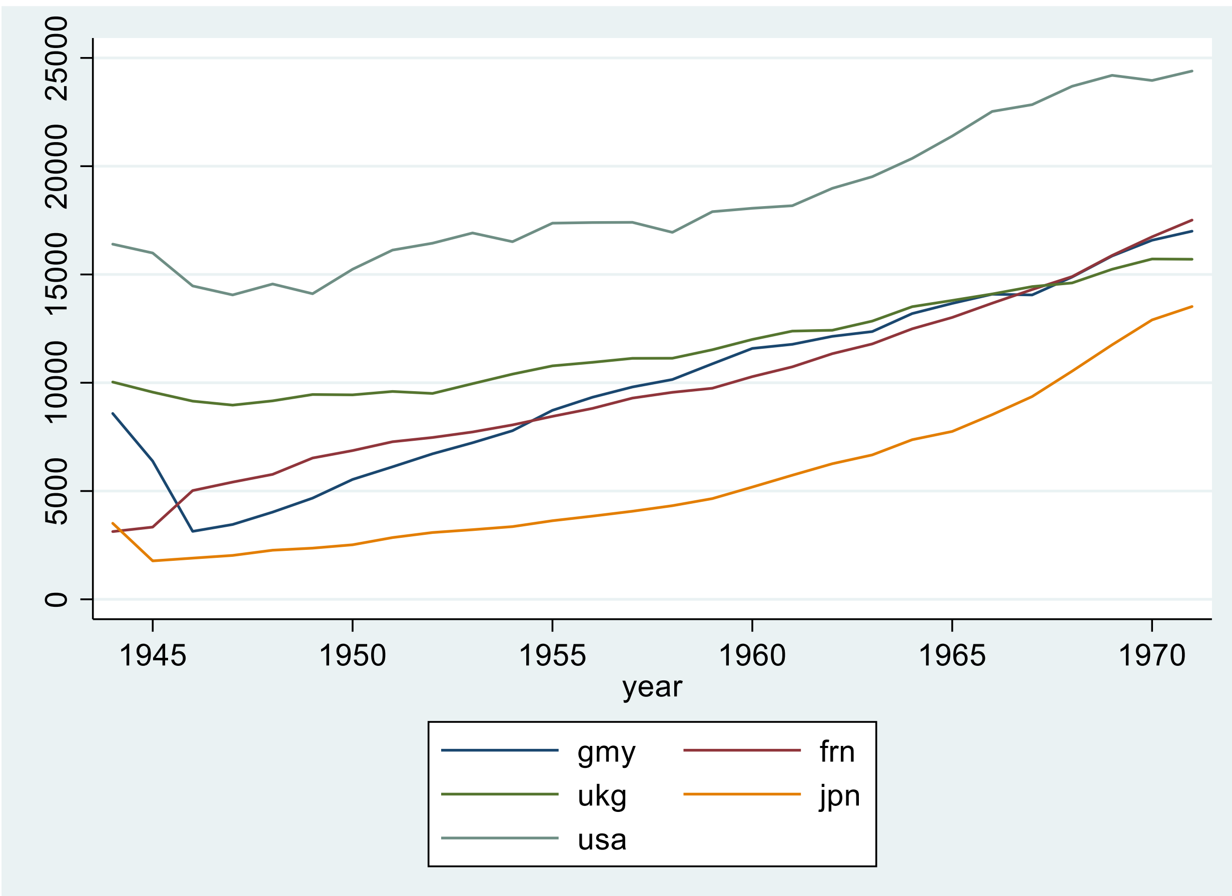
Figure 66: Money (M1) Growth Less Real Output Growth in the G7 Countries, 1951-73[560]



559 Bordo. 1993. Pp. 75.
560 Bordo. 1993. Pp. 75.

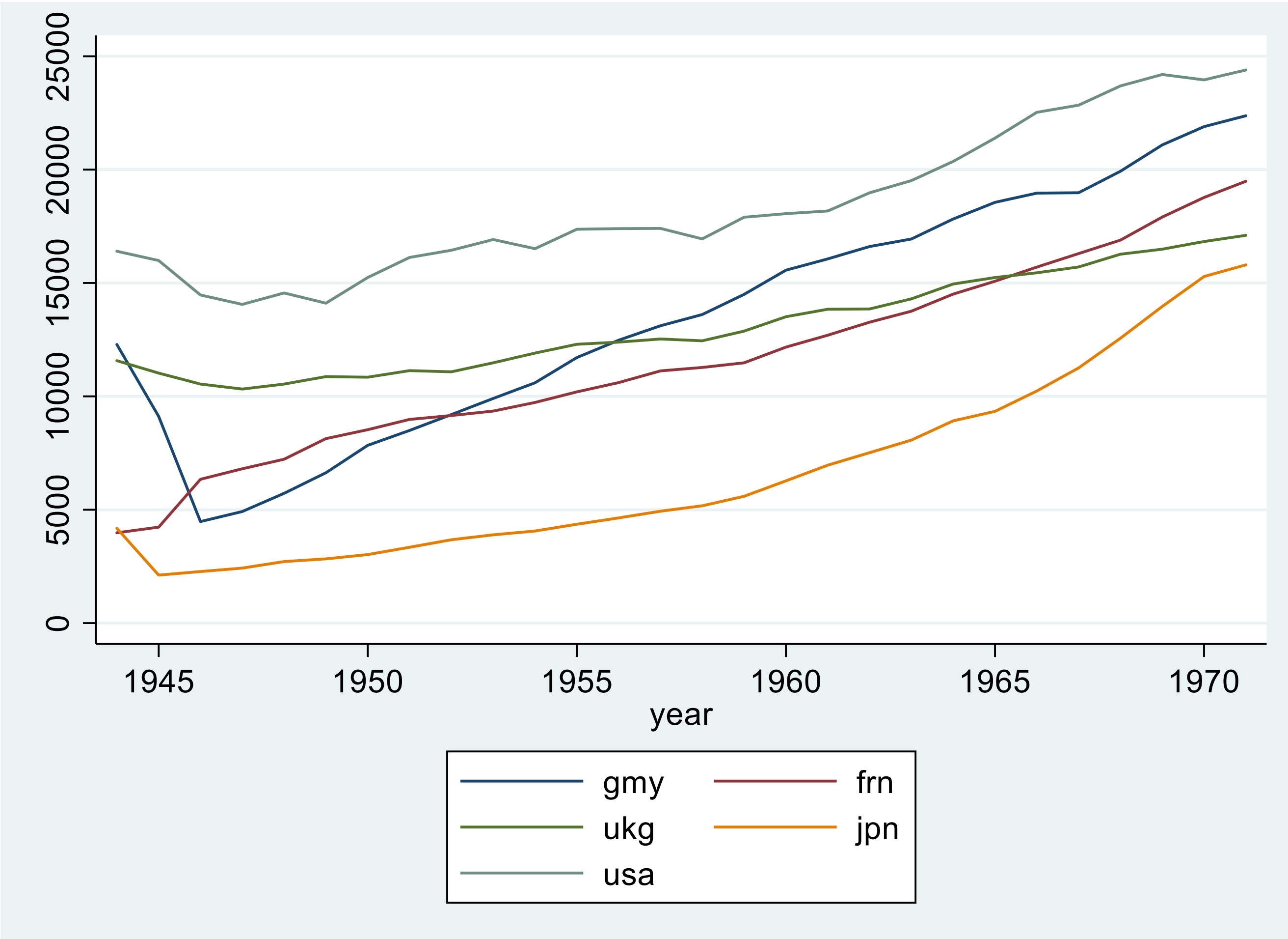
In sum, from 1950 to 1969, the US share for global GDP fell from 27% to 23%, which was still a significant share in comparison to other economies. The fast-growing European Community share stayed the same at 24%, and Japan grew from 3% to 7%.[561] Figure 67 and Figure 68 portray the story of slight catch-up to the United States in terms of real GDP per capita numbers graphically.

Figure 67: Real GDP per capita from 1945-1970 of United States and Other Rising Countries 1[562]



[561] Maddison, Angus. 2001. *The world economy: A millennial perspective*. Paris: Organization for Economic Cooperation and Development.
[562] Data in 2011 US dollars. The method is suitable for cross-country income comparisons. See Maddison Project Database, version 2018.

Figure 68: Real GDP per capita from 1945-1970 of United States and Other Rising Countries 2[563]

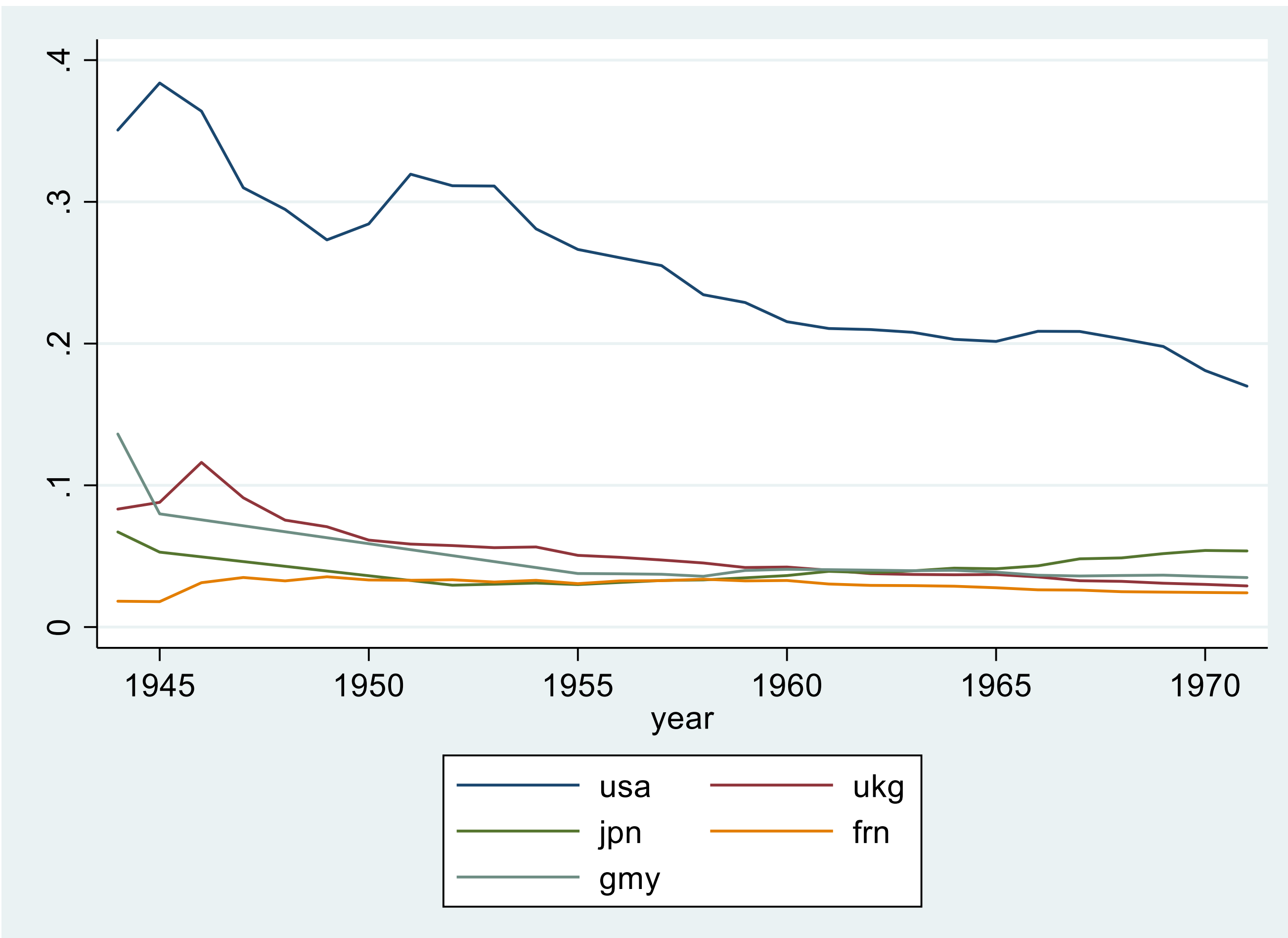


The relative decline in US power is more obvious when we look at the CINC scores. Maybe surprisingly, since this measure includes military expenditures and military personnel and give the Cold period, the US dominance shrinks throughout the Bretton Woods IMS period. Figure 69 displays these results,[564] while Figure 70 displays the relative gap between CINC scores of United

[563] Data in 2011 US dollar, 2011 benchmark. The method is suitable for cross-country growth comparisons. See Maddison Project Database, version 2018.
[564] Data from Singer. 1987.

States on one War hand and other rising powers on the other.[565] Both of them show that by the end of the Bretton Woods IMS period, the rising states in Europe and Japan, jointly reached power parity with United States. Lastly, Figure 71 shows further indicators that speak in favor of US hegemonic decline.[566]

Figure 69: CINC Scores of United States and Other Rising Countries 1945-1970



[565] Data from Singer. 1987.
[566] Krasner, Stephen D. 1977. US commercial and monetary policy: unravelling the paradox of external strength and internal weakness. *International Organization*, 31(4). Pp. 635–71. At Pp. 642–3.

Figure 70: CINC Scores Gap between United States and Other Rising Countries 1945-1970

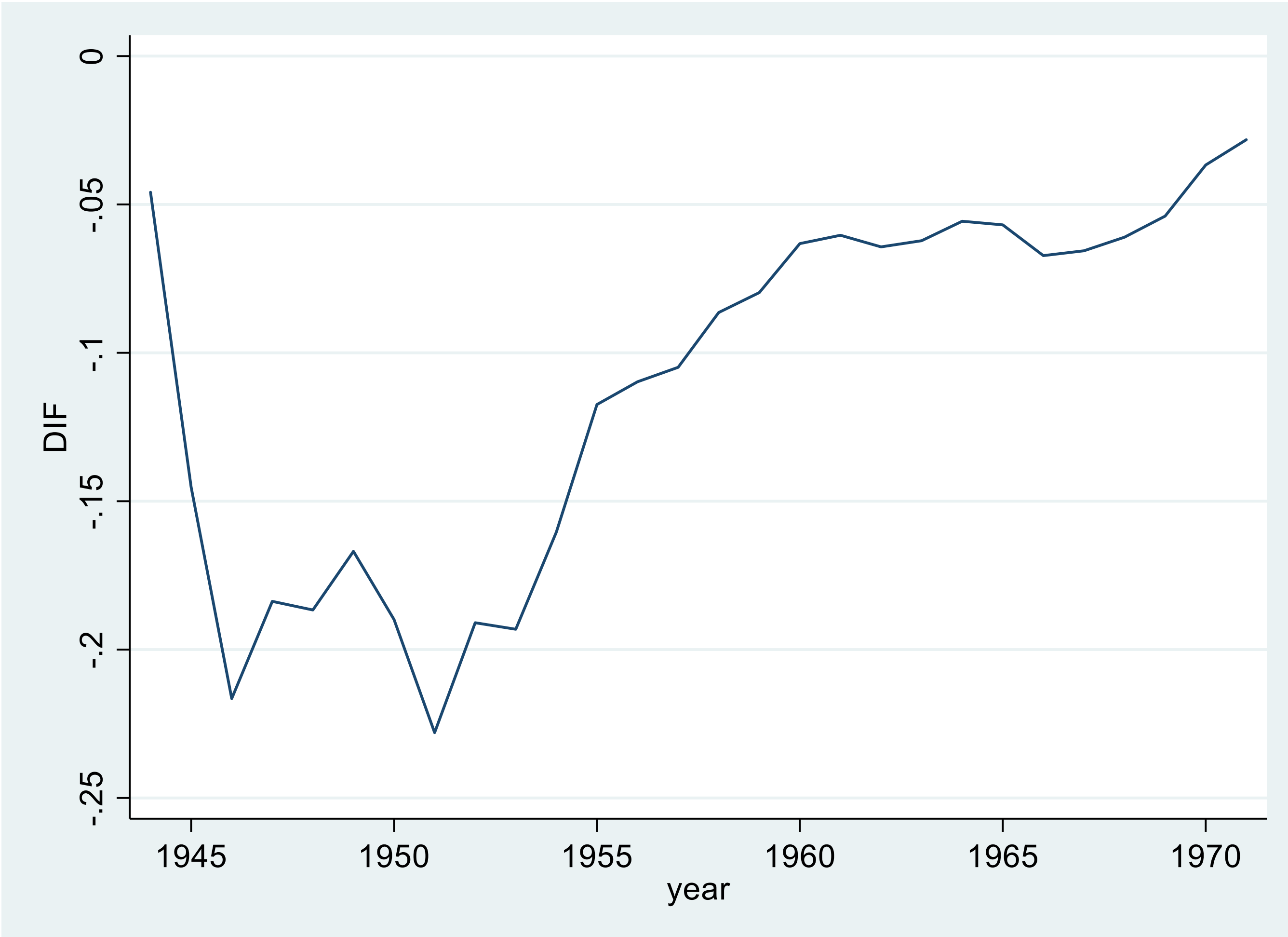


Figure 71: Indicators of Hegemonic Decline of Untied States during Bretton Woods IMS

	A National Income		B Per capita income	C Crude petroleum production		D Crude steel	
	RATIO OF US TO TOTAL MARKET ECONOMIES	RATIO OF US TO NEXT LARGEST	RATIO OF US TO NEXT HIGHEST	RATIO OF US TO TOTAL WORLD PRODUCTION	RATIO OF US TO NEXT LARGEST PRODUCER (EXCL. E. BLOC)	RATIO OF US TO TOTAL WORLD PRODUCTION	RATIO OF US TO NEXT LARGEST PRODUCER (EXCL. E. BLOC)
1937							
1945					3.81 (Ven.)	.64	6.02 (UK)
1948							
1949							
1950						.45	5.31 (UK)
1953		6.43 (UK)[4]	1.58 (Switz.)[5]	.51	3.33 (Ven.)		
1955						.39	4.98 (W. Ger.)
1958		6.33 (UK)[4]	1.52 (Switz.)[5]	.43	2.91 (Ven.)		
1960	.45	6.96 (UK)	1.78 (Swed.)	.33	2.33 (Ven.)	.26	2.64 (W. Ger.)
1965		6.59 (W. Ger.)	1.51 (Switz.)			.26	3.23 (W. Ger.)
1966				.25	3.42 (Saudi Arabia)		
1970	.39	5.23 (W. Ger.)	1.14 (Swed.)	.21	2.48 (Iran)	.20	1.27 (Japan)
1973		3.27 (Japan)	.98 (Swed.)	.16	1.25 (Saudi Arabia)	.20	1.15 (Japan)

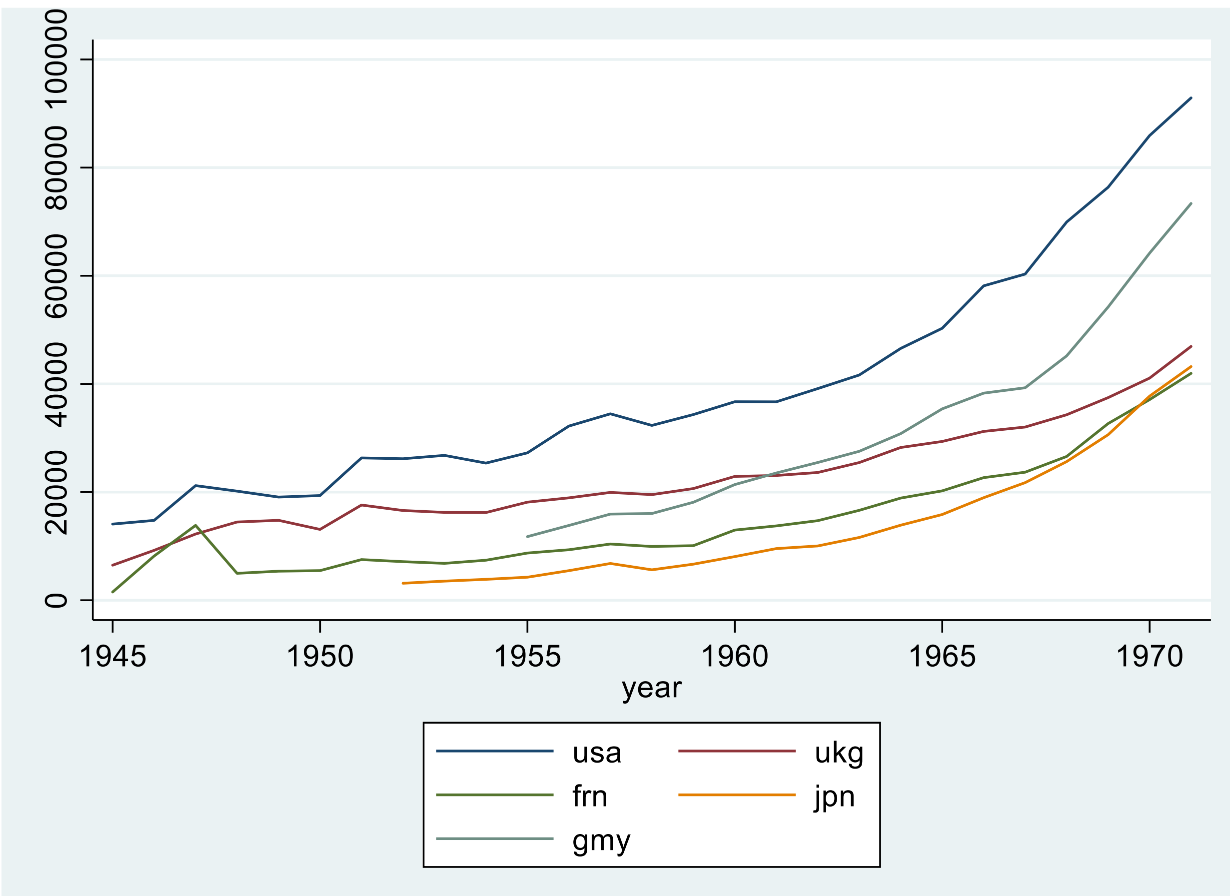
	E Iron ore production		F Energy consumption		G Wheat	
	RATIO OF US TO TOTAL WORLD PRODUCTION	RATIO OF US TO NEXT LARGEST PRODUCER (EXCL. E. BLOC)	RATIO OF US TO TOTAL WORLD CONSUMPTION	RATIO OF US TO NEXT HIGHEST CONSUMER (EXCL. E. BLOC)	RATIO OF US TO TOTAL WORLD PRODUCTION	RATIO OF US TO NEXT LARGEST PRODUCER (EXCL. E. BLOC)
1937			.44[1]	3.72 (W. Ger.)		
1948	.49	6.14 (Swed.)			.24[3]	
1949			.49[1]	4.77 (UK)		
1950	.42	5.06 (Fr.)	.51[1]	5.22 (UK)	.17	2.20 (Can.)
1955	.31[2]	3.28 (Fr.)	.40	5.05 (UK)	.12	1.80 (Can.)
1960	.19	2.20 (Fr.)	.34	5.63 (UK)	.15	2.61 (Can.)
1965	.15	2.29 (Can.)	.34	6.42 (UK)	.13	2.43 (Fr.)
1970	.13	1.82 (Can.)	.33	6.83 (Japan)	.12	1.83 (India)
1973	.11	1.13 (Aust.)	.32	6.45 (Japan)	.12	1.88 (India)

[1] World Excl. USSR, China, and Korea
[2] World Total Excl. China
[3] Excl. USSR
[4] GDP
[5] GDP/capita
Sources: Columns a and b, United Nations, *Statistical Yearbook* and United Nations, *Yearbook of National Account Statistics*, various years. Columns c,d,e,f, and g, United Nations, *Statistical Yearbook*, various years.
Countries in parentheses indicate the next highest non-Communist producer.

This shrinking gap between the hegemon and the non-hegemonic states is supported also by the aggregate trade data, which grew more in the latter group than in the prior (see

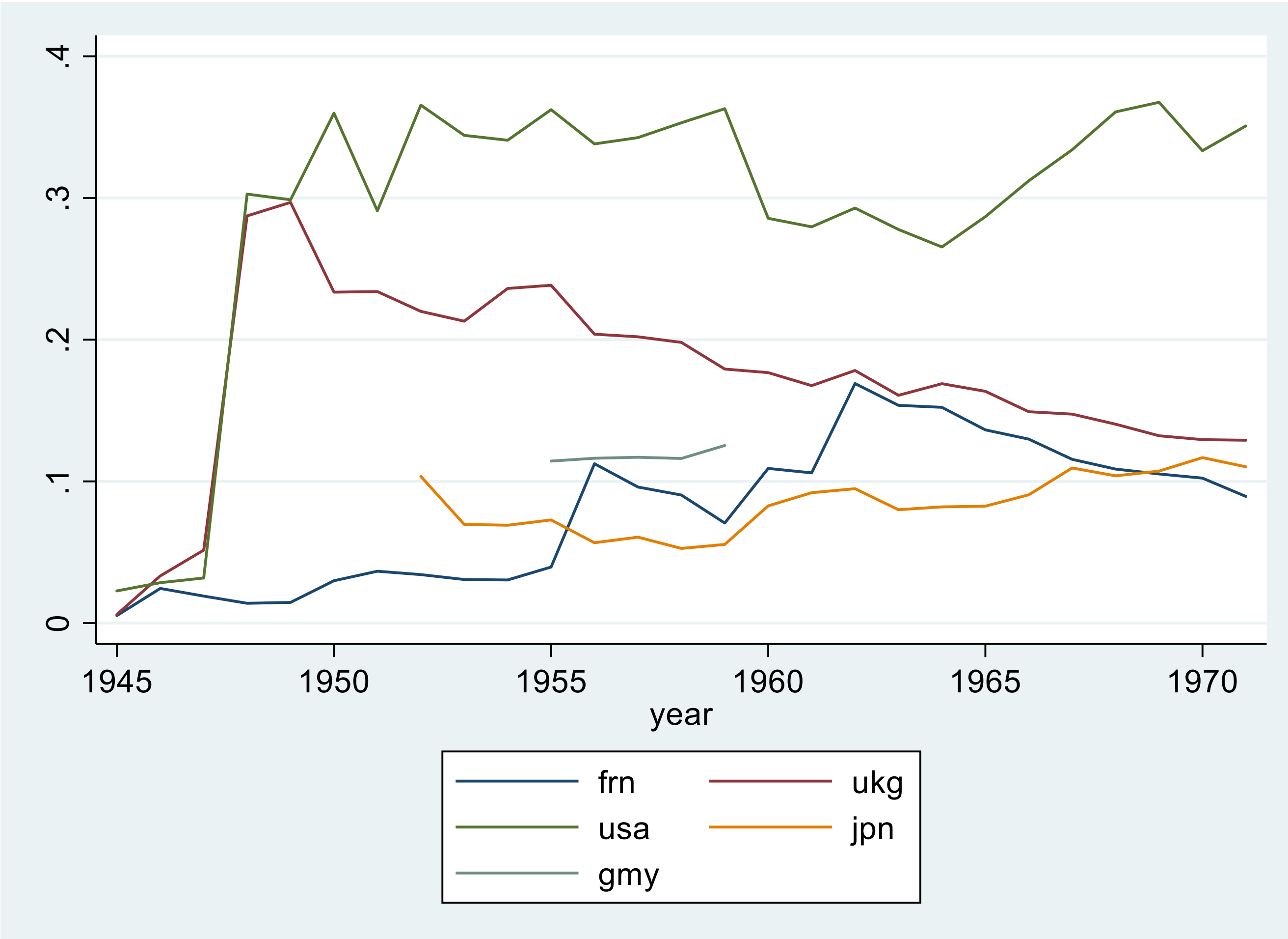
Figure 72).[567] However, this is not the case when it comes to the network position of the United States in the global trade relations (see Figure 73).[568] As it is with the rise of US dollar monetary centrality, so too was the rising centrality of the United States in global trade. Figure 60 shows that the global reserves in US dollar overtook those denominated gold in 1964. While Figure 23 shows that externa dollar liabilities outgrew those denominated in US dollars in 1963. Both events preceded the rise of US trade centrality also in absolute (starting in 1965), not only relative (from 1950) as depicted on Figure 73.

Figure 72: Aggregate Trade of Major States during Bretton Woods IMS



[567] Data from Barbieri, Keshk, and Pollins. 2009.
[568] Data from Barbieri, Keshk, and Pollins. 2009.

Figure 73: Networked Centrality in International Trade of Major States during Bretton Woods IMS



Thus, the story of Bretton Woods IMS is closing the state capacity gap between the hegemon and non-hegemonic states, while at the same time, non-hegemonic states were strengthening the central position of the US dollar in global monetary relations, as well as centrality of United States in global economic relations. Hence, such behavior may be interpreted as a 'buy-in' dynamic – non-hegemonic states actively strengthening the central position of the hegemon and thus, its hegemony. Namely, non-hegemonic states wanted to catch-up economically to the United States, while at the same time secure its hegemony. Following these two objectives, they established US dollar centrality, and they welcomed the free flow of capital. Hence, from the perspective of US hegemony, their actions were not counterproductive. The non-hegemonic actions were undercutting a particular IMS, not US hegemony, which in fact became more pervasive through such behavior. As I will show in the next chapter, when the United States called their bluff with the Nixon shock, the non-hegemonic did not push back against the hegemon, creating a balancing coalition, and a different non-US-centered system, but instead, they actually reproduced the US centrality in the global economy and embraced a new IMS through which United States exercised its hegemony.

On a tactical level Bretton Woods IMS performed well – see Figure 74.[569] But strategically it increasingly became shaky throughout 1960s: the US negative balance of payments, growing public debt incurred by the expenditures for Vietnam War and Great Society programs,[570] private capital outflows,[571] speculative capital transactions,[572] and inflation.[573] The problem manifested as a liquidity problem – there was not enough gold to satisfy the global demand, even when an unofficial global private-non-state-related market for gold arose.[574] However, the crucial issue was that the nature of the economy has changed, and that non-hegemonic states refused to adjust and so contribute to the governance of the Bretton Woods IMS.

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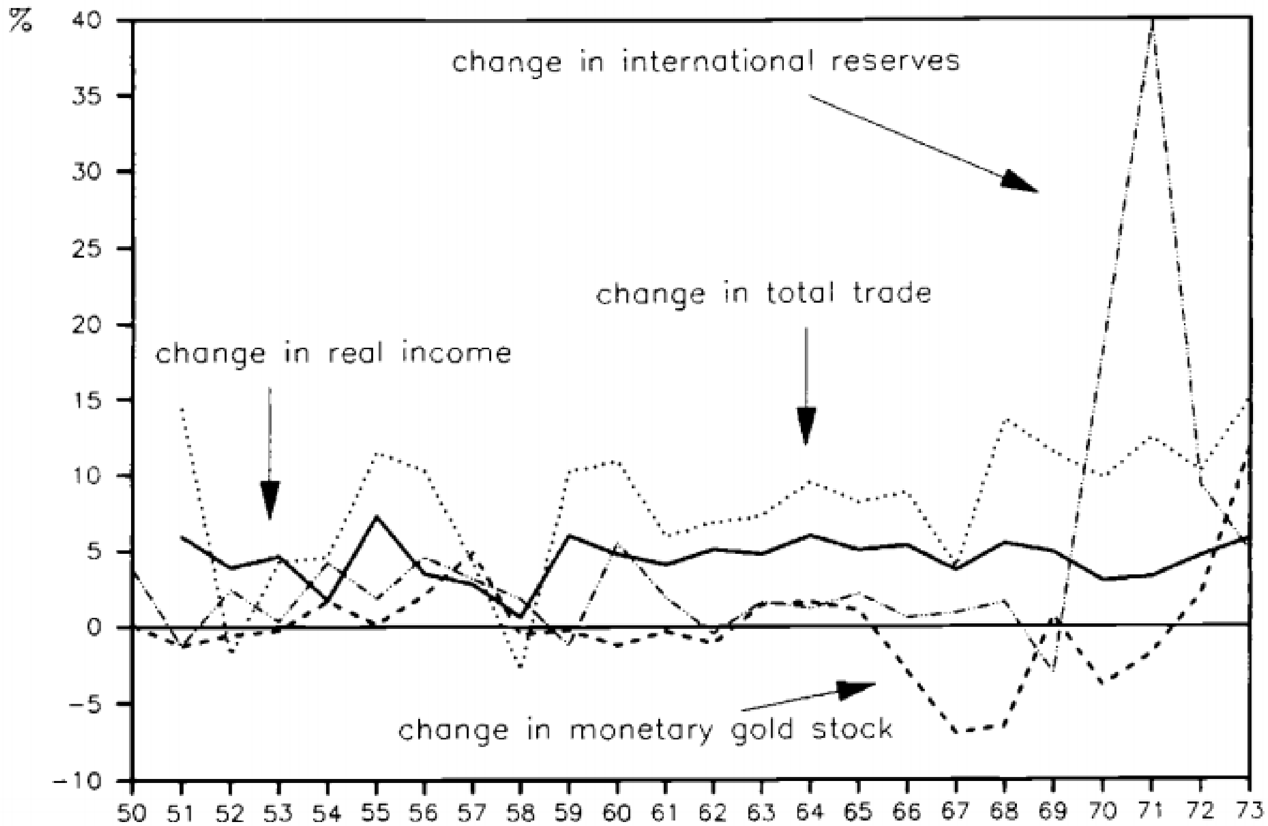
[569] Bordo. 1993. Pp. 64.
[570] They were not paid for by raising taxes, but by sharp decline in current account surplus, see Krugman and Obstfeld. 2008. Pp. 523−4.
[571] See *Economic Report of the President*. 1976. Transmitted to Congress in January. Accessibility: https://fraser.stlouisfed.org/files/docs/publications/ERP/1976/ERP_1976.pdf (25 July 2019). Pp. 274−5.
[572] See James. 1996. Pp. 159.
[573] Orphanides, Athanasios, and John Williams. 2011. *Monetary policy mistakes and the evolution of inflation expectations*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w17080.pdf (11 July 2019).
[574] See Krugman and Obstfeld. 2008. Pp. 523.

The latter was consequential, but not crucial since it was derived from the tactical position of the non-hegemonic states to generate economic growth.

Figure 74: Four Measures of Bretton Woods IMS Performance



The United States was solving the liquidity problem by printing US dollars. This led French economic minister Valery Giscard d'Estaing to call Bretton Woods system 'America's exorbitant privilege'[575] – an asymmetric financial system where non-US citizens "see themselves supporting American living standards and subsidizing American multinationals."[576] Eichengreen explains: "It

[575] Eichengreen. 2010. Pp. 4.
[576] Eichengreen. 2010. Pp. 4.

costs only a few cents for the Bureau of Engraving and Printing to produce a $100 bill, but other countries had to pony up $100 of actual goods in order to obtain one."[577]

The new centrality of the US dollar in global monetary relations indicates non-hegemonic confidence in the US dollar – 'buy-in' dynamic. As Elson writes: "the long run stability of the system was critically dependent on sound economic policy management of the United States" – countries relied on the US economy for a provision of liquidity and finances.[578] The Bretton Woods era led to a deficit in the US capital account, which paired with slumping US exports, made the system unsustainable from the US perspective.[579] Therefore, to satisfy their own interests, the United States had to change the format of the IMS. Moreover, the full-fledged central position of the US dollar in the global monetary relations enabled it to seize the potential of the 'buy-in' dynamic and reform the IMS, without endangering its hegemony.

To conclude, comparing competing theories of hegemon on Bretton Woods IMS, we get the following picture. Coercive Hegemony theory would expect the United States to use coercion to force non-hegemonic states to make proper adjustments and thus, to maintain the Bretton Woods system. There is no evidence of that. The United States repeatedly called for adjustment, which was unheeded, but did not use force (economic sanction or other punitive forms of economic policy) when that did not materialize. Even when a surplus non-hegemonic state depreciated, did the exact opposite what the Bretton Woods IMS would need, there was no punishment that followed from the United States. Moreover, even when we flip the coin onto non-hegemonic states,

[577] Eichengreen. 2010. Pp. 3.
[578] Elson. 2011. Pp. 45.
[579] Despres, Kindleberger, and Salant. 1966.

this theory would expect that with the diminishing of the power gap between the hegemon and the non-hegemonic states, the latter would balance against the prior and with coercion, if necessary, create a new IMS. In fact, the opposite happened; tactically the non-hegemonic states undercut the Bretton Woods IMS, but strategically they entrenched the US hegemony. Thus, this theory fails to explain the (non)functioning of the Bretton Woods IMS.

Second, Cooperative Hegemony theory expects to see states continuously using international organizations to facilitate their cooperation. However, what happened was a weakening of the Bretton Woods institutions since 1945. Namely, alternative groupings arose in 1960s (e.g., Gold Pool, G-10), and none of the states – the hegemon or non-hegemonic – were tied down by these institutions. Therefore, Bretton Woods institutions were not used for global governance. In fact, they were more of a fifth wheel – providing false analysis and policy recommendations. States ignored objectives of Bretton Woods IMS, including its funding document. Thus, they did not impact strategic (enhancing centrality of the US dollar) nor tactical (not adjusting) levels of state behavior. Hence, this theory also performs poorly in explaining the events leading to the 1971 Nixon shock.

Third, Cultural Hegemony anticipates that the hegemon would use its ideology of capitalism and open markets to force non-hegemonic states to position it in the center of their economic activity. But what we see is the repetitive disobedience of the non-hegemonic states to the will of the hegemon. For example, they ignored its calls for adjustment. Furthermore, some states even openly expressed disagreement with the hegemon's ideology (e.g., France). As such, this theory does not offer a good explanation for state behavior during the Bretton Woods IMS.

Alternative to the previous three theories, Opportunist Hegemony can explain the (non)functioning of Bretton Woods, as it captures the Triffin dilemma of United States. In it, the US dollar is treated as an international public good that the United States needs to provide, and liquidity shortages are interpreted as crises through which the non-hegemonic states are signaling their dissatisfaction to the hegemon and the need for more of the public good. Thus, the theory anticipates hegemon's procurement of a public goods. Since the dominance of the latter can also change the policies of the hegemon in assuring it should change. In fact, this is what happened. The United State first provided gold, and then when it became scarce, also gave non-hegemonic states what they craved namely, the U.S. dollar. Therefore, the United States performed a 'buy-out' of the non-hegemonic states and assured its hegemony. Moreover, as the Opportunist Hegemony predicts that providing public good comes at a cost (diminishing power gap between the hegemon and non-hegemonic states) and subsequently the hegemon cannot do so endlessly, it interprets the Triffin dilemma that United States was faced with as such a difficulty of the hegemon. [580]

However, where it falls short is in its underestimating the role of centrality of the US dollar. Opportunist Hegemony explains this fact according to its assumption of pragmatic behavior of non-hegemonic states. Thus, it puts it at par with non-adjustment tactical policies of the non-hegemonic states. Yet, as the next section will show this was not the case, and the centrality of the US dollar was foundational to US hegemony, not epiphenomenal to it.

[580] Triffin argued that once US dollar reserves held by other countries would outgrow US gold reserves this may result in confidence crisis as United States would no longer be able to assure the exchange of these US dollars for gold at the fixed price of $35 an ounce. See Triffin. 1960a.

From the perspective of Pervasive Hegemony Theory, we would expect selfish reasons of the hegemon and non-hegemonic states for positioning the US dollar in the center of their global economic interactions. The reasons are also expected to be different for the hegemon and non-hegemonic states. The hegemon embraces the central position in the global economic relations as this secures its hegemony. The non-hegemonic states support such behavior due to their interest of maximizing autonomy, in other words – they 'buy-in'. Furthermore, it is expected that the 'buy-in' of the non-hegemonic states happens first, after which the hegemon follows up with its part of fulfilling the hegemony (providing the public good). Empirically this is exactly what happened. The United States was ready and willing to accept its central position and provide US dollars only when the non-hegemonic states actively positioned US dollar in the center of their economic relations. Moreover, the United States allowed the non-hegemonic states not to adjust as this was not essential for its hegemony. Hence, the non-hegemonic states could be autonomous in that respect and fulfill their selfish national interest of being autonomous in conducting their international relations. This course of events ended up in a new IMS that revealed the underlying power of a 'buy-in' mechanism underlying a distinctive US-anchored pervasive hegemony.

As such, my theory provides an explanation for the (non)functioning of the Bretton Woods IMS. Moreover, it explains both parts – the creation and its performance – of the Bretton Woods IMS. Unlike, other theories, which explain only one part of this period. The next chapter analyses the second case study – the post-Bretton Woods IMS.

5. POST-BRETTON WOODS SYSTEM

> "/A/fter Bretton Woods, the transition from a government-led to a market-led financial system with rapidly increasing capital mobility raised financial stability concerns, prompting central banks to intensify cooperation in this field."[581]

The latent issues within the Bretton Woods IMS (lack of adjustment and the new economy problems) created an environment where any crisis could 'break the camel's back'. So, when France converted nearly $200 million into gold in July 1971, and Switzerland $50 million in early August[582], this was it. With the US gold reserves at the lowest since 1938 and the United Kingdom requesting gold to cover their assets, the US president Richard Nixon acted.[583] What followed was the breakdown of the Bretton Woods IMS and a gradual creation of a new system through a series of events over an eight-year period. After the initial 'Nixon shock' (suspension of the US dollar convertibility to gold on 15th August 1971), other disruptive measures followed. First, another suspension of the US dollar convertibility to gold in 1973 (i.e., the breakdown of the Smithsonian Agreement, which at the end of 1971 set new fixed exchange rates). Second, in 1974 the United States abandoned capital controls. Third, other developed economies did the same by 1979 and were followed by developing countries in the 1980s.[584]

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[581] Clement, Piet. 2008. Introduction: Past and Future of Central Bank Cooperation. In Borio, Claudio, Gianni Toniolo, and Piet Clement (eds.), *The Past and Future of Central Bank Cooperation*. Cambridge: Cambridge University Press. Pp. 1–15.
[582] Rockoff, Hugh. 2012. Wars and the Trading System 1900-2000. In Caprio, Gerard, Douglas W. Arner, Thorsten Beck, Charles W. Calomiris, Larry Neal, and Nicolas Veron (eds.), *Handbook of key global financial markets, institutions, and infrastructure*. London: Elsevier. Pp. 311−9. At. Pp. 317.
[583] Ledbetter, James. 2017 *One Nation Under Gold: How One Precious Metal Has Dominated the American Imagination for Four Centuries*. New York: WW Norton. Pp. 234.
[584] Shafer, Jeffrey R. 1995. Experience with Controls on International Capital Movements in OECD Countries: Solution or Problem for Monetary Policy? In Edwards, Sebastian (ed.), *Capital Controls, Exchange Rates, and Monetary Policy in the World Economy*. Cambridge: Cambridge University Press. Pp. 119−56. See Appendix 7 for illustration how capital controls fell from 1950 onwards.

> "As each successive crisis exploded on the world stage, the feeling grew that the new situation was too tough to be handled by the old system, and in this way, stage by stage, the system was abandoned and a new one built. First, the August crisis of 1971 convinced all countries that new parities were needed to achieve international adjustment of payment imbalances. The currency crisis of 1972 and 1973 persuaded politicians that arriving at a new parity structure was a practically impossible feat. Then the commodity and oil prices booms added a new dimension to the adjustment problem, in that the amount of adjustment required became radically unpredictable."[585]

Although the Bretton Woods IMS that the United States anchored collapsed, the anchoring role of United states and its dollar prevailed. Moreover, with US power in relative decline, its network centrality, i.e., hegemony, endured. The reason for why that occurred is the remaining focus of this chapter.

Throughout the Bretton Woods period, reforms proved to be elusive due the repeated unwillingness of the non-hegemonic states to contribute to global governance, as well as the tolerance of the United States to accept their free riding. Each state had its own objectives on how to bend the system in its favor. James aptly summarizes:

> "/S/ign of emerging crisis in late 1960s was the attempt of countries to change and manipulate the international financial system for national advantage. The United States depended increasingly on the status of the dollar as a reserve currency in order to finance its overseas military expenditure. The United Kingdom feared any reform that would erode its own reserve status. France wanted to halt what it regarded as an American abuse of the system. Germany felt that its surpluses were leading to an inflation imposed from the outside; but Germany and Japan at the same time did not want a change in the international system that might affect their own powerful export performance. Some developing countries wanted to tie reserve creation to greater development assistance. National currencies consequently became a playball of international politics."[586]

[585] James. 1996. Pp. 259.
[586] James. 1996. Pp. 230−1.

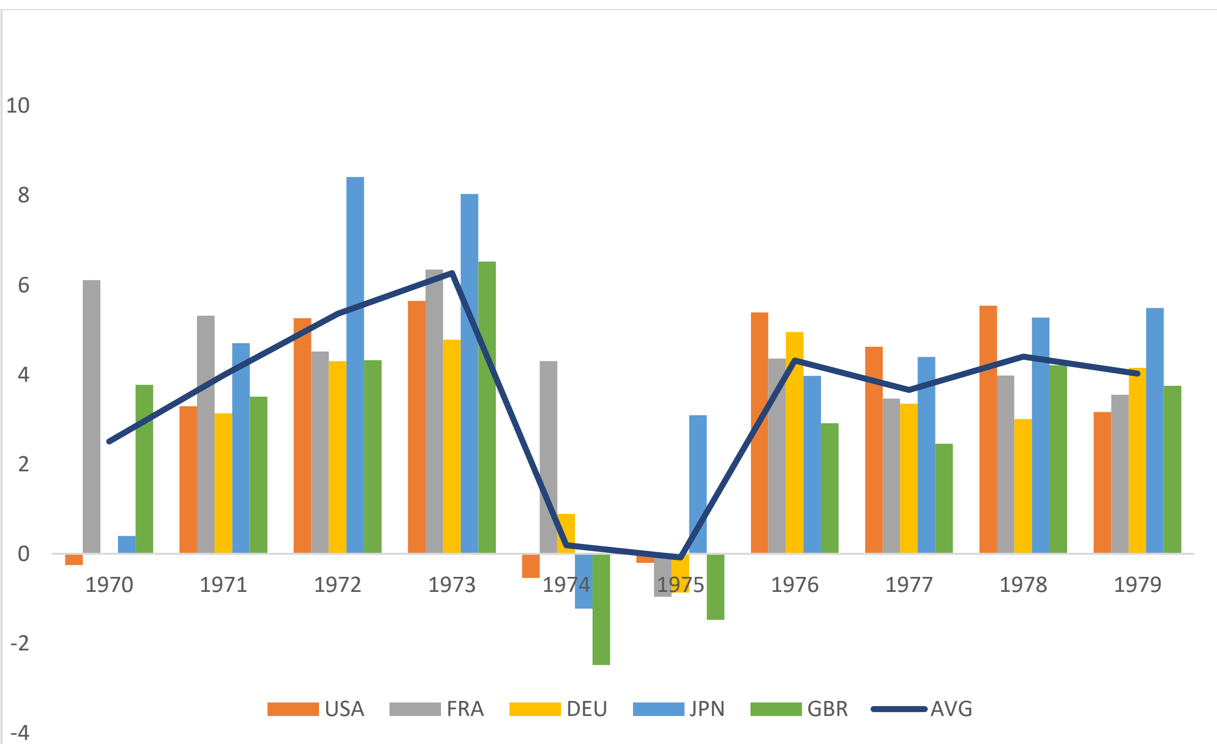
The United States kept the Bretton Woods IMS alive with different measures for enhancing the liquidity described in the previous chapter. As such, an IMS served its interests—enhancing the US dollar centrality in the global economy. Yet, the system was unable to evolve not because of economic-technical reasons, but due to political decisions.[587] So, the solution could not be purely economic, but rather political, and namely, via a political shock.[588] The United States could not and would not bleed itself dry (Triffin dilemma) for the survival of the Bretton Woods IMS. Once its interests could not be achieved by maintaining such an IMS (the US dollar centrality was well established), the hegemon wanted to change the envelope in which this global central monetary unit would come in—change the rules of the IMS, i.e., position the new IMS differently in the monetary trilemma. Since the reform was not possible, it could only do so with a shock – recalling the phrase attributed to Winston Churchill: "Never let a good crisis go to waste".[589] This came "in 1971 as a result of three developments: the imminent entry of Britain into the Common Market, the appointment of John Connally as Secretary of Treasury, and the growing speculative strain on the dollar."[590] Hence, the restructuring of the IMS took place throughout the economically turbulent 1970s (inflation, oil crisis) and resulted in a new IMS by the end of the decade based on the free flow of capital and sovereign monetary policy.[591]

Such a structure embraced the new nature of the economy and outsourced the issue of adjustment to open markets. Moreover, states were still able to generate a decent economic growth

[587] Frieden. 2007. Pp. 344.
[588] In this respect the 1971 Nixon Shock can be compared to 1931 suspension of convertibility of the Sterling by United Kingdom, in that both triggered the collapse of their respective IMS (see De Vries. 1986. Pp. 82.).
[589] Mutter, John. 2016. Opportunity from Crisis, Who Really Benefits from Post-Disaster Rebuilding Efforts. *Foreign Affairs*. Accessibility: https://www.foreignaffairs.com/articles/2016-04-18/opportunity-crisis (9 November 2020).
[590] Kissinger. 1979. Pp. 949.
[591] De Vries. 1986. Pp. 157.

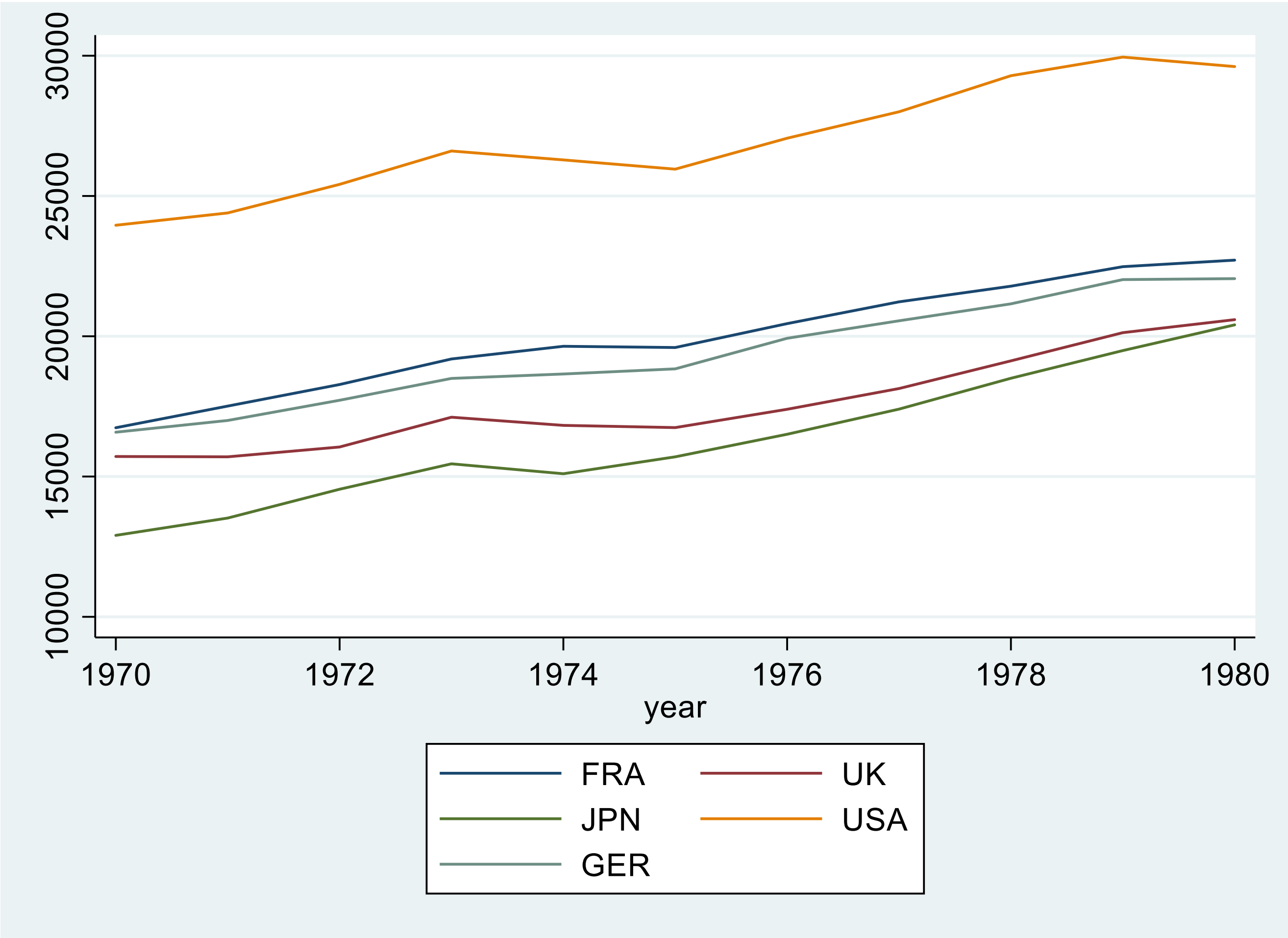
during a rocking period: average growth rate in 1970s was 3.5% and stabilized at around 4% by the end of the decade (Figure 75). Although this was 1.5 percentage points below the growth rates of 1960s, the economic-political environment in these two decades were substantially different and states understood that reality. Furthermore, rising nations were still able to play economic catch-up to the United States (Figure 76 and Figure 77) and diminish the capacity gap between them and the hegemon (Figure 78). However, global trade centrality shows persistent dominance of the United States. In fact, in some cases, one can even observe an increased US relative central position (Figure 80), although the relative spreads of aggregate amount of trade remained the same (Figure 79). Therefore, in a decade where US capacities were relatively growing smaller, its economic centrality and its hegemony were reinforced.

Figure 75: Economic Growth of Major States between 1970 and 1980[592]



[592] Data from World Bank data base: *The World Bank Data*. 2020.

Figure 76: Real GDP per capita from 1970-1980 of Major States 1[593]



[593] Data in 2011 US dollars. The method is suitable for cross-country income comparisons. See Maddison Project Database, version 2018.

Figure 77: Real GDP per capita from 1970-1980 of Major States 2[594]

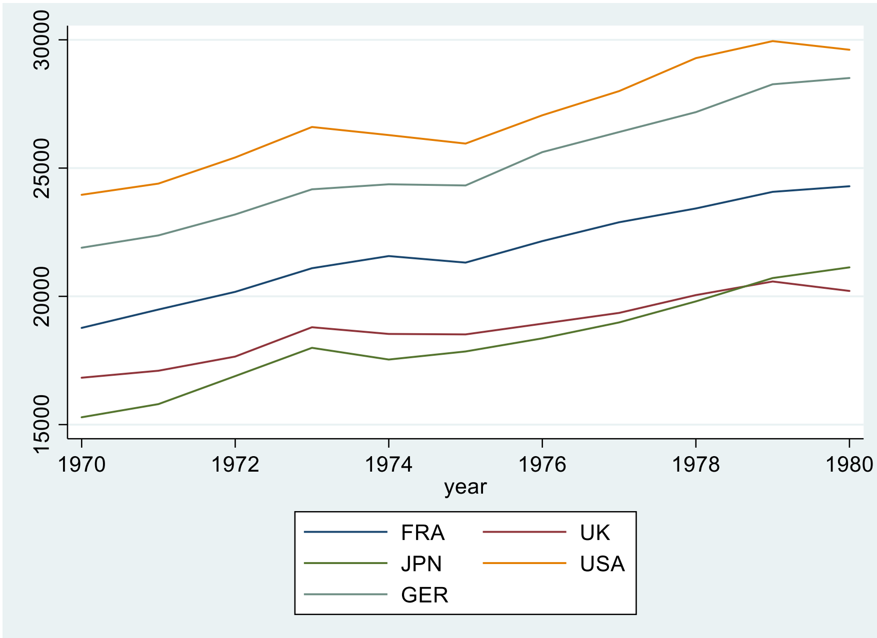
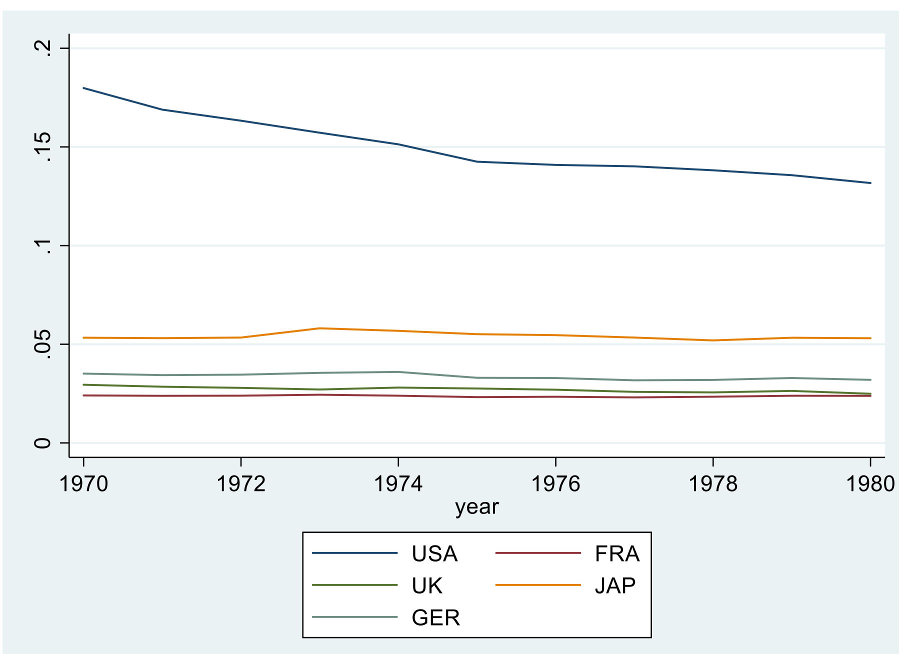
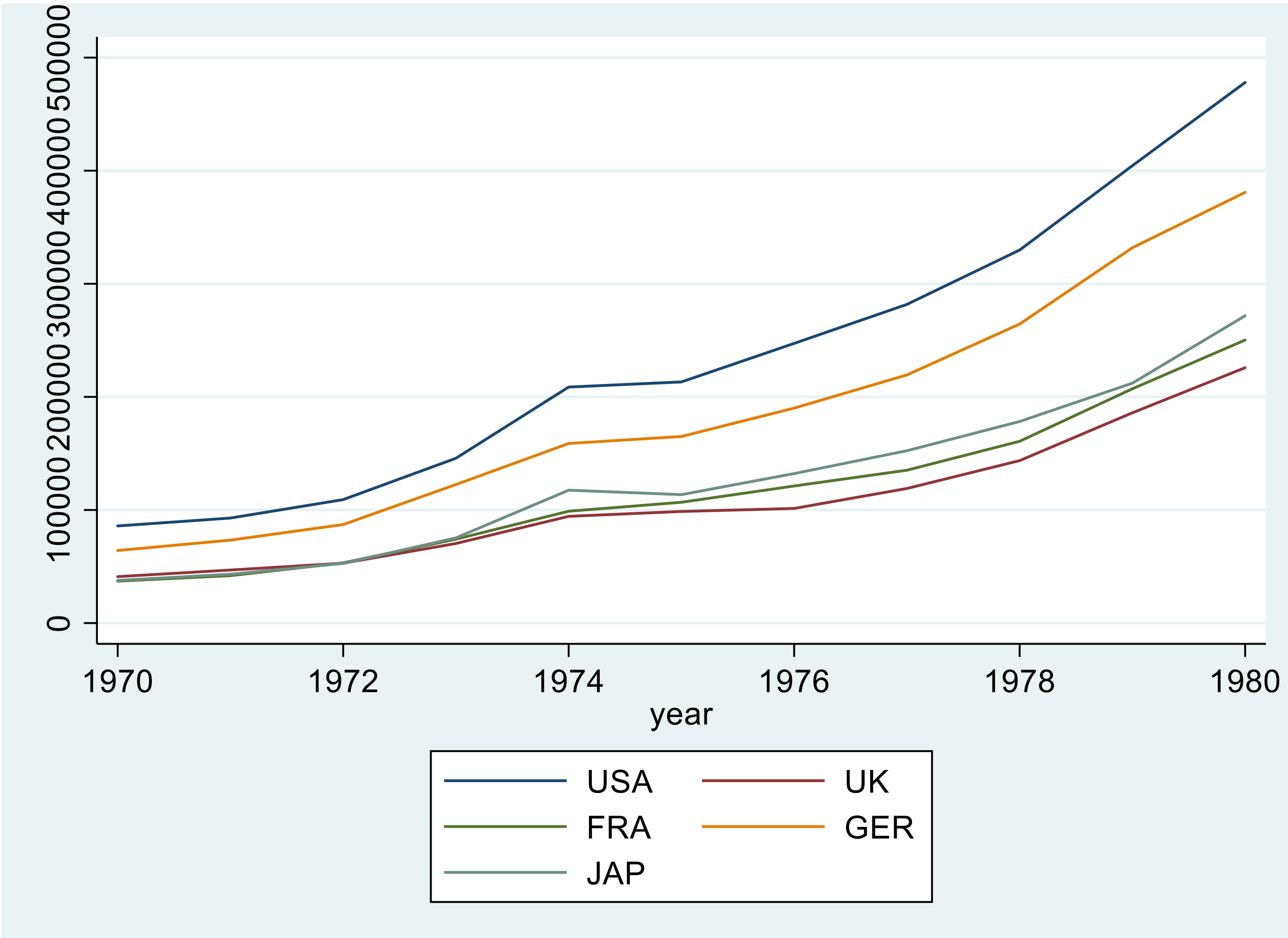


Figure 78: CINC Scores of Major States between 1970 and 1980[595]



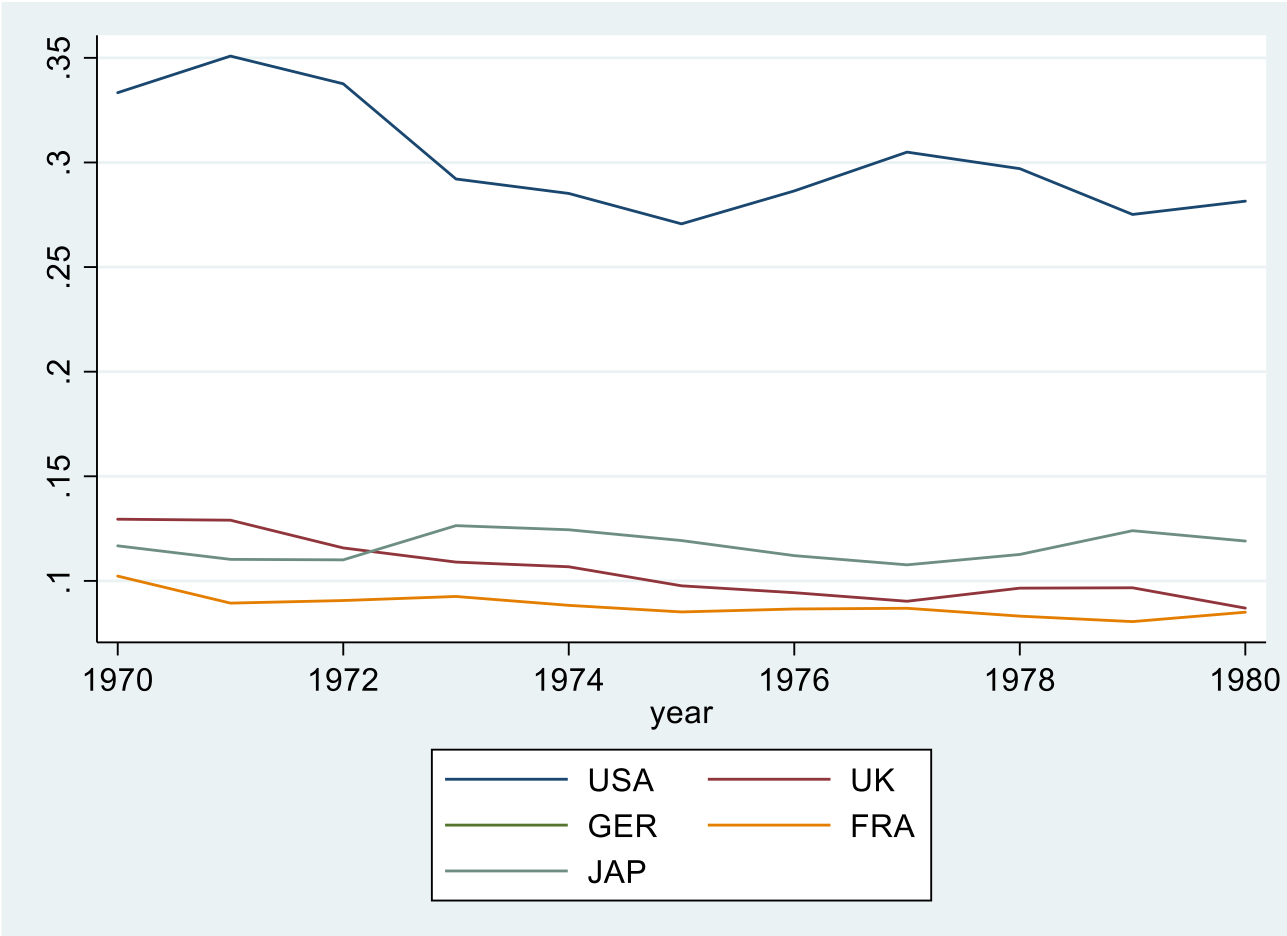
[594] Data in 2011 US dollar, 2011 benchmark. The method is suitable for cross-country growth comparisons. See Maddison Project Database, version 2018.
[595] Data from Singer. 1987.

Figure 79: Aggregate Trade of Major States between 1970 and 1980[596]



[596] Data from Barbieri, Keshk, and Pollins. 2009.

Figure 80: Networked Centrality in International Trade of Major States between 1970 and 1980[597]



The persistent imbalance of power and the US hegemonic endurance appeared intact also by enhanced European cooperation in the realm of monetary policy. Today's second global currency—the Euro—has its roots in the late 1960s and 1970s.[598] Namely, if other two 'in-theory' alternatives to the US dollar did not seem reasonable, feasible, and states rejected them – SDR and

[597] Data from Barbieri, Keshk, and Pollins. 2009.

[598] A concrete idea, not only as a longshot vision, has been developed already in 1950s, but it got its first political shape at the end of the Bretton Woods IMS, see Triffin, Robert. 1953. Systeme et politique monetaires de l'Europe federee. *Economia Internazionale*, 6(1). Pp. 207–14. For a crisp historical overview of early implementation of the common currency in the European Community, see Triffin, Robert. 1978. *Gold and the Dollar Crisis: Yesterday and Tomorrow*. Princeton: International Finance Section, Department of economics, Princeton University. See also Triffin. 1957. Ch 7; Triffin, Robert. 1960b. The size of the nation and its vulnerability to economic nationalism. In Austin Robinson (ed.), *Economic Consequences of the Size of Nations*. London: Palgrave. Pp. 247–64.

return to specie standard – a common European currency had the potential to be such an alternative. It was Triffin that proposed the possibility of a common European currency to de Gaul in 1965: Europeans should create a system of liquidity that would remove the IMF from "any necessity, or any power, of intervening in measures that affect the balance of payments between members of the European Economic Community."[599] Thus, under French leadership, calls for an European monetary union began and in December 1969 at the Hague Summit a working group for common monetary policy was set up that delivered a report in 1970.[600] The 'Werner report',[601] named after the head of the group – Luxemburg Prime Minister Pierre Werner, was submerged by currency instability in 1970 and 1971.[602] Yet, the idea of a European common monetary policy persisted throughout the 1970s and in 1979 finally resulted in the creation of the European Monetary System.[603] Thus, in parallel to the crystallization of the new global IMS, an important regional monetary integration formed. However, the latter took another 20 years to be fully established with the introduction of the Euro only in 1999. Therefore, European countries proved to be rather slow and inefficient when it came to enhancing their union, so this initiative turned out not to be a serious global alternative to the US dollar.[604] The latter holds also today, two decades after the introduction of the Euro, where its limited global reach and institutional challenges make it a highly unlikely alternative to the US dollar.

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[599] Triffin, Robert. 1965. Letter to Charles de Gaulle from February 22. Reprinted in 1973. *Espoir*, 4. Pp. 37–40. Pp. 39.

[600] See Szasz, Andre. 1999. *The Road to European Monetary Union*. London: Macmillan Press. Pp. 8–29; Howarth, David J. 2001. *The French Road to European Monetary Union*. New York: Palgrave. Pp. 21–7.

[601] *Werner Report*. 1970. Accessibility: http://ec.europa.eu/economy_finance/publications/pages/publication6142_en.pdf (5 May 2018).

[602] James. 1996. Pp. 203.

[603] See Szasz. 1999. Chs. 7 and 8.

[604] Its regional scope is both its weakness and its strength also today. It leverages the economic potential of its members; yet, due to the lack of political leadership it also falls short of having a global reach. In fact, it was Triffin that warned about this: "European monetary union /is/ inseparable, of course, from political union" (Triffin. 1978, Pp. 17).

Hence, two things need to be clarified when it comes to the creation of the European Monetary Union – how do regional developments (fixed exchange rates) square with the new post-Bretton Woods IMS (free float), and can such a behavior of European states be interpreted not as 'buy-in' but rather as balancing? Regarding the first, see my discussion on the Eurozone in Chapter 2.1. Moreover, fixed exchange rates in the European Exchange Rate Mechanism were not pegged, but rather had a zone of fluctuation[605] around a value of the European Currency Unit (ECU), which was defined by the weighted value of European basket of currencies.[606] Furthermore, "the respective shares, or weights, were determined not only by reference to each country's gross domestic product, but also by reference to its participation in the Community's external trade."[607] Since these elements depended on the US dollar and United States, the latter was a reference point for the ECU. To make it clearer: "The national currency value of the ECU on any particular day can easily be calculated on the basis of the basket's composition. The amount of each currency in the basket has to be multiplied by its daily rate against a reference currency /US dollar/. The resulting nine amounts in one currency have then to be added together to give the value of the ECU in terms of that currency."[608] As such, indirectly the ECU and individual European currencies still floated against the US dollar. Finally, we also encounter a 'level of agency problem', where the latter changes in the light of my unit of observation – currencies. Namely, European states' currencies ceased to exist, and a new currency – the Euro – became a currency of interest instead, which is not based on state as agencies, but on the European Monetary Union as an agent. Nation

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[605] This is referred to as 'snake in the tunnel', where the snake represents the free flow, and the tunnel the zone within which the currencies can float. This phrase will be used throughout the chapter and explained in detail.
[606] See De Grauwe, Paul, and Theo Peeters. 1988. *The ECU and European Monetary Integration*. London: Macmillan.
[607] European Communities. 1984. *The ECU*. Luxembourg: Office for Official Publications of the European Communities. Pp. 9.
[608] European Communities. 1984. Pp. 11.

states and their currencies were replaced by the Eurozone, which represents the new monetary entity. Nevertheless, what is relevant for my argument is the relations between the Euro or ECU and other global currencies, particularly the US dollar are in line with my theoretical expectations. European states fixed their exchange rates only against other European currencies, not against the US dollar. They have done so in order to gain more economic benefits from the European economic integration in an increasing globalized world.[609]

Regarding the second, it would be incorrect to interpret the initial shaping of the European Monetary Union as anti-American foreign policy or balancing against the hegemon. Both sides were willing to cooperate when their interest converged – e.g., the Cuban missile crisis, ending the Vietnam War, the creation of the Conference on Security and Cooperation in Europe, to list just a few.[610] This would not be the case if Europeans intended to balance against the hegemon. Furthermore, it made sense for the European countries to forge a common currency as they were on the path towards optimum currency area,[611] as well as their integration process was moving towards the single market, where monetary union would be the next integration step.[612] Hence, European countries logically followed economic ideals of regional integration, where eventually they created a new monetary entity into which they vested some of their sovereignty in 1999 – the European Central Bank.[613] As such, creation of the new post-Bretton Woods IMS based on free flow of capital and floating exchange rates is not mutually exclusive to the deeper regional

[609] Verdun, Amy. 2000. *European Responses to Globalization and Financial Market Integration: Perceptions of Economic and Monetary Union in Britain, France and Germany*. London: Macmillan.
[610] See Kissinger. 1994. Ch 24.
[611] See Mundell. 1961.
[612] See Jovanovic, Miroslav. 2014. *International Economic Integration: Limits and Prospects*. London: Routledge.
[613] While at the same time maintained their autonomy to leave the monetary union if they so decide, so the ultimate decision about their monetary policy still resides with the member states of the European Monetary Union.

economic integration in Europe.[614] Moreover, as the ECU and European currencies were still indirectly floating against the US dollar, and European states were enhancing their reserves denominated in US dollars, as well as conducted their economic operations mainly in US dollars (see Figure 80, Figure 8, and Figure 22), there is no evidence that their economic integration and behavior was a balancing act. They continued to reproduce the global economic centrality of the hegemon, while at the same time pursued closer economic integration. As my Pervasive Hegemony Theory predicts, once the non-hegemonic states reinforce the centrality of the hegemon's currency in the global economy, i.e., they 'buy-in', they can pursue autonomous policies in other issues. And regional economic integration classifies as the latter. We should understand the development of common European currency as European states autonomously following their national interests of assuring greater economic growth and development, not as a balancing act to undercut US hegemony. European countries have accepted and reproduced US hegemony, and conversely, if there had not been for the US hegemony, the European states could not venture on the path of closer economic integration.[615]

5.1 THE NIXON SHOCK

In February 1971 Nixon appointed John Connally as the Secretary of Treasury. He was described by Kissinger[616] as an egoist, who was upfront and self-confident. He ran over White

[614] Triffin is of the same opinion (1978. Pp. 14): "I have long considered regional monetary cooperation and integration as complementary, rather than alternative, to feasible world monetary agreements."
[615] Regarding the latter, see McCourt, David M. 2020. Hegemonic Field Effects in World Politics: The United States and the Schuman Plan of 1950. *Journal of Global Security Studies*. Online first. Accessibility: https://doi.org/10.1093/jogss/ogaa035 (12 November 2020); Ginsberg, Roy H. 2007. *Demystifying the European Union: The Enduring Logic of Regional Integration*. Lanham: Rowman & Littlefield; Rappaport, Armin. 1981. The United States and European integration: the first phase. *Diplomatic History*, 5(2). Pp. 121–50.
[616] Kissinger. 1979. Pp. 951−2.

House staff and wanted a direct link with Nixon. In the same manner Connally also treated foreigners; in his mind countries yield to pressure, and he had no faith in consultations except from a position of superior strength. He overtly showed his character for example on May 28th, 1971 in a Munich speech to the international bankers, where he negatively and directly spoke about the Europeans and Japanese actions.[617] Moreover, Connally brought free-market ideas to the administration, which were actually floated by Milton Friedman to Nixon during the 1968 campaign and which were then applied to the upcoming IMS.[618] Moreover, Friedman even served on Nixon's economic policy committee during the campaign, when he prepared a memo proposing a new IMS.[619] Still, Connally played a crucial role in designing the Nixon shock of August 15, the immediate political reactions of United States and negotiations afterwards. He was the spark that turned the policy makers from only thinking about a new IMS and privately labelling Bretton Woods as 'a villain', to undertaking the task of creating a more flexible system.[620]

[617] Some examples for that speech include: "/…/ we today spend nearly 9 percent of our gross national product on defense—nearly 5 billion of that overseas, much of it in western Europe and Japan. Financing a military shield is a part of the burden of leadership: the responsibilities cannot and should not he east oil. But twenty-five years after the Second World War, legitimate questions arise over how the cost of these responsibilities should he allocated among the free world allies who benefit from that shield. The nations of western Europe and Japan are again strong and vigorous, and their capacities to contribute have vastly increased. /…/ Is it natural or inevitable that fully 30 percent of Japanese exports go to the United States market—or do restrictions in Europe help account for the direction of that flow? After years of income growth averaging more than 10 percent, should not the Japanese consumer have free access to the products of the outside world? Must Canada maintain tariffs on private purchases of United States autos at a time when a balance-of-payments surplus has resulted in a 'floating' exchange rate? Is it right that United States agricultural products find access to the densely populated continent of Europe increasingly limited? /…/ we have the right to expect more equitable trading arrangements. We also expect you to accept the responsibility to share more fully in the cost of defending the free world. /…/ And, to be perfectly frank, no longer will the American people permit their government to engage in international actions in which the true long-term interests of the United States are not just as clearly recognized as those of the nations with which we deal." See Connally, John. 1971. Mutual Responsibility for Maintaining a Stable Monetary System. *Department of State Bulletin*, 65(1672), July 12. Pp. 42−6.

[618] See Leeson, Robert. 2003. *Ideology and the International Economy: The Decline and Fall of Bretton Woods*. New York: Palgrave. Pp. 66−7.

[619] Friedman, Milton. 1968. *A Proposal for Resolving the U.S. Balance of Payments Problem: Confidential Memorandum to President-elect Richard Nixon*. Accessibility: https://miltonfriedman.hoover.org/friedman_images/Collections/2016c21/Rowman_1988_a.pdf (20 December 2020).

[620] Memorandum from Paul McCracken to President Nixon, Who is 'The Villain' in International Monetary Disturbances? February 1, 1969. Bentley Library, Papers of Paul McCracken, Box 14.

However, Connally cannot be solely attributed for US actions in August 1971, as he was faced with an 'monetary powder keg'.[621] Since 1964, US exports have risen 100%, while Germany's exports have risen 200% and Japanese exports have risen 400%.[622] Yet, these real economic numbers were not reflected in exchange rates or broader monetary relations. On 5 May 1971, the German central bank suspended official operations in the foreign exchange market and allowed the deutsche mark to float.[623] Similar actions were followed by Austria, Belgium, and the Netherlands.[624] Although this finally meant that the currencies of surplus countries have appreciated against the US dollar, it also created additional pressure for the dollar itself to devalue against the gold. Arthur Burns, the Federal Reserve Chair, warned that "a crisis of confidence in the dollar[625] could begin at any time; that is, both foreigners and Americans could begin to shift financial assets out of dollars into foreign currency in order to profit from an expected change in the value of the dollar."[626] At the end of the summer 1971, there were indications a threat like this would materialize (the aforementioned acts of France, Switzerland, and United Kingdom), adding to a growing sense that it was time for the Nixon administration to act. By early August 1971, the United States was forced by the international situation to protect its national interest and the measures outlined by Nixon were supported not only by Connally, but also by others, including

[621] Even himself recalled in his memoirs: "I had no sooner taken office than we had to confront a very hostile international monetary system. /…/ Throughout 1971, the U.S. economy was in such distress, and the world monetary picture so volatile, that comparisons were being made to 1933." See Connally, John. 1993. *In History's Shadow: An American Odyssey*. New York: Hyperion. Pp. 236.
[622] Reeves, Richard. 2001. *President Nixon: Alone in the White House*. New York: Simon and Schuster. Pp. 340.
[623] See Gray, William Glenn. 2007. Floating the system: Germany, the United States, and the breakdown of Bretton Woods, 1969–1973. *Diplomatic History*, 31(2). Pp. 295–323.
[624] Solomon 1977. Pp. 179.
[625] I.E., its value against the gold, not as a central monetary unit in the global economic relations.
[626] Gerald R. Ford Library, Papers of Arthur Burns, Box 65, Robert Solomon, Options open to the United States in dealing with what may be an Emerging International Monetary Crisis, 21 March 1971.

Arthur Burns, Peter Peterson (Assistant to the President for International Economic Affairs), Volcker, and George Shultz (Director of the Office of Management and Budget).[627]

"One way of /avoiding/ potential crisis lay in the negotiation of a new exchange rate structure; but this would be difficult to achieve in a secret negotiation, and any leak would provoke a general crisis."[628] Moreover, non-hegemonic states did not respond favorably to similar calls in the past. Hence, in the US eyes, why would they do it this time around? Thus, the United States opted to initiate the crisis on their own, which would send a clear signal to the non-hegemonic states that the only way the hegemon is ready to provide the central currency is with a new IMS.[629] However, in 1971 the United States did not have a clear idea how this new IMS should look like, but they did have clearly defined interests what such a system should achieve. Initially, the Nixon shock was meant to be temporary,[630] with an aim to push European countries and Japan to revalue their currencies (adjustment). Therefore, in the immediate aftermath of August 1971, only one problem of the Bretton Woods IMS – lack of adjustment – was tackled.[631] The second fundamental problem – the new nature of the economy – did not penetrate the realm of political negotiations at that point. Furthermore, dealing with this problem came organically after the Nixon Shock, and this dynamic reflects the gradual steps of how the new IMS was shaped. Namely, in December 1971 the Smithsonian Agreement resolved the adjustment problem with new parities. Yet by 1973,

[627] Kissinger. 1979. Pp. 953.
[628] James. 1996. Pp. 212.
[629] See James. 1996. Pp. 212−3.
[630] See Solomon, Robert. 1982. *The International Monetary System: 1945-1981*. New York: Harper & Row. Pp. 187.
[631] Paul Volcker, who was at that point the Under Secretary of the Treasury for International Affairs, stated in August 1971: "I hate to do this, to close the window. All my life I have defended exchange rates, but I think it is needed /…/ But don't let's close the window and sit—let's get other governments to negotiate new rates" (Safire, William. 1975. *Before the Fall: An Inside View of the Pre-Watergate White House*. Garden City: Doubleday. Pp. 514.).

this agreement fell apart since the second issue had not been addressed. States organically embraced the benefits of the free-floating exchange rates and thus gradually shaped a new IMS.[632] Therefore, there are similarities between the Gold Standard that also arose spontaneously and the post-Bretton Woods system.[633]

So how did the idea of a Nixon shock develop? Two days before his inauguration, Nixon received a report from Burns on the growing American balance of payments problem, inflation, and de facto inconvertibility of the dollar into gold.[634] The day after the inauguration, January 21st, 1969, the Nixon administration designed the interagency Volcker Group – named after its chairman. The members were Volcker, Fred Bergsten (assistant for international economic affairs to the National Security Advisor), Dewey Daane (member of the Board of Governors of the Federal Reserve), Henrik Houthakker (member of the President's Council of Economic Advisers), and Nathaniel Samuels (Deputy Under Secretary of State for Economic Affairs), and its meetings were also attended by George H. Willis (Deputy to the Assistant Secretary of the Treasury for International Affairs). This group was tasked "to make recommendations on U. S. international monetary policy to the NSC and to implement policy decisions."[635] This came as a surprise to Paul

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[632] Free flow of capital generated economic growth (interests of the non-hegemonic states), and by making adjustment a market not a political issue, the surplus countries were adjusting (hegemon's interest). See, Helleiner, Eric. 1994. *States and the Re-emergence of International Finance: From Bretton Woods to the 1990s*. Ithaca: Cornell University Press. Pp. 112.

[633] Eichengreen. 1998. Pp. 6.

[634] National Archives, Nixon Presidential Materials, Transitional Task Force Reports 1968-1969, Task Force Summaries (Arthur F. Burns, 1/18/69). Burns's idea how to end the American balance of payments problem was by increasing the official price of gold while still preserving convertibility, believing that the result would be stable currencies to promote international trade and investment. See Wells, Wyatt C. 1994. *Economist in an Uncertain World: Arthur F. Burns and the Federal Reserve, 1970–78*. New York: Columbia University Press. Pp. 37.

[635] National Security Study Memorandum 7. Washington, January 21, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d109 (15 December 2020).

McCracken (Chair of the Council of Economic Advisers) and David Kennedy (Secretary of Treasury) which were afraid of politization and securitization of economic affairs.[636]

Nevertheless, the Volcker Group produced several papers regarding balance of payments deficit, flexibility of exchange rates, and reforming the IMS.[637] They even played with the idea of suspension of the dollar's convertibility to gold, but only until May 1971.[638] Yet, they did not proposed it but nevertheless stressed that whatever happens United States should aim to preserve the position of US dollar as the reserve currency.[639] In fact, they have warned against it, as the consequences of such a shock would be unpredictable:

> "Our strategy therefore calls for either (a) negotiating substantial but evolutionary changes in present monetary arrangements, or (b) suspending the present type of gold convertibility and following this with an attempt to negotiate a new system, in which the United States would undertake a more limited and less exposed form of convertibility of the dollar. The second course, which would necessarily imply

636 Memorandum from Paul McCracken to David Kennedy, February 1, 1969. Bentley Library, Papers of Paul McCracken, Box 14.

637 For example, already at the end of January and early February 1969 the group discussed and produced a paper that analyzed six options: 1) maintenance of the present Bretton Woods system of fixed exchange rates, subject to adjustment for fundamental disequilibrium; 2) use of border taxes to facilitate adjustment in trade accounts, while maintaining fixed exchange rates; 3) adoption of crawling pegs on a mandatory or discretionary basis; 4) adoption of wider margins, 2 percent or less to 5 percent or more; 5) combination of 3 and 4 above; and 6) a gold bloc and a dollar bloc with a flexible exchange link. See Volcker Group Paper, Washington, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d111 (14 December 2020).

638 This was due to Connally appointment on February 11, which marked the change in US policy where closing the gold window became only a question of time. Namely, on May 8th Connally's Department of Treasury prepared a paper with a first objective of "significant revaluation of the currencies of major European countries and Japan as a result of floating rates or other actions." (Paper Prepared in the Department of the Treasury, Washington, May 8, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d152 (14 December 2020)). This indicates that after Connally's assumption and the notion of free-floating exchange rates slowly became the US objective and policy.

639 E.g., Volcker Group Paper, Washington, March 17, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d119 (14 December 2020).

> unilateral action by the United States, would involve an initial shock to other countries. The extent of the shock would vary with the circumstances preceding such a decision. The reaction abroad might be less nervous if the decision were made at the time of an exchange crisis and after large U.S. gold losses."[640]

Moreover, they also did not anticipate the 10% surcharge of the Nixon shock.[641] Nevertheless, a constant notion in the group's papers is that the most difficult thing will be to persuade foreign countries to adjust their exchange rates.[642] Several informal conversations on the latter topic within the group and in the broader administration took place. Clear expressions of skepticism were uttered on the possibility of getting Europeans to contribute more to global monetary governance.[643] Still, the idea of unilateral action was repeatedly brushed aside and the United States time and again strived to facilitate proper adjustments and functioning of the Bretton Woods IMS. For instance, when Volcker traveled to Bern, Bonn, Brussels, The Hague, Rome, and Stockholm between March 21st and 26th 1969, Bergsten wrote:[644]

> "/A/ny decision to relax the present controls has been postponed /…/ Treasury Under Secretary Volcker will thus raise the issue in his upcoming European trip. He will inform them that we plan to reduce our reliance on controls but will seek their views on timing and complementary steps /…/ In fact, it could be argued that it is stretching the President's commitment quite far to consult on an issue of this magnitude. However, I supported Rogers /secretary of state/ on the grounds that any unilateral action should be avoided."

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640 Volcker Group Paper, Washington, March 17, 1969.

641 United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Pp. 291–2.

642 Irwin, Douglas A. 2012. *The Nixon Shock after Forty Years: The Import Surcharge Revisited*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w17749/w17749.pdf (12 December 2020). Pp. 6.

643 For example: "Mr. Volcker said that the Europeans would be likely to say: No." See, Washington National Records Center, Department of the Treasury, Office of the Assistant Secretary for International Affairs: FRC 56 76 108, Studies and Reports, Volume 7, 2/68-11/69. Confidential. See also Memorandum From Secretary of the Treasury Kennedy to President Nixon, Washington, June 23, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d130 (15 December 2020).

644 National Archives, Nixon Presidential Materials, National Security Council Files, Subject Files, Box 309, BOP.

Also, Nixon's position, when visiting European counties in March 1969, was not to aggravate Europeans and seek multilateral efforts to tackle inflation.[645] On a slightly different note – at the onset of Nixon presidency, key advisors were committed to maintaining gold parity and opposed flexible exchange rates. Although they understood that adjustment of the European countries is dire for the success of the Bretton Woods IMS,[646] they wanted to preserve the Bretton Woods IMS with multilateral trade and capital controls; and if there were a change in gold parity it had to happen together with non-hegemonic appreciation.[647]

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[645] See Talking Paper Prepared in the Department of the Treasury, Washington, February 18, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d115 (15 December 2020); Talking Paper Prepared in the Department of the Treasury, Washington, February 19, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d116 (15 December 2020).

[646] On 1st May 1969 Secretary of Treasury David Kennedy wrote to President Nixon: "The German mark should be revalued by 10 percent." (Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon. Washington, May 2, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d123 (15 December 2020)).

[647] Paul McCracken saw no need to increase the price of gold but emphasized that "our interest in a better monetary system, and our concern about growing controls over trade and capital movements." He concluded: "It is equally important not to allow the French, or anyone else, to see any signs of flexibility on gold except in the context of our general position. If we are to be cooperative on gold, there must be a total package that makes it worth our while." Burns shared this position: "/Y/ou have been correctly advised to show no interest on our part in an increase in the price of gold. /…/ By all means let us try to keep the official price as it is, but let us also watch carefully the costs that we may incur through such a policy. And whatever else we may do, let us not develop any romantic ideas about a fluctuating exchange rate: there is too much history that tells us that a fluctuating exchange rate, besides causing a serious shrinkage of trade, is also apt to give rise to international political turmoil." See National Archives, Nixon Presidential Materials, National Security Council Files, President's Trip Files, Box 442, February-March 69 Trip to Europe. On early Nixon administration policy positions regarding international trade (support free trade, oppose quotas, but also favor authority to freely change tariffs if needed as a stick or a carrot in negotiating free trade including removing non-tariff barriers), see Report of the Task Force on Foreign Trade Policy, Washington, January 31, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations of the United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v04/d181 (23 December 2020).

Thus, although United States was aware that Europeans were unlikely to respond favorably to their calls for adjustment, particularly during the economic crisis throughout 1969, they nevertheless pursued the policy.[648] Furthermore, this continued in 1970[649] with the United States seeking bilateral and multilateral support for reforming existing IMS,[650] and stopped only when Connally came to the forefront.[651] Yet, during this time the United States imposed trade barriers

[648] In the mist of economic crisis, starting in 1968, Kissinger wrote to Nixon on May 7th clearly stating the need to reform the IMS, but his proposal was not still embedded in fixed exchange rates: "I agree that we need to move specifically toward reforming the monetary system so that such crises will not recur continuously and that the "crawling peg" is a desirable element in such reform." See, Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon, Washington, May 7, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d124 (15 December 2020). A month later, Kissinger recommended, and McCracken agreed, to Nixon that suspension of the US dollar convertibility to gold is an action of last resort: "/…/ suspend gold convertibility of the dollar if the effort toward a negotiated multilateral solution breaks down or if we are forced to take defensive action as result of a crisis." See, Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon, Washington, June 25, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d131 (15 December 2020). A similar dynamic of options and recommendations subsequently appeared several times, see e.g., Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon, Washington, September 24, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d139 (15 December 2020).

[649] Volcker Group produced in 90 papers in 1970 alone (United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Pp. 407–9).

[650] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 407–9.

[651] For example, the Volcker Group paper regarding exchange rates prepared for the meeting of G-10 and IMF annual meeting, lists two scenarios: Aggressive and Low-key. Stating that aggressive approach would result in a "very difficult bargaining process", they opted to list recommendations closer to the Low-key scenario. See, Volcker Group Paper, Washington, September 10, 1970. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d148 (14 December 2020). See also Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon. Washington, May 2, 1969. Furthermore, in May 1970 on the meeting between the French and US economic ministries (d'Estaing and Kennedy) Volcker outlined four possibilities for a IMS reform: "/W/idening exchange margins somewhat, the possibility of small and frequent changes in exchange parities, and facilitating transitional floating rates for countries moving to a new parity. A fourth possibility, some method of formal Fund approval for the so-called "trotting" rate systems, had found no support outside of the countries resorting to such techniques." The French opposed every single option and absolved themselves from any responsibility: "The French authorities want to know whether the U.S. stands by the basic principle that it is up to the country where the imbalance arises to adjust, either through its fiscal and monetary policies or through an exchange rate change. If this principle is accepted, then we can study ways in which the change might be facilitated--for example, the transitional floating

against several products from Japan and Europe to level the trade balance sheets, which culminated in fears of a trade war.[652]

However, what is most significant in this period for my argument is that the notion of US dollar centrality became explicitly present in the Nixon administration moving towards 1971 to the point that the administration was seeking ways how to maintain and leverage that. For example, one of the papers in the Volcker Group argued that the central position of the US dollar is not only highly beneficial but also it might be in the US interest to expand it.[653] McCracken also stated:[654]

> "Because of the central position of the United States in the international monetary system, and our great interest in monetary stability, it is essential for us to provide leadership in the quest for a better adjustment mechanism. /…/ At the same time, we should recognize that, because we want the dollar to remain the pivot of the entire system (and hence not subject to flexibility), we would in effect be suggesting to other countries that they consider amending their exchange rate policies without our having to make a similar change. In this situation, it is appropriate for us to make our view clear, but to avoid exerting strong pressures on other countries to adopt the innovations which we consider desirable. The circumstances are favorable for a U.S. initiative at the IMF meeting later this month."

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rate. However, this does not seem to be Mr. Volcker's point of view. His ideas are very plausible, but France will not accept the proposition that in a system with only one reserve currency all parities have to be corrected to make the system function." See, Memorandum of Conversation, Camp David, Maryland, May 3-5, 1970. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d146 (15 December 2020).

[652] E.G., Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon, Washington, July 8, 1970. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations of the United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v04/d237 (23 December 2020).

[653] National Archives, Record Group 56, General Records of the Department of the Treasury, Box 10, Volcker Group Papers: 7, U.S. Department of the Treasury, Basic Options In International Monetary Affairs, June 22, 1969.

[654] Memorandum From the Chairman of the Council of Economic Advisers (McCracken) to President Nixon, Washington, September 8, 1969. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d137 (14 December 2020).

Since in two years there was no result, a different kind of approach and politicians became prevalent in the administration. Recalling the Triffin dilemma, the Nixon administration was treating the non-hegemonic states with gloves internationally, but they could still deduct that its priorities were of domestic nature, not international.[655] This made the forming of consensus on the gradual reform of the IMS even less possible.[656]

On January 18, 1971, unsatisfied with the situation, Nixon created the Council on International Economic Policy (CIEP), which he would chair and where the Secretaries of State, Treasury, Agriculture, Commerce, and Labor; the Director of the Office of Management and Budget; the Chairman of the Council of Economic Advisers; the President's Assistant for National Security Affairs; the Executive Director of the Domestic Council; and the Special Trade Representative would be members of.[657] Peter Peterson was named the first Director of the CIEP as well as Assistant to the President for International Economic Affairs.[658]

The composition of CIEP was much more in favor of a different political-economic actions to tackle the IMS issue. Alongside Connally, officials such as George Shultz, the director of the Office of Management and Budget, wanted to abandon the Bretton Woods system of fixed

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[655] A similar turn can be observed also in Nixon's trade policy. During 1969 and 1970 trade policy was systematically considered at the highest levels in the Nixon administration, e.g., National Security Council. Yet, there were no National Security Council meetings dedicated to international trade in 1971 and 1972. The newly established Council on International Economic Policy took on the questions regarding international trade as well, and they were incorporated in the considerations on the international monetary issues. See United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations of the United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Pp. 638.

[656] United States was aware of this, see for example Richard M. Nixon Library, International Economic Policy Council, Box 32, Houthakker Files: 6, Paul McCracken, The U.S. Balance of Payments and the International Monetary System: An Overview of the Policy Issues, April 5, 1971.

[657] *Public Papers of the Presidents of the United States: Richard M. Nixon*. 1971. Washington: United States Government Printing Office. Pp. 40–1.

[658] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 120.

exchange rates entirely and move to a floating exchange rate regime.[659] Moreover, Peterson shared this position and Nixon relied on them heavily moving from February 1971 onwards. Hence, on February 9th, 1971, Nixon wrote[660]: "Shultz – an early project for the Peterson Council[661] should be examination of the need for a new Int'l Monetary system. This should be undertaken with the closest consultation with Treasury, C.E.A. and Burns." On March 2nd, 1971, Shultz wrote a memo calling to abandon capital controls, as they are too costly and their results questionable.[662] Volcker Group opposed these measures.[663] Furthermore, CIEP prepared a draft of International Economic Strategy for 1971-1972, which states:[664]

> "We should begin intensive planning for a major international initiative on a broad range of international economic problems focusing on the US-EC-Japan relationship. While the main emphasis shall probably be on trade problems, it should also consider important related issues such as investment, aid, and monetary problems. The Administration should initiate a basic review of its approach to the balance of payments and international monetary problems. One illustration of the many issues that arise in the context of our balance of payments programs is the capital control program."

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659 Irwin. 2012. Pp. 6.
660 Information Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon. Washington, February 9, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d51 (14 December 2020).
661 This is how he referred to CIEP – indicating also personal reliance and affection to that group.
662 National Archives, Nixon Presidential Materials, National Security Council Files, Agency Files, Box 218, Council on International Economic Policy.
663 Memorandum From the Under Secretary of the Treasury for Monetary Affairs (Volcker) to the President's Assistant for International Economic Affairs (Peterson). Washington, April 1, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d60 (14 December 2020).
664 CIEP Study Memorandum No. 1. Washington, March 8, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d55 (14 December 2020).

The actual International Economic Strategy for 1971-1972 – prepared by the Department of State – on March 16th, shared these concerns, but as the administration itself did not fully developed the specifics of this new approach, and the document was rather vague. It followed typical diplomatic language, yet parts of it resembled a policy enacted less than half of a year later.[665] Moreover, the document clarifies that there should not be a distinction between economic, political, and security affairs in the international relations, since all those issues are interlinked.

Nevertheless, the Volcker Group was not dismantled or silenced. In fact, they were incorporated into the CIEP proceedings. Namely, Connally wrote to Peterson:

> "I have assumed that the deliberations and responsibilities of the Volcker Group were to be continued – this has been the channel for issues such as those posed in paragraph 4. Obviously, as appropriate, the results of the Volcker Group work could be reviewed at sessions of the Council on International Economic Policy."[666]

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[665] Some examples from the text: "/…/ sharp adjustment problems – domestically and internationally – /r/equire urgent attention. /…/ The industrialized countries need to intensify their economic cooperation in all areas, including a better ordering of trade relationships directed toward more liberal access to markets, and a more smoothly functioning monetary relationship. /…/ The two-tier gold system, despite some increase in the price of commodity gold, is functioning well. /…/ /We need/ stronger programs to control short-term capital flows, preferably through U.S. unilateral action but perhaps on a joint basis with other countries. A clear recognition of responsibilities by both surplus and deficit countries, including the relationship of more flexible exchange rates to the adjustment process. /…/ Clearly, we will need legislation at some stage in the game. The questions of what and when cannot be decided until we get a clearer view of what we want and what foreign governments are prepared to do." See, Paper Prepared in the Department of State. Washington, March 16, 1971. International Economic Strategy for the 1970's. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d56 (14 December 2020).

[666] Memorandum From Secretary of the Treasury Connally to the President's Assistant for International Economic Affairs (Peterson). Washington, March 29, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d57 (14 December 2020).

Particularly since the orientation and preference regarding the recommendations within the Volcker Group was changing.[667] An important contribution to that was a memo sent to the group by William Dale (United States Executive Director of the IMF) presenting a plan to close the gold window.[668]

On March 29th, Connally wrote to President Nixon proposing that the CIEP become the principal in establishing international economic policies and that all existing advisory formats should be somehow included as subordinate or subcommittees to the CIEP.[669] However, this could not prevent tensions within the administration. For instance, Kissinger wanted foreign economic policy to be a part of a broader foreign policy, whereas Peterson saw foreign policy as a handmaiden to foreign economic policy.[670] As such, in April 1971 Nixon personally got involved in roping-in different agencies and actors (e.g., Burns and Peterson).[671]

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[667] See e. g., National Archives, Record Group 56, Entry A1-952, Box 1-13, Financing the 1971 Deficit—And Beyond 1971, Memo from Volcker to Willis, February 22, 1971.

[668] National Archives, Record Group 56, Entry A1-952, Box 1-13, Memo from William Dale to Volcker Group, January 28, 1971. However, even in May 1971, when the Germans floated their Mark, Volcker had cold feet if indeed the new approach will be successful, as getting of the gold standard will provoke intense defensive reactions in Europe, see National Archives, Record Group 56, Box 1-13, Volcker Group Memo to Connally, May 7, 1971.

[669] Memorandum From Secretary of the Treasury Connally to President Nixon. Washington, March 29, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d58 (14 December 2020). See also Memorandum From the President's Assistant for International Economic Affairs (Peterson). Washington, March 30, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d59 (14 December 2020).

[670] Memorandum From C. Fred Bergsten of the National Security Council Staff to the President's Special Assistant for National Security Affairs (Kissinger). Washington, April 21, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d64 (14 December 2020).

[671] Nixon tape conversation, No. 52–1, April 8, 1971; Nixon tape conversation, No. 1–63, April 9, 1971.

In May 1971, several papers were presented by the Treasury Department, where the spirit of Connally was evident.[672] One argued that the United States should use the opportunity provided by the monetary crisis to undertake negotiations on the outstanding issues.[673] It also outlined US tactics as:[674]

> "(a) Permit foreign exchange crisis to develop without action or strong intervention by the U.S.
> (b) At an appropriate time when there is growing realization that substantial changes will need to be made, the U.S. should indicate its own preferred solution.
> (c) At that time, the U.S. should be prepared to indicate and, if necessary, use the following measures as negotiating leverage:
> (i) suspension of gold convertibility;
> (ii) imposition of trade restrictions;
> (iii) diplomatic and financial intervention to frustrate foreign activities which interfere with the attainment of our objectives; and
> (iv) reduction of the U.S. military presence in Europe and Japan.
> (d) In the monetary area the "fall back" position would be simply to remain on the system of "floating rates" already largely in place under this scenario. It would be necessary in order to maintain our bargaining position taken through inconvertibility under (i) above, that the U.S. make clear from the start that the U.S. would be prepared to live with the floating rate systems indefinitely."

Moreover, the paper also stressed that the Department of Treasury is ready for immediate negotiations, which should take place preferred bilaterally, in the G-10 at the most.[675] What in fact happened in three months' time, was very similar to this tactic, with only one major difference: it

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[672] Research on the rhetoric in the administration has shown that May 1971 was the tilting point when the decision makers became determined to act unilaterally. Moreover, Nixon apparently had his mind made up long before. See Zoeller, Christoffer J. P, and Nina Bandelj. 2019. Crisis as Opportunity: Nixon's Announcement to Close the Gold Window. *Socius*, 5. Online first, https://doi.org/10.1177/2378023119841812.
[673] Paper Prepared in the Department of the Treasury, Washington, May 8, 1971.
[674] Paper Prepared in the Department of the Treasury, Washington, May 8, 1971.
[675] Paper Prepared in the Department of the Treasury, Washington, May 8, 1971. On preparations for these negotiations see also Paper Prepared in the Department of the Treasury, Washington, May 9, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d153 (15 December 2020).

was the United States, which preventively initiated the crisis, not reacted to one as the blueprint suggested. However, the moral of the story is that in May 1971, the United States was aware and ready to put the existing IMS on the line in order to reform it. On May 4th, when it was confirmed that the Germans would float the Mark, Nixon stated that this is the opportunity to "shake the system up", and tasked Connally to talk to Europeans.[676] On May 8th, Nixon issued a call to the Department of Treasury, Department of State, and Department of Defense, to strategically coordinate the process of ending the gold standard and destroying the existing IMS.[677] On May 11th Connally briefed the administration with the German moves, and proposed to "sit and wait" as United States in not "hurtin' one bit".[678] On May 28th Connally gave the infamous Munich address, where he explained the US 'Economic Nixon Doctrine'. It became clear that an 'evolutionary path' of reform was impossible, and so a 'revolutionary path' of reforming the Bretton Woods IMS[679] was the next step.[680]

Following earlier March 22nd memorandum of Charles A. Coombs from the Federal Reserve Bank of New York to the President of the New York Bank, Alfred Hayes, where he claimed that the dollar was hopelessly overvalued,[681] the Treasury Department made its own

[676] Nixon tape conversation, 490–24, May 4, 1971.
[677] National Archives, Record Group 56, Box 1-13, Memo from President Nixon to Department of Treasury, State, and Defense, May 8, 1971.
[678] Nixon tape conversation, 56–4, May 11, 1971.
[679] A similar distinction with similar labels and similar threshold is also made by Zoeller (2019), only that he differs between three periods: multilateral approach, Articles of Agreement approach, and unilateral. See Zoeller, Christoffer J. P. 2019. Closing the Gold Window: The End of Bretton Woods as a Contingency Plan. *Politics & Society*, 47(1). Pp. 3–22.
[680] See also National Archives, Record Group 56, Department of the Treasury Central File, Box 8, U.S. Department of the Treasury, Contingency Planning, June 4, 1971, Volcker-Willis-Cross. This report already outlined the strategy as temporary suspension of the gold window in order to get the non-hegemonic states to adjust appropriately their currencies. It still argued that a suspension of the dollar standard could be done gradually. Moreover, the paper did not present a longer-term vision and strategy.
[681] NZFA, CF/Foreign Exchange 260. Note from Charles Coombs for Alfred Hayes, 'The Outlook for the Dollar', 22 March 1971.

analysis in May 1971, which concluded that the dollar was overvalued by 10 to 15 percent and that a foreign-exchange crisis was inevitable.[682] This led McCracken to urge Nixon to make an urgent decision where he:

> "would like the international monetary system to develop. In my opinion our best course would be to support implementation of the IMF's flexibility study, published last year. This requires prompt action since the IMF annual report is now being written. Unless recommendations can be brought before the IMF meeting this coming September the public is likely to assume that the flexibility study is dead."[683]

Nixon agreed and in June and July 1971, Peterson worked on ensuring that was the case. He shared his paper with the president as well as other high-level officers in the administration. They discussed it on several occasions throughout the summer at Camp David.[684] This paper laid the policy grounds for August Nixon shock. Yet, the McCracken letter also tells us that in the summer 1971 not everyone in the administration was on board with pursuing unilateral actions. Indeed, there was a consensus for a policy push towards greater exchange rate flexibility, but thoughts on how to achieve that and to what extent differed greatly.

In the summer of 1971, the Nixon administration also began strategically communicating with a broader political audience and thus, prepared its internal audience for the inevitable.

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[682] The U.S. International Competitive Position and the Potential Role of Exchange Rates in the adjustment Process, confidential report from U.S. Treasury Office of Financial Analysis to Under Secretary Paul Volcker, 28 May 1971. See also Odell. 1982. Pp. 252.

[683] Memorandum From the Chairman of the Council of Economic Advisers (McCracken) to President Nixon, Washington, June 2, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d157 (15 December 2020).

[684] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 161–2.

However, Nixon demanded complete secrecy on the exact policies.[685] The latter was proposed already by Burns on May 19th: "/W/e should do all we can – both substantively and cosmetically – to make it appear that other governments have forced the action on us."[686] Hence, on June 3 Congressman Henry Reuss (D – Wisconsin) introduced a Congress Resolution that said that if an international monetary conference was not promptly convened, the United States should terminate the convertibility of the dollar to gold; permit the dollar to float until any disequilibrium had been removed; and entertain claims for compensation by foreign official dollar holders only for those who cooperate on proper exchange rates and adhere to the March 1969 two-tier gold agreement.[687] Nixon was furious about Burns activity in the media, since Burns was not in favor of a unilateral action. Therefore, he appointed Connally to be the administration's sole spokesperson on monetary issues, "or else quit" he said to other members if they do not agree.[688] At the meeting on June 8th Nixon and Connally confronted Bruns stating that he too was expected to conform to the announced policies.[689] In June, the National Security Council staff became aware that future international monetary actions (or no action), would have security considerations.[690] Also, on June 8th, Connally warned Nixon that the changes to the IMS need to happen without undermining

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[685] Nixon tape conversation, No. 546–2, July 26, 1971; Nixon tape conversation, No. 547–9, July 27, 1971. This fits his pattern style-wise and temporally, as on July 15th he 1971 he announced his famous China visit, which was also a very well-kept secret. More on Nixon's trip to China see, Ladley, Eric. 2002. *Nixon's China Trip*. Lincoln: Writers Club Press.

[686] Gerald R. Ford Library, Papers of Arthur Burns, Box N1, Memorandum From Arthur Burns to President Nixon, May 19, 1971.

[687] Congressional Resolution: Action now to Restore a Sound Dollar. 1971. Introduced by Congressman Henry Reuss. Accessibility: https://www.govinfo.gov/content/pkg/GPO-CRECB-1971-pt14/pdf/GPO-CRECB-1971-pt14-1-2.pdf (15 December 2020). Pp. 17906–7.

[688] Nixon tape conversation, No. 514–7, June 8, 1971.

[689] Gerald R. Ford Library, Papers of Arthur Burns, Handwritten Journals, 1969–1974, Box 1, July 8, 1971.

[690] Memorandum From Ernest Johnston of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, June 23, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations Of The United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d160 (21 December 2020).

confidence in the US dollar, and that they should avoid the trap of 'everyone for himself'.[691] At the end of the month, Nixon complained that the country was not doing enough on economic planning for the change of the IMS.[692]

On July 6th, Nixon held a speech in Kansas City, where he foreshadowed his August action.[693] An important contribution in preparing audiences for the August Nixon shock and its trade and internal dimension, was also the July publication of the Commission on International Trade and Investment Policy. The establishment of the Commission was announced on April 7th 1970, with a task to study the US trade and FDI predicament.[694] It was led by Albert Lynn Williams, Chairman of the IBM Finance Committee, so it is often referred to as the Williams Commission.[695] Among its recommendations, the report suggested that if the US balance of payments problem persists, and if other countries find a further accumulation of dollars objectionable, the United States should indicate its readiness to adopt a temporary uniform import tax and export subsidy to promote an exchange rate change. Thus, it argued in favor of compensating the lack of appreciation of the non-hegemonic currencies with import tax and export subsidy. Although a revaluation of foreign currencies was the goal, if that was not feasible then the subsidy and tariff program could improve the US balance of payments with minimum

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691 Memorandum From Secretary of the Treasury Connally to President Nixon, Washington, June 8, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations Of The United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d158 (21 December 2020).

692 Nixon tape conversation, 530–3, June 29, 1971.

693 Richard M. Nixon Library, White House Special Files, President's Personal File, Box 67, Remarks of the President, Media Briefing on the President's Media Briefing on the President's Domestic Policy Initiatives, Holiday Inn, Kansas City, Missouri.

694 United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations Of The United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Pp. 590.

695 Other numerous members were gathered from academia and private enterprises.

distortion to the United States and the world economy.[696] On July 20th, James Schlesinger (Assistant Director of the Office of Management and Budget) wrote a memo to Peterson, stating:[697]

> "The fundamental point, however, is the following: these hardships ought not to be dealt with and cannot be cured by patch-up adjustments on the trade side. This would lead only to a jerry-built structure of controls and to inefficiencies. One must go to the heart of the matter--i.e., the monetary machinery and adjustments of the structure of exchange rate /…/ What is required is a code of behavior or a new set of rules to which the major nations will adhere either voluntarily or per force."

Another publication served the purpose of strategic preparation of the audiences for the August Nixon shock. On July 28th, new data showed that the United States ran a large merchandise trade deficit.[698] As such, it was on track to have its first annual trade deficit since 1935.[699] The day prior to this release, Connally drew one conclusion from them for Nixon: "/I/f we have the defense of the dollar, I don't think we can hold it until the election of '72, plus the fact that as things stand now, we have approximately $10 billion in gold to satisfy $30 billion worth of commitments. If we try to defend the dollar between now and next year, which we can do, it's one of the alternatives, but it's going to take some drastic action on your part regardless."[700] To which Peterson added: "We need bold action soon."[701] And Connally continued:

[696] Commission on International Trade and Investment Policy. 1971. *United States international economic policy in an interdependent world*. Washington: United States Government Printing Office.
[697] Memorandum From the Assistant Director of the Office of Management and Budget (Schlesinger) to the President's Assistant for International Economic Affairs (Peterson), Washington, July 20, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations Of The United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d161 (21 December 2020).
[698] U.S. Department of Commerce, Bureau of the Census. 1971. *U.S. Foreign Trade, Export and Import Merchandise, June 1971*. Published on July 28th. Washington: United States Government Printing Office.
[699] Irwin, Douglas A. 2017. *Clashing over commerce: A history of US trade policy*. Chicago: University of Chicago Press. Pp. 539. See also Bach, Christopher. 1972. *US balance-of-payments problems and policies in 1971*. St. Louis: Federal Reserve Bank of St. Louis. Accessibility: https://files.stlouisfed.org/files/htdocs/publications/review/72/04/Balance_Apr1972.pdf (15 December 2020).
[700] Nixon tape conversation, No. 547–9, July 27, 1971.
[701] Nixon tape conversation, No. 547–9, July 27, 1971.

> "Here's what you want to do, is to write a letter. You write to the International Monetary Fund, it's a very simple thing. It's a letter of two paragraphs. The first paragraph in effect says that you no longer will convert dollars to gold. You do that with one sentence. Secondly, you say, assuming you want to go this route, you say you no longer will support the fixed exchange rates section of the International Monetary Fund. That means you're going to float."[702]

This Connally recommendation came to be Nixon's eventual course of action.

This data also convinced Volcker and other officials (e.g., John Petty, Assistant Secretary of the Treasury for International Affairs) that had not yet intimately endorsed the closing of the gold window that the existing dollar parities could not hold much longer.[703] However, still not everyone was on board as was clear after Peterson's meeting at Camp David, with Under Secretaries from the Department of State, the Department of Labor, the Department of the Treasury, the Council of Economic Advisers, and the National Security Council. Here the State Department, the Council of Economic Advisers, and the National Security Council supported preserving the existing IMS.[704] However, there was an agreement that Houthakker recalls as an understanding that if the dollar were devalued under the rules of Bretton Woods, then all European currencies would be devalued by the same percentage on the same day.[705] Subsequently, the administration could now work in line to be prepared to close the gold window at a time of their own choosing.[706] After being briefed on these developments, Connally instructed Volcker to draw

[702] Nixon tape conversation, No. 547–9, July 27, 1971.
[703] See Forbord, Thomas Austin. 1980. *The Abandonment of Bretton Woods: The Political Economy of U.S. International Monetary Policy*. Ph.D. Dissertation, Harvard University. Pp. 243–4.
[704] See Nixon Tape conversation, 549–7, July 28, 1971.
[705] Houthakker, Hendrik S. 1978. The Breakdown of Bretton Woods. In Sichel, Werner (ed.), *Economic Advice and Executive Policy: Recommendations from Past Members of the Council of Economic Advisors*. New York: Praeger. Pp. 45–64. At Pp. 54. See also Odell. 1982. Pp. 253.
[706] Irwin. 2012. Pp. 9.

up contingency plans for the closing of the gold window, including import surcharge. Volcker was reluctant to do so, as he was not in favor of protectionism, and hoped that Connally's request for higher duties on imports would be forgotten, but it was not.[707] Therefore, "Connally appears to have been the key figure who wanted the import surcharge as a way of gaining "leverage" against countries that were reluctant to allow their currencies to appreciate."[708]

On July 22nd, Nixon explained to his aids that the purpose was to improve the position of the United States. "This is not going to be comfortable for other people, but it might be very damn helpful for us."[709] McCracken became so frustrated with the direction of the administration that he told Nixon he intended to resign and desired to return to the faculty at the University of Michigan at the end of the year.[710] According to Petty, in the last week of July Nixon agreed to bold policy measures including the wage-price freeze and budget reductions and possibly a suspension of convertibility.[711] "The distressed foreign exchange markets of May 1971 had calmed in June and July, but as August began were roiled again."[712]

On August 2nd, 1971, Connally met with President Nixon, who also insisted that the meeting would be attended by George Shultz.[713] At that point, they agreed to reduce inflation and

[707] Volcker, Paul A., and Toyoo Gyohten. 1992. *Changing fortunes: The world's money and the threat to American leadership*. New York: Crown. Pp. 76. See also Forbord. 1980. Pp. 246.
[708] Irwin. 2012. Pp. 9. Subsequent meetings confirmed that as Nixon embraced all policies presented by Connally.
[709] Nixon tape conversation, 542–4, July 22, 1971.
[710] Memorandum from Paul McCracken to President Nixon, Meeting with Paul W. McCracken, July 22, 1971, August 4, 1971. Bentley Library, Papers of Paul McCracken, Box 15.
[711] Forbord. 1980. Pp. 261. Some other reports claim that Nixon only became certain of the closer of the gold window after events in early August, see Odell. 1982. Pp. 255.
[712] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 454.
[713] Odell. 1982. Pp. 255.

shore up the economy by closing the gold window, wage and price controls, and tax cuts.[714] Almost everything that was eventually announced on August 15th, 1971, was decided on this day. The recordings reveal Connally as the primary architect of the Nixon Shock. Still, he could not have his way entirely as his proposal on surcharge was not taken.[715] Nixon, Connally, and Shultz, also discussed the timing of the unilateral move. Nixon wanted to wait until the end of the year, but Connally argued they should act sooner rather than later. The group then agreed on the early September as Congress would have returned to session, as the date for an announcement of the new policy.[716] Nixon concluded: "I tend not to be as persuaded by the international monetary arguments as I am by the domestic arguments."[717] He already considered the communication aspects of his decision, saying: "The floating thing I think is so goddamned confusing that nobody's going to understand. Closing the gold window sounds as if the dollar is going to hell, that's to the average person."[718] Whereas devaluing the US dollar required Congressional approval, Nixon was thrilled that ending the link between the dollar and gold did not.[719] Another cheerful fact for Nixon was that Burns was on board with the decision as well, as he agreed with domestic protectionism, not as much international.[720] They also discussed timing of action, but no agreement was made on that front.[721] Nixon and Connally discussed the latter also on 4th August, where early September became the favorable date.[722]

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[714] Nixon tape conversation No. 553–6, August 2, 1971. See also United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 454–6.
[715] Nixon tape conversation No. 553–6. See also Irwin. 2012. Pp. 9.
[716] Nixon tape conversation No. 553–6. See also Matusow, Allen J. 1998. *Nixon's Economy: Booms, Busts, Dollars, and Votes*. Lawrence: University Press of Kansas. Pp. 147; Odell. 1982. Pp. 255.
[717] Nixon tape conversation No. 553–6, August 2, 1971.
[718] Nixon tape conversation No. 553–6, August 2, 1971.
[719] Nichter, Luke. 2015. Richard Nixon and Europe: The Reshaping of the Postwar Atlantic World. Cambridge: Cambridge University Press. Pp. 56.
[720] Nichter. 2015. Pp. 56.
[721] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 455.
[722] Nixon tape conversation, No. 554–7, August 4, 1971.

On August 6th, the US Congress Joint Economic Committee's Subcommittee on International Exchange and Payments issued a report, which concluded that the US dollar was overvalued.[723] It stated: "The consequent dollar overvaluation leads to the perpetuation of U.S. deficits and thus increases the risk of an international monetary crisis that would break the system apart."[724] The report called for the United States to pressure other countries to appreciate their currencies, and if that were not to happen, then the United states should go off the gold standard as a transition to new parities.[725] In fact, the chair of this committee, Henry Reuss, is the same Congressman that in June introduced a resolution calling for the closing of the gold window.[726] Furthermore, on the same day, the United States had to provide 1 billion US dollars in gold to France, Belgium, and Netherlands.[727] To make matters worse, and enhance the speculations, the US dollar depreciated on August 9th against the German mark, which was floating since May 1971, to the lowest level since the Second World War.[728] American bankers claimed that they lost the balance of payments battle and speculations of the US devaluation enhanced.[729]

Connally pushed Nixon again to act on August 6th, 1971.[730] He managed that Nixon understood how domestic and international economic policies are linked. Nixon said: "If we put

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[723] *Action Now to Strengthen the US dollar*. 1971. Accessibility: https://www.jec.senate.gov/reports/92nd%20Congress/Action%20Now%20to%20Strengthen%20the%20US%20Dollar%20(517).pdf (24 April 2019). Note that the title of the report is economically rather misleading. Namely, to strengthen would refer to appreciate, whereas the cure for the US dollar was exactly the opposite. Therefore, we need to understand the title in its political meaning – finding the right answer to strengthen oneself.
[724] *Action Now to Strengthen the US dollar*. 1971. Pp. 8.
[725] *Action Now to Strengthen the US dollar*. 1971. See also Odell. 2012. Pp. 255–6.
[726] See also, Angel, Robert C. 1991. *Explaining Economic Policy Failure: Japan in the 1969-1971 International Monetary Crisis*. New York: Columbia University Press. Pp. 81.
[727] Irwin. 2012. Pp. 10.
[728] Hybel, Alex Roberto. 2001. *Made by the USA: The International System*. New York: Palgrave. Pp. 183.
[729] See Odell. 2012. Pp. 256.
[730] Nixon tape conversation, 556–4, August 6, 1971.

this wage price thing on, we've got to shake the country and say 'look, you people have got to get off your ass and go to work. We've got to be more competitive. It's time for America to be more competitive in the world'." [731] The same push came on August 9th from McCracken, which was even more tailored for the likes of Nixon – referring to strong leaders and strong leadership and how they relate to domestic economic policies.[732] On August 10th, "Volcker and Shultz met and agreed that the United States had to act soon, or else foreign central banks might begin demanding gold in exchange for the dollars that they were holding."[733] On Wednesday, Shultz met with Nixon and endorsed the import surcharge. He claimed that if the United States took this aggressive act against its trading partners, it was to stabilize a situation all agreed needing correction, and that the United States would have to follow up with constructive proposals.[734] Moreover, if he were to close the gold window and took no other action, he might not get the needed change in the exchange rate if others intervened to maintain the value of their currencies. Shultz suggested an immediate closing of the gold window and a temporary import tax, followed by negotiations.[735]

On Thursday, 12th August, Nixon met with Connally and Shultz again. Connally wanted to move with the plan as he wanted to avoid potentially lengthy discussions in Congress.[736] Connally said: "We expect a bad day tomorrow /.../ we're constantly losing the initiative, I'm afraid. /…/ the least we could do is to move on the international front this afternoon."[737] During the day, Nixon

[731] Nixon tape conversation, 556–4, August 6, 1971.
[732] Memorandum from Paul McCracken to President Nixon, Memorandum for the President, August 9, 1971, Bentley Library, Papers of Paul McCracken, Box 15.
[733] Irwin. 2012. Pp. 10–1.
[734] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 457.
[735] National Archives, Nixon Presidential Materials, White House Tapes, Recording of Conversation Between President Nixon and Budget Director Shultz, August 11, 1971.
[736] Nixon tape conversation, No. 273–20, August 12, 1971.
[737] Nixon tape conversation, 7–112, August 12, 1971.

called also Burns and McCracken to tell them the news, which they were not happy about.[738] Also on August 12th, European countries bought 1 billion US dollars' worth of gold and everyone expected that the United States would devalue yet again.[739] Namely, states (e.g. UK) made an informed guess that the United States will repeat the measure taken on August 6th. That is why everyone rushed to claim their US dollar reserves for gold – since if the US dollar devalues then these reserves would be worth less tomorrow than today.[740] To avoid such a 'bank-gold run',[741] Nixon called an emergency weekend meeting at Camp David with his closest advisors and, where the decision for the Nixon Shock was finalized.[742] "He said they were not ready to go ahead with the entire package, but that if all the key players went to Camp David they could be prepared to act by Monday."[743] Nixon asked if closing the gold window would stop the crisis? Connally responded: "That stops the crisis from our losing assets, but in effect it may create a crisis in terms of the international money markets. It'll leave them in a chaotic state until something else happens, in my judgment." Nixon continued: "/One has/ to say of course, that when you do this ... that the United States was taking action to preserve the dollar ... and that we were temporarily closing the gold window, and that we would be prepared now to discuss with ... nations around the world ... a better, more stable system. ... I would not have you do it ... at prime time, at night."[744] Finally, they also agreed that both, domestic and international, measures in the Nixon shock were to be

[738] Nichter. 2015. Pp. 64.
[739] Information Memorandum from Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington August 13, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d167 (14 December 2020).
[740] See Gowa, Joanne. 1984. State power, state policy: Explaining the decision to close the gold window. *Politics & Society*, 13(1). Pp. 91−117. At Pp. 108.
[741] In the week between 9th and 13th August, foreign central banks bought about 3.7 billion US dollars to prevent their currencies from appreciating. See Irwin. 2017. Pp. 544.
[742] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 457.
[743] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 458.
[744] Nixon tape conversation, No. 273–20, August 12, 1971.

announced jointly, not sequentially where closing the gold window would come first, and surcharge second in September.[745] Nixon underlined that the "primary goal must be a continued upward surge in the domestic economy", and he aimed to announce it on Monday, August 16th. "Our primary goal must be a continued upward surge in the domestic economy. And we must not, in order to stabilize the international situation, cut our guts out here."[746] Yet, it was Shultz who persuaded him, to announce it on Sunday evening, so that the decision would already impact the markets on Monday.[747] Nixon concluded: "The thing is, John, I personally have pretty much decided what I want to do anyway. ... I'm pretty well decided."[748] The meeting ended with everyone agreeing that this decision will be the most important one since the end of the Second World War.[749]

At this retreat, Connally led the adoption of the series of sweeping measures.[750] Hence, The New Economic Policy and the Nixon Shock were adopted. These actions represented an effort to arrange new parities. Although there were alternatives, such as to raise interest rates, cut spending, restrain wages and profits, these measures would most likely cause a recession, which was something Nixon was unwilling to do particularly due to upcoming elections.[751] He instead opted for the 'shock' and put the ball on the court of the non-hegemonic states. Such a decision was in line with Nixon's prioritizing domestic to international interests. One can even claim that he was a mercantilist, as he wanted to generate domestic political support and stimulate domestic

[745] Nixon tape conversation, No. 273–20, August 12, 1971.
[746] Nixon tape conversation, No. 273–20, August 12, 1971.
[747] Nixon tape conversation, No. 273–20, August 12, 1971.
[748] Nixon tape conversation, No. 273–20, August 12, 1971.
[749] Nixon tape conversation, No. 273–20, August 12, 1971.
[750] Kissinger. 1979. Pp. 954.
[751] Frieden. 2007. Ch. 15.

employment growth by expanding exports and restricting imports.[752] For example, besides focusing on export promotion, Nixon had some promises to keep from his 1968 election. As part of his 'Southern strategy'[753] he courted South Carolina Senator Strom Thurmond, where the latter was promised that the administration would further limit imports of textiles from Japan.[754] As such, the ideational root of his decision is rather murky. Indeed, he had an ear for monetarist ideas, as did others in his administration, but the argumentation that the same people made for their decision was rather mercantilist.[755] Therefore, the rationale behind it was to advance US vital interests, and signal to the non-hegemonic states that this is a make-or-break situation. The United States was ready to live without its hegemony, were Europeans and Japan? Although Nixon lacked "interest in economic issues", he adored power politics,[756] and this was one such moment – economic power politics, which is why he supported import duties as it was a way to strike against other states and extract concessions.[757] Moreover, he saw this as a political, not economic challenge and crisis, since deciding on the structure of IMS (monetary trilemma) in fact is.

At the weekend retreat of August 13th at Camp David, Nixon was accompanied by – Connally, Shultz, Volcker, Burns, Kenneth Dam (Program Assistant Director for National Security and International Affairs at the Office of Management and Budget), McCracken, Herbert Stein (member of the Council of Economic Advisors), William Safire (speechwriter), Peterson, and Caspar Weinberger (Deputy Director of Office of Management and Budget). Strangely, there were

[752] See, Matusow. 1998.
[753] See Aistrup, Joseph A. 2014. *The Southern Strategy Revisited: Republican Top-Down Advancement in the South*. University Press of Kentucky.
[754] Irwin. 2012. Pp. 5.
[755] On economic theories and ideas see Ekelund, Robert B., and Robert F. Hébert. 2013. *A History of Economic Theory and Method*. Long Grove: Waveland Press.
[756] Kissinger. 1979. Pp. 963.
[757] Nixon tape conversation No. 576–8. See also Irwin. 2017. Pp. 544.

no officials from the State Department and the National Security Council, many of whom were surprisingly unaware that such a meeting was taking place.[758] The group specified in detail a plan named the 'New Economic Policy', which Nixon outlined with Shultz and Connally in their White House meetings on August 2nd and August 12th.[759] Burns descried the weekend meeting as: "peaceful and harmonious."[760]

Nixon understood that the decisions they were making were designed to manage two economic crises – domestic and international (Triffin dilemma).[761] First, the domestic – Vietnam war (paying for it with borrowed money and cuts in domestic spending), poor economic growth, current account deficit, and inflation (improved economic growth was the key for Nixon's reelection). Initially after being appointed as the head of The Federal Reserve in 1969, Burns tried to curb inflation via tightening money supply, not only resulting in recession but stagflation (higher inflation and unemployment) for the first time ever.[762] This was opposed by Nixon, who ordered him to get the economy going: "You see to it: no recession!"[763] Nixon could live with inflation,

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[758] Irwin. 2012. Pp. 12. State Department was considered by Connally as an agency representing foreign governments, see United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 455. Moreover, a Memo from 13th August shows that these two agencies were really in the dark, as they still contemplated what to do and weighted in on different options, see Memorandum From the Acting Assistant Secretary of State for Economic Affairs (Katz) to Secretary of State Rogers, Washington, August 13, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations Of The United States, 1969–1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d166 (21 December 2020); Information Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, August 13, 1971.

[759] See United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 453−60.

[760] Gerald R. Ford Library, Papers of Arthur Burns, Handwritten Journals, 1969–1974, Box 1, August 22, 1971.

[761] De Marchi, Neil. 1975. The first Nixon administration: Prelude to controls. In Goodwin, Craufurd D. W. (ed.), *Exhortation and controls: the search for a wage-price policy, 1945-1971.* Washington: Brookings Institution. Pp. 295−352. At Pp. 345.

[762] Hargrove, Erwin C. 2015. *Effective Presidency: Lessons on Leadership from John F. Kennedy to Barack Obama*. New York: Routledge. Pp. 80.

[763] Hargrove. 2015. Pp. 80; Wells. 1994. Pp. 42. Some account claim that this was said before his appointment, see Kettl, Donald. 1986. *Leadership at the Fed*. New Haven: Yale University Press. Pp. 120. See also Abrams, Burton A. 2006. How Richard Nixon Pressured Arthur Burns: Evidence from the Nixon Tapes. *Journal of Economic*

but not with recession. This desire of expansionary monetary policy generated additional domestic pressure on the US dollar parity. Also, Milton Friedman warned Nixon about this on June 8th.[764] Yet, this only strengthen Nixon's determination to take the US dollar off the gold standard, which would allow him to continue with expansionary monetary policy. Remembering his experience and impact that the economy has on elections, Nixon stated: "/…/ in 1958 we cooled off the economy and cooled off 15 senators and 60 congressmen."[765] Namely, Nixon was convinced that a recession at the end of 1950s cost him the electoral win in 1960. He did not want to repeat the same mistake. On July 26th he said to Peterson: "I've never seen anybody beaten /in elections/ on inflation in the United States. I've seen many people beaten on unemployment."[766] The measures imposed on August 15th were targeted primarily US jobs and workers. Therefore, the domestic objective of the Nixon shock was to assure US economic wellbeing that would guide Nixon to a second term. Second, the international crisis – the gold standard and the role of the US dollar was playing in relations to other currencies, which I have elaborated in the previous chapter.

Thus, on Sunday August 15th, Nixon issued Executive Order 11615, imposing a 90-day wage and price controls, a 10% import surcharge, and most significantly, making the US dollar directly inconvertible to gold.[767] He also addressed the nation and announced his policy.[768]

Perspectives, 20(4). Pp. 177−88; Abrams, Burton A., and James L. Butkiewicz. 2012. The political business cycle: new evidence from the Nixon tapes. *Journal of Money, Credit and Banking*, 44(2–3). Pp. 385–99.

[764] Nixon tape, conversation No. 514–8. In this conversation Friedman warned Nixon that raising interest rates would result in the rise of unemployment, while raising money supply could only result in inflation. He backed his argument with the experience of contractionary monetary policy in 1969 which produced recession and unemployment in 1970.

[765] Gowa. 1983. Pp. 68.

[766] Nixon tape conversation No. 546–2.

[767] *Executive Order 11615, Providing for Stabilization of Prices, Rents, Wages, and Salaries*. Adopted, August 15, 1971. Accessibility: https://www.presidency.ucsb.edu/documents/executive-order-11615-providing-for-stabilization-prices-rents-wages-and-salaries (11 September 2018).

[768] Nixon, Richard. 1971. *Televised address to the nation on 15th August*. Accessibility: https://www.youtube.com/watch?v=iRzr1QU6K1o (14 October).

Although his statements came across as persuasive, and his actions bold, Nixon, nor Connally, did not have a blue-print for what came next and what they were ultimately aiming for. They knew that IMS needed to change, but their tactics was that this shock would cause the Europeans and the Japanese to start negotiating new parities. Maybe the most explicit recollection of such rationale came from Shultz and Dam:[769]

> "/W/e wanted to get their /other countries'/ attention, to make them realize how serious we were, and to equip our negotiator, Secretary Connally, with more tools for bargaining /…/ an implicit devaluation on the import side, an attention getter, and a bargaining chip /…/ Although we knew that economists could and would show that the import surcharge had a perverse market effect by reducing U.S. imports and thereby offsetting the tendency for the U.S. dollar to weaken on the exchange markets, we regarded the surcharge as a temporary part of our negotiating strategy."

Nevertheless, in August 1971, there was no vision of a contemporary post-Bretton Woods IMS.[770] What guided the Nixon administration was concern for US national interest. The wellbeing of the United States came first, the IMS second.

Several accounts of the Camp David meeting draw the same picture.[771] Gowa writes:

> "Most, although not all, of the administration's economic officials believed that the surcharge coupled with the suspension constituted overkill, dangerous because it invited retaliation by other nations. Camp David participants generally adhere to the view that the surcharge would not have been imposed had Connally not been secretary."[772]

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[769] Shultz, George P., and Kenneth W. Dam. 1977. *Economic Policy beyond the Headlines*. New York: WW Norton. Pp. 115.
[770] See Farrell, John A. 2017. *Richard Nixon: The Life*. Toronto: Vintage. Pp. 448.
[771] Expansion of the Nixon taping system to Camp David did not occur until 1972.
[772] Gowa. 1983. Pp. 150, footnote 2.

However, Volcker recalled that "the only really active debate about the program was over the import surcharge. As I remember it, the discussion largely was a matter of the economists against the politicians, and the outcome wasn't really close. I think the president had been convinced that it was both an essential negotiating tactic and a way to attract public support,"[773] This means that the disagreements on the dollar peg to the gold were minute and that Burns, and McCracken were the only ones who strongly opposed closing the gold window.[774] For both – Burns and McCracken – this was the zenith of their influence in the Nixon administration.[775] However, everyone agreed and recognized this was a historic decision.[776]

On the other end of the stick was Connally as the principal proponent of the import surcharge. He argued that simply closing the gold window would be insufficient to get other countries to revalue their currencies. The surcharge would be temporary, but without an explicit time limit, so that it could achieve its goal of eliciting foreign concessions. He claimed that the measures would be politically popular at home and would shock foreign countries into agreeing to America's demands.[777] Therefore, he argued, the import surcharge should remain in place until new exchange rate parities would be negotiated.[778] He had an adversarial exchange with McCracken who noted that the import surcharge might strengthen the dollar at a time when they wanted it to fall against other currencies. Connally countered: "It's more understandable to the American people to put on a border tax. I know it's inconsistent; you are right. But the tax may make a change in the exchange rate possible."[779] President Nixon was clearly attracted to the idea,

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[773] Volcker and Gyohten. 1992. Pp. 78.
[774] Nichter. 2015. Pp. 58–67.
[775] Nichter. 2015. Pp. 64.
[776] Nichter. 2015. Pp. 64.
[777] Safire. 1975. Pp. 513.
[778] Irwin. 2017. Pp. 544.
[779] Safire. 1975. Pp. 513.

saying that "the border tax is not too damned aggressive, just aggressive enough."[780] Implying that an effective administration response could also forestall protectionism on the part of Congress, Nixon added that "we can screw around with an exchange rate but Mills[781] is coming in with an import surcharge."[782] "When the president asked if other countries could retaliate against the surcharge, Peterson replied that, under the GATT, other countries could not retaliate if it was imposed for balance of payments purposes."[783] Nixon endorsed the idea of import surcharged because it "is not too damned aggressive, just aggressive enough."[784] He saw the IMS crisis as an opportunity, and as in the past where Nixon did not seized crisis to announce a new policy, he did so here framing the domestic and international narrative in his favor.[785] Thus, when on Sunday evening, 15th August, Nixon addressed the nation and explained his decision to close the gold window, which was not portrayed as a devaluation of the dollar, but as a measure of enhancing the competitiveness of United States. The bulk of his speech was dedicated to domestic measures – wage freeze. On the international dimension he said:[786]

> "I am taking one further step to protect the dollar, to improve our balance of payments, and to increase jobs for Americans. As a temporary measure, I am today imposing an additional tax of 10 percent on goods imported into the United States. This is a better solution for international trade than direct controls on the amount of imports. This import tax is a temporary action. It isn't directed against any other country. It is an action to make certain that American products will not be at a disadvantage because of unfair exchange rates. When the unfair treatment is ended, the import tax will end as well. As a result of these actions, the product of American

[780] Safire. 1975. Pp. 513.
[781] Wilbur Mills (D – Arkansas) was a congressman who chaired the House Ways and Means Committee, which is the crucial tax writing committee. Mills had a history of favoring surcharge, see Lyndon B. Johnson Library, Transcript, Bess Wilbur Mills History Interview I, 11/2/71, by Joe B. Frantz, Electronic Copy. Accessibility: https://www.ssa.gov/history/pdf/mills1.pdf (17 December 2020).
[782] James. 1996. Pp. 233.
[783] Irwin. 2012. Pp. 13.
[784] Safire. 1975. Pp. 513.
[785] See Zoeller and Bandelj. 2019.
[786] *Address to the Nation Outlining a New Economic Policy: "The Challenge of Peace"*. Accessibility: http://www.presidency.ucsb.edu/ws/index.php?pid=3115 (17 December 2020).

> labor will be more competitive, and the unfair edge that some of our foreign competition has will be removed. This is a major reason why our trade balance has eroded over the past 15 years."

On the domestic front, Nixon's policies were seen as successful – the Dow Jones rose by 3.7% and the S&P 500 by 3.2% on August 16th.[787] Yet, the 1970s are not remembered as an economic booming period: oil crisis (1973 and 1979), rising inflation and unemployment, stock-market crash in 1973 and subsequent recession. Nevertheless, the US public supported Nixon's decision[788] and his approval rankings began to rise until the Watergate scandal.[789] The positive sentiment is also reflected in a New York Times article published on August 16th, 1971:[790]

> "After months of drift, President Nixon has moved with startling decisiveness to stabilize the dollar and spur economic growth. The comprehensiveness of the program he announced last night makes immediate assessment of all its details impossible, but we unhesitatingly applaud the boldness with which the President has moved on all economic fronts—and most especially his order for a ninety-day freeze on prices and wages as a preliminary to a flexible policy for checking the runaway spiral that has eroded the purchasing power of all Americans and made American products increasingly uncompetitive in world markets. /…/ Mr. Nixon has now provided the leadership which is even more essential than any specific proposal for turning the economy around and starting it back on the road to full employment, price stability and competitiveness in an open world market."

However, international results and responses were more complex, and the next section is devoted to their complexity and how the post-Bretton Woods IMS was finally shaped. One would

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[787] See Silber, William L. 2012. *Volcker: The triumph of persistence*. New York: Bloomsbury. Pp. 361.
[788] A Harris Survey showed that 71% of Americans Nixon's policy, see Harris Survey. 1975. *Yearbook of Public Opinion in 1971*. New York: Lewis Harris & Associates. Pp. 184.
[789] See *Presidential Approval Ratings Gallup Historical Statistics and Trends*. Accessed: https://news.gallup.com/poll/116677/presidential-approval-ratings-gallup-historical-statistics-trends.aspx (23 July 2019). After the record Dow jump, Nixon also jumped in the polls against at that point democratic front runner – Edmund Muskie. The latter was observed by Variety magazine in a leading article entitled 'New Score is Dow 32, Nixon 72', see Zeiler, Thomas W. 2013. Requiem for the Common Man: Class, the Nixon Economic Shock, and the Perils of Globalization. *Diplomatic History*, 37(1). Pp. 1–23. At Pp. 11–2.
[790] Call to Economic Revival. 1971. *The New York Times*, 16 August. Pp. 26.

expect that such a *fait accompli* move would force other nations to fall in line, and Coercive Hegemony Theory predicts the rationale behind such action; namely, an assertion of US strength thereby, forcing others to follow. Yet, as stated in his address to the nation, Nixon did not intend these policies to be permanent, but temporary, and to be understood as a starting point for bargaining about the new IMS.[791] So why would he state that if the rationale was to coerce others? In private conversations, however, the vocabulary was more vivid. For example, Nixon said: "Now is the time to reform the international monetary system and strike back at the gangsters and vampires sucking the blood out of every transaction."[792] Connally concurred arguing: "Foreigners are out to screw us. Our job is to screw them first."[793] Moreover, Connally was extremely blunt with the Europeans, when shortly after taking office, he told European bankers: "The dollar may be our currency, but it's your problem."[794] Similarly he also said: "The Japanese are still fighting the war, only now instead of a shooting war, it is economic war." To which Nixon responded: "We'll fix those bastards."[795] Still, both of them were aware that there were turbulent times ahead. As Burns noted: "Other nations are proud, and they will retaliate."[796] Therefore, the key take-away from the shock was the showcase of American strength – the presence of the imbalance of power. The United States had to display its force and assure everyone that it is still the principal actor, or that it is still capable of being behind the driving seat.[797] It also served as a signal to the non-hegemonic states in that the resolution of the crisis would have to be done outside the formal institutions – as the United States made clear on August 15th via a "notification to the IMF that

[791] See *Address to the Nation Outlining a New Economic Policy: "The Challenge of Peace"*.
[792] Farrell. 2017. Pp. 446.
[793] Odell. 1982. Pp. 263.
[794] Volcker and Gyohten. 1992. Pp. 81.
[795] Reeves. 2001. Pp. 341.
[796] Safire. 1975. Pp. 514–5.
[797] Keohane, Robert O., and Joseph S. Nye. 1977. *Power and interdependence: World Politics in Transition*. Boston: Little Brown. Pp. 122–3.

there would no longer be free buying and selling of gold in the United States".[798] Thus, coercion was an integral part of the international dimension of the Nixon shock; nevertheless, it was not the sole rationale. Taken in isolation, the Nixon shock might be understood as coercive bargaining by the hegemon: a display of force that aspired to straighten-up the non-hegemonic states. But the United States did not engage in sustained coercive diplomacy, nor did it intend to. Its strategy and actual pursuit were policy of restraint in managing the reactions of the non-hegemonic actors. The picture, therefore, is more complex than what the Coercive Hegemony theory suggests. Hence, something more was at play here – preserving the US dollar centrality and along with-it US hegemony. With this move the United States has put everything on the line. Either the non-hegemonic-states would 'buy-in' and continue to use the US dollar and participate in global governance by adequately adjusting, or disorder would follow suit. Such was the logic behind the Nixon shock and was in-line also with the Nixon Doctrine.[799] Hence, Coercive Hegemony explanation of the event is good, yet still incomplete.

Cooperative Hegemony theory would oppose the very notion of unilateral action of the United States. If the hegemon and non-hegemonic states are bounded through regimes, then reform of the IMS would have to come from within institutions of that IMS. Yet, as seen in the previous chapter, those institutions were eroded by establishment of new fora – e.g., G-10. Still, if we treat multilateralism as a regime in and of itself, the United States did try to use it before deciding on

[798] James. 1996. Pp. 219.
[799] Nixon Doctrine was introduced on 25th July 1969 at the press conference in Guam, and elaborated in a speech on 3rd November 1969, where President Nixon reconfirmed US commitment to defending the democratic world, but only if these allies also contribute to their own defense. See, Litwak, Robert S. 1986. *Détente and the Nixon Doctrine: American Foreign Policy and the Pursuit of Stability, 1969-1976*. Cambridge: Cambridge University Press.

the unilateral shock. Therefore, even this broader understanding of Cooperative Hegemony does not explain how the Nixon shock came about.

On the other hand, the Nixon Shock does not directly go against the expectations of Cultural and Opportunist Hegemony Theory. Both can explain a unilateral action if the latter is in accordance with an ideology or logic of changing the provision of public good, respectively. Yet, opinions on the nature of the Nixon shock differed in the administration. Furthermore, mercantilist and monetarist economic ideas were intertwined as ideational fundaments. Finally, the decision makers did not have a clear ideological road map for the future. All this attributes to my conclusion that Cultural Hegemony Theory poorly explains the Nixon shock. Second, when it comes to Opportunist Hegemony, it would explain the August 15th, 1971, event as an interaction change, where the hegemon changes the nature or the manner of the public good it provides. In return for that provision, it expects certain behavior from the non-hegemonic states. Yet, the United States reversed that sequence and as such, my empirical findings do not map over this account. Namely, the hegemon put the public good – the US dollar – on the line in that its utility depended on the non-hegemonic states to first change their behavior – i.e., exchange rate adjustment – and consequently reap the benefits of that public good. Hence, this explanation is incomplete.

In comparison, Pervasive Hegemony Theory provides the most comprehensive and detailed picture; namely, it expects that the hegemon would initiate a crisis when it has to remind the non-hegemonic states of a hegemony relevant issue where they need to display a ‘buy-in’ in order that the hegemony can endure. As every state – hegemonic or non-hegemonic – followed its selfish national interests, the United States positioned itself in the center of the global economy during the Bretton Woods IMS. As it could not reform this IMS to further assure the centrality of the US dollar, as it came with the too high of a domestic cost, it opted to create a shock to remind the non-hegemonic states that the centrality of the US dollar comes only if they 'buy-in' first into a new IMS. It signaled the quintessential feature of its hegemony. Empirical evidence shows that the domestic situation drove concerns in the United States about the centrality of the US dollar and that the hegemon wanted to negotiate an IMS that would alleviate the costs of assuring this centrality. However, it could not do so without creating a shock and killing the IMS it had created.[800] In fact, the United States could use other monetary actions to tackle the dollar crisis (pay it out), in spite of the fact that international events narrowed the possibilities of its scope. The latter attests to the persistent economic and general imbalance of power, which still existed in August 1971. Moreover, the United States could also continue to use other political means to tackle the problem (reform through IMF). Hence, its decision for the shock was intentional and strategic, which derived from the premise of maximizing its interest, signaling the relevant issue for its hegemony (US dollar centrality), and enabling a 'buy-in' dynamic that would assure its hegemonic endurance. Moreover, the non-hegemonic behavior of maximizing their autonomy made these alternatives less beneficial for the United States and therefore less likely. However, a future research project can deal with this counterfactual.[801]

The Nixon shock generated a new IMS, as well as crystallized a type of hegemony, which is reinforced by structurally grounded (imbalance of power) 'buy-in' from the hegemon and the

[800] See Gowa. 1983. Pp. 152.
[801] Namely, what were to happen with the Bretton Woods IMS if the non-hegemonic states would be more willing to adjust and contribute to the global governance? Would there be a different Nixon Shock, if at all? Could such action withhold the problem of changing of the nature of the economy? Would US hegemony then still be a pervasive hegemony?

non-hegemonic states alike. This enables a hegemonic endurance, where coercion, institutions, ideology, and 'buy-out- appear to be secondary at best. The final empirical chapter is devoted to illustrating this process and the nature of US hegemony – pervasive hegemony.

5.2 CREATING THE NEW INTERNATIONAL MONETARY SYSTEM

Kissinger recalled that the Nixon Shock was needed "bring about serious negotiations."[802] In the fall of 1971 after it initiated the Nixon Shock, United States led a series of bilateral meetings among the big powers, among which most significant were the meetings between United States and France. Kissinger recalls that the Nixon shock:

> "began the tortured process of systemic international adjustment. It was an extension of /Nixon's/ bold strokes in foreign policy to the field of economics. /.../ The immediate significance of the new program was its effects abroad; it was seen by many as a declaration of economic war on the industrial democracies and a retreat of the United States from its previous commitment to an open international economic system. The industrial democracies especially Japan were in state of shock because of the suddenness of the announcement, the unilateral nature of some of the measures, and the necessity they imposed to consider a formal restructuring of the entire international economic system."[803]

Immediately after 15th August, Volcker traveled to London and from there on to Paris.[804] He assured allies that United States did not have a particular plan for solving the crisis, and that

[802] Kissinger. 1979. Pp. 956.
[803] Kissinger. 1979. Pp. 955.
[804] Even though Volcker met with key non-hegemonic states' representatives already in London, Nixon insisted on the second Paris meeting since Pompidou was helping with negotiations with the North Vietnamese (see Nichter. 2015. Pp. 69). Moreover, Pompidou was the most knowledgeable on monetary policy of any head of state (Memorandum of Discussion, Federal Open Market Committee, Box G8, 24th August 1971. Gerald R. Ford Library, Papers of Arthur Burns, Box G8.).

these talks were consultations not negotiations.[805] "Volcker said we had no plans to propose for reshaping the system. We wanted to hear the views of the other countries so that we could reach a consensus."[806] This was Connally's 'do nothing' strategy,[807] and the rationale behind it was that this would strengthen US bargaining position.[808] It was on the other non-hegemonic states to decide whether they want to maintain the US dollar centrality and hence US hegemony, or not. At the London meeting French, German, Italian, and Japanese delegates were present.[809] Whereas the meeting in Paris was only attended by Giscard d'Estaing – French minister of Economics and Finance.[810] Volcker's argument was that such action is an "assertion of US strength."[811] He

[805] Memorandum of Conversation, London, August 16, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d170 (21 December 2020). At the meeting in Paris with d'Estaing, Volcker there is an even greater danger of growing protectionism in the United States that only an international monetary reform could prevent, see Memorandum of Conversation, Paris, August 17, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d171 (21 December 2020).

[806] Memorandum of Conversation, Paris, August 17, 1971.

[807] For instance, Connally was convinced that the negotiations are a war of attrition, where United States must not cave. See, Nixon tape conversation, 576–8. Moreover, at the meeting with the Japanese minister of Finance, Mikio Mizuta, Connally explained: "The U.S. is reluctant to table any proposal, for one good reason that other nations always complain that we are telling them how to run their business. Other countries kept saying that the U.S. should do something. Now we have done what we could to solve our problem and it is up to the others to cooperate. If we were to make any proposal, within 24 hours every nation in the world would denounce it and us /.../ It is, therefore, up to the other countries to come forward with ideas to solve the problem." See, Memorandum of Conversation, Washington, September 10, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d77 (21 December 2020).

[808] Nixon said to Connally: "I feel so strongly that ... we don't want to ... rescue this international monetary thing too soon. Let it stew." (Nixon tape conversation, No. 8–42). At another occasion he said: "I want to do the responsible statesmanlike thing, but not now /…/ Now if we give up too soon, we back down, and we decide we're going to revalue the dollar, and we're going to do this, and we're going to be responsible, and we're going to be good neighbors, and we're going to grin and bear it, believe me, the American people are going to say what the hell, we thought we had a president finally who was going to stand up for us. Now that's where it's at... My point is, that right now, we are in a period, where the United States, the people of this country, could very well turn isolationist unless their president was looking after their interests. And we must not let this happen." (Nixon tape conversation, No. 570–4).

[809] Memorandum of Conversation, London, August 16, 1971.

[810] Memorandum of Conversation, Paris, August 17, 1971.

[811] James. 1996. Pp. 221.

stressed that United States will not devalue against the gold and that it is upon others, the market, to determine where the US dollar will float. Moreover, also the duration of US dollar float and other measures depends on actions of others now. To which d'Estaing warned that the United States actions broke the rules and might trigger worldwide protectionism. Furthermore, we warned that the central banks may not want to hold US dollars anymore. To this Volcker added that they are aware of the dangers and the objectives is not to finance US deficit, but to eliminate it.[812] Tensions were inevitable. United States was juggling with making enough pressure for adjustments of other non-hegemonic states, while at the same time not provoking trade wars and jeopardizing political relations.[813] It had called the bluff of everyone and received what it hoped for – no push back. Yet, United States received even more. States begun posing the question how their markets could function without the 'flood of dollars'?[814] Although the position of the US dollar was unclear, the non-hegemonic states signaled that they will 'buy-in' already at the meeting in London.

> "A member of the German delegation Otmar Emminger (Bundesbank) said all countries were interested in the restoration of strength of the dollar. They had found out that difficulty for the dollar meant difficulty for their own currencies and they understood that the monetary system could only be based on a common position. He was concerned about the immediate problem of how to reopen exchange markets on a credible basis that would not require first one country and then another to take measures to protect itself. We were all in a position of interdependence. The dollar position must be credible and the position of other currencies must be credible."[815]

[812] Memorandum of Conversation, Paris, August 17, 1971.
[813] Kissinger. 1979. Pp. 956−7.
[814] Memorandum of Conversation, London, August 16, 1971.
[815] Memorandum of Conversation, London, August 16, 1971.

This indicated that European countries were not willing to balance against the United States. However, this was not a sign of a smooth sailing towards the new agreement. The non-hegemonic states initially tried to offset for a floating US dollar, which soon proved to be futile.[816] Although they did not present a specific roadmap for solution, they did continue to conduct their international economic activities in US dollars. Thus, signaling that they were willing to accept US dollar centrality. This apparent 'buy-in' was the basis for the later deal. Volcker remembered in his memoires: "In my naïveté, I thought we could wrap up an exchange rate realignment and start talking about reform in a month or two /…/ Instead, I got a fast lesson in big-league negotiations /…/ What we found, even after we shut the gold window was fierce resistance by key countries to their currencies floating upward against the dollar."[817] In fact, the proponents of free-floating exchange rate IMS were still by and large limited to academia.[818] Although their numbers steadily grew throughout the early 1970s.[819]

"/A/pplying real pressure on major currencies through public statements /what the United States did/ carried great political risk. In a situation in which each country was attempting to

[816] On Monday and Tuesday, August 16th and 17th, Japan bought 1.3 billion US dollars to support the yen. Moreover, the Bank of Japan tried to restrict foreign exchange transactions. Yet, all this failed to stabilize the yen against the US dollar. In one week, Japan's foreign exchange reserves increased 30% (Angel. 1991. Pp. 128–39). Therefore, by the end of August, yen was (dirty) floating.
[817] Volcker and Gyohten. 1992. Pp. 80.
[818] Friedman, Milton. 1953. *Essays in Positive Economics*. Chicago: University of Chicago Press. Pp. 157−203; Williamson, John H. 1965. *The Crawling Peg*. Princeton: International Finance Section, Department of economics, Princeton University; Johnson, Harry G. 1969. The case for flexible exchange rates. *Federal Reserve Bank of St. Louis Review*, 51(6). Pp. 12–24; Okun, Arthur M. 1970. *The Political Economy of Prosperity*. Washington: Brookings Institution; George Nikolaus Halm. 1970. *Approaches to greater flexibility of exchange rates*. Princeton: Princeton University Press.
[819] E.g., German Council of Economic Experts. 1972. *Toward a new basis for international monetary policy*. Princeton: Princeton University Press. Accessibility: https://ies.princeton.edu/pdf/S31.pdf (30 July 2019). Surprisingly, even IMF research unit produced a paper in 1970 (International Monetary Fund, A Report by the Executive Directors. 1970. Mechanism of Exchange Rate Adjustment. In De Vries, Margaret Garritsen. 1976. *The International Monetary Fund, 1966-1971, Vol II: Documents*. Washington: International Monetary Fund. Pp. 273–330) that spoke in favor of such system, but it was watered down after a few months, and more importantly no one paid attention to it, See James. 1996. Pp. 213.

impose a larger part of the burden of adjustment on other countries, any statement or calculation about exchange rates looked as if it constituted an intervention in a complex and ferocious international bargaining process."[820] However, the Nixon administration was aware of the potential downward spirals – Burns presented a list of retaliatory measures planned by the major trading partners which would produce a net outcome highly disadvantageous to United States.[821] Based on this the Nixon administration also reassessed its strategy. Since the non-hegemonic states displayed a 'buy-in' behavior that meant that United States could settle for new par value system. Namely, in September Burns and Kissinger persuaded Nixon to be satisfied with new parities.[822] Subsequently, Kissinger suggested to Nixon to formalize a small group that would establish a new negotiation position – Kissinger, Connally, McCracken, and Shultz. This group would meet once a week in October and designed new arrangement that was later adopted as the Smithsonian Agreement.[823] Still, in diplomatic meetings, Kissinger continued Connolly's strategy to do nothing, and waited for European ideas, particularly from France. His aim was to first carve out a realistic concrete proposal, which could be circulated at any point the president would decide so.

The agreement was made at the G-10 meeting at the Smithsonian Institution in Washington that gave it its name between December 17th and 18th. Under the Smithsonian Agreement[824] US dollar peg to gold was raised from $35 per ounce (during the Bretton Woods era) to $38 per ounce. Furthermore, other countries also appreciated their currencies between 7% and 9% against the US dollar.[825] The agreement followed US interests that the non-hegemonic states should appreciate.

[820] James. 1996. Pp. 221.
[821] Solomon. 1982. Pp. 195−218; Kissinger. 1979. Pp. 957.
[822] Solomon. 1982. Pp. 195−218.
[823] Kissinger. 1979. Pp. 957−8.
[824] *Smithsonian Agreement*. 1971. Accessibility: https://www.gold.org/sites/default/files/documents/after-the-gold-standard/1971dec.pdf (25 April 2019).
[825] James. 1996. Pp. 236–38.

At the same time, it strengthened the central position of the US dollar in the global monetary relations. Nevertheless, what is most significant is that the non-hegemonic states prioritized adjustment to other alternatives. This was a strong signal of their willingness to 'buy-in'. They might be uncomfortable with it, but they accepted it nonetheless as it was the only way to assure them the US dollar.

Still, everyone understood that the adjustments made in the Smithsonian Agreement will not be sufficient to tackle the international monetary problem. The new nature of the economy was too big of a monster to be tamed by an aggregate of 15% adjustment. Therefore, negotiations on the future arrangements began immediately after the Smithsonian Agreement was made. In early 1972 Volcker stated that the stage is set for conducing a more fundamental reform of the IMS.[826] Throughout 1972 unformal talks were conducted in the environment of gradually increased realization of the failure of the Smithsonian Agreement, the interest of everyone to preserve the centrality of the US dollar, and preference for liberalization of financial and capital markets. United States deliberately excluded the IMF from negotiations due to its "attachment to the fixed exchange rates."[827]

But these efforts were not fruitful, and in February 1973 United States made another unilateral decision float the US dollar, and the non-hegemonic states followed suit.[828] The key figure in this move was Shultz, who took over from Connally, both in his position as Secretary of Treasury, as well as the most influential economic figure in the administration, in 1972, when

[826] Paul Volcker, A Start Toward Negotiating International Monetary Reform, February 22, 1972, Treasury Department, VG/LIM/72, Box 19, Whitman Files: 1.
[827] Shultz and Dam. 1977. Pp. 121.
[828] James. 1996. Pp. 239–43.

Connally resigned to help with the reelection campaign for Nixon and leading 'Democrats for Nixon'.[829] Throughout this period the non-hegemonic states continued to be stringent, and on January 11th, 1973 Shultz announced the economic stabilization program would entail voluntarism[830] – which meant *de facto* free floating exchange rates. On February 7th, 1973, Shultz send Volcker to negotiate bilaterally with European countries and Japan.[831] The negotiations were not successful. Subsequently, om February 12th United States devalued the US dollar for 10%.[832]

Similar to events immediately after the Nixon Shock, the noon-hegemonic states wanted to preserve the Smithsonian parities. "In the first ten days of February, the flow of dollars into the official reserves of European countries and Japan approximated $10 billion. The Deutsche Bundesbank alone was forced to take in $5.9 billion in the first nine days of February."[833] Yet, such a defense of the Smithsonian Agreement, as it was with the Bretton Woods system, was futile. Namely, within a month, all countries let their currencies float. By March, Japan, Switzerland, and Italy were floating their currencies,[834] alongside United Kingdom, Germany, Canada, and United States.[835] In the first 6 months, the US dollar depreciated 30% against the German mark, but after that it settled down (see Figure 81). This meant that the misalignment was not as severe as the opponents of the floating regime feared.[836] Furthermore, as it was in 1971, so too the non-

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[829] For more on Democrats for Nixon and his 1972 campaign, see Mason, Robert. 2004. *Richard Nixon and the Quest for a New Majority*. Chapel Hill: University of North Carolina Press. Ch. 5.
[830] Gerald R. Ford Library, Papers of Arthur Burns, Box 101, January–February 1973, White House Press Secretary Press Release, 11 January.
[831] Leeson. 2003. Pp. 177.
[832] Gerald R. Ford Library, Papers of Arthur Burns, Box 101, January–February 1973, Treasury Press Release, 12 February.
[833] De Vries, Margaret Garritsen (ed.). 1985a. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol I: Narrative and Analysis*. Washington: International Monetary Fund. Pp. 66.
[834] Emminger, Otmar. 1977. *The D-Mark in the Conflict between Internal and External Equilibrium, 1948–75*. Princeton: Princeton University Press. Accessibility: https://ies.princeton.edu/pdf/E122.pdf (28 July 2019). Pp. 36.
[835] See De Vries. 1985a. Part I.
[836] Eichengreen. 1998. Pp. 138−9.

hegemonic states unenthusiastically agreed to follow US interests of a new IMS in order to preserve the US dollar centrality in 1973.[837] However, this time around, United States was not ready to settle for a revised version of a Bretton Woods system. It took three years for the states to reach an agreement regarding for the new IMS – Jamaica Accords (7th – 8th January 1976)[838] and subsequent Second Amendment to the IMF Articles of Agreement (March 1976). The latter entered into force on April 1st, 1978.[839]

If the G-10 countries needed 4 months to reach a very moderate reform of the Bretton Woods system (Smithsonian Agreement), then the slow pace in fundamentally changing and codifying the new IMS does not come as a surprise. In fact, this attests to a rather organic development. De Vries explains that the changes in reserves gradually crystalized the need for balance of payment adjustment, especially through the flexibility of exchange rates.[840] Namely, the surplus non-hegemonic states were immediately compelled to appreciate in the aftermath of both the first and the second unexpected US closing of the gold window (1971 and 1973). Their efforts to save the existing parities in both instances, indicate that they were not pleased about such moves of the United States. Still, they wanted to preserve the US dollar centrality. As such, they needed time to fully embrace the idea behind the new IMS. Moreover, as it was the case in the US administration and bureaucracy (e.g., after the Nixon Shock Connally vs. Kissinger),[841] there were different voices also other non-hegemonic states.[842] Thus, states needed to reach a domestic

[837] Solomon. 1977. Pp. 233.
[838] Press Communiques of the Interim Committee. 1976. *IMF Annual report*. Washington: International Monetary Fund. Pp. 126−7.
[839] James. 1996. Pp. 271.
[840] De Vries. 1986. Pp. 114.
[841]See, Sargent, Daniel J. 2015. *A Superpower Transformed: The Remaking of American Foreign Relations in the 1970s*. Oxford: Oxford University Press. Pp. 116−7; Irwing. 2012. Pp. 18−9.
[842] For example, even though Germany anticipated the Nixon shock and floated first, a majority on the Bundesbank council resisted pressure from the German government to move to a floating rate system, instead favoring exchange-

ideational agreement in order to be successful internationally. Both sides, the hegemon, and the non-hegemonic states, displayed a preference for resolving the crises through bilateral meetings. As such, they wanted to assure the implementation of their parochial interests, which in turn meant longer period to achieve and coordinate the agreement. Evenly important is also the fact that multilateral frameworks and initiatives – IMF and other IOs – were irrelevant in this process.[843] United States did not like multilateral settings since Europeans coordinated before them. From the US perspective, this made negotiations in those settings harder.[844] United States also distrusted IMF personal. Nixon even complained when his staff were talking to IMF officials, even if it was his chief of staff – Harry Haldeman.[845] Another factor attributing to slow progress was the fact that European countries and Japan became more powerful. Kissinger remembers that as Europe grew economically so did it politically and transatlantic relations had to be elaborated to fit the interest of both sides of the Atlantic – a common focus among partners.[846] Furthermore, non-hegemonic states were also interested in their bilateral positions against other non-hegemonic states. For example, Germany and France had diametrically opposite initial views on the IMS:

> Germany did not want to lose competitiveness visà-vis its European trade partners and therefore did not want to agree to a formal revaluation of the mark unless other European currencies were revalued as well. /…/ France was willing to allow the dollar to depreciate against the franc, but not allow the franc to appreciate against gold. That is, France insisted that the franc remained fixed in terms of gold and the dollar be devalued in terms of gold."[847]

rate fixity with the dollar and capital controls as a means of remaining within the Bretton Woods system. See Marsh, David, 1992. *The Bundesbank: The Bank That Rules Europe*. London: Heinemann. Pp. 180–93.

[843] Not even closed small groups were preferred, such as G-10. US thought that he latter "suffered institutionally from overrepresentation of Europeans, and perhaps also, some Americans thought, from the nonrepresentation of the developing world (James. 1996. Pp. 244)."

[844] See James, Harold. 2012b. *Making the European Monetary Union*. Cambridge: Harvard University Press. Pp. 98.

[845] Haldeman, Harry R. 1994. *The Haldeman Diaries: Inside the Nixon White House*. New York: Putnam. Pp. 374−5.

[846] Kissinger. 1982. Pp. 131−2.

[847] Irwin. 2012. Pp. 20.

Thus, as Figure 81 and 82 show, Germany had no problem appreciating against the US dollar, while it was depreciating against the Frank. However, both sides were committed to generate deep cooperation that would serve as the ground for a broader European cooperation.[848] Moreover, 1970s were an era of (economic) turmoil – inflation, two oil crises, unemployment, recessions (e.g., 1973-1975), restructuring of the economic sectors, and markets re-scoping due to decolonialization process.[849] States needed time to resolve their difficult domestic economic positions first, before they could focus on reforming IMS. Finally, with the unilateral move, United States placed the ball in the European court and waited for their response. Awaiting non-hegemonic initiatives United States did not use coercive measures in 1971 nor 1973, which had an effect on prolonged process of establishing the new IMS.[850]

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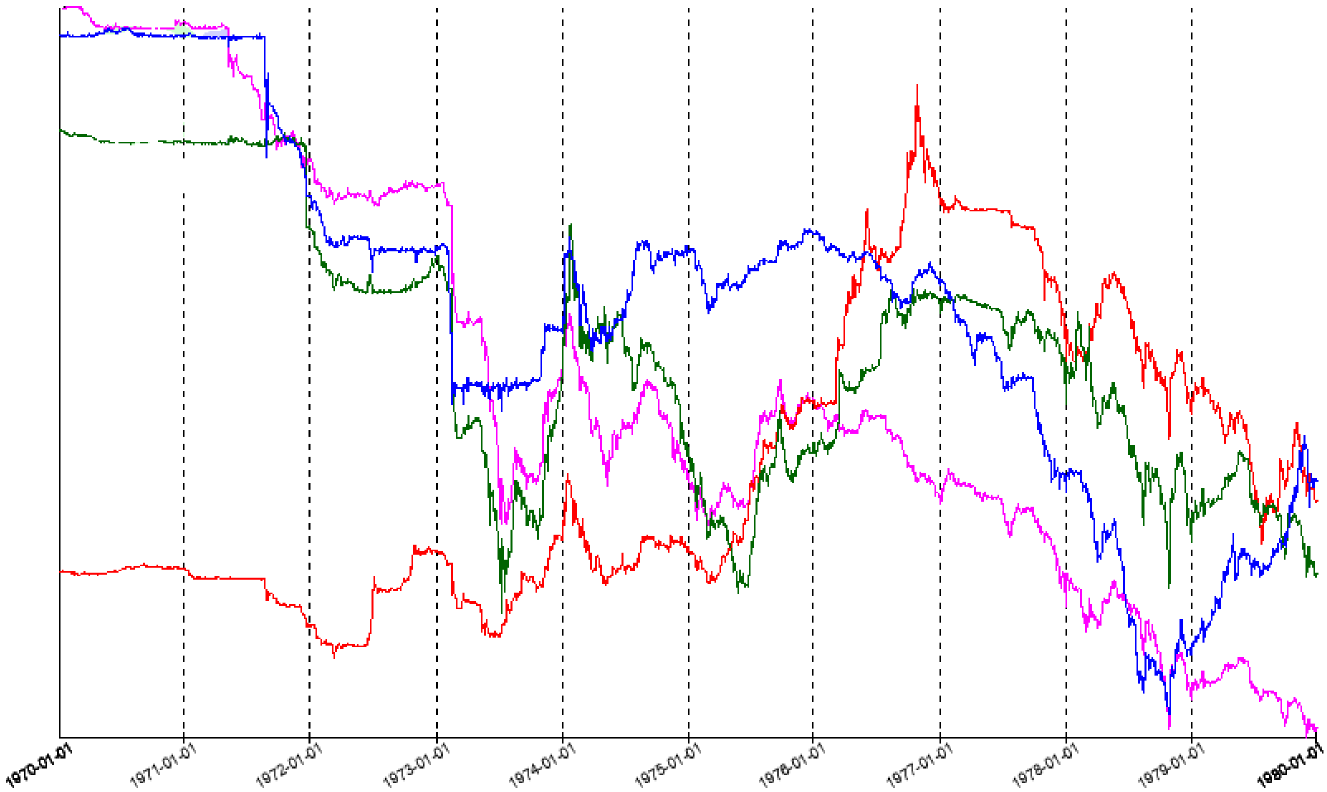
[848] See Gray. 2007.

[849] See, Tarantelli, Ezio, and Gerhard Willke (eds.). 1981. *The Management of Industrial Conflict in the Recession of the 1970s*. Firenze: European University Institute; Barsky, Robert B., and Lutz Kilian. 2004. Oil and the Macroeconomy since the 1970s. *Journal of Economic Perspectives*, 18(4). Pp. 115–34; Ferguson, Niall, Erez Manela, and Daniel J. Sargent (eds.). 2011. *The Shock of the Global: the 1970s in Perspective*. Cambridge: The Belknap Press; Borstelmann, Thomas. 2013. *The 1970s: A new Global History from Civil Rights to Economic Inequality*. Princeton: Princeton University Press.

[850] By this Volcker was puzzled since European countries could not live with the uncertainty. See Lowenstein, Roger. 2011. *The Nixon Shock*. Bloomberg, August 4. Accessibility: https://www.bloomberg.com/news/articles/2011-08-04/the-nixon-shock (24 July 2019).

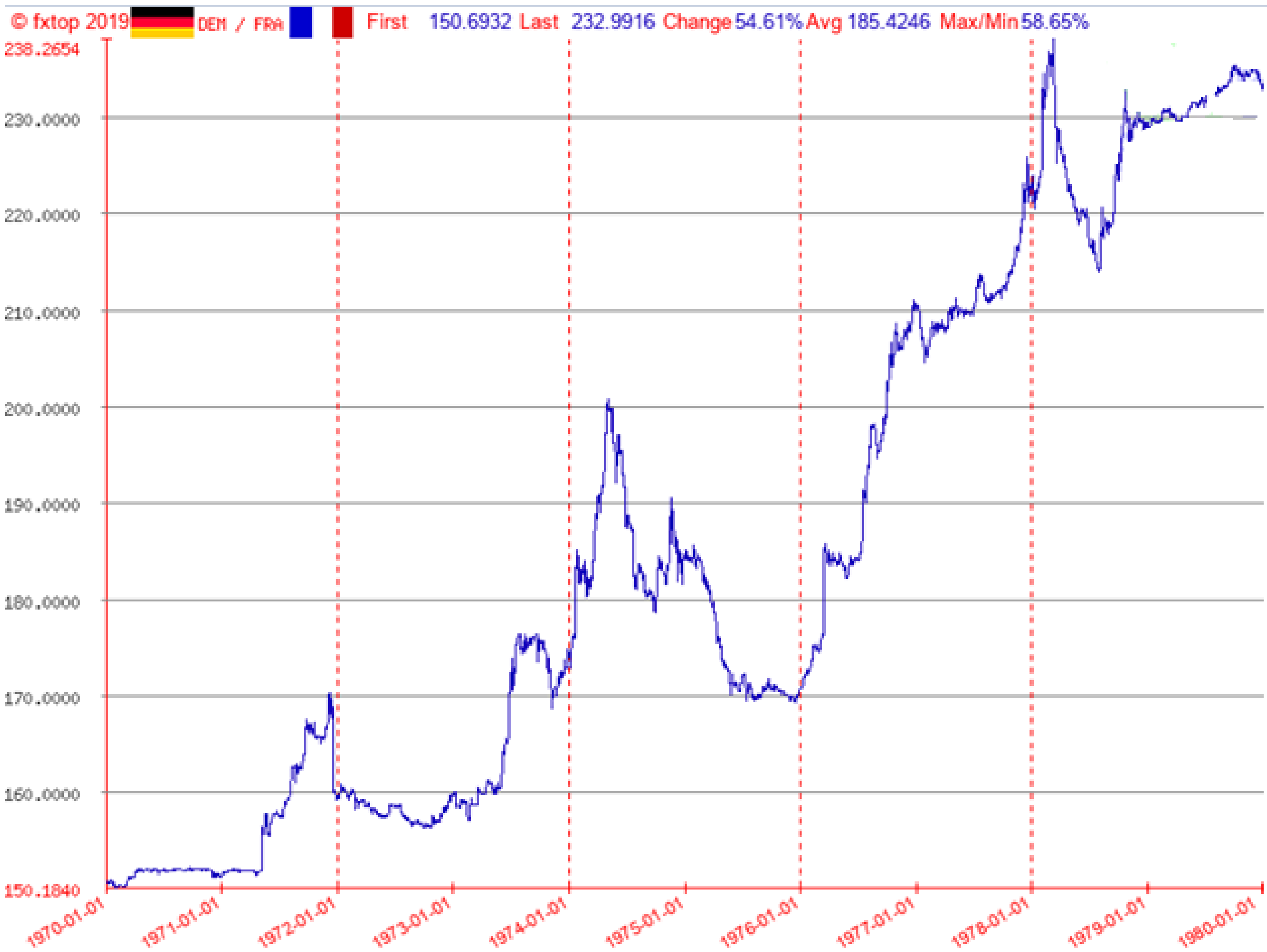
Figure 81: Exchange rates between US dollar, and Frank, Sterling, Yen, and Mark, 1970-1980[851]



	USD / DEM	USD / GBP	USD / FRA	USD / JPY
Max/Min :	116.09%	69.14%	42.70%	103.16%
% Change :	-53.07%	7.89%	-27.45%	-33.05%
Max	3.6900	0.6385	556.0696	359.8019
Min	1.7076	0.3775	389.6758	177.1004
1st	3.6899	0.4165	556.0428	357.7218
Last	1.7315	0.4494	403.4250	239.4882

[851] Data from: *Major Historical Exchange Rates Comparison*. 2020. Accessibility: https://fxtop.com/en/historical-exchange-rates-comparison.php (27 December 2020). The scale is proportional.

Figure 82: Exchange rates between Mark and Frank, 1970-1980[852]



5.2.1 Towards the Smithsonian Agreement

With the Nixon Shock, United States risked the global central position of the US dollar and consequently also its hegemony.[853] However, it was willing to do so, as its vital interests related

[852] Data from: *Major Historical Exchange Rates Comparison*. 2020.
[853] The administration was fully aware of this, what is reflected in Nixon's short letter to German Chancellor Willy Brandt, on August 16th, where he mentions confidence in the US dollar twice. See, Telegram From the Department of State to the Embassy in Germany, Washington, August 16, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic*

to exchange rate realignment and subsequent competitiveness of its economy. Volcker wrote that even Connally, a vivid supporter of closing the gold window, was willing to consider a reduction in the reserve role of the US dollar. Moreover, Volcker himself was also willing to accept diminished global position of the US dollar, if that meant assuring exchange rate realignment and flexibility.[854] Thus, US hegemony was on the line, and the only thing that could save it was the 'buy-in' of the non-hegemonic states. United States did not make any efforts or proposals, as the burden was on the non-hegemonic states and United States could wait.[855] And the non-hegemonic states across the globe did 'buy-in'.[856] They were absorbing US dollars in their reserves and continued to use them in their economic activities; however, they have also expressed their biggest concerns – surcharge.[857] As such, they signaled that their fundamental interest was linked to the US dollar, not to the nature of the exchange rate, while in United States it was reverse. Such positions of the hegemon and the non-hegemonic sates enabled the solution to the crisis and a new international monetary architecture. The non-hegemonic state behavior, domestic considerations that the crisis would not prolong into the election year, contributed to hegemon's readiness to do its part of resolving the crisis.

Policy, International Monetary Policy, 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d169 (15 December 2020).

[854] National Archives, Record Group 56, General Records of the Department of the Treasury, Records Pertaining to Monetary Reform, 1968-1978, Box 6, Paul Volcker, Proposed Negotiating Stance, August 30, 1971, MR-8, U.S. Plans (General).

[855] See Sterling-Folker, Jennifer. 2012. *Theories of international cooperation and the primacy of anarchy: Explaining US international monetary policy-making after Bretton Woods*. Albany: SUNY Press. Pp. 145.

[856] Probably, the most explicit favorability for the US dollar uttered came from Colombian finance minister who met with Nixon on September 4th, and said that Columbia, Argentina, and Mexico choose to hold US dollars, but that the coming potential economic unrest may generate a front against the US dollar. He concludes that this is an opportunity for the United States to gain support in the region, see Nixon tape conversation, No. 567–9. Moreover, Germany bounded itself to make purchases form the United States, in US dollars, and also using credits issued in US dollars. See, Telegram From Secretary of State Rogers to the Department of State, Brussels, December 10, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d86 (15 December 2020).

[857] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 484–5.

After the initial confusion,[858] by the end of August 1971 the size of foreign exchange transactions grew to the extent that it was impossible for any non-hegemonic government to maintain the previous pegs (Japan endured the longest). Projections were made that the resolution of the issue will take a year or two.[859] Hence, deputy finance ministers of G-10 countries met in Paris on September 3rd, and finance ministers in London from September 15th through 16th.[860] At both meetings US position was again that it does not have a particular plan how to resolve the situation. It has presented the calculation targeting trade measures, and adjustment in the non-hegemonic states' monetary policy, which would lead to 13 billion US dollars check, while non-hegemonic states countries argued in favor of measures of only 2-3 billion US dollars on their end.[861] The non-hegemonic states stressed that both sides should adjust – United States should depreciate, while the non-hegemonic states appreciate.[862] Yet, both meetings ended

[858] European markets were closed on 16th August and remained closed throughout the whole week, see Gerald R. Ford Library, Papers of Arthur Burns, Box B54. Chronology of Official Actions taken Abroad since August 15th that have affected the Foreign Exchange Markets, 1971. Furthermore, European countries hardly agreed on a common action, German proposal of limiting exchange bands to 1.5% (see Memorandum from Herb Stein to President Nixon, Monetary and Financial Developments, Box 15, August 20th, 1971. Bentley Library, Papers of Paul McCracken). They were caught off gourd as they saw the administration as asleep on the issue and were genuinely afraid what future holds, especially if the American measures were tightened even further (see Historical Archives of the European Commission, Brussels: Commissions of the European Economic Community, 3–1978 556, August 19, 1971, Telex from European Commission Liaison Office Washington D.C. to European Commission; Historical Archives of the European Union, Florence, Papers of Robert Triffin, Box 24–25, draft of article, "The Community and the World Dollar Problem," August 28, 1971.

[859] Bundesbank deputy Otmar Emminger said that at the August 16th meeting in London, he was also impressed by the comprehensiveness of the Nixon's New Economic Policy, see Memorandum of Conversation, London, August 16, 1971. Such a view was also expressed by Nixon and Connally on 7th September, see Nixon tape conversation, No. 8–42, and Burns, see Nixon tape conversation, No. 577–3.

[860] Also, in September, US Congress returned to session and criticized Nixon for the unilateral action, which should be done through legislative body (Nichter. 2015. Pp. 70).

[861] James. 1996. Pp. 223−4. US proposal would mean that Yen and Mark would have to appreciate for 24% and 18% respectively. See, Irwing. 2012. Pp. 15. The number 13 billion was based on Department of Treasury study, see Paper Prepared in the Department of the Treasury, Washington, September 10, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d76 (15 December 2020).

[862] See, Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, September 6, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic*

inconclusively.[863] However, all non-hegemonic states were ready to have bilateral talks with United States.[864] For example, Germany was eager to express the preference for free floating exchange rates, as there were only two alternatives for them – inflation or impose controls. The latter is what the French wanted,[865] but not the Germans, since it would hamper economic growth.[866] Thus, Connally and Schiller issued a statement parallel to the September G-10 meeting that supported freedom of capital movements. The split between the French and Germans made things worse for the British, which was entering the European Community and hence overwhelmed with finding its way in the politics of this entity.[867] "We are particularly badly placed to complain

Policy, International Monetary Policy, 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d174 (15 December 2020). See also Telegram From the Embassy in the United Kingdom to the Department of State, London, September 17, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d175 (15 December 2020).

863 Kissinger. 1979. Pp. 956−7. Volcker even recalls references to 'the outrageous demands of the Americans' (Volcker and Gyohten. 1992. Pp. 82).

864 Frasher, Michelle. 2013. *Transatlantic politics and the transformation of the international monetary system*. London: Routledge. Pp. 74−7. Karl Schiller (German economic minister) warned that without a settlement, European nations would enact their own import tariffs in response to the American actions, while other Europeans also argued forcefully that an effort to return to fixed parities should occur as soon as possible. See, Telegram From the Embassy in the United Kingdom to the Department of State, London, September 17, 1971. These multiple bilateral relations were tailored to each state individually in scope and topics (trade, monetary relations, military arrangements etc.), see, Information Memorandum From the President's Assistant for International Economic Affairs (Peterson) to President Nixon, Washington, December 10, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001b. *Foreign Relations of the United States, 1969-1976, Vol IV, Foreign Assistance, International Development, Trade Policies, 1969–1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v04/d260 (15 December 2020).

865 De Vries. 1976. Pp. 543−51. French wanted to preserve existing fixed parities with capital and trade controls. The French were also the biggest opponents and critiques of US measure. They have concluded that Nixon's actions were "contrary to the International Monetary Fund, to GATT, and to the norms of trade." See, Conférence de presse de Pompidou, Palais de l'Elysée. Transcription de la sténotypie, September 23, 1971. Centre d'accueil et de recherche des Archives Nationales, Papiers des Chefs de l'État, Présidence de la République, Georges Pompidou (5 AG 2), 660.

866 James. 1996. Pp. 224.

867 Nichter. 2015. Pp. 84. See also Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, September 6, 1971. "The Common Market is locked in a stalemate between France--which opposes any revaluation of the franc because it feels its weak competitive position cannot stand it, and which continues to demand that the dollar be devalued vis-a-vis gold (thereby increasing the value of French gold reserves)--and Germany, which wants the Common Market to float against the dollar." On September 25th meeting between Schiller and Connally, Germany reiterated this position, and was predominately concerned with its relative position towards other non-hegemonic countries, particularly, France. It was interested in knowing if 10% appreciation of the Mark is enough for United States. See, Memorandum of

about the import surcharge: because we put one on ourselves /in 1964/ ... it is in these circumstances that a US import surcharge and a float are probably about as good a deal as we are likely to get."[868] The least concerned with a solution was Japan that "opposed any meaningful change in /its status quo/ policy, confident /that this/ was in Japan's best long-term interests, and confident they could weather the storm of international criticism through skillful manipulation of international elite and public opinion."[869] Interestingly, in preparation for the meeting with Japan,[870] Kissinger stressed the objective of the United States for a new IMS, which he soon changed (mid-September) and consequently also the administration: "How much revaluation of the yen did we want? /…/ Had the President ever been given the opportunity to decide whether we wanted a monetary system based on fixed exchange rates or one based on floating rates? The President didn't just want to patch up an old system. If possible, he would like a good new one."[871]

At the same time, United States refused to include or work through the IMF.[872] Therefore, the IMF took its own initiative and proposed a new peg of the US dollar at the end of August

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Conversation, Washington, September 25, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d181 (15 December 2020).

[868] National Archives, Papers of the Foreign and Commonwealth Office, 49–337, Implications of President Nixon's Measures, September 23, 1971.

[869] Angel, Robert C. 1988. Explaining policy failure: Japan and the international economy, 1969–1971. *Journal of Public Policy*, 8(2). Pp. 175−94. At Pp. 190. Moreover, at its bilateral meeting with United States on September 10th, Japan was in favor of reforming the exchange rates, but not as much removing their trade barriers and subsidies that generated big trade balance surplus with the United States.

[870] On this see, Memorandum From Secretary of State Rogers to President Nixon, Washington, September 1, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d74 (15 December 2020), where Nixon is reminded that the Japanese like to be told what to do but like to be publicly pressed to do so. Which was exactly Connally's approach later at the meeting on September 10th.

[871] National Archives, Record Group 59, S/S Files: Lot 80 D 212, National Security Study Memorandum 122.

[872] See Kahler, Miles. 2005. The United States and International Monetary Fund: Declining Influence or Declining Interest? In Karns, Margaret P., and Karen A. Mingst (eds.), *The United States and multilateral institutions: Patterns of changing instrumentality and influence*. London: Routledge. Pp. 62−77. At Pp. 69.

1971.[873] However, no one paid much attention to it.[874] Moreover, United States as well as the non-hegemonic states preferred to have free floating exchange rates until they reach an agreement themselves than to accept the IMF proposal.[875] As such, in September some commonalities between the hegemon and non-hegemonic states crystalized: they preferred to deal with the issue bilaterally, not in a multilateral setting; they would rather have free floating exchange rates than to follow IMF parity proposal, and both sides wanted to maintain US dollar centrality. Similar reservations as the administration had towards International Organizations, so too it was unwilling to further politicize these decisions in domestic settings. Namely, throughout the course of the fall 1971, considerations about when and if to seek Congressional approval also took place. Connally thought that such action is unnecessary, and Volcker also downplayed such need at the hearing before the Subcommittee on Foreign Economic Policy of the House Foreign Affairs Committee on September 21st.[876]

Although US exports surged,[877] fears grew in the administration that if there is no deal then the non-hegemonic states could retaliate with protectionism, and most significantly stop using US dollar as the global central monetary unit.[878] On September 9th, Nixon met with Connally to discuss

[873] De Vries. 1976. Pp. 541.
[874] Nixon met with IMF Managing Director Pierre-Paul Schweitzer on September 29th and the couple exchange pleasantries with no indication of policy direction. See, Nixon tape conversation, 580–5. Nevertheless, after this meeting was over, Nixon, Haldeman, and Kissinger met and openly stated that Schweitzer is "no friend". Nixon even states: "/H/e's been pissing on us". The group agrees that United States should always act in its own self-interest. See, Nixon tape conversation, 580–13.
[875] De Vries. 1976. Pp. 542. This was made explicit in the two of September meetings, were United States proposed a floating exchange rates regime as there could not be any agreement, and the non-hegemonic states did not dismiss it. See, De Vries. 1976. Pp. 550.
[876] Richard M. Nixon Library, White House Central Files, Staff Member and Office Files, Papers of Paul W. McCracken, Box 10, Statement of Paul A. Volcker before Subcommittee on Foreign Economic Policy of the House Foreign Affairs Committee, September 21, 1971.
[877] Charles Colson (Special Counsel to the President as well as Director of the Office of Public Liaison) attributed this to the surcharge, but McCracken was more cautious. See Nixon tape conversation, No. 603–7.
[878] On August 31st, Volcker Group met and discussed options to put forth to the president that would include how to achieve that the US dollar remains a reserve currency, nature of the convertibility if the US dollar, what is the future

how to proceed. Connally proposes a renegotiated fixed exchange rates in order to prevent retaliation using tariffs by the non-hegemonic states. He stresses that the issue has broader national security implications. Interestingly, only Volcker, who was reluctant to close the gold window in the first place, now supported that markets should regulate thee exchange rates. Nixon concludes with a decision that he will oversee the creation of a common position and activities of State, Commerce, and Treasury departments. Most telling evidence that the administration understood the signal from the non-hegemonic states and that it also understood the role it needs to play now in order to preserve its hegemony and satisfy its interest when Nixon states that political interests are more important than economic, to which Connally responds: "It's not about money anymore."[879] Subsequently, on the same day Nixon meets with Kissinger,[880] and from now on economic advisors had lesser influence on the matter than leading to the Nixon Shock.[881] Nixon and Kissinger[882] share the position, which was also one of the non-hegemonic states, to negotiate

role of gold, and how to get more convertibility. See, Memorandum From Deane R. Hinton of the Council on International Economic Policy Staff to the President's Assistant for International Economic Affairs (Peterson), Washington, September 1, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d173 (15 December 2020).

[879] Nixon tape conversation, No. 568–9. An important contribution to this development was also Peterson's call for a crystallization of US positions, see Memorandum From the President's Assistant for International Economic Affairs (Peterson) to President Nixon, Washington, September 20, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d177 (15 December 2020).

[880] Nixon tape conversation, No. 568–12.

[881] Illustrating that United States was aware that the crisis is political not economic, Kissinger said to the Japanese ambassador on August 21st that knew nothing about economics and thought economic leaders were usually 'political idiots' (United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 169).

[882] However, after receiving several memos (from Robert Hormats of the National Security Council staff) arguing that the surcharge was not powerful enough to achieve the exchange rate adjustments, the trade concessions, and the increased burden sharing that Connally desired, Kissinger (1979, 955-56) "grew concerned about the unsettling impact of a prolonged confrontation on allied relationships." See e.g., United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 484–5; Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, September 6, 1971; National Archives, Nixon Presidential Materials, National Security Council Files, Agency Files, Box 218, Council on International Economic Policy, Memorandum From Hormats to Kissinger, September 11, 1971; Information Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, September 28, 1971. In United States Department of State, Duncombe,

bilaterally.[883] Peterson and Connally were tasked to negotiate with the Japanese. Moreover, Nixon also specifies that he wants one negotiation and policy team on the matter composed of Connally, Kissinger, and Shultz.[884]

By the end September 1971 Nixon was persuaded that United States needs to be more active and he also did not rule out renegotiating the fixed exchange rates. This was not easy as the US government was divided on the issue. Shultz and Dam note[885] that the Federal Reserve,[886] the State Department, and the National Security Council wanted to maintain fixed rates, while the Treasury Department, the Council of Economic Advisers, and the Office of Management and Budget wanted to move to floating exchange rates so that domestic policies would not be constrained by international considerations. Furthermore, positions also diverged on the question of surcharge. Connally was of opinion that the impact of the surcharge would increase over time, while National Security Council believed the opposite, to the extent that it can even permanently damage US trade and other foreign relations.[887] Such reports caused Nixon to lean on the side of a patchwork reform was the possibility of the economic stalemate impacting 1972 elections as well his security policy – détente.[888] However, even with this turn, the administration did not lose its ultimate objective that it is the non-hegemonic states that need to contribute more to global

Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d182 (15 December 2020).

[883] Nixon also said to Burns and Connally: "Darn it, they must not think that they now have a soft touch here. We have got to play a very hard game." (Nixon tape conversation, No. 570–4)

[884] Nixon tape conversation, No. 568–12.

[885] Shultz and Dam. 1977. Pp. 119.

[886] Even in mid-October, FED produced a paper arguing in favor of SDRs taking greater role to assist US dollar with fixed exchange rates. See, National Archives, Record Group 56, General Records of the Department of the Treasury, Box 19, Volcker Group Papers, 1971, Robert Solomon, A Reformed International Monetary System Based on SDRs, October 19, 1971.

[887] See, e.g., Information Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, September 28, 1971.

[888] See Irwing. 2012. Pp. 21.

governance (adjustment) if the IMS were to be based on fixed exchange rates. Shultz put it bluntly in an interview: “Santa Claus is dead”.[889] The problem with Connally’s strict approach was that it was very “effective at telling the Europeans what the United States would not accept, but he offered very little in the way of what he would accept.”[890]

Furthermore, United States did not put forward any compromise proposal.[891] Connally’s multiple trips were marked by his hard position that he made at G-10 meeting in mid-September – appreciation of the non-hegemonic states of about 20%.[892] Yet, it was not only the harsh US position that bothered some within the administration, nor Connally’s strategy, but rather his rigid approach, which is not to be equalized with toughness. For example, Peterson told Kissinger on September 17th that this is causing problems with the Europeans that may spill onto other issues.[893] Kissinger also shared these concerns with Nixon when Connally was away for an IMF meeting on 30th September: “the Texans really don’t have the diplomatic touch.”[894] Similar conversation took place between Shultz and Kissinger, where Shultz point out that Connally’s tough negotiations are causing problems in other issues: “Connally has seized all power but doesn’t know how to exercise it.”[895] Until Nixon realized the problem, Kissinger approached the matter diplomatically, saying

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[889] Bonafede, Dom. 1971. White House Report: Peterson Council Helps Shape International Economic Policy. *National Journal*, 46. Pp. 2238–48.
[890] Nichter. 2015. Pp. 82.
[891] Even Burns agreed with Connally’s ‘do nothing’ strategy, as he called it ‘tactical stubbornness’. See Nixon tape conversation, No. 577–3.
[892] Burns, again, agreed with this, since he thought that depreciating US dollar to the gold would reward the bad guys – South Africa, the French, and the Soviets. However, he did propose a more moderate appreciation for the non-hegemonic states ten to fifteen percent. See Nixon tape conversation, No. 577–3. Since Burns was a supporter of fixed exchange rates, his proposal may be understood as more realistic and indicates that Connally’s position was indeed on the extreme end.
[893] Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 11, September 17, 1971.
[894] Nixon tape conversation, No. 582–9.
[895] Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 11, September 29, 1971.

to Connally: “Did anyone ever tell you, you are a mean negotiator?”[896] Also Volcker, who worked with Connally as his Under Secretary, was by the end of October of opinion that hardball tactics can jeopardize the IMS reform.[897]

Regarding the aforementioned IMF meeting at the end of September, Connally met with Nixon on September 20th to brief him about previous meetings.[898] They concluded that the non-hegemonic deserve a carrot for their ‘buy-in’ and to avoid ill temper, which came in a proposal of a removal of the import surcharge if other states dismantled their trade barriers.[899] Yet, Nixon and Connally agree that the latter should only be allowed to talk about the surcharge, not the exchange rate – the most important open issue. They continue by looking at the non-hegemonic states and their bilateral negotiations, how to tailor US position in each of them.[900]

Also, on September 20th, Nixon met Burns, who has understood the will of the president for expansionary monetary policy and is now bluntly trying to leverage that to becoming more influential when it comes to administration’s policies by serving as a track two secret diplomacy channel through the central banks.[901] He intervenes against Connally: “There's something else,

896 Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 11, October 1, 1971.

897 Volcker and Gyohten. 1992. Pp. 83.

898 Nixon tape conversation, No. 576–8.

899 Leeson. 2003. Pp. 138.

900 Nixon tape conversation, No. 576–8.

901 Nixon tape conversation, No. 577–3. The two also met the next month, October 29th, where Burns again tried to break int the Nixon’s administration as the person who would negotiate the new international monetary architecture with the other central banks. See Nixon tape conversation, No. 607–11. Nixon only agrees to the extend as a means of finding what the other countries really think and what are their positions (Nixon tape conversation, No. 577–3). Between the two meetings Burns send a report to Nixon saying that the French were willing to appreciate 5 or 6%, while the Japanese 15%, and the Germans 10%. See Letter From the Chairman of the Board of Governors of the Federal Reserve System (Burns) to President Nixon, Washington, October 14, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government

Mister President. I'm not sure Connally's your best negotiator here. He doesn't understand foreigners. And he now has, now there's a certain opinion that the Europeans have formed of him, you see. And the opinion, I think, has two dimensions: First, he's very tough, and that's good. Second, he doesn't understand us, and that isn't good."[902] He also stresses that exchange rates regime is not the main concern of the Europeans, what United States should seize to make a deal.[903] Burns also proposes to devalue US dollar to help the non-hegemonic states to appreciate more and faster: "There is no reason in the world why we shouldn't help them deal with their problems by raising the price of gold, from thirty-five to thirty-seven." Nixon understands this but his concern is how to link the economy with political question: "What is involved here are great political forces and movements, and we've got to try link economics with the politics. It's got to be linked. ... The question is how do you rationalize these things? ... We don't want to move too quickly." On that note, Burns suggest to bring-in Kissinger as advisor on political dimensions.[904] Finally, Nixon met Kissinger on the same day.[905] Kissinger suggests that through the network of bilateral negotiations, United States should prevent European unification[906] and he agrees with Connally's idea of

Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d183 (21 December 2020).

[902] Nixon tape conversation, No. 577–3.

[903] Burns runs through the crucial states: "I don't know what to think about the French. I explained that if we tried to restore convertibility, the whole thing could blow up in a few days. They're not going to cause any trouble on that issue /…/ The British no longer have any political dependents, because they are entering the Common Market, and they have got to play with the Europeans. The Germans are, well, privately they tell me they are with the United States, and for a while I think that's true. Whether that will be their permanent policy or not I don't know" (Nixon tape conversation, No. 577–3).

[904] Nixon tape conversation, No. 577–3.

[905] Nixon tape conversation, No. 577–8.

[906] Nixon stated this also to Burns and Connally on September 11th: "/…/ split them up, don't let them get together." (Nixon tape conversation, No. 570–4). He also commissioned a study on how to leverage the current position of the US dollar in the favor of United States, see Action Memorandum From the President's Assistant for National Security Affairs (Kissinger) and the President's Assistant for International Economic Affairs (Peterson) to President Nixon, Washington, September 20, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d176 (15 December 2020).

offering to end the surcharge,[907] but he conditions it to the free-floating exchange rates. Nixon is concerned: "The difficulty is the surcharge, Henry, is so popular domestically, we just can't end it until we get something for it. That's the, hell, the surcharge is supported by 85% of the people. Good God, you just can't give it away."[908]

The latter attests that moving towards 1972, Nixon was ever more concerned with domestic considerations and forthcoming elections. On 11th September, the president met with Burns and Connally, where he said:

> "Between now and the election in November /1972/, there must be one paramount consideration. And that paramount consideration is not the responsibility of the U.S. in the world ... it isn't the fact that in foreign /policy/ we've done this, that, or the other thing. The main thing is that we have to create the impression that the president of the United States, finally, at long last, after twenty-five years with blood, sweat and tears, is ... looking after its interests."[909]

On 24th September Friedman visited Nixon and warned him of inflationary threat. For five weeks wage and price controls provided an illusion of price stability and expansionary fiscal and monetary policies would in such setting have a devastating effect (inflation and unemployment):

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907 The surcharge was the measure that hurt the non-hegemonic states the most. Irwing calculated, while controlling for dock strikes, that it reduced dutiable imports into the United States by about 2 percent (Irwing. 2012. Pp. 31). Looking at the share of total exports to the United States subject to the surcharge Japan was exposed about 30%, while European nations only 10% (Irwing. 2012. Pp. 33–5). Subsequently, it also does not come as a surprise that three days after the Nixon Shock, the chairman of Japan's Chamber of Commerce called for the appreciation of the Yen as preferred to the continuation of the surcharge (Angel. 1991. Pp. 129). Moreover, this further explains why United States demanded that Japan appreciates mora than Europeans, which is also reflected in the first papers produced by US administration after August 15th. They have targeted the question of Japan – Where is Japan going?; What kind of Japan do we want?; How do we get it to go there?; and What are the costs? They also explored the Possibility of a looser relationship with Japan and Its consequences. E.g., National Archives, Record Group 59, S/S Files: Lot 80 D 212, National Security Study Memorandum 122. See also United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 171–2.

908 Nixon tape conversation, No. 577–8.

909 Nixon tape conversation, No. 570–4.

"Now on the domestic side, there are two questions or problems. One is the technical problem of how you unwind the price control. But I think there is a more fundamental or basic problem. The great danger lies in the path we are now on, is that, under cover of suppressing the inflation, the true inflationary forces will be increased. That's the real danger. /Congressman would like to spend more/ The same danger /is/ with the Fed. /…/ Now from your point of view and our point of view, we want to look forward, not only to '72, but beyond that. We don't want, we all want a victory in '72, but we don't want a victory which has to be followed by a course of action that puts the Democrats in power for 20 years. /…/ If you let the inflationary pressure build up over us, we might be able to hold it down at least through the election. After this, you'll have a great upsurge in inflation. /…/ You'll have to have an even worse recession. Now that's a horror story."[910]

Nixon did not heed his advice in its entirety, and Friedman was proved right in the mid-1970s recession. Thus, FED continued with lowering interest rates in 1971.[911] Nevertheless, Nixon now did want to reach an international agreement that would allow him to suspend the imposed freezes. Hence, a position that it was better to propose cosmetic changes to the existing system – rearrange the parities – became a standard in the administration.[912] Furthermore, United States was now ready to accept a new par value system, if it was negotiated on their own terms, not presented by the IMF.

Strengthening the course that the United States was heading towards i.e., removing the surcharge and re-setting the gold peg, as well as pointing out the political benefit of doing so under the 'buy-in' behavior of the non-hegemonic states (it costs United States nothing, but it avoids prolonging negotiations, uncertainty, and potential retaliations), was the aforementioned Friedman's visit to Nixon, where he also stated:[913]

[910] Nixon tape conversation, No. 578–5.
[911] More on this, see Abrams. 2006.
[912] Irwing. 2012. Pp. 19−21
[913] Nixon tape conversation, No. 578–5.

> "It's very simple, purely political. You're a central banker in France, and you stand up in Parliament ... one says to you, 'are you on the dollar system,' 'are you a satellite of the U.S.?' The central banker likes to say, 'no, we're on a gold standard.' That's a hundred percent of the whole reason. It's to provide a political achievement at home, because in fact, changing the price of gold or leaving the window closed has no effect. It makes no differences whether we don't sell gold at 35 dollars an ounce, or we don't sell it at 38 dollars an ounce. From their point of view, they can maintain the fixed rate, that gold has a role to play, and they can say to their politicians the U.S. contributed to this change. In a way, it's very tempting to do it, because it costs us nothing /even if it means going to Congress/."

Throughout October 1971 negotiations continued as well as the US cosmetic position of using surcharge as a tool and not wanting to open the question of exchange rates.[914] However, the non-hegemonic states were also concerned with their bilateral exchange rates among them. For example, "Germany did not want to lose competitiveness visà-vis its European trade partners and therefore did not want to agree to a formal revaluation of the mark unless other European currencies were revalued as well."[915] "The Bank of Japan and the Ministry of Finance are reported as resisting /revaluation of the yen/ pressure on the grounds that Japan should wait for further multilateral movement. Government officials believe any unilateral action to revalue the yen now would be treated by others merely as an opening bid."[916] In mid-October stock markets were off somewhat and Haldeman suggests that it is the growing international concerns to be blamed for

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[914] Connally insisted that the surcharge "is going to stay on for awhile because it frankly is to our advantage to keep it on for awhile" (Solomon 1977, 199-200). Also, he slightly softened his stance, to demand a 20% appreciation of the Yen and 15% for the Mark. He also hinted that countries that would appreciate, would also have their surcharge lifted. (Irwing. 2012. Pp. 20). Nevertheless, this did not generate results, since divisions within the US administration became known to the non-hegemonic states and that as well contributed to the lack of success of these negotiations in October, see e.g., Note de M. Bellard (Directeur des Services d'Information et de Presse du Ministère des Affaires Etrangères. Conférence de presse de Pompidou, Palais de l'Elysée, October 14, 1971. Centre d'accueil et de recherche des Archives Nationales, Papiers des Chefs de l'État, Présidence de la République, Georges Pompidou (5 AG 2), 117.

[915] Irwing. 2012. Pp. 20.

[916] Memorandum From the Executive Secretary of the Department of State (Eliot) to the President's Assistant for National Security Affairs (Kissinger), Washington, September 24, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d178 (15 December 2020).

it.[917] Meanwhile stage is set for internal reordering of the administration that took place later in 1972. Namely, Nixon meets with John Ehrlichman, his Domestic Affairs Advisor, on 23rd October, where they have discussed how much they trust and what should be their future positions in the administration. Volcker and Peterson come first, both of whom Nixon tries to undermine. Ehrlichman amplifies that by stressing that Volcker has lunch with Burns, of whom the president has his doubts. They intend to set Peterson aside by making him Secretary of Commerce, what he eventually became in 1972. Nixon agrees that Connally has many qualities, but that he lacks economic knowledge. He praises Shultz: "Shultz is the key to this. He knows more than Connally or Peterson...Neither Connally nor Peterson knows a hell of a lot about it." Eventually in 1972 Shultz would take over for Connally, while the latter would help with the re-election.[918]

Hence, most important in clarifying and uniting of the US position were the meetings at the end of October 1971 and early November.[919] On 25th October, Nixon was still determined that he does not want to peg US dollar to the gold again: "I'll be damned if we will raise the price of

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[917] Nixon tape conversation, No. 599–6.
[918] Nixon tape conversation, No. 601–33.
[919] This process begun with the aforementioned study commissioned by Kissinger on September 20th, and it was delivered by Peterson on September 24th, see Memorandum From the President's Assistant for International Economic Affairs (Peterson) to the President's Assistant for National Security Affairs (Kissinger), Washington, September 24, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d179 (15 December 2020). This paper stressed two types of goals – immediate and long-term. The first should be negotiated before Christmas of 1971 (surcharge), while the second can take longer (IMS). It also presents the level of desired appreciation of the non-hegemonic states (10%). The paper presents the objective for the phase one deal where Untied States should accept US dollar gold peg if others appreciate to their desired levels. This is what later happened with the Smithsonian Agreement. On October 25th, the Volcker Group was tasked to start debating the second – IMS – phase of negotiations. See, Letter From the President's Assistant for International Economic Affairs (Peterson) to the Under Secretary of the Treasury for Monetary Affairs (Volcker), Washington, October 25, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d184 (15 December 2020).

gold like Arthur /Burns/ wants."[920] Shultz proposed that the surcharge be lifted for every state that floats their currency, to what Nixon does not respond favorably but tells Shultz that they need to get more aggressive in resolve int international monetary crisis.[921] On 26th October, Nixon said to Connally and Shultz: "/S/crew the French and the British, all the way."[922] Ironically, it was both hard-liners, Connally and Shultz, that at this point warned the president that the longer the surcharge is maintained the more likely the retaliation[923] and more importantly, an agreement among the Europeans.[924] This is a stark contrast to September Connally's position that "we would break the European Common Market, the Community!"[925] However, this further pushed Nixon to become more flexible. It became apparent that France was the crucial state for the deal to be made, since the Germans did not want to appreciate officially if the same was not done by the French as well.[926] And the French were not affected by the surcharge, so Nixon understood that he needs to become more flexible:[927]

> "The surcharge provides little leverage against France, and France does not abhor the trade wars and bloc formation which could develop. We can therefore achieve an effective French revaluation only by devaluing the dollar /…/ The United States should agree to devalue the dollar against gold by 5% to 8% if the following

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[920] Nixon tape conversation, No. 304–17.
[921] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 521.
[922] Nixon tape conversation, No. 303–9.
[923] Denmark announced in October that it will impose a 10% surcharge on imports (Irwin, 2012. Pp. 20).
[924] Nixon tape conversation, No. 303–9.
[925] Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 11, September 7, 1971.
[926] Memorandum From the President's Assistant for International Economic Affairs (Peterson) to Secretary of the Treasury Connally, Washington, October 26, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy, International Monetary Policy, 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d185 (15 December 2020). In this memo, Peterson also posed an important question to Connally: "If we get an average realignment of say 10-11% with a gold price change and 5-6% without it, are the benefits of the larger exchange rate realignment worth the costs of a gold price change? Can we devise ways of affecting a gold price change that minimize the costs and risks (political, implied movement toward gold and convertibility)?"
[927] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 520. This analysis was done by Peterson and send to Connally on 25th October was what essentially happened in December.

> monetary conditions are met: 1. Simultaneous revaluations of at least 10% by Japan and 5% by Germany, leading to effective exchange rate changes of at least 15%-18% for Japan; 10%-13% for Germany; and 5%-8% for France, Italy, Britain (hopefully)."

On 28th October, all key advisors met with Nixon (Burns, Connally, McCracken, Shultz, Peterson, Kissinger).[928] Peterson urged the president to take advantage of the non-hegemonic 'buy-in' and make steps towards their position before this political capital goes away. He pointed out that the French president Pompidou said to him that they would allow the US dollar to depreciate against the Frank, but they would not allow the Franc to appreciate relative to gold. The rationale was rather simple and logic. The French government had in previous years urged people to invest in gold as a hedge against inflation, and now facing appreciation, this could reduce this value, and subsequently cause problems at the elections. Thus, Peterson proposed an agreement that would lift the surcharge for any country that would allow its currency to appreciate against the gold. This, however, would not be favorable in Europe, where countries are looking for concessions on trade, particular in agricultural sector, where France had its eyes on. Nixon was reluctant since he needed US agricultural votes in 1972. It became obvious that France was the most difficult to please or put pressure on since their trade with the United States presented only 4% of their trade, therefore, Nixon stated: "There's not a hell of a lot we can do for the French, or to them."[929] Since France wanted the price of gold to stay the same in Francs, this required a slight depreciation of US dollar in terms of gold. Burns believed that moving from 35 US dollars to 37 US dollars an ounce may suffice. Connally opposed and proposed to negotiate with everyone but the French, which would change their mind. Furthermore, he even proposes to sell the US gold reserves to flood the market

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[928] Nixon tape conversation, No. 606–2.

[929] A month earlier, September 11th, Nixon was more explicit regarding the French: "The French are selfish bastards." (Nixon tape conversation, No. 570–4).

and thus devalue its value: “Tell Pompidou and his people, 'You like gold? We're going to have plenty of it for you. Because we're going to unload it'.” Peterson calms things down and says that United States should instead convince the French that maintaining the US dollar gold parity is already concession to France. Furthermore, in his conversation with D'Estaing they have already talked about 5% or 6% appreciation of the Frank,[930] which Peterson thinks, they can push to 7% or 8 %. He also points out that each percentage point that US dollar depreciates contributes to about 800 million US dollar improved balance of trade. Finally, Peterson states that if there is no deal, there will be foreign policy problems with Europe. Then, Shultz takes the stage and frames different positions into a coherent negotiation objective: fixed exchange rates with new parities, ending convertibility for two years, removing trade barriers, reducing the role of gold, and ending the dollar’s position as the sole vehicle currency. Therefore, United States was again ready to put on the line the centrality of the US dollar and its hegemony, if that was what it took to assure its interest. These objectives would still be better than potential trade war that would spill into financial war have no agreement be reached. The latter was clear to everyone. Nevertheless, Connally objects and Nixon partly backs him up stating: “We all know that the monetary situation is going to mean a hell of a lot more, but trade issues matter more domestically /.../ The United States has always allowed itself to get kicked in the teeth without getting anything in return.”[931]

The next day Nixon meets with Kissinger and told him to work closely with Shultz.[932] Connally’s hard stance slowly draw him out of the most inner circle of the president. After all, Nixon was a pragmatist, and he liked what Shultz and Peterson had to say the day before. Nixon

[930] See Letter From the Chairman of the Board of Governors of the Federal Reserve System (Burns) to President Nixon, Washington, October 14, 1971.
[931] Nixon tape conversation, No. 606–2.
[932] Nixon tape conversation, No. 607–4.

instructed Kissinger: "/Y/ou and Shultz sit down and try to come up with a way that we can try to play the political and monetary game together." Kissinger took a swing at Connally' reluctance to negotiate, and he tweaked his argument in the same manner as Connally always has – domestic politics: "The Europeans will raise Cain, and the Democrats will say that we've thrown away all our friends."[933] On October 30th, the couple met again.[934] Kissinger made an effort for the president to be more active in resolving the international monetary question. He reiterated the risks of retaliation if the surcharge is maintained. Nixon is ready to lift it with Canada, Latin America, and Japan. He also would do the same with Germany to draw a wedge between European states. Lastly Kissinger agrees that average American only cares about trade issue, but: "If you can go into the election as the man who created a new system of international finance, and at the same time trade has improved somewhat, that would be the best possible outcome."[935]

Hence, by November 1971, Nixon was determined that he wants to reach a deal not only regarding the surcharge and trade, but also regarding the IMS.[936] Kissinger confronted Nixon on Connally and the severeness of the situation on November 11th: "/I/f we screw everybody in this free world, and force them to surrender, we are going to give them an incentive to organize ... we will then undermine the whole structure of free world cooperation /…/ You can still drive a very

[933] Nixon tape conversation, No. 607–4.
[934] Nixon tape conversation, No. 609–11.
[935] Nixon tape conversation, No. 609–11.
[936] Still, his instruction to his team is that they should not reveal to the non-hegemonic states that they are ready to compromise on the IMS. Nixon thinks this will hurt their position: "I believe it is essential that there be no further speculation within the Administration which might get into the press or into foreign circles with regard to changing the price of gold or a return to some form of convertibility. Our planning at this time should proceed on the assumption that we are not going to move in that direction." See, Memorandum From President Nixon, Washington, November 2, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d189 (21 December 2020).
[936] Nixon tape conversation, No. 615–8.

hard bargain. But give them the sense that they are participating in the decision."[937] Connally was making efforts to stall things, while Nixon send Kissinger to persuade him to change his mind on his strategy moving forward: "I want you to say that: that our policy regarding this international thing was right. We should have done this. They were screwing us. Sympathize with him on that, but then say, 'Now, how do we work it out?'."[938] Moreover, the non-hegemonic states were willing to negotiate, also Europeans, as well as kept their monetary and financial activities with the US dollar. But time was running short.[939] Nixon received a similar warning regarding Connally on November 15th from Peterson, ho conveyed the concerns also from the non-hegemonic states.[940] Nixon did not want to send mix signals, so he ordered that the amendment to a bill in the House of Representatives that would allow him to impose quotas or surcharges in 'balance of trade

[937] Nixon tape conversation, No. 298–5. Leading to that meeting, Kissinger was briefed that: "Secretary Connally seems to have departed from what many had perceived to be a more "cooperative" line. Last week in San Francisco he told the American Bankers Association that the surcharge "is going to stay on for a while because it frankly is to our advantage to keep it on for a while." The Europeans, Canadians, and Japanese, as the result of this and other such statements, increasingly believe that the U.S. is unwilling to cooperate with them to bring about conditions for removal of the surcharge. And there are indications that they feel that even if they are forthcoming, the U.S. will maintain an unreasonable posture and retain the surcharge indefinitely." See, Information Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, November 1, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d188 (21 December 2020)).

[938] Nixon tape conversation, No. 618–11. Kissinger met with Connally the same day and the latter became rather defensive in that he claimed that he is being cut out from the inner circle. See, Nixon tape conversation, No. 618–26. That may be the case ideationally, but politically Nixon still considered Connally as very close advisor.

[939] For example, American Ambassador to Paris Arthur Watson reported: "In the last few weeks /…/ key French officials have begun to warn us that, if we do not soon indicate clearly what our terms for a settlement are, opinion will turn decisively against us, with incalculable consequences for our political interests in Europe /…/ a major effort on our part to break the present stalemate is needed." (Telegram From the Embassy in France to the Department of State, Paris, November 15, 1971, 1555Z. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d197 (21 December 2020)).

[940] "In some of these calls to me, I am asked to do what I can with yourself and John Connally to "cool it", quit the "saber rattling", and stop the "don't give a damn attitude"." See Information Memorandum From the President's Assistant for International Economic Affairs (Peterson) to President Nixon, Washington, November 15, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d195 (21 December 2020).

emergency' was removed.[941] Therefore, the initial Shultz synthesis from the end of October was updated, where the Treasury Department[942] and Office of Management and Budget[943] produced papers that stated US crucial mission and interests are fostering the dollar's role as the central international currency.

Thus, in early November, Nixon untangled the knot of internal vs. external interests of the United States, its political and economic dimensions, and had a cognitive map how to assure his personal interests of reelection in this difficult puzzle. The non-hegemonic states were reproducing the US dollar centrality and as such US hegemony.[944] He needed to meet them halfway now, so that the crisis would not prolong into the election year and that the non-hegemonic states would not stop 'buying-in'.[945] So, he wanted a deal on both fronts – surcharge and IMS. The latter would

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941 Nixon tape conversation, No. 615–8.

942 National Archives, Record Group 56, General Records of the Department of the Treasury, Department of the Treasury Central Files, 04/01/1969 – 01/24/1981, Treasury Central Files, Box 12, New Monetary System 1969-1971, George H. Willis, Over-all Goals, November 8, 1971.

943 National Archives, Record Group 56, General Records of the Department of the Treasury, Volcker Group Papers: 10, Box 9, Office of Management and Budget, An Analysis of a Dollar Standard/Flexible Exchange Rate World, November 23, 1971.

944 On November 4th in Paris, the European Countries also decided that all of them would appreciate and that they would propose such a package on November G-10 meeting. The proposal would also include 5% devaluation of the US dollar. See, Telegram From the Embassy in Germany to the Department of State, Bonn, November 5, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d190 (21 December 2020). After this agreement Emminger sends a letter to Volcker where he makes it clear that without US dollar devaluation, the negotiations will be stuck, nevertheless he reiterates the potential ranges of appreciation of the non-hegemonic states. See, Letter From the Vice President of the Deutsche Bundesbank (Emminger) to the Under Secretary of the Treasury for Monetary Affairs (Volcker), Frankfurt, November 12, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d192 (21 December 2020).

945 See, e.g., Telegram From the Embassy in the Netherlands to the Department of State, The Hague, November 15, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d196 (21 December 2020); Telegram From the Embassy in France to the Department of State, Paris, November 15, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic*

contribute to US competitiveness, assure economic wellbeing of US voters, and subsequently lead to his reelection. This cognitive process also lifted Kissinger as the key negotiator for international economic issues. The latter was appreciated by the non-hegemonic states, which in bilateral meetings expressed their concerns with Connally and appraisal for Kissinger.[946]

On November 15th, Nixon and Kissinger also carved out their idea of reaching the deal. Nixon: "Now, I don't want to go back to gold, and we can't go back to convertibility. There might be a way to give Pompidou the gold thing without giving him convertibility." Kissinger agreed and pointed out that Rowland Baring, the Earl of Cromer, the UK ambassador to the United States, and a former Governor of the Bank of England, is willing to present such a proposal.[947] Kissinger also warns that Germany is ready to appreciate against the US dollar, but not if the Frank does not do the same. Subsequently he proposes 5% US dollar depreciation and 5% Mark appreciation. Finally, they also agree how to politicize the surcharge lift for Canada with their relations towards

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Policy 1969-1972, International Monetary Policy 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d197 (21 December 2020); Telegram From the Embassy in Germany to the Department of State, Bonn, November 17, 1971, 1450Z. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d199 (21 December 2020).

946 Richard M. Nixon Library, National Security Council Files, Box 473, Memorandum From Alexander Haig to Henry Kissinger, Presidential Travel Plans, November 5, 1971.

947 Kissinger also started working to arrange the bilateral summit between Nixon and Pompidou. See United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 531–3. United Kingdom had a good sense of the situation and what is at stake. A cable from London stated: "In UK view, there are no real difficulties within Europe, rather the basic obstacle is the US and possibly Japan. If the US is prepared to move on the dollar gold price and the Japanese revalue enough to leave a sufficient DM-yen differential, the intra-European exchange rate realignment could be agreed among the Europeans fairly quickly. While Neale / Second Permanent Secretary, UK Treasury/ did not say how much differential between the DM and yen was required, he gave as illustrative figures 15 percent for the yen and 10 percent for the DM." Telegram From the Embassy in the United Kingdom to the Department of State, London, November 12, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d193 (21 December 2020).

Europeans.[948] On November 16th, Nixon met with Peterson, Shultz, Kissinger, but not Connally and stressed the importance of Kissinger taking the lead in negotiations.[949]

On November 17th McCracken urges Nixon to move on negotiations, since the economic tide might be turning in Japan and Italy, leaving them less likely to compromise.[950] Furthermore, the stalemate endangered the stability of German government, which if fell, would result in a government that would be less favorable towards the United States.[951] The next day Nixon said to Kissinger: "Connally will be the architect."[952] From November 18th through November 22nd, several papers specifying different negotiating positions, objectives, and interests of the non-hegemonic states and United States were circled back and forth among the decision-makers. These served as preparation for the G-10 meeting at the end of November.[953] On November 23rd Connally and Nixon laid out the final plan.[954] Connally was not happy about the substance.[955] "We're going

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[948] Nixon tape conversation, No. 618–11.
[949] Nixon tape conversation, No. 295–14.
[950] Nixon tape conversation, No. 619–12. See also a discussion between Nixon and Kissinger on the matter – Nixon tape conversation, No. 619–7.
[951] See Telegram From the Embassy in Germany to the Department of State, Bonn, November 17, 1971.
[952] Nixon tape conversation, No. 621–18. However, the key negotiator and the dealmaker was Kissinger, who told Burns about his deal with Nixon: "I will solve it ... and it will be close to your proposal ... you are the only sane person ... it will be 98 percent your proposal. Don't tell Connally I told you this." (Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 12, November 26, 1971).
[953] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 555–7; Paper Prepared in the Department of the Treasury, Washington, undated. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d201 (21 December 2020); Information Memorandum From Robert Hormats of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Washington, November 22, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d202 (21 December 2020).
[954] Nixon tape conversation, No. 623–3.
[955] Some days later Burns wrote that he heard Connally say: "I did not take this apart to put it back at a cheap price." See Gerald R. Ford Library, Papers of Arthur Burns, Handwritten Journals, 1969–1974, Box 1, November 26, 1971. Yet, Burns did not detest Connally only in the administration, he was not fond of Shultz and the president as well. He only trusted Kissinger but doubted his knowledge: "Here we are – Kissinger, a brilliant political analyst, but admittedly ignorant of economics; Connally, a thoroughly confused politician, suppressing his desire to punish

to be better off than we were...we're not going to get all we deserve."[956] Nixon on the other hand, understood that also by depreciating the US dollar, they can ameliorate their trade balance: "America's products are more competitive abroad." The proposal itself called for the appreciation of the Mark for 5%, Yen 10%, and depreciation of the US dollar for 5%, all relative to gold. The Frank would stay the same. Moreover, Connally proposes to hold half of the surcharge for Japan in case it does not agree.[957] The next day, Nixon presents this plan to Burns, stating that he wants to meet each ally individually.[958] Burns proposes to let the decision of parities be made at IMF, since that was its original role under the Bretton Woods IMS. Connally rejects him as well as SDRs' role stating that this deliberate decision is the result of the US dollar central role in global monetary relations.[959] Instead, he outlined US rationale for its decision: preserving the ownership of the central monetary unit.

Nixon also understood that he needed to meet and deal with the French first, before moving to other states.[960] The shift in the US will opened a window of opportunity to get France on board for the reform.[961] Thus, a meeting on the Azores islands (13th and 14th December) was arranged

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foreigners in view of the President's moving away from narrow domestic political considerations; Shultz, a no less confused amateur economist; I, the only one there with any knowledge of the subject, but even I not a real expert on some aspects of the intricate international problem! What a way to reach decisions! No one from the State Department there, no technical expert to aid us!" See, Gerald R. Ford Library, Papers of Arthur Burns, Handwritten Journals, 1969–1974, Box 1, November 26, 1971.

[956] Nixon tape conversation, No. 623–3.

[957] Nixon tape conversation, No. 623–3.

[958] Nixon also made sure that throughout the fall that Burns kept his promises of growing money supply by putting additional pressure not only from the administration, but also the private sector on him. The latter was crucial for domestic economic growth as well as satisfying international cravings for US dollars. See Nixon tape conversation, No. 619–12.

[959] Nixon tape conversation, No. 624–20.

[960] Richard M. Nixon Library, National Security Council Files, Box 55, Backchannel telegram from White House to American Embassy Paris, November 11, 1971; Nixon tape conversation, No. 623–3; See also United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 564–7.

[961] France was the crucial piece of this puzzle, since Germany was already floating its Mark and was ready to accept any meaningful solution that would enable their economic rise. United Kingdom was on the doorstep of becoming a member of the European Community, so their concerns were predominately linked to the European balance of power. See Nichter. 2015. Chs. 6 and 7.

between Nixon and Pompidou.[962] Namely, United States and France shared the position to re-fix the exchange rates. Moreover, the French also proposed that the December G-10 meeting would be postponed after the bilateral summit, and other European states agreed. Therefore, it was clear that they wanted to resolve the issues bilaterally with United States first; and that other European states would follow, and therefore, United States agreed to such plan and timetable.[963]

Leading up to the bilateral summit meeting with France[964] and subsequent G-10 summit, United States is determined to lift surcharge for Latin America, Canada, and Japan, as a leverage against Europe.[965] Furthermore, G-10 finance ministers met in Rome from November 30th though December 1st, where Connally presented a coherent American negotiating position for the first time.[966] The group dynamics of that meeting was different. "The newfound American optimism that settlement was imminent was exceeded only by French optimism."[967] McCracken reported

[962] Kissinger. 1979. Pp. 958. See also United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 531–3.
[963] Kissinger. 1979. Pp. 959.
[964] Already on September 11th, Nixon told Connally, that they should have a bilateral meeting with Pompidou, since he is the real expert (Nixon tape conversation, No. 570–4).
[965] Nixon tape conversation, No. 627–4. Connally, also asks his Canadian counterparts, Edgar J. Benson (Minister of France) and Jean Luc Pepin (Minister of Industry, Trade and Commerce), to help at the G-10 meeting facilitating other non-hegemonic states to appreciate, or even to float their currencies. See, Memorandum for the Record, Washington, December 6, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d85 (21 December 2020).
[966] See, Telegram From Secretary of the Treasury Connally to the White House, Rome, November 30, 1971, 1243Z. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d211 (21 December 2020).
[967] Nichter. 2015. Pp. 93. European countries and United States also agreed to start trade negotiations as a complement to the international monetary resolution. They first met in Brussels already on December 21st and 22nd. This indicates that the non-hegemonic states were certain of a monetary resolution already at the end of November and were aware that they need to work also on ameliorating trade relations. Both reflects their willingness to display and facilitate a 'buy-in' behavior. See, United States Department of State, Duncombe, Bruce F. (ed.). 2001b. Pp. 668–70.

that the French mood had changed as soon as Nixon had agreed to meet with Pompidou.[968] The countries were now convinced that all of them now have the political will for early solution.[969] In private Connally even conceded on convertibility, not only on the devaluation of the US dollar, which is not what Shultz and Nixon had in mind in October and November.[970] Moreover, also the British Prime Minister Edward Heath expressed his delight of the forthcoming deal, and American Ambassador to London Walter Annenberg congratulated to Connally: "The reaction around Europe is that you're pretty close to a deal. It's just a question of the president and some of the leaders putting the finishing touches on it, at least that's the reaction I get out of all the countries over here."[971]

Henry Kissinger had a secret meeting with French Ambassador to Washington Charles Lucet, in which they agreed that the forthcoming summit should symbolically settle the question of monetary architecture.[972] As anticipated, Pompidou consulted German Chancellor Willy Brandt before the summit on December 3rd. At the meeting, the French President said that the US proposal

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[968] Memorandum From the Chairman of the Council of Economic Advisers (McCracken) to President Nixon, Washington, November 24, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d204 (21 December 2020).

[969] Telegram From the Embassy in the Netherlands to the Department of State, The Hague, December 6, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d215 (21 December 2020).

[970] See the report from Shultz and subsequent clarifications – United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 582–3.

[971] Nixon tape conversation, No. 16–80.

[972] Telegram N. 7248/57 from French Embassy in Washington (Lucet), "Entretien avec M. Kissinger, December 1, 1971 (Très secret), December 1, 1971. Centre d'accueil et de recherche des Archives Nationales, Papiers des Chefs de l'État, Présidence de la République, Georges Pompidou (5 AG 2), 117.

is not problematic for Germany and Japan, but it is for France, Italy, and Great Britain.[973] However, as it turned out later in Azores and in Washington, the agreement was reached with relative ease.

At the December meeting in the Azores, Pompidou insisted on excluding finance ministers, so that he would have a *tete-a-tete* with Nixon.[974] This indicated two things: the French wanted these negotiations to succeed and they wanted to have as much leverage as possible in them.[975] Still, Kissinger was present and United States position was that they would like the French to take the lead in generating the agreement (reminiscence of Connally's 'do nothing' strategy) as well as that they take the lead in heading the European Community.[976] Both proposals were embraced by the French. On the other hand, the French did not want to accept a free float, but they would not resist a revaluation.[977] Over breakfast on December 14th, Nixon and Kissinger endure a Gaullist lecture on gold and the evils of the dollar standard.[978] Pompidou was pleased that Nixon was willing to remove the import surcharge and the job development immediately, which was the objective of the Europeans.[979] After the breakfast, Kissinger drafted the Memorandum.[980]

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973 Gespräch des Bundeskanzlers Brandt mit Staatspräsident Pompidou in Paris. In Akten zur Auswärtigen Politik der Bundesrepublik Deutschland 1971, Koopmann, von Martin, Matthias Peter, and Daniela Taschler (eds.). 2002. München: R. Oldenbourg Verlag. Pp. 427.

974 Leading to the meeting Connally advised Nixon that the United States should be willing to compromise on exchange rate flexibility and capital liberalization in order to avoid a breakdown of negotiations, although such outcome may not be the maximal interest of United States. See, John B. Connally, Monetary and Trade Issues Aiming at the Azores Meeting, December 10, 1999.71, John Connally Memos for the President, 1971, Box 7, Records of Secretary of the Treasury George P. Shultz, 02/10/1971 – 05/03/1974, Record Group 56, National Archives at College Park, College Park.

975 Kissinger. 1979. Pp. 960.

976 Kissinger. 1979. Pp. 960.

977 Kissinger. 1979. Pp. 961.

978 Volcker and Gyohten. 1992. Pp. 88.

979 Nichter. 2015. Pp. 99.

980 Paper Agreed by President Nixon and President Pompidou, Angra, The Azores. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d220 (21 December 2020). The crucial aspects of the memorandum were: United States lifting of the 10 percent import surcharge, raising the price of gold to 38 US dollars an ounce, and a band of 2.25% for currencies to float.

This agreement paved the way to the subsequent G-10 agreement a week later at Smithsonian Institution in Washington a few days later.

> "On the first day of the Smithsonian negotiations, the United States asked for 19.2 percent revaluation of the yen and 14 percent for the mark. Germany agreed to a 13.57 percent revaluation of the mark. The United States agreed to devalue the dollar by raising the dollar price of gold from $35 per ounce to $38 per ounce, an increase of 8.57 percent. Britain and France did not change their gold parity, so their currencies rose 8.57 percent against the dollar. Italy and Sweden devalued 1 percent against gold so that their currencies rose 7.5 percent against the dollar."[981]

"All of this put pressure on Japan because German officials insisted that the yen be revalued by at least 4 percentage points more than the mark, or at least 17.57 percent. The Japanese finance minister insisted that the number had to be less than 17 percent."[982] Connally agreed and United States got what it desired: US dollar remained the central monetary currency, its devaluation against the gold was minimal, the non-hegemonic states appreciated their currencies and committed to appreciate further within the much bigger band than under the Bretton Woods IMS. Nixon removed the surcharge on December 20th, during his meeting with British Prime Minister Heath in Bermuda.[983] Volcker recalls that the new system was to be defended by European countries, not by United States.[984] More specifically:[985]

> "/T/he Smithsonian Agreement the countries realigned their currency exchange rates in a revised fixed rate system; United States agreed to devalue the dollar to $38 per ounce of gold" with a 2.25% trading band for each currency for

[981] Irwing. 2012. 22. See also James. 1996. Pp. 236–8.
[982] Irwing. 2012. 22.
[983] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 599.
[984] Volcker and Gyohten. 1992. Pp. 82 and 104.
[985] Garber, Peter M. 1993. The Collapse of the Bretton Woods Fixed Exchange Rate System. In Bordo, Michael D. and Barry Eichengreen (eds.), *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*. Chicago: University of Chicago Press. Pp. 461−94. At Pp. 466.

appreciation and depreciation; meaning that an "average devaluation of the US dollar against other currencies was 10% /yet/ dollar convertibility into gold by United States was not restored, and United States made no commitment to support its dollar."

Nixon called (December 18th) the Smithsonian Agreement "the most significant monetary agreement in the history of the world" and the "most difficult in history."[986] Yet, it was neither. "It was little more than a bridge between Nixon's August 15 announcement and a longer phase of negotiations that did not conclude until 1973."[987] The agreement only codified what the markets have already established.[988] Nevertheless, it paved the way for further reduction of trade barriers across the board and enabled states to start talking about the new IMS with no pressure. Therefore, everyone understood at the time that this agreement was not revolutionary, but its rationale was situated alleviate the situation and that everyone came to terms that a new IMS was needed.[989] Thus, everyone was aware that this agreement will not last long,[990] and so they have built into the agreement the call for further negotiations on the new IMS. In the grand scheme of things, the Smithsonian Agreement served its purpose. Namely, if the Nixon Shock crystalized and catalyzed

[986] Nixon tape conversation, No. 16–114.
[987] Nichter. 2015. Pp. 98.
[988] Hence, the question was the surcharge necessary, would not closing of the gold window be enough? It may have been enough if United States had a different strategy, but in a given situation, without the surcharge, the non-hegemonic states would not be as willing to negotiate, furthermore, this may even endanger the US dollar centrality. As such, both the closing of the gold window and the surcharge were essential for crystalizing pervasive hegemony of the United States.
[989] Rogers pointed that out to Nixon already on December 2nd: "The shock treatment used to achieve this major breakthrough, however, has left bruised feelings and concerns about the future direction of American economic policy. The succession of consultations you will have can lead to a strengthening of allied relationships and create a firm basis for going on with the next stage in talks looking toward the creation of new monetary arrangements and negotiations for expansion of trade. Your talks can serve the purpose of beginning this next stage with the firm assurances that the United States, under your leadership, has no intention of retreating into an isolationist or protectionist policy." See, Memorandum From Secretary of State Rogers to President Nixon, Washington, December 2, 1971. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d83 (21 December 2020).
[990] Volcker called the Smithsonian Agreement "Bretton Woods without the gold ... I hope it lasts three months." (Volcker and Gyohten. 1992. Pp. 90).

the non-hegemonic portion of the 'buy-in' (reproducing the centrality of the US dollar) and made them understand US position, then the Smithsonian Agreement facilitated that the hegemon contributed its portion to the pervasive hegemony and made it understand that once the non-hegemonic states display the 'buy-in' the hegemon needs to follow up.[991] Hence, United States assured the provision of the US dollar, and now that both sides clearly signaled their interests, the real negotiations on the new IMS could begin.

Kissinger and Connally were instrumental in this period.[992] One can make an analogy to the gas and break paddle. One needs both that the car does not crash. If Connally served as a gas paddle, pushing for floating exchange rates, then Kissinger was the break paddle, eying the broader political landscape and the possibilities it currently offered. However, Connally's 'do nothing' strategy might have prolonged the process of reaching the agreement, yet it allowed the non-hegemonic 'buy-in' to crystalize.

5.2.2 Breakdown of the Smithsonian Agreement

The reforms brought by the Smithsonian Agreement had a short-term domestic success in United States. "In 1972, the United States enjoyed the largest real growth (5.7%) and the lowest

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[991] If there were no agreement in December, then the French were ready to use the Mark as a reference point. See, Extrait du compte-rendu de l'entretien du 13 décembre 1971 dans l'après-midi, relatif aux questions monétaires. (Nixon, Pompidou, Kissinger), December 13, 1971. Papiers des Chefs de l'État, Présidence de la République, Georges Pompidou (5 AG 2), 1022.

[992] To the point where they became myths – Nixon 1972 presidential campaign centered around his economic and monetary policies. At the Republican National Convention in Miami a full four pages were devoted to John Connally and the group that met at Camp David over August 15 (see, United States Air Force Museum, Papers of Stanley Goodwin, AR.2002.175 Box 3, Trips 3, Republican National Convention, Miami Beach, August 1972). Nixon compared the impact of August 15th to July 15th (announcement that he would be the first American president to visit China). The latter indeed became legendary, yet the former was more important in the bigger picture.

rise in consumer prices (3.3%) in years. Unemployment declined to 5.1%, and the American balance of payments deficit shrunk drastically from 29.8 billion in 1971 to 10.4 billion US dollars."[993] Yet, the industrial countries were aware that the agreement was only the beginning and that the reform process needed to continue. As such, the agreement itself stated that negotiations on the future IMS should commence promptly and that these negotiations should be managed within the context of the Bretton Woods institutions. This presented a fundamental problem since IMF was not included in the forming of the Smithsonian Agreement. Still, the latter re-established some of the principles of the Bretton Woods IMS and hence, it made some sense that the future negotiations take place in such a setting. Nevertheless, as it turned out in 1972, states ignored this decision and opted for a more informal forums and resorted to bilateral talks.[994] Volcker recalls the sentiment in United States at the onset of 1972:

> "/I/t was well short of what we felt we needed to restore a solid equilibrium in our external payments, even if we had succeeded in opening Japanese and European markets in trade talks. But the stonewalling of the Common Market and Japan had been effective. With the exchange rate realignment settled and the import surcharge removed, we had little negotiating leverage."[995]

However, situation in 1972 was substantially different than in August 1971. Namely, in 1972 states were in agreement that further reforms towards greater flexibility are needed, they only differed in the opinion of how much and how to achieve it.[996] Moreover, in 1972 the structural feature of the future IMS – the centrality of the US dollar – was shared by all states.[997] Given these

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[993] Calleo, David P. 1982. *The Imperious Economy*. Cambridge: Harvard University Press. Pp. 64.
[994] This further attest that International Organizations are epiphenomenal to the US hegemony, not its core feature or explanation.
[995] Volcker and Gyohten. 1992. 89−90.
[996] De Vries. 1986. Pp. 114.
[997] The non-hegemonic states displayed the 'buy-in' by continue to use the US dollars in their international economic activity, as well as increased their reserves denominated in US dollars, see Whitman, Marina V. N. 1974.

two facts, United States was skeptical about a fixed exchange rate system but was still ready at the end of 1972 to agree to another par value system if other non-hegemonic states would commit to the revaluing their currencies. The existing Smithsonian system displayed confidence in the US dollar, as well as sufficient liquidity (some would even argue too much of it). Thus, the crucial question was again related to adjustment. If the new agreement would target solely the non-hegemonic states, then United States could support fixed exchange rates. Yet, the more burden would have to be shared by the United States, the more it would need to see flexibility of the exchange rates. This was the US bottom line trade off. Such flexibility features were: reserve currency countries should be able to change their par values more readily than under the previous system; IMF should be authorized to take the initiative in suggesting par value changes to its members; substantially wider margins should be accepted; some kind of objective indicators to suggest the need for changes in par values should be introduced; and the IMF should have more power to approve temporary floating rates.[998]

Thus, at the onset of 1972, there was a great amount of optimism. Not only regarding economic relations, but also politically. Namely, after the Azores meeting, US-French relations flourished.[999] Nixon and Pompidou were akin in their unsentimental recognition of the importance

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The Current and Future Role of the Dollar: How Much Symmetry? *Brookings Papers on Economic Activity,* 5(3). Pp. 539–91. At 555–70.

[998] De Vries. 1986. Pp. 113−4. For an outline of these positions see Shultz, George P. 1972. Statement by the Governor of the Fund and Bank for the United States. In *Summary Proceedings of the Twenty-seventh Annual Meeting of the Board of Governors, September 1972*. Washington: International Monetary Fund. Pp. 34–44.

[999] The French did continue to raise their concerns over depreciation of US dollar. Although this movement was within agreed boundaries of the Smithsonian Agreement, France expected that United States will act to maintain the strength of the dollar at the Smithsonian parity. They understood the signal that not doing so indicates that United States is aiming for free floating exchange rates. See, Urgent Information Memorandum From Robert Hormats and Helmut Sonnenfeldt of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger). Washington, January 24, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d222 (21 December 2020).

of the balance of power, skepticism of Soviets, as well as of German foreign policy (nationalism and *Ostpolitik* of German Chancellor Willy Brandt). This trust resulted in a secret arrangement of the French for the talks about Vietnam in Paris that Kissinger attended.[1000] Furthermore, "as late as the end of 1972 few foresaw at the economic disturbances that lay just ahead."[1001]

So why the agreement on the new IMS could not be reached in 1972? Smithsonian Agreement calmed the relations between the hegemon and the non-hegemonic down, provided stability, and drew a path for future negotiations. But its multilateral mechanism for negotiating the new IMS did not reflect these positive developments. "The magnitude of the crisis, /which/ had generated a consensus on the urgent need for a thoroughgoing reform of the entire international monetary system",[1002] was apparently not as urgent throughout 1972. Furthermore, due to elections in the fall of 1972, United States did not want to touch this hot potato, since the Nixon administration laid its grounds at the end of 1971. The pace of generating negotiations was slow, and the nature of the new economy proved to be too fast.[1003] Nevertheless, underneath the political tranquility, the speculations on further revaluation of currencies grew throughout 1972. Such financial pressures pushed many currencies to the limits of their allowed volatility under the Smithsonian Agreement. So, the system itself was bent to its breaking point. In a similar fashion to August 1971, in February 1973, United States unilaterally announced that they will again devalue the US dollar (42 US dollar per ounce of gold) and in March the US dollar floated in its relation to the gold. This meant that the Smithsonian Agreement was over just after 14 months.

[1000] Kissinger. 1982. Pp. 129.
[1001] De Vries. 1986. Pp. 151.
[1002] De Vries. 1986. Pp. 84.
[1003] For instance, in September 1972 at the IMF summit, Shultz stated: "Today is not the occasion for presenting a detailed blueprint for monetary reform" (Shultz. 1972. Pp. 37).

Subsequently, Japan did the same and throughout 1973 gradually all major states decided to float their currencies.[1004]

In March 1972 it became obvious that the Smithsonian Agreement would have to be defended by active engagement and coordination by leading countries.[1005] "United States trade balance deteriorated dramatically" and more importantly, the continued increase of the money supply (Nixon believed that this would get him reelected)[1006] put pressure on the exchange rates.[1007] States were therefore, focused on their relative position towards others in the certain case of the breakdown of the Smithsonian IMS, and so were less eager to negotiate a new IMS. Nevertheless, it was not solely the US increasing money supply that undercut the IMS, the non-hegemonic states also had their share of the blame. They too did not follow the agreement. As the Smithsonian Agreement was seen as dead – United States understood it as a mechanism of buying time[1008] – the political calmness was a façade. Under this uncertainty states did not want to negotiate. However, they were sharpening their arguments and ideas about the future. Finally, when the United States pulled the plug in February 1973, although again unannounced but more expected than in 1971, this did not cause another Nixon shock. States were anticipating some US action and they were prepared to float.

[1004] Mastanduno, Michael. 2009. System Maker and Privilege Taker. *World Politics*, 61(1). Pp. 121−54.
[1005] Coombs, Charles A. 1976. *The arena of international finance*. New York: John Wiley & Sons. Pp. 226−7.
[1006] See Nixon tape conversation, No. 670–5.
[1007] James. 1996. Pp. 238. Abrams (2006, 183) elaborates: "The money supply was now growing rapidly. Over the two months before this conversation, M1 grew an annualized rate of 10 percent and M2 at an annualized rate of 12.8 percent." Furthermore, from the conversation with Burns on February 14th, it is clear that Nixon did not care what type of monetary policy FED continues after April 1972, since the lag of its effect would not impact the elections (Nixon tape conversation, No. 670–7).
[1008] Irwing. 2012. Pp. 23.

In late 1972 and early 1973 double digit inflation rocked industrial countries. Several factors contributed to that: the US war in Vietnam (which was not being paid by taxing US citizens), US Great Society expenditure, 1971-72 expansionary fiscal and monetary policy of other industrial economies to overcome the slump of 1969, cyclical peak of business, crop failures in 1972 and 1973, speculative rush on commodities, new dimensions of welfare-state (new expenditures), subsequent inflationary expectations – unions demanding wage increases to cope with the inflation what in turn caused even more inflation and longer inflation, and the rise of unemployment all generated additional inflation, and with contracting economy and inflation coexisting the term stagflation was forged.[1009] This economic crisis was further prolonged throughout 1973 and expanded by the oil shock at the end of the year.

> "During 1972, speculators, who saw the devaluation as too small in the Smithsonian Agreement, pushed many European currencies to the tops of their permissible – and now wider – exchange-rate bands. Reflecting the continued uncertainty, gold prices reached $60 per ounce by mid-1972, well above the new official price. US monetary policy did little to build confidence after the devaluation in Bretton Woods as it continued its stop-go behavior. Although it firmed up slightly immediately following the Smithsonian Agreement, US monetary policy eased again in September 1972. The real federal funds rate, however, remained below 2% throughout the year. The money stock continued to grow at double-digit rates or 4 percentage points faster than output growth each quarter through 1973 /…/ In 1972, foreign central banks accumulated large amounts of unwanted dollars, as they defended their currencies' parity values. In doing so they stoked home inflationary pressures. Price levels in G-10 nations rose 7.7% on average for the year. US inflation, although lower than the G-10 average, began rising sharply. Foreign central banks' attempts to tighten monetary policies only encouraged capital inflows. Many countries increasingly attempted to adopt or strengthen their capital restraints. On 12th February 1973, with exchange markets in Europe and Japan closed and gold prices hovering around $90 per ounce, United States devalued its dollar again by an additional 10% to $42 per ounce."[1010]

[1009] De Vries. 1986. Pp. 151−2.
[1010] Bordo, Michael D., and Owen F. Humpage. 2016. Federal Reserve Policy and Bretton Woods. In Bordo, Michael D., and Mark A. Wynne (eds.), *The Federal Reserve's Role in the Global Economy: A Historical Perspective*. Cambridge: Cambridge University Press. Pp. 89−120. At Pp. 116.

On February 12th, 1973 Shultz, who was at that point Secretary of Treasury, also announced the end of US capital controls.[1011] When markets re-opened speculation sky-rocketed, since "those holding, lending, or even invoicing dollars had been taught a harsh lesson, and their main concern now seemed to be to eliminate further risk on that score."[1012] The only pushback against US decision came from France, which saw capital controls as necessary to fight pressures on exchange rates. "Within a month nearly all major currencies were floating against the dollar. The Bretton Woods system in its revised Smithsonian Agreement version – ended. Economic growth, full employment, and price stability now took precedence over exchange-rate fixity."[1013] States needed to find new policies how to assure their economic objectives within the new nature of the economy, where quick responses were a crucial virtue.[1014]

> "A dramatic shift had occurred: from a widely held consensus that some kind of internationally planned response to the crisis of the world economic system was required, to an urgent insistence by the most powerful countries that only the market, and no amount of reform of the system, could provide a solution. Why did this shift occur? To a large extent the answer lies in the changing understanding of the mechanics and implications of reform. This in turn was a response to international inflation and to its most obvious and disruptive manifestation, the oil price shock."[1015]

[1011] Shulty, George. 1973. Statement by Secretary Shultz on Devaluation of the Dollar. *New York Times*, February 12. Accessibility: https://www.nytimes.com/1973/02/13/archives/statement-by-secretary-shultz-on-devaluation-of-the-dollar.html (24 January 2021).
[1012] *Federal Open Market Committee Minutes*, 7 March 1973. Accessibility: https://www.federalreserve.gov/monetarypolicy/files/fomcmod19730307.pdf (27 July 2019). Pp. 3.
[1013] Bordo and Humpage. 2016. Pp. 116−7.
[1014] De Vries. 1986. Pp. 100. The biggest test in 1970s was inflation, where "Germany was the star pupil, having brought down inflation to 3%, with the United States in second place at a rate of 5.3% in 1976", and the worst were Britain and Italy (De Beaufort Wijnholds, Onno. 2015. *Gold, the Dollar and Watergate*. London: Palgrave Macmillan. Pp. 228–9).
[1015] James. 1996. Pp. 258.

Simply put – states in 1973, but not in 1971, fully understood the possibilities and the mechanisms of the nature of the financial economy.[1016] A confidential document entitled 'A Sketch of a World Monetary System', which was written by Shultz – "the principal architect of the managed floating rate regime"[1017] − stated: "/…/ we want the apparent freedom of the looser exchange rate regime, while keeping the advantages of a strong international consensus as to certain basic rules of good behavior."[1018] In other words, the United States was committed to the centrality of the US dollar in the global monetary relations as the basic rule, while at the same time allowing free floating exchange rates.

> "Large countries like the United States and Japan, for whom the importance of international transactions was still limited, opted to float. For them, the uncertainties of a fluctuating exchange rate, while not pleasant, were tolerable. For smaller, more open economies, especially developing countries with thin financial markets, floating exchange rates were even more volatile and disruptive. They opted for the other alternative: attempting to establish a fixed currency peg /thus losing their sovereign monetary policy/. The countries of Western Europe, for whom intra-European trade was exceptionally important and whose Common Agricultural Policy (CAP) could be seriously disrupted by exchange rate swings, sought to peg their currencies to one another, there too behind the shelter of controls. They created new institutions to structure the international cooperation needed to support a collective currency peg."[1019]

Large, developed countries followed free floating exchange rates – preferring to keep their sovereign monetary policies and free flow of capital. On the other hand, 73% of developing countries had a peg in 1982, and by 1991 that number was down to 50%; "comparable figures for

[1016] An illustrious explanation came from Secretary of Defense James R. Schlesinger, who in July 1973 explained free floating exchange rates to Kissinger as "a system that insulates the defense component of the balance of payments from the rest of the balance of payments," which would "get that monkey off our backs." Kissinger replied that the scheme was "masterful." See, Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 21, July 15, 1973.
[1017] De Vries. 1986. Pp. 95.
[1018] Leeson. 2003. Pp. 171.
[1019] Eichengreen. 1998. Pp. 135

small countries were 97 and 84 percent."[1020] Such a trend continues to this day, where only special case countries opt for a fixed exchange rate since they have a very particular situation and interests (e.g. Hong Kong).[1021] Furthermore, most of these countries pegged themselves to the US dollar, some to the Sterling and French franc.[1022] What these facts tell us is that small developing countries moved adjustable exchange rates to hard fixed pegs – doing so they also lose their sovereignty over their monetary policy. However, since they were so closely economically linked to one of the bigger countries and its currency, that was not considered as a big loss and was actually a move that enhanced their interest. Therefore, by opting for free flow of capital and fixed exchange rates, they have sacrificed their sovereign monetary policy, what meant that their monetary policy was shaped by the United States, which in turn further positioned the US dollar into the center of the global monetary relations.

So, what happened with the discussion on the new IMS during the 1972? The sheer decision as to who should guide such a discussion, took more than half of 1972 – until 26th July.[1023] Eventually, G-10 decided that such a process should not be guided by the Executive Board of the IMF, but rather an *ad hoc* Committee of the Board of Governors on Reform of the International Monetary System and Related Issues, or the Committee of Twenty (C-20).[1024] "The twenty were:

[1020] Eichengreen. 1998. Pp. 179.
[1021] Elson. 2011. Pp. 28.
[1022] De Vries. 1986. Pp. 95; Ilzetzki, Reinhart, and Rogoff. 2017. See also Appendix 8 for empirical visualizations of the matter.
[1023] Establishment of the Committee of Twenty, Board of Governors of the International Monetary Fund, Resolution No. 27-10 of the Board of Governors. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 151–3.
[1024] United States opposed IMF leadership: "Connolly, in particular, took offense at IMF managing director Pierre Paul Schweitzer's interventions in the pre-Smithsonian negotiations, tipping them toward US agreement to raise the dollar's par value in terms of gold. In 1972 Connolly passed the word that the United States would not support Schweitzer's reelection in the fall of 1973." (Truman. 2017. Pp. 24). Therefore, C-20 'killed three birds with one stone'. United States wanted to position the official negotiations into a setting that was not controlled by the IMF leadership. Moreover, C-20 was doomed to fail due to its broad composition. As such it also served US public diplomacy objectives as the C-20 included also developing countries and was not an exclusive club like G-10. This

Governors of the Fund corresponding to the twenty constituencies that existed for the appointment of the Fund's Executive Directors. Since the Committee was to include for each party a finance minister, central bank governor, and a senior civil servant (or 'deputy'), the meetings began with 60 members",[1025] which resulted in unworkable large setting. Thus, the real practical work was done by deputies in their separate all alone meetings 2-5 days each second month and the subcommittees they formed. Reflecting the inefficiency of the C-20, the deputies labeled C-20 as 'multilateral monologue'.[1026] C-20 debates, which continued also after February 1973, when the Smithsonian Agreement broke, were often hijacked by delegates representing developing countries that wanted to link SDR to international aid obligations, which was treated as a public good. There was no support for such a position in the developed countries, who recognized only the monetary role of the SDR.[1027] This 'link' idea became a cornerstone of UN proposals for the new world order in 1974 – New world economic order declaration of the general assembly.[1028] G-77 (UN grouping of developing nations) lobbied for SDR linkage to development aid within the UN and spoke against the Paris club bias.[1029] One of their more tangible results was that the IMF did become more flexible in their financial arrangements that favored developing countries.[1030]

left United States room and time to conduct informal bilateral negotiations, which was essentially what United States wanted.

[1025] James. 1996. Pp. 246.

[1026] James. 1996. Pp. 246.

[1027] Elson. 2011. Pp. 59.

[1028] *Declaration on the Establishment of a New International Economic Order*. 1974. Adopted May 1. Accessibility: http://www.un-documents.net/s6r3201.htm (25 April 2019).

[1029] "The Paris Club is a voluntary, informal group of creditor nations who meet approximately 10 times per year, to provide debt relief to developing countries." Weiss, Martin A. 2004. *The Paris club and international debt relief*. Congressional Research Service. Accessibility: https://fas.org/sgp/crs/misc/RS21482.pdf (4 August 2019).

[1030] See Elson. 2011. Pp. 60−2.

The C-20 "started from the premise that the exchange rate mechanism in the reformed system would be one of stable but adjustable par values."[1031] "The first meeting of the C-20 took place during the IMF Annual Meeting in September 1972", and the body met regularly until January 1974, when C-20 "recognized the failure of its broad mission."[1032] It has reduced its task from the original six points in the Smithsonian Agreement (stable exchange rates, insuring convertibility, resolve the role of gold, reserve currencies, and SDR, assure appropriate liquidity, determine permissible margins of fluctuation of exchange rates, other measures to deal with capital movements) to three points (balance of payments adjustment, settlement of payments imbalances, and volume and composition of reserves), and added one (address problems of the developing countries).[1033] Such a change displays that concerns or objectives of the non-hegemonic states regarding the fixed exchange rates changed. They were no longer fixed on fixed exchange rates and reluctant to embrace the free flow of capital.

C-20 could not bridge the divide between United States and France. The former "insisted on the establishment of some automatic mechanism for forcing surplus countries to reduce their surplus positions".[1034] The latter "responded by arguing that the principle of equity in the international system requited a provision for the convertibility of dollar reserves into gold or foreign exchange."[1035] C-20 self-dissolved in 1974.[1036] Although G-10 tasked the C-20 for producing a IMS reform proposal,[1037] it was IMF itself that rushed to present a paper for reform in

[1031] De Vries. 1986. Pp. 113.
[1032] James. 1996. Pp. 246.
[1033] Solomon. 1977. Pp. 238.
[1034] James. 1996. Pp. 246.
[1035] James. 1996. Pp. 246−7.
[1036] Truman. (2017, 24) draws a continuous line between C-20, Interim Committee (established in 1974 as a successor of C-20), and G-20, which was established as an aftermath of the Asian Financial Crisis in 1999.
[1037] See De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 155−64, and 197−205.

the summer of 1972. It proposed greater role of SDR and so the interests the hegemon, as well as other states.[1038] Namely, states were already committed to the centrality of the US dollar as a vehicle for the new IMS. What IMF paper and the inefficiency of the C-20 did, was to reinforce the believe that the new IMS needs to be negotiated bilaterally. Hence, it is not surprising that the proposal was simply discounted by all states, which understood that the deal needs to be made between the interests of the hegemon and the non-hegemonic states. Moreover, IMF initiatives had the same fate as C-20: no real impact in facilitating the new IMS.

Thus, one cannot get rid of the impression that a decision for C-20 was intentional: states reached the Smithsonian Agreement after a set of bilateral meetings and brushed aside multilateral fora. Therefore, they wanted to keep such a game-plan in action for the future: resolve the matter bilaterally. On January 6th and 7th, 1972 Nixon met with Japanese Prime Minister Sato, where both agreed that the cooperation of the Free World great economic powers must continue and that they must consult to build a stable and productive environment.[1039] This initiative had some fruit, as OECD was tasked in May also as a forum where discussions on the link between international monetary and trade reforms.[1040] However, even a third track of negotiations for the new IMS (the first two being C-20 and OECD) took place in parallel. Third being the bilateral approach.[1041] Therefore, how did we come to the reprise of August 1971 in February 1973?

[1038] Report of the Executive Directors, Reform of the International Monetary System. 1972. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 19−56.
[1039] See, National Archives, Nixon Presidential Materials, National Security Council Files, Box 925, VIP Visits, Japan-Sato San Clemente January 1972.
[1040] See, National Archives, Nixon Presidential Materials, National Security Council Files, Agency Files, Box 273, OECD.
[1041] Throughout the 1972 it was the bilateral trade relations between Japan and the United States that dominated this track. At the meeting in Hawaii between Nixon and the Japanese Prime Minister Tanaka a deal was announced (see, President Nixon and Japanese Prime Minister Tanaka meet in Hawaii. 1972. *Department of State Bulletin*, 67(1735). Pp. 329–33). On the path to this deal and bilateral relations, see National Archives, Nixon Presidential Materials,

On January 19, 1972, Willis send Volcker a paper entitled 'Alternative Possibilities for Coordinating Balance of Payments Improvement', where he noted that several departments and agencies had responsibilities in the balance-of-payments area and concluded they could best be coordinated by a Cabinet-level committee chaired by the Treasury Department. He proposed that Council on International Economic Policy would be replaced by a Cabinet Committee on the Balance of Payments.[1042] The latter did not take place, but within the Volcker Group, Volcker proposed that a smaller set of people would begin working on the ideas and papers[1043] for the new IMS in February 1972.[1044] Volcker proposed that this group would be known as 'Volcker Group Alternates' and their work their papers fought to protect the US dollar as a reserve currency and

National Security Council Files, Box 925, VIP Visits, Memorandum of conversation, December 22, Japan-Sato San Clemente January 1972; Washington National Records Center, Department of the Treasury, Files of Under Secretary Volcker, FRC 56 79 15, San Clemente Talks with Tanaka, 1/72, Memoranda of conversation, January 6 and 7; Memorandum of Conversation, Washington, July 17, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d92 (21 December 2020); Washington National Records Center, Department of the Treasury, Files of Under Secretary Volcker, FRC 56 79 15, Japan General, Memorandum of conversation, July 29; National Archives, Nixon Presidential Materials, National Security Council Files, Country Files, Far East, Box 538, Japan Volume 8 5-12/72; U.S. Position Paper, Washington, U.S.-Japan Trade Issues. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d95 (21 December 2020); Memorandum of Conversation, Karuizawa, Japan, August 19, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d96 (21 December 2020); Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon, Washington, August 29, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d98 (21 December 2020).

1042 See Washington National Records Center, Department of the Treasury, Files of Under Secretary Volcker, FRC 56 79 15, BOP—General.

1043 National Archives, Record Group 56, General Records of the Department of the Treasury, Treasury Files on International Monetary Reform: 1, Volcker Group, Box 4, Paul Volcker, Development of Proposals for U.S. Positions in Future Discussions of International Monetary Reforms, February 22, 1972, MR-2.

1044 They met three times a week to draft papers for consideration by the Volcker Group. Jack Bennet, long time Treasury official became the representative of this Alternative Group to the President and other officials. See, United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 611.

advocated for foreign governments to hold US dollars, while minimizing the role of SDR.[1045] In a nutshell, their proposals were about the centrality of the US dollar and the non-hegemonic 'buy-in'. By May 1972, Volcker Group also agreed with their proposals, which until then was thinking regarding enforcement mechanisms within the existing IMS.[1046] Moreover, United States feared that the IMF's institutional interest in preserving its relevance would lead it to sidetrack multilateral negotiations and get in the way of such liberalizing reforms.[1047] Hence, it made sure that IMF proposals did not achieve any support and the C-20 forum was muddling through with its bureaucratic procedures.

Peter Flanigan, an Assistant to the President, 1969-1972 and thereafter also Executive Director of the Council for International Economic Policy, was tasked to travel to the non-hegemonic states and gather their take of the reform.[1048] Yet, the US dollar continued to depreciate against other currencies within the margins of the Smithsonian Agreement. Dealing with this issue,

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[1045] See e. g., National Archives, Record Group 56, General Records of the Department of the Treasury, Treasury Files on International Monetary Reform: 3–4, Volcker Group, Box 4, MR-2, Jack F. Bennett, U.S. Objectives in Longer Term Reform of the International Monetary System, March 13, 1972; Geza Feketekuty, Discussions by Volcker Group Alternates of International Monetary Reform, May 31, 1972, Treasury Department, Treasury Files on International Monetary Reform (1972-1973), Box 44, General Records of the Department of the Treasury. Record Group 56. National Archives at College Park; Richard M. Nixon Library, White House Central Files, Files of Herbert Stein, 1969-1976: 6.

[1046] E. g. Volcker Group Paper, Washington, April 27, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d228 (21 December 2020); Volcker Group Paper, Washington, June 5, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d230 (21 December 2020).

[1047] U.S. Department of the Treasury, Organization for Negotiations on Monetary Reform, March 13, 1972, MR-2 Volcker Group, Box 4, Treasury Files on International Monetary Reform: 3, General Records of the Department of the Treasury. Record Group 56. National Archives at College Park.

[1048] See, Report by the President's Assistant for International Economic Affairs (Flanigan), Washington, June 20, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d91 (21 December 2020).

Pompidou wrote to Nixon that United States should consider capital controls.[1049] This attempt of restoration of an old IMS was responded by Nixon:

> "In view of the major disturbances which were experienced during 1971, we have recognized that the foreign exchange markets could not be expected to return immediately to entirely settled and normal attitudes. For this reason, since December 18, we have refrained from any steps to relax our controls on capital, despite the doubts I expressed to you as to their effectiveness and usefulness and despite my strong wish to move away from these controls as promptly as possible. /…/ In the light of conditions in the exchange markets in recent weeks, I believe we are fortunate that our compromise has permitted a wider band of fluctuation to absorb and diffuse movements of funds without requiring large scale central bank intervention. I confess that your concern over the comments on flexibility in the recent report of my Council of Economic Advisers surprises me in the light of our conversation, since I believe we both recognized this question would need to remain an open issue for the planned discussions of the future of the international monetary system."[1050]

Later in March the US Ambassador in France called "for more intensive high-level US effort to counter European charges that US is indifferent to fate of dollar." He also recommended making clear that the United States was "fully committed to continued cooperation with them in interest of restoring stability to the system and indeed improving it."[1051] Nevertheless, the time was not right. As Europeans were not ready to make any move regarding trade liberalization, also

[1049] Letter From President Pompidou to President Nixon, Paris, February 4, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d223 (21 December 2020).

[1050] Letter From President Nixon to President Pompidou, Washington, February 16, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d224 (21 December 2020).

[1051] National Archives, Record Group 59, Central Files 1970-73, FN 10, Telegram 4718 from Paris, March 11, 1972.

United States was not willing to make any moves before elections in 1972 when it came to monetary issues. Kissinger put it bluntly: "Time is not yet ripe."[1052]

Also, in March, Connally pushed that his portfolio would include not only monetary and tax policies, but also overall trade, since things were interrelated.[1053] Connally's role in the government increasingly became disruptive and counterproductive. [1054] A new wave of positive attitude towards the idea and policy of seeking free floating exchange rates came after May 16, when the White House announced that Shultz will succeed Connally as the Secretary of Treasury. As it turned out, as Connally was indispensable for the Nixon Shock and Smithsonian Agreement, so was Shultz for the codification of the post-Bretton Woods IMS.[1055] His primary objective was to leverage and strengthen the centrality of the US dollar in the global monetary relations. A simple logic of reducing transaction costs and subsequently reducing uncertainty if the non-hegemonic states used US dollars, would strengthen the centrality, which would be used as a leverage to generate the free-floating exchange rates. Therefore, Shultz butted heads with Burns when advocating for imminent removal of American capital controls and forcing a dollar devaluation on

[1052] Richard M. Nixon Library, National Security Council Files, Subject Files, Box 356, Monetary.
[1053] See Washington National Records Center, Department of the Treasury, Files of Under Secretary Volcker, FRC 56 79 15, PAV International Monetary Reform 1972.
[1054] After the infamous Nixon visit to China in February 1972, European states complained about the spirit of Transatlantic relations. So, the German State Secretary, Egon Bahr, raised the need for improved relations among the partners to Kissinger (see, Richard M. Nixon Library, National Security Council Files, Box 686, Memoranda of Conversation between Egon Bahr and Henry Kissinger, March 28, 1972). This led to Nixon and Kissinger labelling 1973 as the 'Year of Europe', where the Transatlantic partners would find a new modus operandi in the light of the Nixon doctrine, détente, growing impact of European Community, trade issues, and the process of forming the new IMS (for more on the Year of Europe see, Scott, Andrew. 2011. *Allies Apart: Heath, Nixon and the Anglo-American Relationship*. London: Palgrave. Ch. 5; Moon, Richard J. 1995. *The year of Europe: 1973/74. A study in alliance diplomacy*. Ph.D. Dissertation. London School of Economics and Political Science).
[1055] He recalls his crucial role in one of his memoires, see Shultz, George P. 2017. Reforming the International Monetary System in Practice George. In Bordo, Michael D. Bordo and John B. Taylor (eds.), *Rules for International Monetary Stability*. Stanford: Hoover Institution Press. Pp. 282–90.

other countries by refusing to intervene in foreign exchange markets.[1056] The US dollar centrality was also reinforced by the private sector, where the banking community felt that this would benefit them by attracting additional transactions; one prominent banker noted that even without gold convertibility, the US dollar was still 'convertible' into US goods and corporate stocks.[1057]

The slow pace of commencing negotiations on the IMS was used by United States to prepare ideationally for alternative possibilities and how United States could fulfill its interests through them. As such, The Volcker Group and the 'Alternates' were very active. On June 5th, the first asked the second to think through:

> "/…/ how the objective of flexibility can best be achieved in practice; how "presumptive," i.e. how near to automatic, should the actions be to induce corrective steps by disruptive governments; how detailed would be the guidelines for governmental trade measures, investment controls, and domestic incentive programs; and by what means the role of gold can best be diminished in the international monetary system."[1058]

The last task – targeting gold – is in line with the position of both groups that it is quintessential for the United States that the US dollar remains in the center of the global monetary relations. In June, the British abandoned the Smithsonian Agreement, and so the Sterling

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[1056] Conversation Among President Nixon, Secretary of the Treasury Shultz, and the Chairman of the Federal Reserve System Board of Governors (Burns), Washington, February 6, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d3 (24 January 2021).

[1057] Gerald R. Ford Library, Gerald R. Ford Vice Presidential Papers, 1973-74, Gaylord Freeman, The Current International Monetary Situation, March 7, 1973, Dollar Crisis, Box 140.

[1058] Volcker Group Paper, Washington, June 5, 1972.

followed.[1059] This positioned it next to the Canadian Dollar, which continued to float also after the December 1971, and Nixon applauded such development:

> "I share your conclusion that this latest episode in a series of monetary crises over recent years illustrates the need for fundamental changes in the monetary framework. To the extent this point is generally grasped, the cause of practical reform will have been reinforced--and, I hope, speeded. This can be a highly constructive by-product of otherwise unfortunate turbulence. I particularly welcome your reaction because 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."[1060]

In the aftermath of the floating of the Starling, Shultz warned Nixon that events could easily spiral to the point of replication of the fall 1971 and further explaining the subsequent events:

> "Since the British decision on June 24 to float the pound, strong speculative pressures have again developed in the foreign exchange markets. In two days at the end of last week, $2-1/2 billion flowed into foreign central banks. The total flow of dollars into the central bank reserves in the past three weeks has amounted to almost $5 billion. In terms of the direct and short-term impact on the U.S. economy and trade position, this turmoil is of limited significance. It is quite possible that, without further action by us, the foreign central banks will continue to support the dollar until the present speculative pressures pass. They have a strong interest in not allowing the dollar to decline."[1061]

[1059] "The British government announced early this morning (June 23rd) that the English Pound would be permitted to float. This action was taken after the Bank of England had bought $1 billion of pounds on Thursday, half that amount on Wednesday, with total Bank support during the week estimated by the Fed at $3 billion." (Memorandum From the President's Assistant for International Economic Affairs (Flanigan) to President Nixon, Washington, June 23, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d232 (21 December 2020)). Hence, the move was a consequence of the speculative capital run on the Sterling, serving as another example for all states that preserving the parities is extremely costly to float the currency.

[1060] Letter From President Nixon to Prime Minister Heath, Washington, July 10, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d233 (21 December 2020).

[1061] Memorandum From Secretary of the Treasury Shultz to President Nixon, Washington. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III,* Shultz stressed also that floating exchange rates help the US balance of payments and decrease pressure on the value of the US dollar. He outlined three possible courses of action: passive approach (which could raise 'we do not care' sentiment with the non-hegemonic states), limited intervention (buying US dollars in support of the value of US dollar), and broader initiatives (e. g. capital controls, multilateral statements, and actions).[1062] Furthermore, also in June, Flanigan returned from his Europe trip stating:

> "/I/t became apparent that the EC, as a unit, is still a long way from any kind of consensus concerning the objectives which "Europe" should seek in reform negotiations. The first meeting at which the Finance Ministers of the 10 will discuss this question has just been scheduled for July 17 and 18 in London. The most optimistic expectation for the emergence of a consensus, according to Barre, would be at or after the September IMF meeting. A more realistic estimate would be not before October or November, at best /…/ I asked each of the Finance Ministers I saw after the Brussels stop to comment on this scenario. All agreed that it would not be realistic to expect a fully coordinated EC position before year-end, if then. The British even remain skeptical that there will ever be a fully common EC position short of the point of final agreement internationally. I used these admissions to remind the Ministers that, given the lack of a common EC position, I hoped they no longer believed that it was the U.S. which was dragging its feet on initiating reform negotiations. All agreed that the fault was not ours."[1063]

After Kissinger met with Helmut Schmidt, German Minister of Economics and Finance, on July 20th, United States opted for the second option – limited intervention – in order to maintain Smithsonian Agreement. It did not want another monetary crisis before the elections, and Schmidt warned Kissinger that Europeans will stop buying US dollars and thus defending its value.[1064] This

Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d234 (21 December 2020).

[1062] Memorandum From Secretary of the Treasury Shultz to President Nixon, Washington.

[1063] Report by the President's Assistant for International Economic Affairs (Flanigan), Washington, June 20, 1972.

[1064] Information Memorandum for the Record, Washington, July 20, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic* did not come as a surprise for the United States, since the FED was intervening to some extent to preserve the value of the US dollar already in early July and even earlier in spring 1972.[1065] Nevertheless, these interventions were minimal, and Schmidt complained about it in August, when he also warned that the potential speculations regarding the value of US dollar in the fall could be devastating for the Smithsonian IMS.[1066] He was right in his analysis, but the fall came in early 1973, not in the fall 1972.

It is safe to assume that Flanigan was the author of a paper outlying objectives for trade and monetary negotiations of the United States. Subtracting the title – Objectives For Trade Negotiations And Monetary Reform – there is very little regarding monetary policy in it – no mention of exchange rate regimes, convertibility, the position of the US dollar. Nevertheless, if we can deduct from the paper main points of free trade and minimal governmental interventions, the author(s) of the paper would be in favor of free flow of capital, and free-floating exchange rates.[1067] Moreover, when it comes to the US dollar, we do not have to look far, as in 25th August Shultz wrote to Nixon saying: "Japan has no alternative at present to holding dollars in any case. /We

Policy 1969-1972, International Monetary Policy 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d235 (21 December 2020).

1065 See Burns explanations at: Memorandum of Conversation, Washington, July 25, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d236 (21 December 2020).

1066 Telegram From the Embassy in Germany to the Department of State, Bonn, August 1, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d240 (21 December 2020).

1067 Paper Prepared in the Council on International Economic Policy, Washington, U.S. Objectives For Trade Negotiations And Monetary Reform. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d94 (21 December 2020).

should/ avoid a commitment to the specific yen-dollar parity in the future."[1068] This memo attests two things: first, Untied States was aware of the non-hegemonic 'buy-in' – their favorability of keeping the US dollar in the center of global monetary relations; second, United States wanted to pursue towards free floating exchange rates.

If in the first half of 1972, Japan was on the top of the US agenda, then moving towards the elections in the fall, dealing with Europe became a priority. 10 days after he agreed on a trade deal with Japan, Nixon had a discussion with CIEP, where he stressed bilateral approach in dealing with European countries after the elections, and that trade issues should not be independent of political considerations:

> "Nationalism in Europe is stronger than nationalism in the US and it is damned strong here. They enjoy kicking the US around. Eighty-eight percent of all the European media is violently anti-US. They will cut their own throats economically to take us on politically. /…/ Let there be no doubt that our position before the election is one of protectionism. /…/ Between now and the election we should say nothing, but we should give careful thought about how trade relations fit in the context of our overall relations. We should examine what price we might have to pay on the trade side for this political relationship, and they should do so as well. /…/ What is at stake here is a major shift in the world balance of power, particularly among ourselves, the Russians, the Chinese, and the Japanese. As regards Europe, they will have one hell of a time acting as a bloc. They do not get along with each other. The French don't get along with the Germans, the Germans don't get along with the British. It will be some time before they can learn to act as a group. This means we have to work with the heads of Government in the various countries and not that jackass in the European Commission in Brussels. /…/ It is important that after the elections we look at the long-range relations. We have to tie this in with the whole problem of what we want our relations with Europe to be."[1069]

[1068] Memorandum From Secretary of the Treasury Shultz to President Nixon, Washington, August 25, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d97 (21 December 2020). Kissinger was of the same opinion, see Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon, Washington, August 29, 1972.
[1069] Memorandum of Conversation, Washington, September 11, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic*

Members of the CIEP presented him four options how to conduct relations with European countries. The next day[1070] he decided for an option called 'Modified confrontation':

> Continue to defend interests strongly and bring many problems to a head but stop short of bringing issues to a GATT vote, which we would probably lose. We could deal with major issues at a Summit. We would press for solution of some issues even at the risk of damaging relations. /…/ In our negotiations on EC enlargement we would attempt to get compensation on grain or we could unilaterally unbind tariffs."[1071]

In early October, a traditional meeting between United States and European Community delegation took place, where "the European representatives recognized that the US was seriously disturbed over the manner in which the EC was handling the GATT aspects of enlargement and the preferential trade aspects of arrangements with non-member countries."[1072] After his big electoral win in November, Nixon ordered a broad study to be made regarding a holistic approach to Europe for his second administration. The study was to be completed by January 1st, 1973, for consideration by the NSC Senior Review Group."[1073] In the light of this Kissinger's request, the State Department developed a Paper, where they addressed economic, political, security, military,

Policy 1969-1972, International Monetary Policy 1969-1972. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d100 (21 December 2020).

[1070] Memorandum From the President's Assistant for International Economic Affairs (Flanigan) to the Special Representative for Trade Negotiations (Eberle), Washington, September 12, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d101 (21 December 2020).

[1071] Memorandum of Conversation, Washington, September 11, 1972.

[1072] See, Memorandum From the Deputy Secretary of State (Irwin) to President Nixon, Washington, October 7, 1972. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d102 (21 December 2020).

[1073] National Archives, Record Group 59, S/S Files: Lot 80 D 212, Box 1113, National Security Study Memorandum 164.

scientific and technological dimensions of relations between the United States and European countries. It pointed that the Europeans have accepted non-convertible US dollar (buy-in) for the time being, and stressed:

> "US policy has been to: press major surplus countries to revalue or to take other measures to bring their payments balances into equilibrium; develop a new multilateral monetary system based on a more symmetrical adjustment process that facilitates freer trade and capital flows; favor EC movement toward a closely integrated monetary union consistent with the foregoing US aims." [1074]

However, it was in the summer of 1972, after the floating of the Sterling, when United States started to prepare for the breakdown of the Smithsonian Agreement. Shultz oversaw the plans and considerations done in Volcker Group and the 'Alternates' how to move forward with the IMS reform.[1075] The crackdown begun in early 1973. On 22nd January 1973, Italy established a two-tier exchange market,[1076] what caused the Swiss to float the franc the day after.[1077] These events were a symptom of the market pressures on the exchange rates. This in turn was an indication of a low level of market confidence in the Smithsonian arrangements. The Nixon administration was divided "over the urgency of the need for progress in the negotiations to reform

[1074] Paper Prepared in the Department of State, Washington, NSSM RESPONSE. In United States Department of State, Duncombe, Bruce F. (ed.). 2001a. *Foreign Relations of the United States, 1969-1976, Vol III, Foreign Economic Policy 1969-1972, International Monetary Policy 1969-1972*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v03/d108 (21 December 2020).
[1075] United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 656.
[1076] On January 20th, Italy announced that on January 22nd it would "split its foreign exchange market in two: one market for the purchase of lire for current account transactions where the lira's value would remain relatively fixed, another for the purchase of lire for capital account transactions where the lira's value would be allowed to float." (United States Department of State, Duncombe, Bruce F. (ed.). 2001a. Pp. 3).
[1077] Truman. 2017. Pp. 28.

the international monetary system."[1078] Shultz and Hormats were not in favor of a quick progress, whereas Flanigan and Burns argued in favor of a quick response.[1079]

On February 6th Nixon met with Bruns, Shultz.[1080] Burns explained the situation: "Since January 22nd, when it began, the outflow of dollars amounts to $4.3 billion, and 2.6 of that has gone to Germany, and the rest is scattered. So, it's no long—and today, today the Germans took in a billion and a half; so, it has accelerated." On the proposition of Shultz, the group decides to devalue and float the US dollar, since "/w/e pretty much agree among ourselves that this speculative flurry that we now see, whether it passes or not, is based on reality."[1081] Shultz continued:

> "We don't think that's going to go away in a hurry. Therefore, we feel that there is this underlying situation that needs correction, and the Smithsonian Agreement basically didn't do it, in part because it wasn't large enough, in part because there are all sorts of offsets that countries have used, and in part because it's deteriorated /…/ And that is to say, and we wouldn't have to consult with anybody about this, that we think the dollar is still over-valued, and that exchange rates should change, and they should change by something like this amount, and that that's our view, and we're not going to engage in any intervention or whatnot. In other words, more or less float the dollar and try to force others to let it float."[1082]

Burns objected to such action, and surprisingly even Nixon was reserved at the beginning: "And I think it's just too much of a "To hell with the rest of the world" as a policy."[1083] Yet, Shultz

[1078] United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. Pp. 2.
[1079] See, National Archives, Nixon Presidential Materials, National Security Council Files, Box 290, Agency Files, U.S. Treasury, Vol. III, Jan. 1972–Sept. 18, 1973; National Archives, Nixon Presidential Materials, National Security Council Files, Box 942, VIP Visits, UK (Prime Minister Heath) Visits to the US, February 1–2, 1973.
[1080] Nixon tape conversation, No. 851–4.
[1081] Nixon tape conversation, No. 851–4. See also Nixon conversation with Shultz on 8th February – Nixon tape conversation, No. 853–12.
[1082] Nixon tape conversation, No. 851–4.
[1083] Nixon tape conversation, No. 851–4.

managed to persuade Nixon, who became more conserved with timing and argumentation for such a move:

> "But, the way it has to be presented is that the dollar, at the present time—that we are doing this because American goods are at a disadvantage, in an unfair advantage in the world market, and that's due to the fact that the dollar is overvalued as against other currencies. And so, we are trying to—we're change—we're making this change in order to get, again, American goods in a competitive position. You know, if you go back and [unclear] the August 15th, for the rhetoric at least."[1084]

Moreover, once Burns saw where the wind blows on the US action, he begun talking about the future IMS negotiations, where he favored a bilateral summit approach:

> "This crisis may give us a strong lever, and we may move forward as a result. /Special envoys/ get together, and they wrestle, and they debate, and they just irritate one another and get nowhere. Now, I'm afraid that's the mood. The—my own thinking has been running in this direction more and more; in that trade, monetary reform, and defense—international security, will all have to be handled together and will have to be done at the summit level. But, to handle it at that level, we—we've got to be more fully prepared, I would say, than we are at the moment, because if you go in to a summit conference, you will want to be very sure as to precisely the point where you want to come out and then know the margin for—that could be negotiated out."[1085]

Volcker was sent to Japan, where he decided to also visit London and Paris. Moreover, there were multiple cables and telephone calls between the United States and European sates leading up to Monday 12th February when the announcement of a devaluation of the US dollar was made. In Japan, Volcker warned that there is a great monetary disruption, which is a consequence of trade and monetary policy of Japan: "The imbalance has caused the disturbance, and because Japan is dealing with it by passing dollars on to the rest of the world, its effect appears

[1084] Nixon tape conversation, No. 851–4.
[1085] Nixon tape conversation, No. 851–4.

elsewhere."[1086] He stressed that the Europeans feel the same, and that "the President is prepared to announce an answer this weekend, provided Japan and the Europeans agreed."[1087] As such, Volcker warned Japan about a decision United States will make, but they were led to believe that it will be a coordinated prior to the announcement, which was not the case. Japan Finance Minister Aichi replied that Japan, unlike Germany, sees no need to revalue the yen upward. Moreover, they wanted that Smithsonian Agreement would continue and be the framework where new parities would be established after multilateral negotiations. However, he did also hint that Japan is ready to float the yen after they pass the budget in April, he also assumed that the US answer will be a devaluation of the US dollar, not a float.[1088]

Germans urged Nixon to intervene in the monetary market, so that the exchange rates in Europe and in United States would be the same, which would prevent arbitrage and further pressure Europeans to change their exchange rates.[1089] Also, Europeans desired fast IMS reform: "Needless to say, that I also deem it urgently necessary that a reform of the international monetary system has to take place."[1090] Nixon responded somewhat favorably. He wrote to Chancellor Brandt on Saturday, so Brandt received his letter on Sunday 11th February: "In these circumstances, I had

[1086] Memorandum of Conversation, Tokyo, February 8, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d5 (24 January 2021).
[1087] Memorandum of Conversation, Tokyo, February 8, 1973.
[1088] Memorandum of Conversation, Tokyo, February 8, 1973.
[1089] Letter From the West German Chargé d'Affaires Ad Interim in the United States (Noebel) to President Nixon, Washington, February 9, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d6 (24 January 2021).
[1090] Letter From the West German Chargé d'Affaires Ad Interim in the United States (Noebel) to President Nixon, Washington, February 9, 1973. See also National Archives, Nixon Presidential Materials, National Security Council Files, Box 687, Country Files, Europe, Germany (Bonn), Vol. XIII, January–September 1973, Telegram 26260 to Bonn, February 12.

come to the same conclusion as you on the importance of our authorized representatives working together immediately to find solutions."[1091] However, Nixon hinted that United States will make a move: "As you know, through market intervention by the Federal Reserve, we have collaborated in recent days in the effort to prevent the development of disruptive conditions in international markets. We have undertaken this intervention even though we had undertaken no commitment for such intervention at the Smithsonian."[1092] In fact, the draft of the telegram cleared by Shultz, Haldeman, Ehrlichman, and Burns contained an additional sentence, which was even more explicit and was struck out by hand: "Yesterday, in the light of your message, the Federal Reserve, in consultation with the Treasury, continued its efforts in the face of increasingly adverse conditions in the market."[1093]

In Paris, Volcker met with d'Estaing. The French were mostly concerned with the relations in Europe; as such, they favored a joint action of France, Germany, and the UK. For an example a joint float, "would be fine with the U.S., and it would be consistent with the evolution of international monetary arrangements."[1094]

> "On February 12, 1973, overwhelming speculative pressure against the dollar prompted the closure of Western European exchange markets; that same

[1091] Telegram From the Department of State to the Embassy in the Federal Republic of Germany, Washington, February 10, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d6 (24 January 2021).
[1092] Telegram From the Department of State to the Embassy in the Federal Republic of Germany, Washington, February 10, 1973.
[1093] United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. Pp. 42.
[1094] Notes of a Telephone Conversation Among Secretary of the Treasury Shultz, the Deputy Under Secretary of the Treasury for Monetary Affairs (Bennett), and the Under Secretary of the Treasury for Monetary Affairs (Volcker), February 11, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d10 (24 January 2021).

> speculative pressure had led to the closure of the Japanese foreign exchange market on February 10. On the evening of February 12, Secretary of the Treasury George Shultz announced that the administration would seek Congressional approval of a 10 percent devaluation of the dollar."[1095]

When the exchange markets reopened in Europe and Japan, a modicum of calm temporarily returned, "but, by the final week of February, speculative pressure had again mounted against the dollar."[1096] "European central banks once again absorbed massive sums of dollars in an effort to support the value of the US dollar. The speculative pressure quickly grew too great, and several Western European exchange markets were closed on March 2."[1097] Nixon held a press conference on March 2nd, where he stated that the United States would survive the international speculative attack upon the dollar, and continued:

> "Let me say there will not be another devaluation. I would say, second, we are going to continue our program of fiscal responsibility so that the dollar will be sound at home and, we trust as well, abroad. And we also are going to continue our efforts to get the other major countries to participate more with us in the goal that we believe we should all achieve, which we set out at the time of the Smithsonian and other agreements, and that is of getting an international monetary system which is flexible enough to take care of these, what I believe are, temporary attacks on one currency or another."[1098]

United States did its part to stabilize the markets, it devalued the US dollar, and subsequently put the ball on the court of the non-hegemonic states. If they wanted to keep fixed exchange rates they would have to appreciate. As this was politically too costly, they opted for floating exchange rates. At the same time, they wanted to keep the benefits of US dollar flows, as

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[1095] United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. Pp. 47.
[1096] United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. Pp. 48.
[1097] United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. Pp. 48–9.
[1098] National Archives and Records Administration. *Public Papers of the Presidents of the United States: Richard M. Nixon, 1973*. Washington: U.S. Government Printing Office. Pp. 159.

such, already on March 2nd, Brandt wrote to Nixon, indicating the German 'buy-in': "I am convinced that a joint action represents at the same time an element of stabilization in the world political situation. This is to the benefit of all members of the Western world. A weakening of the Community by separate action would be harmful to all."[1099]

The next day, March 3rd, Nixon met with Volcker, Stein, Burns, Shultz, and Rot Ash, who in February 1973 became the Director of the Office of Management and Budget. At the meeting Volcker observed the situation in Europe:

> "The Europeans really are in a mood where they think their floating is their first option. I think this is the first time they've been in this mood. And, not necessarily happily, but they, for one reason or another, are inclined to think that's the primary direction in which to go."[1100]

Shultz added: "I talked to Tony Barber this morning, briefly, and what they're seeking is a method of working out some kind of a joint float."[1101] It was his and Burns's opinion that achieving that on the European side will be difficult. The group agreed that the biggest threat for the United States is that there is a one view formed in Europe, namely the French view. Volcker said it bluntly: "And the European solution is a euphemism for saying, "Let's leave the United States out of the world."[1102] Hence, Nixon understood that if United States leaves the ball on the European court it risks more than if they take a positive leadership role, which was advocated by Burns (yet in the

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[1099] Message From West German Chancellor Brandt to President Nixon, Bonn, March 2, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d15 (24 January 2021).
[1100] Nixon tape conversation, No. 868–8.
[1101] Nixon tape conversation, No. 868–8.
[1102] Nixon tape conversation, No. 868–8.

light of his position on fixed exchange rates).[1103] Stein summarized the meeting with a simple US position – a strive for a "system in which there's flexibility and rules /…/ rules governing flexibility." Since the group embarked on the political-strategic turf, Nixon decided to call Kissinger to join them.[1104] Kissinger said:

> "I came to the judgment that the Europeans are going to take a common position, or are going to try to take a common position, but they think that position will be unpalatable to us, and that they are trying, or that Brandt is trying, to buy us off in phrases about European integration and world stability for what he knows we won't like in the position they're going to come up with /…/ we don't look strong if, two weeks after the devaluation there's another speculative wave that then, again, changes the exchange rate."[1105]

In this discussion Shultz concluded that he likes the idea of common EU float. While Kissinger and Nixon questioned whether European integration is in the US interest.[1106] The group finished with a decision that a letter will be send to Germans, British, and Japanese.[1107] Since the group expressed fears that European countries could bundle together and in a new IMS replace the position of US dollar, Nixon wrote:[1108]

[1103] Nixon tape conversation, No. 868–8.
[1104] See, Nixon tape conversation, No 868–15.
[1105] Nixon tape conversation, No 868–15.
[1106] See also Draft Memorandum From President Nixon to the President's Assistant for National Security Affairs (Kissinger), March 10, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d31 (24 January 2021). Furthermore, even before the formation of the Smithsonian Agreement Kissinger and Nixon exchanged and shared the view that it was one of the worst mistakes to push Britain into the Common Market (Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 12, December 2, 1971).
[1107] Nixon tape conversation, No 868–15.
[1108] Message From President Nixon to West German Chancellor Brandt, Washington, March 3, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d18 (24 January 2021). See also, Message From President Nixon to British Prime Minister Heath, Washington, March 3, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d19 (24 January 2021); Message From

> "It therefore seems to me that any proposal to deal with the present currency crisis can only be put forward on the basis of full consideration with countries whose interests are involved—including especially the United States and Japan. I would therefore hope that before any proposals are made final we will have an opportunity to express our views."[1109]

As it turns out, the fear did not materialize, in fact British Prime Minister Health responded the same day, underlying that Britain shares US position.[1110] But these surroundings illustrate the uncertain situation at that point – Europe had the economic muscle, but lacked political unity, it had an idea of a common currency, but it was 'buying-in' the US dollar. This became obvious moving towards mid-March when US dollar floated.

On March 5th, Kissinger admitted to Shultz that he now agrees with him, and he is more in favor of the US dollar float.[1111] Moreover, the Germans got scared that a potential float of the US dollar prior to a common decision of the European Community, would endanger the cohesion of that community, which in turn could negatively impact German economic interests.[1112] To calm

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President Nixon to Japanese Prime Minister Tanaka, Washington, March 3, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d20 (24 January 2021).

[1109] For a general overview of US-Japan economic relations, see Destler, Irving M., and Hideo Satō. 1982. *Coping with US-Japanese economic conflicts*. Lexington: Lexington Books.

[1110] Message From British Prime Minister Heath to President Nixon, London, March 4, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d22 (24 January 2021).

[1111] Transcript of a Telephone Conversation Between Secretary of the Treasury Shultz and the President's Assistant for National Security Affairs (Kissinger), Washington, March 5, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d24 (24 January 2021).

[1112] Transcript of a Telephone Conversation Between West German Minister of Finance Schmidt and the President's Assistant for National Security Affairs (Kissinger), March 5, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d25 (24 January 2021).

the Europeans down, Shultz traveled to Europe on March 9th. Before his trip, he met with Kissinger and Nixon, where they have agreed on the constraining event of the French parliamentary elections on 11th March, and that they should not single out France before it and so help the Gaullists.[1113] Moreover, on March 7th Kissinger had a frank conversation with Schmidt:

> "S: Would the US be happy with a common European float?
> K: Well, it's a question of happy—we can live with a common European float if you do not attach too many conditions to it.
> S: I see.
> K: If you attach a lot of discriminatory conditions to it, then it becomes complex again.
> S: Yes. Brandt's favor is a European thing, you know.
> K: Well, we would not oppose that. But our concern is that the only way you can get a European float is by accepting so many of the French conditions.
> S: For the moment being, it's more the British conditions and the Italians.
> K: Oh, really.
> S: Yes. They are—the British are deeply worried about the future course of the Parliament.
> K: Well, we would not oppose a common European float if it were not discriminatory in some of its restrictions.
> S: I understand, Henry, I understand. So far the field of trade policy has not been touched in all these considerations and these talks.
> K: Right. Well, if that is the case we would not oppose, but if you have to go to certain alternatives then we would be prepared to discuss with you how to make them politically more bearable for you.
> S: Yes, I understand this clearly. I will talk to Willy Brandt tomorrow morning about it."[1114]

Among the positions prepared for Shultz to operate with on his Europe trip was also a measure to enhance US dollar centrality by: "reduction of withholding taxes on foreign investment income from U.S. Elimination of taxes on foreign-owned estates in U.S. Liberalization of foreign

[1113] Nixon tape conversation, No. 871–5.
[1114] Transcript of a Telephone Conversation Between West German Minister of Finance Schmidt and the President's Assistant for National Security Affairs (Kissinger), March 7, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d27 (24 January 2021).

restraints on capital outflows. Liberalization of foreign restricts on imports."[1115] On March 9, G–10 financial representatives met in Paris, where United States was represented by Shultz, Burns, and Volcker. The ministers agreed that the crisis was due to speculative movements of funds. They also agreed that:

> "/T/he existing relationships between parities and central rates, following the recent realignment, correspond /…/ to the economic requirements and that these relationships will make an effective monetary contribution to a better balance of international payments. In these circumstances, they unanimously expressed their determination to ensure jointly an orderly exchange-rate system."[1116]

United States was disappointed as such a statement showed that current international settings at that stage cannot offer much of a solution.[1117] The feeling was mutual also from the perspectives of the European countries. Hence, the next day the members of the European Community, announced that after March 16th the values of their currencies would jointly float vis-à-vis the value of all other currencies, while remaining relatively fixed vis-à-vis one another. "That is, their currencies would form a "snake," whose value in relation to non-snake currencies would be determined by market forces. The Federal Republic of Germany also announced that it would revalue the mark within the snake by 3 percent."[1118]

[1115] Memorandum From the Chairman of the Council of Economic Advisers (Stein) to Secretary of the Treasury Shultz, Washington, March 7, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d29 (24 January 2021).
[1116] National Archives, Record Group 56, Office of the Under Secretary of the Treasury, Files of Under Secretary Volcker, 1969–1974, Accession 56–79–15, Box 2, G–10, EPC, WP–3 (General).
[1117] See Volcker message to Shultz from March 10th, which is quoted in its entirety in Backchannel Message From Helmut Sonnenfeldt of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger) Moscow, March 13, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d32 (24 January 2021).
[1118] Backchannel Message From Helmut Sonnenfeldt of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger) Moscow, March 13, 1973.

On March 15th, Shultz met with Schmidt and Brandt, who in fact "said that perhaps the way to approach the consultation problem was through a series of closely coordinated bilateral contacts."[1119] The same day Shultz, Burns, Volcker, and Helmut Sonnenfeldt (senior staff member at the National Security Council) drafted a final communiqué for G–10 ministerial, which Shultz presented to the French and Germans, who both supported it.[1120] The next day, March 16th, G-10 ministers met, along with representatives from Denmark, Ireland, Luxembourg, Switzerland, IMF, OECD, BIS, and the European Commission in Paris, where they approved of the European Economic Community snake, or in other words floating exchange rates against the US dollar.[1121] Moreover, the statement also endorsed removal of capital controls and blessed US plan to remove them by 1974.[1122] In the evening of March 14th, Kissinger talked over the phone with William Simon (Deputy Secretary of the Treasury, who in 1974 became also Secretary of Treasury). Kissinger said: "But we should create conditions in which the Common float is as hard to work as possible." Simon and Kissinger agreed that a policy of non-intervention would be appropriate to that goal. Simon added, "Or intervening at some times to help some people but not others."[1123]

1119 See Backchannel Message From Helmut Sonnenfeldt of the National Security Council Staff to the President's Assistant for National Security Affairs (Kissinger), Paris, March 16, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d34 (24 January 2021).

1120 National Archives, Nixon Presidential Materials, National Security Council Files, Box 424, Backchannel Files, Backchannel Messages—Europe—19.

1121 Communiqué issued by the Group of Ten and the European Economic Community, Paris, 16 March 1973. Accessibility: https://www.cvce.eu/content/publication/2002/9/9/dfc3caec-4638-4413-9475-4f611692687f/publishable_en.pdf (10 March 2021).

1122 Communiqué issued by the Group of Ten and the European Economic Community, Paris, 16 March 1973.

1123 National Archives, Nixon Presidential Materials, Kissinger Telephone Conversations, Box 19.

As such, by spring 1973, the non-hegemonic states embraced the free-floating exchange rates, as well as committed to the free flow of capital. At the same time, they continued to use US dollar in their respective economic activities. Hence, they have now subscribed to the hegemonic preference of an IMS without the need for constant intervention. For the final third of the 20th century, Nixon thought that "economic power will be the key to other kinds of power, the future of the world in other ways in the last third of this century".[1124] "As a result, he did not wish to make any American sacrifice for the sake of economic internationalism": e. g., he mistrusted the SDR.[1125] Moreover, although in the non-hegemonic rhetoric one can still find reminiscence of fixed parities and the enhanced role of SDR, their deeds and actions were different. Therefore, the hegemonic and non-hegemonic commitment to free floating exchange rates only grew over time. Nevertheless, codifying these preferences, and moving also rhetorically away from previous features of IMS, required time. As such, a new wave of negotiations commenced after the 1973 stalemate in 1974. These negotiations would eventually be successful and create a new IMS of free flow of capital, floating exchange rates and sovereign monetary policy. In such a process, the US strategy was the same as in the aftermath of the Nixon Shock, and which was illustrated by Kissinger's aforementioned phone call – do nothing. Although it took several years to codify the new IMS, the non-hegemonic states continued with their 'buy-in' and gradually the rhetorical memory of fixed exchange rates gave way for new possibilities and policies more attune to the new nature of the economy and its respective post-Bretton Woods IMS.

[1124] Gaddis, John Lewis. 2005. *Strategies of Containment: A Critical Appraisal of Postwar American Security Policy*. New York: Oxford University Press. Pp. 278.
[1125] James. 1996. Pp. 210.

5.2.3 New post-Bretton Woods IMS

In 1973 there was an implicit agreement between the hegemon and the non-hegemonic states in liberalizing the capital flows and floating the exchange rates. Furthermore, the impotence of the C-20, slow movement of the EC countries towards a monetary union, and the failure of the oil crisis to enhance the role of SDR, left no alternatives to the US dollar. Throughout the 1970s, and with the development of new financial instruments that were traded in US dollars, the latter also strengthened its position in international oil market, in the international trade in general, and in international reserves, which relative position grew until 1975, when 80% of global reserves were held in US dollars (see Figure 8).

Although all the ingredients of a new IMS were in place by the early 1973, its codification prolonged. Watergate scandal left its mark: "European governments distanced themselves from the United States as a result of Watergate and the increased Congressional scrutiny of the White House."[1126] Nevertheless, the distrust was mutual, Burns wrote: "Kissinger ... spoke without any doubt: what we had to do adroitly is to throw a monkey wrench into the Common Market machinery, for European unity in economic areas would definitely work against U.S. interests."[1127] Yet, Kissinger and Nixon were pragmatic and as such, they wanted to rebuild the transatlantic relations, with by refocusing their foreign policy towards Europe in a process they called 'The year of Europe'.[1128] "After tensions had been reduced between the United States and the Soviet Union

[1126] Nichter. 2015. Pp. 140.
[1127] Gerald R. Ford Library, Papers of Arthur Burns, Handwritten Journals, 1969–1974, Box 1, April 3, 1973.
[1128] For more on the Year of Europe, see Moon. 1995. The initiative itself was launched with Kissinger's speech on 23rd April 1973 (Kissinger, Henry. 1973. The Year of Europe. In *Department of State Bulletin*, 68(1768). Pp. 593–98).

and China in Nixon's first term, by 1973, the need to overhaul transatlantic relations was long overdue."[1129] Their goal was a new Atlantic Charter – a reference to a 1941 declaration of international principles guiding relations after the Second World War.[1130]

Kissinger saw the French as the key to his Year of Europe project.[1131] United States needed real allies that were confident and strong, allies that could be a counterweight to Soviets in Europe, only so could the Nixon Doctrine work.[1132] It so happens that France was not only crucial in this regard, but also when it comes to codifying the new IMS, as it was the most reluctant to embrace these new rules. Hence, Kissinger pushed for a bilateral meeting, where he was most effective, especially when it comes to dealing with the French.[1133] A summit was planned for May 31st through June 2nd in Reykjavik, Iceland. At a cabinet meeting Kissinger explained: "Pompidou is the key to getting Europe on board."[1134] The French also preferred bilateral meetings for the same reasons, as in such settings they can exercise more influence over the interlocutor.[1135] Therefore, it was not difficult to arrange a meeting.

[1129] Nichter. 2015. Pp. 155.

[1130] For more on the 1941 Atlantic Charter, see Brinkley, Douglas, and David R. Facey-Crowther (eds.). 1994. *The Atlantic Charter*. London: Palgrave Macmillan.

[1131] Trachtenberg, Marc. 2011. The French Factor in US Foreign Policy during the Nixon-Pompidou Period, 1969–1974. *Journal of Cold War Studies*, 13(1). Pp. 4–59. At Pp. 27.

[1132] Kissinger, Henry. 1965. *The Troubled Partnership: A Re-appraisal of the Atlantic Alliance*. New York: McGraw Hill. Pp. 235. See also Kissinger. 1979. Pp. 86; Memorandum of Conversation, 1 March 1969, Nixon and De Gaulle. Accessibility: https://www.nixonlibrary.gov/sites/default/files/virtuallibrary/documents/jan10/088.pdf (17 April 2020).

[1133] Nichter. 2015. Pp. 131. In this process, Kissinger travelled to Paris to meet with Jobert (17 May) and Pompidou (18 May), where he explained US thinking regarding Europe: A strong Europe is essential and in this strong Europe, France needs to play a pivotal role, since the Germans are toying with Ostpolitik, and the British are not ambitious enough. See Memorandum of Conversation, 17 May 1969, Kissinger and Jobert. Accessibility: http://www.sscnet.ucla.edu/polisci/faculty/trachtenberg/ffus/00727.pdf (17 April 2020); Memorandum of Conversation, 18 May 1969, Kissinger and Pompidou. Accessibility: http://www.sscnet.ucla.edu/polisci/faculty/trachtenberg/ffus/00728.pdf (17 April 2020).

[1134] Richard M. Nixon Library, National Security Council Files, Box 1027. Memorandum of conversation between Henry Kissinger, President Nixon, and the Cabinet, Cabinet Room, May 25, 1973.

[1135] E. g., Centre d'accueil et de recherche des Archives Nationales, Papiers des Chefs de l'État, Présidence de la République, Georges Pompidou (5 AG 2/1023), Entretiens franco-américains, conférences des chefs d'état de la

At Reykjavik, Nixon asked Pompidou to identify ways in which to expedite European consideration of the Year of Europe. The goal was to get French support the principles behind the Declaration on Atlantic Relations before other nations became involved.[1136] Pompidou, referring to the internal gridlock following expansion of the European Community on January 1st, cautioned him: "Conception is more fun than giving birth."[1137] In exchange for his help with European matters, Nixon offered Pompidou expanded bilateral nuclear cooperation.[1138] He even suggested that it could be possible for France to obtain a level of military cooperation similar to that between Britain and the United States, which was a long-standing desire of President Pompidou.[1139] However, the tempting proposal was not enough to offset the difficult structural environment – Pompidou sickness, Watergate scandal, and mutual distrust. United States was a bit surprised that the French were skeptical about the new Atlantic Charter and the Year of Europe in general.[1140]

Deteriorating Pompidou's health contributed to intensified relations between United States and France, since the key person on the French side, Michael Jobert (Chief of staff and later French Foreign Minister) did not want to accept the new economic reality, nor re-forge Transatlantic

CEE, notes, télégrammes, correspondance, voyages officiels, 1969–1974, Ministère des Affaires Etrangères, Entretiens de Reykjavik 31 mai-1er juin 1973, Note de Synthese 18 mai 1973.

[1136] Paper Prepared in the National Security Council, Proposed Outcome of the Meeting Between Presidents Nixon and Pompidou in Iceland, Washington. 1973. In United States Department of State, Rasmussen Kathleen B. (ed.). 2014. *Foreign Relations of the United States, 1969-1976, Vol E-15, Part 2, Documents on Western Europe, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76ve15p2/d19 (21 December 2020).

[1137] Kissinger. 1999. Pp. 605.

[1138] Kissinger tried to use this carrot even after the Reykjavik summit, see Memorandum of Conversation, 8 June 1973, Kissinger and Jobert. Accessibility: http://www.sscnet.ucla.edu/polisci/faculty/trachtenberg/ffus/00748.pdf (17 April 2020).

[1139] Vaïsse, Maurice. 2004. Les 'relations spéciales' franco-américains au temps de Richard Nixon et Georges Pompidou. *Relations Internationales*,119(3). Pp. 345–62. At Pp. 359.

[1140] See National Archives, Nixon Presidential Materials, National Security Council Files, Box 949, VIP Visits, Pompidou-Nixon meeting., Iceland, May–June 1973, Kissinger memorandum for Nixon, 30 May 1973.

relations during the Year of Europe.[1141] Therefore, the summit at Reykjavik was not successful. According to Kissinger: "Pompidou offered no solution to perplexities /…/ he had no vision of a common future."[1142] He argued that "nothing would work in any forum."[1143] In fact, Pompidou played down the economic issue, saying it is 'easy to solve' and that the real problems lay elsewhere.[1144] Kissinger may have agreed with that, but also on 'the issues that mattered' the French were devoid. In the light of potential geopolitical condominium idea of Europe between United State and Soviet Union,[1145] France miss-understood the initiative as a mean to strengthen US hegemony and grip over its part of Europe, when in fact it was meant to empower Europe.[1146] While some European countries, such as Italy and Holland, were ready to accept anything that the United States would propose, others, e.g., Germany, were waiting for the result of these negotiations. In vain, as even on the subsequent lower-level meetings after the summit (e.g., June 5th, 1973) France was not specific what it desired and was there only to oppose.[1147] In order to bolster its negotiation power, France used European Community as an excuse and a tool. Namely, under the pretense of European unification process, France pushed to strengthen the European

[1141] In fact, Kissinger's aide Helmut Sonnenfeldt remembers that Jobert was set to get "under Henry's skin; he studied his technique and set out to irritate him" (Horne, Alistair. 2009. *Kissinger: 1973, The Crucial Year*. New York: Simon and Schuster. Pp. 115). Jobert was a hard-DeGaulist (Kissinger. 1982. Pp. 163−4), whom Kissinger labelled later as an idiot (*White House Memorandum of Conversation*. 1974. February 9. Accessibility: https://www.fordlibrarymuseum.gov/library/document/0314/1552661.pdf (28 July 2019). Pp. 4). He was sardonic, but Kissinger did not dispute his intellect, analytical capabilities, and culture (Kissinger. 1982. Pp. 164).
[1142] Kissinger. 1982. Pp. 178.
[1143] Kissinger. 1982. Pp. 178.
[1144] Memorandum of Conversation, 31 May 1973, Nixon and Pompidou. Accessibility: http://www.sscnet.ucla.edu/polisci/faculty/trachtenberg/ffus/00742.pdf (17 April 2020).
[1145] More on the French fears over detente and potential carving out of Europe, see Association Georges Pompidou. 1995. *Georges Pompidou et l'Europe*, Bruxelles: Complexe.
[1146] Memorandum of Conversation, 25 May 1973, Nixon, Kissinger, Rush, Haig, Garment, Scowcroft. Accessibility: http://www.sscnet.ucla.edu/polisci/faculty/trachtenberg/ffus/00738.pdf (17 April 2020). At the meeting with Jobert, Kissinger even stated that United States is "not against French autonomy" (Memorandum of Conversation, 17 May 1969, Kissinger and Jobert), and he went on a great length to explain the US position the day after with Pompidou (Memorandum of Conversation, 18 May 1969, Kissinger and Pompidou). Yet, in vain.
[1147] Kissinger. 1982. Pp. 177−81.

political cooperation in matters of foreign policy in Copenhagen in July 1973. The document stated that European Community members would negotiate with the United States as one entity.[1148]

Thus, what was needed for a new start in Transatlantic relations, was a fresh set of political faces. "Although transatlantic relations were a mess, Kissinger comforted himself with the knowledge that the EC was in an even bigger mess."[1149] US officials were frustrated over the slow pace of European coordination.[1150] Particularly, as the United States was ready to strike a deal, as its bodies developed several studies, papers, and alternatives how to codify the new IMS.[1151] But

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[1148] Second report on European political cooperation in foreign policy matters. 1973. Adopted July 23rd. Accessibility: https://www.cvce.eu/content/publication/1999/1/1/8b935ae1-0a38-42d4-a97e-088c63d54b6f/publishable_en.pdf (26 April 2019).

[1149] Nichter. 2015. Pp. 149. Nixon referred to European Community as 'Frankenstein monster' (Draft Memorandum From President Nixon to the President's Assistant for National Security Affairs (Kissinger), March 10, 1973). While Kissinger went as far as calling Europeans 'bastards' (Transcript of a Telephone Conversation Between Secretary of the Treasury Shultz and the President's Assistant for National Security Affairs (Kissinger), August 15, 1973. In United States Department of State, Rasmussen, Kathleen B. (ed.). 2009. *Foreign Relations of the United States, 1969–1976, Volume XXXI, Foreign Economic Policy, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76v31/d52 (24 January 2021)). Kissinger explained the absurdity (Memorandum of Conversation, 28 November 1973, Kissinger, Sonnenfeld, Rusk, Dillon, Rockefeller, Bundy, Vance, McCloy. Accessibility: http://www.sscnet.ucla.edu/polisci/faculty/trachtenberg/ffus/00928.pdf (21 December 2020): "/T/he countries who can negotiate with us won't talk and those who can talk with us can't negotiate."

[1150] "There is no real negotiation, since the Europeans state their position, then we state ours, and then the Europeans go away to work out their response, after which the whole process is repeated" (Richard M. Nixon Library, National Security Council Files, Box 1027, Memorandum of conversation among Henry Kissinger, Dean Rusk, Douglas Dillon, Nelson Rockefeller, McGeorge Bundy, Cyrus Vance, and John McCloy, November 28, 1973). As the gridlock continued and the Year of Europe did not go as planned, the vocabulary became more vivid. For example, at one point Kissinger asked Haig what he thinks of "/t/hese fucking Europeans?" To what Haig responded that Nixon told him to "get the football" (Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 24, March 16, 1974). Football here is a reference to the briefcase in which the President of the United States has the codes to authorize a nuclear attack. And at different occasion Kissinger expressed his fears to his advisors that France is moving towards anti-American left: " "Things will be worse. The trend in France is toward the left and the left is anti-American. We have every reason to break the French now /…/ I would rather break the European Community than have it organized against the U.S. Only the French have a strategy and it is anti-American" (Memorandum of Conversation, Washington, March 5. In United States Department of State, Rasmussen Kathleen B. (ed.). 2014. *Foreign Relations of the United States, 1969-1976, Vol E-15, Part 2, Documents on Western Europe, 1973–1976*. Washington: United States Government Printing Office. Accessibility: https://history.state.gov/historicaldocuments/frus1969-76ve15p2/d50 (21 December 2020)).

[1151] E.g., The US Proposals for Using Reserves as an Indicator of the Need for Balance-of-Payments Adjustment. Supplement to Chapter 5. 1973. In *Economic Report of the President*. Washington: US Government Printing Office. Pp. 160–74.

at the same time, the situation was in part of US doing as they preferred bilateral negotiations and neglected that Europeans need to coordinate their responses due to the common market.[1152] "Europeans were too self-absorbed with the European integration movement and that they had subordinated the Atlantic alliance in the process."[1153]

This stalemate lasted until early 1974, when on February 28th, British Prime Minister Edward Heath was defeated, and a more American-friendly Labor party under Harold Wilson came to power. This was a prelude of change among the political leaders in all relevant countries – France, Germany, United States, Japan – by the end of 1974. After the UK, Georges Pompidou died on April 2nd. He was succeeded by Giscard d'Estaing, and equally important: Jobert did not receive any position in the new government. The new Foreign Minister Jean Sauvagnargues stated to a journalist at Le Figaro that this turn of events mean the end of the most absurd dispute ever.[1154] In Germany, Willy Brandt resigned on May 6th due to an affair where it was reviled that a Stasi agent was a part of his cabinet (Günter Guillaume).[1155] He was replaced with a genuinely pro-Atlanticism Helmut Schmidt.[1156] On August 9th, Nixon resigned due to the Watergate scandal, thus

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[1152] Kissinger said to Brent Scowcroft: "We have broken the Community, just as I always thought I wanted to" (Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 24, February 12, 1974). And Nixon felt the same: "The point is the European Community, instead of having that silly unanimity rule, learned they can't gang up against us ... people will see it later, Henry. By God it was a hell of thing" (Richard M. Nixon Library, National Security Council Files, Henry A. Kissinger Telephone Conversation Transcripts, Box 24, February 14, 1974). Indeed, the Germans were tiered of Jobert, and they even suggested that France should move towards a 'half in – half out' position in the European Community, as they have done in NATO (National Archives, Record Group 59, State Department, Central Foreign Policy Files, Telegram from American Embassy Bonn to Secretary of State, FRG, France and Europe: German Bitterness Intensifies, February 14, 1974).

[1153] Nichter. 2015. Pp. 155.

[1154] "C'est la fin de la dispute la plus inutile du monde." See, Jacques Ogliastro, *Le Figaro*, June 20, 1974.

[1155] Spohr, Kristina. 2016. *The global chancellor: Helmut Schmidt and the reshaping of the international order*. Oxford: Oxford University Press. Pp. 10.

[1156] For a foreign policy comparison of Brandt and Schmidt, see Haeussler, Mathias. 2018. Two very different Atlanticists? Willy Brandt and Helmut Schmidt, 1945-1992. In Rother, Bernd, and Klaus Larres (eds.), *Willy Brandt and International Relations: Europe, the USA and Latin America, 1974-1992*. London: Bloomsbury Publishing. Pp. 51–65.

making his vice-president Gerald Ford the head of the hegemon.[1157] Ford made minor reshuffles to Nixon's cabinet and advisors.[1158] Finally, in Japan on 9th December 1974, prime minister Kakuei Tanaka resigned due to corruption scandals.[1159] Takeo Miki his replacement, had a domestic and international appeal as he was considered a politician with morals and personal integrity. However, this eventually would also cause his downfall in 1976, as he lost favorability among the elites and leaders of The Liberal Democratic Party of Japan.[1160]

Throughout the months of political stalemate in 1973 and 1974, C-20 continued with its work.[1161] On March 27th, 1973, after the major currencies began to float, the C-20 admitted that floating exchange rates could be useful mechanism,[1162] and with that, negating its original objective. The C-20's communique from the meeting summed its progress:

> "Members of the Committee recognized that exchange rates must be a matter for international concern and consultation and that in the reformed system the exchange rate regime should remain based on stable but adjustable par values. It was also recognized that floating exchange rates could provide a useful technique in particular situations."[1163]

[1157] For a good overview of the transition see Werth, Barry. 2007. *31 Days: Gerald Ford, the Nixon Pardon And a Government in Crisis*. New York: Anchor.
[1158] "The only new face among Ford's main advisors was Alan Greenspan" (De Beaufort Wijnholds. 2015. Pp. 216), who became the Chair of the Council of Economic Advisers.
[1159] See, Johnson, Chalmers. 1995. *Japan, who governs?: the rise of the developmental state*. New York: WW Norton. Ch. 9.
[1160] More on Japanese Prime Ministers see, Hayao, Kenji. 2014. *The Japanese prime minister and public policy*. Pittsburgh: University of Pittsburgh Press.
[1161] C-20 even created a group, led by an American Robert Solomon, to examine different proposals regarding the adjustment. The group met throughout April and May 1973, See Truman. 2017. Pp. 30.
[1162] Leeson. 2003. Pp. 178.
[1163] Communique of the ministerial meeting of the Committee of Twenty, March 27. 1973. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 197–99.

Furthermore, similar wording did also appear in its interim report[1164] and final report.[1165] As such, C-20 was faced not only with political obscurity, but also with ideational confusion. Hence, in desire to become relevant and pragmatic, the members opted for hodgepodge recommendations, which did nothing but reinvent the wheel and did not contain plan of action or were not accompanied with steps how to implement them. The authors blamed this vagueness on the uncertain environment.[1166]

> "/T/he C-20 deputies met on January 14-15, 1974, and there followed by a ministerial meeting on January 17 and 18. Both sets of meetings agreed not to pursue reform proposals in the current international environment, but rather to recommend some much more modest patchwork repairs to what had remained of the old system: strengthening of the IMF's surveillance function by the addition of a continuing body for ministerial meetings, and the elaboration of conditions and rules for floating."[1167]

Thus, it was clear long before in June 1974, the C-20 produced the final report − Outline for Reform – that his report is dead on arrival.[1168] It listed measures to be adopted immediately to serve during the evolution to the new system. One of them was a creation of the Interim Committee to further discus and produce reform steps.[1169] Interim Committee first meet on 3rd October

[1164] Report to the Board of Governors of the International Monetary Fund by Chairman of the Committee on Reform of the International Monetary System and Related Issues. 1973. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 155−63.
[1165] Report to the Board of Governors of the International Monetary Fund by the Committee on Reform of the International Monetary System and Related Issues. 1974. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 165−96.
[1166] Report to the Board of Governors of the International Monetary Fund by the Committee on Reform of the International Monetary System and Related Issues. 1974.
[1167] James. 1996. Pp. 255.
[1168] Report to the Board of Governors of the International Monetary Fund by the Committee on Reform of the International Monetary System and Related Issues. 1974. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 165−96.
[1169] De Vries. 1986. Pp. 127.

1974,[1170] the day after it was formally established[1171] and when the C-20 was terminated.[1172] Truman makes a good summary of the C-20 final report:

> "/T/hat the exchange rate regime should be based upon par values but with greater scope for exchange rate adjustment than under the Bretton Woods regime and tolerance of floating with the approval of the IMF. In addition, the committee agreed the balance of payments adjustment process should be more symmetrical with settlement responsibilities for all countries. In other words, countries running current account surpluses should be subject to graduated pressures to reduce those surpluses, and the United States should not be allowed to finance its international transactions via the unlimited issuance of liquid liabilities. Finally, an increasing flow of real resources to developing countries, and their capacity to obtain goods and services from abroad, should be promoted."[1173]

Moreover, the report also suggested that countries should not use capital controls and spoke in favor of reinstating SDR as IMF's reserve unite.[1174] As such, states would have to create a Substitution Account[1175] in the Balance of Payments would be created for SDR transactions. IMF pushed for greater role of SDR in the global monetary architecture – becoming a reserve asset, unit of account, and also presented a new method of valuing SDR in terms of basket of currencies

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[1170] The communiques of the Interim Committee, 3rd October. 1974. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 217.

[1171] Composite Resolution on the Work of the Ad Hoc Committee on Reform of the International Monetary System and Related Issues and on a Program of Immediate Action, Second Resolution (No. 29-8). In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 213−5.

[1172] Composite Resolution on the Work of the Ad Hoc Committee on Reform of the International Monetary System and Related Issues and on a Program of Immediate Action, First Resolution (No. 29-7). 1974. In De Vries, Margaret Garritsen (ed.). 1985b. *The International Monetary Fund 1972-1978, Cooperation on Trial, Vol III: Documents*. Washington: International Monetary Fund. Pp. 208.

[1173] Truman. 2017. Pp. 25.

[1174] Report to the Board of Governors of the International Monetary Fund by the Committee on Reform of the International Monetary System and Related Issues. 1974.

[1175] More on the idea of the substitute account, which was never implemented, see McCauley, Robert N., and Catherine R. Schenk. 2014. *Reforming the international monetary system in the 1970s and 2000s: would an SDR substitution account have worked?*. Accessibility: https://www.bis.org/publ/work444.pdf (20 March 2020).

instead of gold.[1176] But states under the influence of the oil shock disagreed.[1177] They preferred free flow of capital, floating exchange rates, and the US dollar.

Furthermore, the report was overshadowed by IMF adoption of guidelines for the management of floating exchange rates on June 13th, 1974, and a new method of calculation of SDR value based on 16 currencies.[1178] This was the difference between the IMF and the C-20. If the prior learned from being ignored in the past two years and accepted the economic evolution in that floating exchange rates are something that the new IMS will have to embrace, the C-20 did not. C-20 was out of touch from the reality and its proposals mushy – without a clear framework. It failed to understand that 1973 free floating currencies were structurally as significant as 1944 Bretton Woods agreement. 'Back to the future' was simply not possible; a new Bretton Woods was not what states preferred.[1179]

The initial experience with floating exchange rates made states realize that this is a neat mechanism to assure easy adjustment. "Countries were not willing to give up the flexibility offered by the ad hoc system that was currently operating."[1180] This conviction was so adamant and omnipresent that in September 1973 the French finance minister Giscard d'Estaing proposed a one-year suspension of all negotiations on the matter.[1181]

[1176] De Vries. 1986. Pp. 122–3.
[1177] See Elson. 2011. Pp. 56–8.
[1178] *International Monetary Fund Annual Report*. 1974. Washington: International Monetary Fund. Pp. 51. In fact, the C-20 final report endorsed these guidelines.
[1179] See Williamson. 1977. Pp. 67–71.
[1180] Truman. 2017. Pp. 31.
[1181] Truman. 2017. Pp. 31.

However, it also became clear that enhanced capital flows generate greater volatility, which meant that cooperation and surveillance became much desired.[1182] Namely, high yields of oil salles made oil exporters invest in Europe and United States; they have also created Sovereign Wealth Funds (SWF)[1183] and recycled the money through private banks not through the international institutions. Thus, after 1971, and particularly with the oil crisis in 1973 (October 10–17), the rise of private markets and transactions was dramatic. "The main source of balance of payment financing /was/ no longer IMF but private banking institutions".[1184] This led to gradual lowering of the maternity of loans and other financial instruments.[1185] This was a testament to the fact that the new financial economy is enhancing the volatility as well as the capital movements and subsequently number of transactions. Moreover, volatility should not be equated with crisis. Although "the new floating rates have proved to be much more volatile than had originally been expected"[1186] the states still possessed measures how to deal with them – enhancing the role of their Reserve Accounts. This also made states aware that a surveillance mechanism would be beneficial, which is what eventually became a new dominant task for the IMF, allowing this organization to survive in the new IMS.

After the failure of C-20, the Interim Committee continued its work, and during its mandate the agreement on the new IMS was reached. Yet, the reasons for the success cannot be attributed to the Interim Committee, which was by and large executing what the new aforementioned political

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[1182] De Vries. 1986. Pp. 134−5.
[1183] More on SWFs see Csurgai. 2009.
[1184] Cohen, Benjamin J. 1983. Balance-of-Payments financing: evolution of a regime. In Krasner, Stephen D. (ed.), *International regimes*. Ithaca: Cornell University Press. Pp. 315−36. At Pp. 315.
[1185] "While in 1974, two thirds of the loans still had a maturity of between seven and ten years and one tenth had a maturity of more than ten years in 1975 two thirds were dated between one and six years, and only 1 percent had a maturity of more than ten years" (James. 1996. Pp. 319−20).
[1186] De Vries. 1986. Pp. 122.

leaders agreed in their rather informal conversations on their bilateral summits.[1187] Namely, a series of bilateral meetings took place between December 1974 and November 1975, which led to a second amendment to the IMF Articles of Agreement.[1188] The Interim Committee adopted this amendment in Jamaica in January 1976; and it entered into force in April 1978. However, the Interim Committee can be attributed to resolving the gold problem at its June 1975 Paris meeting. The speculative market prices of gold were three or four times higher than official price,[1189] and so the official price of gold was abolished, and states agreed "to abrogate obligations to use gold in payments between the Fund and the members."[1190] They also decided what to do with IMF gold – some of it would be sold on the market and some of it returned to members on the same price as it bought it. Profits would go to advance developing members.[1191] Thus, the saga of establishing and codifying a new IMS ended – almost seven years after it begun with the Nixon Shock.

Such a sequence of events poses questions: Why were bilateral meetings the route to solution after March 1973, just like it was after August 1971? Why did the formalization of an agreement take even longer after 1973 than in 1971? In both cases the institutionalist route did not offer the hegemon nor the non-hegemonic states a feasible route to assure their interests.[1192] No-one wanted to "submerge immediate national interest to the benefit of the world economy as a whole and suggest policies that would reconcile conflicting interest."[1193] Thus, working informally and bilaterally was the only feasible option. Hence, a new round of bilateral negotiations was necessary once the Smithsonian Agreement broke down, and again the hardest nut to crack were

[1187] See De Vries. 1986. Ch. 15.
[1188] De Vries. 1986. Pp. 115.
[1189] De Vries. 1986. Pp. 95.
[1190] De Vries. 1986. Pp. 130.
[1191] De Vries. 1986. Pp. 130.
[1192] See also, Shultz and Dam. 1977. Pp. 121.
[1193] De Vries. 1986. Pp. 156.

the opposing positions of the United States and France. The reason why it took longer, I claim, was threefold.[1194] First, Smithsonian Agreement in 1971 needed not be ratified by states, as in the case with second amendment to the IMF Articles of Agreement. Second, 1973 and 1974 were consumed by political tensions, as a culmination of previous years and events, as well as states wanted to see how floating exchange rates will perform. Once these issues were resolved, the bilateral negotiations could be successful. Therefore, real negotiations and work on the IMF amendment took less than a year. In the light of the magnitude of the agreement, this is not that much. Third, in 1971 there was a sense of urgency, which was absent after 1973 when the negotiations commenced.

Thus, a transition to a floating regime proved to be smooth, as states stayed committed to it after March 1973. Suh an engagement proved useful also for the negotiations on the new IMS, as it allowed easy adjustment to the oil shock that had begun in October 1973. Regarding the latter 'market first' sequence, James explains:

> "/T/he markets developed largely independently of the wishes or intentions of policymakers. The monetary expansion and the activity of international financial markets meant that the reserve problem disappeared altogether as a global concern: there were clearly sufficient reserves, although the extent of global imbalances meant that they were badly, or unequally distributed. In addition, the United States remained the default major issuer of reserve currency, Germany and Japan, feared the potential effects of reserve use on their own ability to control domestic monetary behavior and the external exchange rate. In consequence, they were for the moment

[1194] I disagree with Krugman and Obstfeld (2008. Pp. 540−2), who claim that the delay was due to the oil shock, which kept countries occupied to avoid further deadlocks on international monetary reform. If anything, I see the oil crisis as catalyst for the agreement since it contribute to the awareness of states about the benefits of free-floating exchange rates and free flow of capital. De Vries (2011. Pp. 95) elaborates: "While relationships between currencies changed markedly, there was an absence of the disruptions in foreign exchange transactions, forced market closings, quick massive shifts of capital, and resulting panic over reserve losses that had characterized economic events of lesser moment in the declining days of the par value system."

unwilling to take many of the liberalization measures that might have made their currency more attractive as a reserve asset."[1195]

All this crystalized that the free-floating exchange rate regime served the interests of both the hegemon and non-hegemonic states.[1196] Moreover the 1973 oil crisis, when the OPEC surpluses were recycled through the Euro-dollar market, created excessive liquidity. This in turn killed the idea of enhanced role of SDR,[1197] as these markets were by-and-large conducted in US dollars and the liquidity question did not cause any issues.[1198] Furthermore, the oil crisis had had two more consequences:

[1195] James. 1996. Pp. 251.

[1196] Cohen, Benjamin J. 1977. *Organizing the world's money: the political economy of international monetary relations*. New York: Basic Books. Pp. 95−7; Cohen. 1983.

[1197] In the regard of SDR, oil crisis came in handy for United States, since now it need not to push for low interest rates for SDR in order avoid incentivizing countries to run a surplus (see, National Archives, Record Group 56, General Records of the Department of the Treasury, Box 2, Volcker Group Papers: 21, Reserve Assets and Convertibility: U.S. Views, January 5, 1973). With lower interest on the SDR than dollar securities, foreign financial institutions would likely find holding dollars more attractive (Gerald R. Ford Library, Papers of Arthur Burns, Box B74. Charles Siegman, Some Comments on Treasury Draft – Some Comments on the Nature of Reserve Assets in the Context of a Reformed International Monetary System). Thus, although SDR was formally recognized by the Jamaica Agreement, it never caught on as a reserve asset (Gerald R. Ford Library, Papers of Arthur Burns, Box K29, Robert V. Roosa, The Jamaica Agreements, Testimony for Submission to the International Finance Subcommittee of the Senate Banking Committee, August 27, 1976).

[1198] Most of oil was priced in US dollars and dollar securities also received the greatest position of the investment coming from OPEC countries. US Treasury estimated that 25% of OPE surpluses were invested in the United States, and an additional 45% went into the Euro-dollar market. As such, there was little risk that the crisis would impact the position of the US dollar in the global economic relations. See, Gerald R. Ford Library, Papers of Arthur Burns, Box B86, Oil, Peter Fousek, The Jump in Oil Prices and the World Economy, April 2, 1974. In fact, United States saw an opportunity how to finance its deficit in the recycling of petrodollars: countries exporting goods to the US would also reinvest those surplus US dollars back into American financial market, particularly US bonds. See *Effect of Petrodollars on Financial Markets, Hearing Before the Subcommittee on Financial Markets of the Committee on Finance of the United States Senate, 94th Congress, January 30, 1975. Statement of William Simon, Secretary of the Treasury*. Accessibility: https://www.finance.senate.gov/imo/media/doc/petrodollars.pdf (17 February 2021). William Simon, Secretary of the Treasury, visited Saudi Arabia in July 1974 and proposed such an arrangement. Hence, until 1977 the Saudi and Middle Easter in general investments in the US debt increased to 65% from 43% (Miller, Judith Miller. 1977. U.S. Securities Draw More OPEC Dollars. *New York Times*, September 22. Accessibility: http://query.nytimes.com/mem/archive/pdf?res=F5081FFE3D5C167493C0AB1782D85F438785F9 (25 February 2014). Nevertheless, Saudi Arabia still attempted to gain more by using coercive diplomacy and threatened to switch from using the US dollars to SDR. However, the United States took decisive action to undercut the SDR. It engaged in intense bilateral diplomacy with Saudi Arabia, the OPEC nation with the most sway over the invoicing decision via its market share, and in 1978 agreed to a deal that would give Saudi Arabia increased voting power in the IMF in exchange for Saudi opposition to SDR use (Spiro, David. 1999. *The Hidden Hand of American Hegemony*. Ithaca: Cornell University Press. Pp. 104–5). By ensuring the dominant role of the US dollar in a crucial commodity trade, United States established an essential line of defense for its economic centrality for the next few

> "First, private commercial banks became a primary source of funds for the world, especially for the oil importing developing countries, and international banking became one of the few growth industries of the times. Second, oil importing developing countries were left with a legacy of tremendous external debt that would be difficult to service, let alone to repay, in the years to come. The creditworthiness of developing countries had been lowered, and the risk to the solvency and liquidity of commercial banks increased."[1199]

Hence, how did the bilateral meetings shape the new IMS after Reykjavik and the Year of Europe initiative? Although there were no high-level summits, there were numerous bilateral meetings at the level of secretaries and deputies, which were described at that point by French Finance minister – Valery Giscard d'Estaing – as private, informal meetings of those who really matter in the world, a conversation between very few people and almost on a private level.[1200] It became clear that the proceedings got stuck between the positions of United States and France. The former argued in favor of codifying free-floating exchange rates, blamed fixed exchange rates for high inflation and argued that floating exchange rates could prevent a crisis in exchange markets and could prevent depressions. The latter presented a diametrically opposite view.[1201] Empirically, United States was right, and slowly but surely the French realized they need to alter their perspective on the matter.[1202]

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decades. Moreover, seeking high yields for their surplus US dollars, the US debt market also generated incentives and interests of oil producing countries to preserve the centrality of US dollar.

[1199] De Vries. 1986. Pp. 154.

[1200] Putnam, Robert D., and Nicholas Bayne. 1984. *Hanging together: The seven-power summits*. Boston: Harvard University Press. Pp. 15.

[1201] De Vries. 1986. Pp. 128.

[1202] France slowly began to understand that the floating exchange rates take away US power that they were complaining about since 1960s – exorbitant privilege (Trachtenberg. 2011. Pp. 16)

With the change of personalities at the head of the executive of states, the stalemate broke.[1203] The frequency of the meetings increased: in early 1975 seven-teen of those took place in a spread of only three months at the level of deputy ministers.[1204] Yet, more importantly, summits again appeared on the diplomatic menu.

In December 1974, Ford met Schmidt as well as d'Estaing. At the summit with Schmidt on December 4th through 5th, a German Chancellor displayed more interest in economics (particularly inflation) than security. Schmidt met with Ford's economic team separately and gave critical views on the global economy. This generated trust between the two countries, since Schmidt now saw and was convinced that the economic destinies of the West were interlinked. Furthermore, Schmidt argued that extensive US deficit spending was needed for global recovery. Ford disagreed and focused on consumer solidarity. Schmidt also offered to help persuade France on the issue, which was later displayed at the summit with France.[1205]

The summit with d'Estaing took place in Martinique (14-16th December) with energy being the key topic.[1206] Monetary reform was not high on the agenda. However, they could not avoid the topic, since 1974 and 1975 were the years of "deepest international recession in four decades."[1207]

[1203] When it comes to the United States that meant that "Arthur Burns became close with Ford /…/ In 1975, Burns had no less than 48 meetings with Ford, and for the 2″ years of the president's tenure, 69 times, a uniquely high number. /…/ By the middle of 1975 early signs of economic recovery—so-called green shoots—had become visible in the United States, prompting a shift toward a tougher stance on inflation. Expansionary budget policy was halted, no longer providing stimulus to the economy, while the Fed was easing monetary conditions. Such a policy shift taken in great harmony owed much to the personalities involved. The /new/ president's chief economic advisor, Alan Greenspan, /also/ enjoyed an excellent rapport with Ford" (De Beaufort Wijnholds. 2015. Pp. 218).
[1204] James. 1996. Pp. 268.
[1205] Kissinger, Henry. 1999. *Years of renewal*. New York: Simon & Schuster. Pp. 687.
[1206] Kissinger. 1999. Pp. 686−7.
[1207] De Vries. 1986. Pp. 153.

All this made statesmen aware of a truly integrated world economy – not only financial markets, but also trade, manufacturing production, and labor.[1208]

> "Accordingly, the influence of exchange rate, monetary, and financial policies on balance of payments capital accounts had become at least as important a consideration in determining these policies as their impact on trade and other current account items."[1209]

Furthermore, United States proposed in Martinique to create regular economic meetings among the great powers.[1210] From this US initiative G-5 organization was established, which later morphed into the G-7, G-8, and finally G-20.[1211]

> "The most important result of Martinique meeting was the decision to constitute an informal and unofficial group of trusted advisors of key industrial democracies. /They were/ to meet regularly to plan joint policies regarding the oil crisis and economic recovery."[1212]

United States preferred this G-5 (United States, United Kingdom, France, Germany, and Japan) setting than G-10, since the number of European states was smaller, and they could avoid the 'nine vs. one' situation.[1213] The first such summit was held in Rambouillet from 15th through 17th November 1975.[1214] There Germany took the lead in economic coordination, Japan on trade,

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1208 De Vries. 1986. Pp. 96–7.
1209 De Vries. 1986. Pp. 98.
1210 Kissinger. 1999. Pp. 689.
1211 For history of G-7 and its successors G-8 and G-20 see Baker, Andrew. 2006. *The Group of Seven: finance ministries, central banks and global financial governance*. New York: Routledge; Hajnal, Peter I. 1999. *The G7/G8 System: Evolution, role and documentation*. New York: Routledge; Hajnal, Peter I. 2007. *The G8 system and the G20: evolution, role and documentation*. New York: Routledge.
1212 Kissinger. 1999. Pp. 688.
1213 Elson. 2011. Pp. 68–9.
1214 Kissinger. 1999. Pp. 692–3. Ford brought back Shultz, who left the government in 1974 for a position in a private sector, as an informal ambassador (Shultz and Dam. 1977. Pp. 113). Thus, Shultz, "meet with Giscard and Helmut Schmidt, as well as with Harold Wilson, the British prime minister, to sound them out. Marking progress, a dinner was arranged at Marly, a residence near Versailles reserved for French presidents. In a congenial atmosphere,

France on monetary issues, and United States on oil.[1215] Elson describes the role and work of the G-5, as a backbone of global governance:

> "operated without any formal secretariat, relying instead on the network of informal contacts among subcabinet level treasury staff and senior central bank officials in the major capitals. Most major decisions taken by other IOs, e.g. IMF, would be agreed in advance by this group, which in effect replaced the G-10 as the locus of decision making regarding the international financial architecture. The G-7 would come to see institutions such as the IMF and World Bank as key instruments of the international financial architecture for managing problems affecting developing, emerging market and transition countries in the global economy. The main rationale for this forum is that it has allowed for an effective exchange of views on international economic issues and a peer review process for macroeconomic policy cooperation among key representatives of the major financial powers with strong common interests in the international financial system, in a relatively closed setting that facilitated dialogue and debate."[1216]

If the Martinique summit was a breakthrough towards the new IMS, then Rambouillet summit was the crucial steppingstone. It resulted in a Declaration[1217] that reflected the previous lower-level agreements that daily consultation "between central banks, weekly between finance ministry officials, and quarterly by finance ministers" were to take place, as well as that "the IMF should be excluded from these meetings".[1218] However, the document included no formal decision-making machinery and no compulsion for states to agree with specific criteria as to what might constitute erratic exchange rate movements.[1219] Yet, it was clear: free flow of capital became the crucial feature of the architecture of the new IMS. Its second feature – floating exchange rates – was not as clearly codified, but nevertheless observed empirically. States moved away from fixed

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the discussion focused on the monetary system and proved to be a turning point" (De Beaufort Wijnholds. 2015. Pp. 224), which set up the Rambouillet summit.

[1215] Kissinger. 1999. Pp. 694.

[1216] Elson. 2011. Pp. 69.

[1217] *Declaration of Rambouillet*. 1975. Adopted 17 November. Accessibility: http://www.g8.utoronto.ca/summit/1975rambouillet/communique.html (28 April 2019).

[1218] James. 1996. Pp. 269.

[1219] *Declaration of Rambouillet*. 1975.

parties as described in Chapter 2. Namely, the United States and France agreed to disagree, yet found a way how to make an arrangement that would serve both principles, by relaying on the principle of sovereignty or freedom of states to choose the exchange rate. This de-facto meant that the fix exchange rates no longer were corner of the new IMS according to the monetary trilemma. While the agreement legalized floating exchange rates, it allowed states to have fixed exchange rates if they assured its stability and assure the surveillance of the IMF.[1220] The Rambouillet summit led to a G-10 meeting in December 1975, which approved the agreement that was finally signed at the IMF Interim Committee meeting in January 1976 in Jamaica.[1221] The Accords codified free floating exchange rates and determined that the IMF would not be a "supranational central bank or the strongest regulation agency" as in the past.[1222]

The Jamaica Accord was the last step in officially ending the Bretton Woods system with recommendations on how to change the foundational document of the IMF.[1223] The document confirmed and codified, the trend that began after 15th August 1971. The Second Amendment to IMF Articles of Agreement was adopted,[1224] and hence the role of IMF was to be preserved as a watchdog for excessive volatility in the exchange rates[1225] – "to ensure that they were managing their exchange rate system in a manner that was consistent with external and internal

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1220 Article 4 of the IMF Articles of Agreement.

1221 International Monetary Fund. 1976. Press Communiques of the Interim Committee. In *International Monetary Fund Annual Report*. Washington: International Monetary Fund. Pp. 126−7.

1222 De Vries. 1985c. Pp. 761.

1223 *IMF Annual Report*. 1976. Appendix III. Pp. 119−27.

1224 See Gold, Joseph. 1978. *The Second Amendment of the Fund's Articles of Agreement*. Washington: International Monetary Fund.

1225 "A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members" (*IMF Annual Report*. 1977. Surveillance over Exchange Rate Policies, IMF Executive Board decision no. 5392 (77/63), April 29, 1977. Accessibility: https://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1977.pdf (29 July 2019). Pp. 108).

sustainability".[1226] This in fact reduced the duties of IMF to the level of other international institutions that had been tasked with surveillance – BIS and G-10.[1227]

> "While more decision making on the global governance of the international financial system began to move outside of the IMF with the growing influence of the G-7 and G-10, the G-10 also began to give more prominence to international financial issues in its deliberations within the BIS /…/ Another sign of a diminished role for the Fund *vis-à -vis* the advanced countries was the decision of European countries to work toward a regional system of stable exchange rates, which ultimately led to the creation of the Euro. For this project of economic and financial integration to be effective, the European countries developed a strong process of peer review of each government's economic and financial policy operating through the European Council of Finance Ministers (ECOFIN) and other fora, such as the Committee of Governors of member states of the EEC, which held its meetings at the BIS /…/ Other peer review arrangements also took on importance for the advanced countries with the regular meetings of Working Party 3 of the Economic Policy Committee of the OECD."[1228]

Its only political leverage was its ability to condition the access to its finances with specific policy measures (e.g., reducing deficits, spending cuts, tax increases, reducing protective trade barriers, and contractionary monetary policy).[1229] As such, IMF became a monitoring institution and annual reviews became mandatory.[1230] However, within the realm of institutions with the capacity to supply ideas, gather data, perform research and analysis, and provide information, the IMF has an undisputed authority.[1231] Moreover, it served as a measure to prevent beggar thy neighbor policies, which was particularly a concern for France, and hence also generated confidence in the new system. By providing developing countries with assurances on the financial markets, as they were afraid that they would not get credits because now the biggest creditors were

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[1226] Elson. 2011. Pp. 62–3.
[1227] James. 1996. Pp. 273.
[1228] Elson. 2011. Pp. 67–8.
[1229] Stiglitz, Joseph E. 2002. *Globalization and its Discontents*. New York: WW Norton. Pp. 12–3; Eun, Cheol, and Bruce Resnick. 2015. *International Financial Management*. New York: McGraw-Hill. Pp. 34–40.
[1230] See *IMF Annual Report*. 1977. Pp. 107–9.
[1231] James. 1996. Pp. 275.

private banks,[1232] IMF served also as a guarantor for development. Finally, keeping the IMF as a supervisory body also helped facilitating cooperation among states, since "floating exchange rates had not successfully solved the problem of current account balances, or reduced the need for international cooperation."[1233]

Therefore, the new IMS was very much flexible in terms of monetary trilemma. Anchored in the free flow of capital and preferred floating exchange rates, it did allow states to forgo their sovereign monetary policy in order to establish a fix exchange rate:

> "/The new IMS/ recognized that the conditions of the global economy did not allow unanimity of view on a single exchange arrangement that would be appropriate for all members of the Fund, and that countries could have a preference for different exchange arrangements depending on their economic conditions, level of development, and so on. However, once they chose a specific form of exchange rate arrangement, they were expected to communicate this decision to the IMF and fully cooperate with it in ensuring that it was implementing its exchange rate regime in a manner consistent with a stable international monetary system."[1234]

The new system allowed the member states to maintain their freedom when it comes to exchange rate;[1235] yet, they had to pursue sustainable policies.[1236] Commitment to the new IMS was quickly tested in the 1979 oil crisis, where there was much less 'third world solidarity'. Namely, "Saudi Arabia initially held down the oil prices and increasing production in the hope of preventing price chaos and a disintegration of the world economy."[1237] This contributed to even greater integration of the oil market into the global financial markets with the development of

[1232] Cohen. 1983. Pp. 327–33.
[1233] James. 1996. Pp. 411.
[1234] Elson. 2011. Pp. 63.
[1235] De Vries. 1986. Pp. 155.
[1236] Eichengreen. 1998. Ch. 5.
[1237] James. 1996. Pp. 345.

additional financial instruments such as futures.[1238] Thus, the crisis actually enhanced the commitment to free flow of capital and embracing the new financial economy.

In terms of liquidity, the new IMS enabled "financing of such large current account balances would have seemed an insuperable challenge in the circumstances of earlier decades."[1239] Hence, liquidity was not an issue under the new system. In terms of confidence: "/the/ problem was now privatized or transferred away from public sector."[1240] Furthermore, all agencies displayed confidence in such a system. In terms of adjustment: this was also determined by the free market forces of supply and demand of a currency.[1241] Hence the new post-Bretton Woods IMS was successful in providing liquidity, generated confidence, and entailed adjustment mechanisms. It presented a political solution that enabled states to reap benefits from the centrality of the US dollar, as well as assured US persistent imbalance of power.[1242]

> "The shift to increased reliance on private lenders for official financing purposes marked the culmination of a secular transformation of the process of liquidity creation. This transformation had already been going on for some time. Its roots lay in the development of the international financial markets-in particular, the growth of the Euro-dollar market-which gradually made it easier for governments to rely on private international financial intermediation rather than on the deficits of reserve centers to obtain new monetary reserves. The international markets act as worldwide financial intermediaries between the lenders and borrowers of loanable funds (including official as well as private lenders and borrowers). Private capital and the accumulated reserves of surplus countries flow into the market and then ultimately are lent on to countries in balance-of-payments difficulties. Increases of demand for credit in borrowing countries are financed by the markets, within the usual institutional and legal constraints, by borrowing or attracting de- posits from the banking systems of surplus countries with available loanable funds. The events

[1238] James. 1996. Pp. 345.
[1239] James. 1996. Pp. 262–3.
[1240] James. 1996. Pp. 263.
[1241] James. 1996. Pp. 263.
[1242] On a similar conclusion see also Cohen. 1977.

> of 1974-76 simply confirmed and accelerated a trend in the process of liquidity creation that had been evident well before the oil price increases of 1973."[1243]

Nevertheless, it would be false to label the new IMS as rule-less and claim that since it was more or less a reflection of the supply and demand on the financial market states do not play any role in it.[1244] States still have important economic tools at their disposal: interest rates, inflation targets, fiscal policies, SWFs, and also 'dirty floats'.[1245] Using these measures a state can exercise its sovereign monetary policy over its floating exchange rate and direct it towards its desired value.[1246] It can do so as long as the IMF surveillance does not get involved.

Thus, after 1973 states displayed a 'buy-in' towards the US dollar and subsequently the new IMS. Doing so they also have reproduced US hegemony. The non-hegemonic states did not see walking away from the American centric imbalance as being in their favor. Combined with the willingness of the United States to remain foundational by having the will to provide the US dollar as the central currency, led to an outcome that many would not have expected. A fundamental replacement of the core political economic mechanisms without a replacement of the central player of the political economy itself. In other words, US hegemony endured in a crisis that one would not expect displaying unique hegemonic features.

If we compare existing competing explanations for the creation of the post-Bretton Woods System, it does not appear that US hegemony was prolonged through a coercive power,

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[1243] OECD. 1977. *Towards full employment and price stability: a report to the OECD by a group of independent experts*. Paris: OECD. Para 159.
[1244] I disagree with Gilpin who argues that post-Jamaica system was a 'nonsystem'; see Gilpin. 2001. Pp. 239.
[1245] For more on 'dirty float' see Frankel, Jeffrey A. 2017. *Systematic Managed Floating*. Cambridge: National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w23663.pdf (30 July 2019).
[1246] See Feldstein, Martin S., and Charles Yuji Horioka. 1979. *Domestic savings and international capital flows*. National Bureau of Economic Research. Accessibility: https://www.nber.org/papers/w0310.pdf (30 July 2019).

institutional stickiness, ideological preference, nor the 'buy-out'. United States did not act coercively after the Nixon shock and during the negotiations leading to Smithsonian Agreement and Jamaica Accords. It did not act as a Coercive Hegemony Theory would expect. In fact, it did the opposite – it showed restraint. This theory fails to also explain the behavior of the non-hegemonic states. Namely, it would expect that in a time of a hegemonic crisis a balancing alliance would be formed. Yet, there was a lack of it. There were clear chances and options to balance against the hegemon, but even France did not push for the alternatives. The United States did not compel other states to subscribe to the new IMS and its hegemony.

Cooperative Hegemony Theory fails on similar account. Nor the hegemon, nor the non-hegemonic states did rely on international institutions and multilateral for a to resolve the crisis. In fact, everyone sought to side-track them. Both sides preferred bilateral meetings, and only when these meetings produced a solution, they moved into informal settings, and finally to multilateral fora. International organizations did very little to facilitate trust and generate negotiations. Moreover, International organizations did also very little to tie the hegemon down, as the United States executed policies completely irrelevant to the IMF and other institutions or existing rules. IMF was substantially reformed to serve the purpose of a new IMS, and this incentive for such a reform did not come within the IMF, but it was exogenous – from the state.

Cultural Hegemony Theory also falls short in providing a good explanation. Although the economic idea behind the new IMS did change,[1247] it is far from a satisfying explanation. The new

[1247] See Leeson. 2003. Roosa argued in 1967 that 90% of academic economists favor 'fluctuating rates', what Friedman disagreed with, but an observation stands that a majority of the economy scholars were in favor of enhancing flexibility in a IMS before 1971 (Friedman, Milton and Robert Roosa. 1967. *The Balance of Payments: Free versus Fixed Exchange Rates*. Washington: American Enterprise Institute. At. Pp. 177, 133–4). As such, the monetarist ideas were not dominant within the Nixon administration. In fact, there has been a diverse set of ideational opinions that were involved in a tug of war within the administration from August 1971 onwards (Burns vs. Connally vs. Shultz vs. Kissinger). Furthermore, there was also no ideological unanimity among the non-hegemonic states. All states followed their interests that were expressed very much materially – concerns for their trade balance, balance of payments, competitiveness, and development. Probably the best example of this is in fact France, which was the most reluctant to support floating exchange rates and the most adamant supporter of fixed parities. Nevertheless, it was France that was the first to leave the 'European snake' of fixed exchange rates in January 1974, because its interests guided her to do so. Ideological preferences had nothing to do with it. The non-hegemonic states accepted the new architecture because they wanted to preserve the benefits of using a US dollar and they have seen also the benefits of the free flow of capital. Ideology had very little to do with their decision.

Although the Opportunist Hegemony Theory can explain the creation of the new post-Bretton Woods IMS, it provides a weaker empirical answer to the puzzle than the Pervasive Hegemony Theory. United States has with the Nixon shock scaled down in providing its public good (US dollar pegged to the gold), without clearly stating that it will be replacing it with a different kind of public good (fiat US dollar).[1248] Moreover, the sequence of establishment of the fiat US dollar as the anchor currency or the new public good, starts with the non-hegemonic states accepting the new architecture of the IMS first, before this provision is assured. Hence, the order

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idea of more flexible IMS transcended the fault lines between economic theories and ideas. Monetarists and Keynesians both saw its benefits. Yet, one should not equate an agreement on a particular issue with a general dominance of a theory or an idea, or even an ideology. In regards of its adherence, monetarism was a minute school of thought.

[1248] Mankiw (2010. Pp. 81) defines fiat money as "money that has no intrinsic value /and it is used/ because it is established as money by government decree."

is reversed from what the Opportunist Hegemony Theory would predict, even though it rightly anticipates the ingredients of the outcome.

Finally, the explanatory power of the Pervasive Hegemony Theory exceeds others. Unlike the Opportunist Hegemony Theory, it rightly predicts the sequence of the acceptance of the fiat US dollar as a central currency in the new IMS: the non-hegemonic state 'buy-in' to the US dollar first. Because of this sequence, the post-Bretton Woods IMS arose more organically, which led James as far as to argue that it "was /not/ an agreed solution, but /a product/ of a failure to produce an agreed solution."[1249] I disagree with this conclusion since it is evident that all states preferences aligned with the preserving the centrality of the US dollar, assuring free flow of capital, and commitment to floating exchange rates. The latter is the least obvious due to the manner in which the Second revision of IMF Articles of Agreement was done. However, this if anything is a token of state commitment to reach an agreement – making sure that France is on board with moving towards free floating exchange rate regime.

[1249] James. 1996. Pp. 234.

6. CONCLUSION

> "The more the world relies on the dollar, as it did as a source of liquidity and stability during the global financial crisis, the harder it will be to move away from it."[1250]

The present research has shown that existing theories of hegemony – Coercive Hegemony, Cooperative Hegemony, Cultural Hegemony, and Opportunist Hegemony – do not have comprehensive explanatory power when it comes to US hegemony. Their common causal mechanism – ineffective balancing – where the hegemon puts balancing at bay by using different strategies – coercion, institutional leverage, ideological indoctrination, and buyout – proved less applicable for the United States case than my new Pervasive Hegemony Theory. The latter assumes that the imbalance of power is not resisted, but rather serves interests of non-hegemonic states. Hence, they reproduce the hegemony together with the hegemon. I name this dynamic as 'buy-in': the non-hegemonic states continue to position the hegemon's monetary unit in the center of global monetary and economic relations. This happens also in a time of severe monetary crisis and a change in international monetary system. Here, the hegemon signals the new architecture in which it will want to provide the monetary unit, and the non-hegemonic states 'buy-in' to that first, before reaping benefits from the central monetary currency provided by the hegemon. Therefore, US hegemony displays a different nature and fundamental mechanism behind its functioning than what is in the scope of existing theories. Although US relative power is declining, its global monetary network centrality is not. Moreover, even in times of severe crisis, such as global financial crisis in 2008, we have not witnessed US monetary centrality decline. In fact, quite the opposite is true. These facts go against what the existing theories would predict. Therefore, the

[1250] Prasad, Eswar. 2014. *The Dollar Trap*. Princeton: Princeton University Press. Pp. 18–9.

research has outlined the causal mechanism of the Pervasive Hegemony Theory by looking at the change of the International Monetary System in 1971. Figure 83 shows the performance of competing theories of hegemony in explaining US hegemony – the change of international monetary system in 1971.

Figure 83: Comparing the performance of different hegemonic theories on US hegemony

	Bretton Woods Creation	**Functioning of Bretton Woods**	**1971 Nixon Shock**	**Creation of the post Bretton Woods system**
Coercive Hegemony (10)	✓ 1	✗ 4	✓ 2	✗ 3
Cooperative Hegemony (14)	✗ 3	✗ 3	✗ 4	✗ 4
Cultural Hegemony (14)	✗ 4	✗ 4	✗ 3	✗ 3
Opportunist Hegemony (10)	✗ 4	✓ 1	✗ 3	✓ 2
PERVASIVE HEGEMONY (6)	✓ 2	✓ 2	✓ 1	✓ 1

Pervasive Hegemony Theory comes on top using two different measures of performance. First, it is the only one that can causally explain all four parts of the empirical record. Alternatively Coercive Hegemony and Opportunist Hegemony persuasively only explain two of the four. Second, the quality of Pervasive Hegemony's explanation is also better overall than that of the existing four theories. Namely, the quality of the explanation was simply ranked from the best through the least. As such, the lower score in the brackets in the table means a better score. What is even more significant is the performance of Pervasive Hegemony in comparison to other theories after 1971, namely on the international monetary system we live in today. Here Pervasive Hegemony Theory provides a stronger explanation supporting the prescription that we need to re-think the basis of policy recommendations and analysis for contemporary United States' policy. I will briefly outline this in the present concluding chapter. Lastly, it is worth pointing out the poor performance of Cooperative Hegemony Theory, which was so far a dominant idea behind US hegemony. It generated popular phrases in diplomacy and politics, such as 'rules-based order' and 'liberal international order'.[1251] Nevertheless, as it turns out, this theory is a poor framework to understand US hegemony. "International policy cooperation is very much like Nessie, the lovable Loch Ness monster: oft-discussed, seldom seen."[1252]

To summarize my key findings: First, the nature of the US hegemony is different than what existing theories would have us believe. Second, subsequent debate on decline or persistence of the US hegemony is set in the wrong environment since it misunderstands the nature of the US

[1251] For some latest policy examples on liberal international order, see Niblett, Robin, and Leslie Vinjamuri. 2021. The Liberal Order Begins at Home: How Democratic Revival Can Reboot the International System. *Foreign Affairs*. Accessibility: https://www.foreignaffairs.com/articles/2021-03-30/liberal-order-begins-home (30 April 2021); World Economic Forum. 2021. *The Future of Global Liberal Order*. Accessibility: https://www.weforum.org/focus/the-future-of-global-liberal-order (30 April 2021); Dworkin, Anthony. 2021. *Built to order: How Europe can rebuild multilateralism after covid-19*. Accessibility: https://ecfr.eu/wp-content/uploads/How-Europe-can-rebuild-multilateralism-after-covid-19_Dworkin.pdf (30 April 2021). For some latest policy examples on rules-based order, see Starting, Bec. 2021. *Perspectives: Preserving the 'Rules-Based Order'*. Accessibility: https://asialink.unimelb.edu.au/insights/perspectives-preserving-the-rules-based-order (30 April 2021); Walt, Stephen. 2021. China Wants a 'Rules-Based International Order,' Too. *Foreign Policy*. Accessibility: https://foreignpolicy.com/2021/03/31/china-wants-a-rules-based-international-order-too/ (30 April 2021); *Subcommittees on Strategic Forces and International Development, International Organizations and Global Corporate Social Impact Hearing: "Creating a Framework for Rules Based Order in Space"*. 2021. 5 May. Accessibility: https://armedservices.house.gov/2021/5/subcommittees-on-strategic-forces-and-international-development-international-organizations-and-global-corporate-social-impact-hearing-creating-a-framework-for-rules-based-order-in-space (10 May 2021).

[1252] Ghosh, Atish R., and Mahvash S. Qureshi. 2017. Toward a More Stable International Monetary System: Key Takeaways. In Ghosh, Atish R., and Mahvash S. Qureshi (eds.), *From Great Depression to Great Recession: The Elusive Quest for International Policy Cooperation*. Washington: International Monetary Fund. Pp. 219–26. At Pp. 219.

hegemony. Third, the arche of the US hegemony is the 'buy-in' of the non-hegemonic states. Fourth, the 'buy-in' has its origins in the centrality of the US dollar in the global monetary relations. Fifth, the status of US hegemony is far from decline.[1253]

This final chapter is dedicated to the fifth key point of my findings: implications of Pervasive Hegemony theory for the threats to the US hegemony and US grand strategy to tackle those prospective threat.[1254] Namely, the crucial threats for US hegemony do not come from the declining coercive power gap between the United States and rising powers, nor from the eroding international liberal order, nor from the diminishing role of capitalist ideology, nor from the decreasing capacity to buy the non-hegemonic states out. Instead, the crucial threat for the US hegemony is a potential change in the global monetary relations that would impact the central role of the US dollar.[1255] I identify three potential threats: the Euro, the Renminbi, and the introduction of digital currencies. The first two are threats of the same kind and nature as the existing economic

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[1253] "Declinist literature sets forth images of a nation winding down economically, living beyond its means, losing its competitive edge to more dynamic peoples, sagging under the burdens of empire, and suffering from a variety of intensifying social, economic and political ills" (Huntington, Samuel P. 1988. The US-decline or renewal. *Foreign Affairs*, 67(2). Pp. 76–96. At. Pp. 77). The empirics presented here show a completely different story.

[1254] For the purpose of this concluding chapter, it is of utmost importance to stress the second finding, since multiple and continuous erroneous predictions of the US decline that derive from the flawed assumption on the nature of the US hegemony – last case in point was the literature after 2008 Global Financial Crisis. The mismatch between reality and the forecasts were vast. Yet, what is even more troublesome is a general impression of a failure to acknowledge these mistakes and approach the matter anew.

[1255] This also stands for China, as I will display later on. Indeed, one can claim that Chinese strategy is to 'borrow-in' not 'buy-in', by which it means that China is pursuing a 'buy-in' behavior only temporarily, until it masters enough power to over through the US hegemony. The problem with this argument is that the 'buy-in' behavior reproduces the centrality of the US dollar, hence Chinese currency global position will not be enhanced with such a behavior. Moreover, growing their other capabilities, i.e., military, will not be enough replace US hegemony. Lastly, if China is pursuing a 'borrow-in' behavior from a selfish perspective, this may not be that different from the motivation of other non-hegemonic states. Namely, states 'buy-in' due to their selfish national interests. They may not like it United States, but they still reproduce its hegemony. The issue here is that China may have clear intentions and motivations to challenge US hegemony, whereas others only have wishful thinking. As such, their behavioral strategies are somewhat different from motivation standpoint. But not from US perspective. If United States secures a 'buy-in' dynamic, even a rouge strong state cannot challenge its hegemony. Other states will side with the hegemon if the 'buy-in' holds. If the latter indeed breaks down, then we can no longer speak of a pervasive hegemony, and the hegemonic downfall is more likely. Therefore, China would have to undercut the 'buy-in' behavior, not grow its capabilities, if it wanted to challenge the US hegemony.

system. However, the third one is a threat similar to the 1971 crisis – a change in the nature of the economy. Thus, it potentially presents the biggest danger for US hegemony. Furthermore, with the contemporary COVID pandemic the narratives of the change in the global order or acceleration of this change go hand in hand particularly with this third threat.[1256] As I will demonstrate, the first two threats are rather counter-intuitively inhibited by the COVID crisis.[1257] The latter has negatively impacted the prospects of a greater global role for the Euro and Renminbi. It seems that it has only strengthened the central position of the US dollar.

Namely, immediately when the pandemic hit the world, the Bloomberg Dollar Index, which "tracks the performance of a basket of 10 leading global currencies versus the U.S. Dollar", rose, and it only began to fall in the second half of 2020 – see Figure 84.[1258] What this indicates is a similar dynamic, as I have presented in the Introduction for the 2008 Global Financial Crisis. The US dollar played the role of a safe haven for investors in global financial markets when crisis hits. Only when things calmed down and trajectories were somewhat clearer, a search for yields come back into play and hence the US dollar index declined.[1259] Also, US bonds continued to be

[1256] For example: Campebell, Kurt M., and Rush Doshi. 2020. The Coronavirus Could Reshape Global Order. *Foreign Affairs*. Accessibility: https://www.foreignaffairs.com/articles/china/2020-03-18/coronavirus-could-reshape-global-order (9 May 2020); Haas, Richard. 2020. The Pandemic Will Accelerate History Rather than Reshape It. *Foreign Affairs*. Accessibility: https://www.foreignaffairs.com/articles/united-states/2020-04-07/pandemic-will-accelerate-history-rather-reshape-it (9 May 2020).

[1257] For an early analysis on the economic impact of the COVID crisis on the global economy see Baldwin, Richard E., and Beatrice Weder di Mauro (eds.). 2020. *Mitigating the COVID economic crisis: Act fast and do whatever it takes*. London: CEPR Press; Congressional Research Service. 2021. *Global Economic Effects of COVID-19*. Accessibility: https://fas.org/sgp/crs/row/R46270.pdf (30 April 2021).

[1258] *Bloomberg Currency Indices*. 2021a. Accessibility: https://www.bloomberg.com/professional/product/indices/bloomberg-currency-indices/ (9 May 2021).

[1259] "/M/uch of this turbulence was internationally driven. Global investors' gross purchases of US Treasury bonds and notes reflected a classic flight to quality, jumping from $1.79tn in February 2020 to $2.67tn in March. Yet this was more than offset by foreign sales, which jumped from $1.79tn to $2.98tn, nearly a trillion higher than the previous peak over the decade" (Plender, John. 2021. *The demise of the dollar? Reserve currencies in the era of 'going big'*. Accessibility: https://www.ft.com/content/408d4065-f66d-4368-9095-c6a8743b0d01 (25 May 2021)). See also a report that explains how hedge funds in late March begun their dash for cash since their solvency was in jeopardy due to the downward markets. Their sales resulted in further price declines (Schrimpf, Andreas, Hyun Song the fundamental financial element – even China increased its holdings throughout 2020 and 2021.[1260] Moreover, also for the global COVID recovery, the US dollar and the US economy are indispensable. Bloomberg analysis is unambiguous:[1261]

> "The dollar has long been a safety trade for global investors. But in post-recessionary phases with the help of fiscal aid, it can double as a bet on a global recovery. With that in mind, as capital flows to the U.S. increase, so might the bid for the currency -- much to the chagrin of traders who entered 2021 with overstretched short dollar positions. /…/ It's unlikely, however, to be a straight shot up. Given the influx of stimulus in the near term, the dollar could weaken first. As the economy recovers, investors are likely to abandon the dollar and metals as havens and buy risk, like emerging-markets assets. But that may not last long. The subsequent spike in yields and the potential outperformance of U.S. stocks will draw investors back to American shores. So the dollar smile trade will be shallow, with the bounce in the greenback likely to last well into 2021."

Shin, and Vladyslav Sushko. 2020. Leverage and margin spirals in fixed income markets during the Covid-19 crisis. *BI*S *Bulletin*, April. Accessibility: https://www.bis.org/publ/bisbull02.pdf (24 October 2020).

[1260] Department of the Treasury. 2021. *Major Foreign Holders Of Treasury Securities*. Accessibility: https://ticdata.treasury.gov/Publish/mfh.txt (25 May 2021).

[1261] Gupta, Kriti, and Vincent Cignarella. 2021. *Dollar Is Evolving From a Haven Into a Must-Have Recovery Play*. Accessibility: https://www.bloomberg.com/news/articles/2021-01-14/dollar-is-evolving-from-a-haven-into-a-must-have-recovery-play (30 January 2021).

Figure 84: Bloomberg Dollar Index[1262]

The rebound of the US economy after and already during the pandemic was great and so are its projections. In fact, it seems that due to proper fiscal and monetary reactions, the consequences of this economic crisis will not be long-lasting in comparison to other crises. We can speak of a V-shaped recovery – see Figure 85. Yet, this is only the latest example of the enduring US hegemony, which stems from the position of the US dollar in the global economy:

> "There are a few reasons why the dollar's role has proven so durable. First, the market in dollar-denominated assets, especially government debt, is far deeper than any other. Foreign exchange reserve managers typically hold high-grade securities, not cash. As a result, they often have nowhere else to turn but dollar assets, especially ultra-liquid Treasuries. /…/ Second, a consequence of the imperative of holding dollar assets is that many central banks have a lot of them. China and Japan each hold more than $1.1tn in US Treasuries, let alone other dollar assets. A dramatic shift away from the dollar would imperil the value of these holdings, putting large holders in a Catch-22. Historically, this barrier has been overcome only when conditions are so dire — such as the shift from pound to dollar during the wars of the 20th century — that adding on the cost of a currency regime change

[1262] Roach, Stephen. 2021. *The Dollar's Crash Is Only Just Beginning*. Accessibility: https://www.bloomberg.com/opinion/articles/2021-01-25/the-dollar-s-crash-is-only-just-beginning (30 January 2021).

will not make things much worse. /…/ Third, the dollar's outsized role in international trade, payments and banking means governments alone cannot decide its fate. Roughly half of world trade is invoiced and settled in dollars, and the proportion is especially high for crucial commodities such as oil. That dominance reflects, in part, the efficiency associated with using a single dominant currency. But it also reflects the centrality of American consumers in the global economy. /…/ Moreover, a crucial element of the greenback's appeal is that dollars represent claims on American goods and services. Fiat currencies are backed not just by governments but by the strength of the economies in which they are used. Today's digital currencies cannot lay claim to anything remotely comparable."[1263]

Figure 85: US stock market crashes and their respective recoveries[1264]

Returning to the threats to the US hegemony, the latter has proven to be rather resilient to a variety of challenges. In fact, with the ownership over the central monetary unit in the

[1263] Zoffer, Joshua. 2019. *Why the dollar doomsayers have it wrong*. Accessibility: https://www.ft.com/content/127c77a4-007d-11ea-be59-e49b2a136b8d (30 April 2021).
[1264] Wolf, Martin. 2021. *Economies can survive* a *stock market crash*. Accessibility: https://www.ft.com/content/a8e8475a-c808-4552-96fb-7ce5551e338e (30 April 2021).

international monetary system, the United States was in fact able not only to guide the change in the architecture of the international monetary system in 1971, when the very nature of the economy was changing, but also to actively destroy the old regime before setting up an alternative.[1265] This feature is unprecedented in history.[1266] As stated in chapter 2, there is a small community of scholars that has recognized this. However, their approach to the issue is structural. As such, I do not believe that they get to the core of the nature of the US hegemony. Namely, to have a central position is one thing, but what is the mechanism behind it, they do not show.[1267] Moreover, it is also wrong to map different conclusions about the trajectory of the US hegemony onto Security Studies vs. International Political Economy.[1268] US hegemony is not a result of international structures, but rather of relations between the United States and the non-hegemonic states, where both sides maintain US hegemony.

Hence, Winecoff (2020) uses a matrix of two centrality measures – eigenvector and betweenness – to display that the US central position goes beyond economic domain.[1269] Figure 86 shows the distribution of the global portfolio investment network (IMF Coordinated Portfolio Investment Survey); Figure 87 presents a trade network (WTO and OECD, which allows it to look

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[1265] This is by no means a small feat, as this change was as fundamental as a shift from Newtonian to Einsteinian physics (Bordo, Michael, and Harold James. 2006. *One world money, then and now*. National Bureau of economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w12189/w12189.pdf (13 December 2020)).

[1266] In fact, this finding alone is strong enough to debunk the Cooperative Hegemony Theory and its proponents. The empirical record of international institutions as the instrument for prolonging the US hegemony even after US declines in terms of capabilities, is flawed. United States actively destroyed a crucial regime before it established or fully designed a new one.

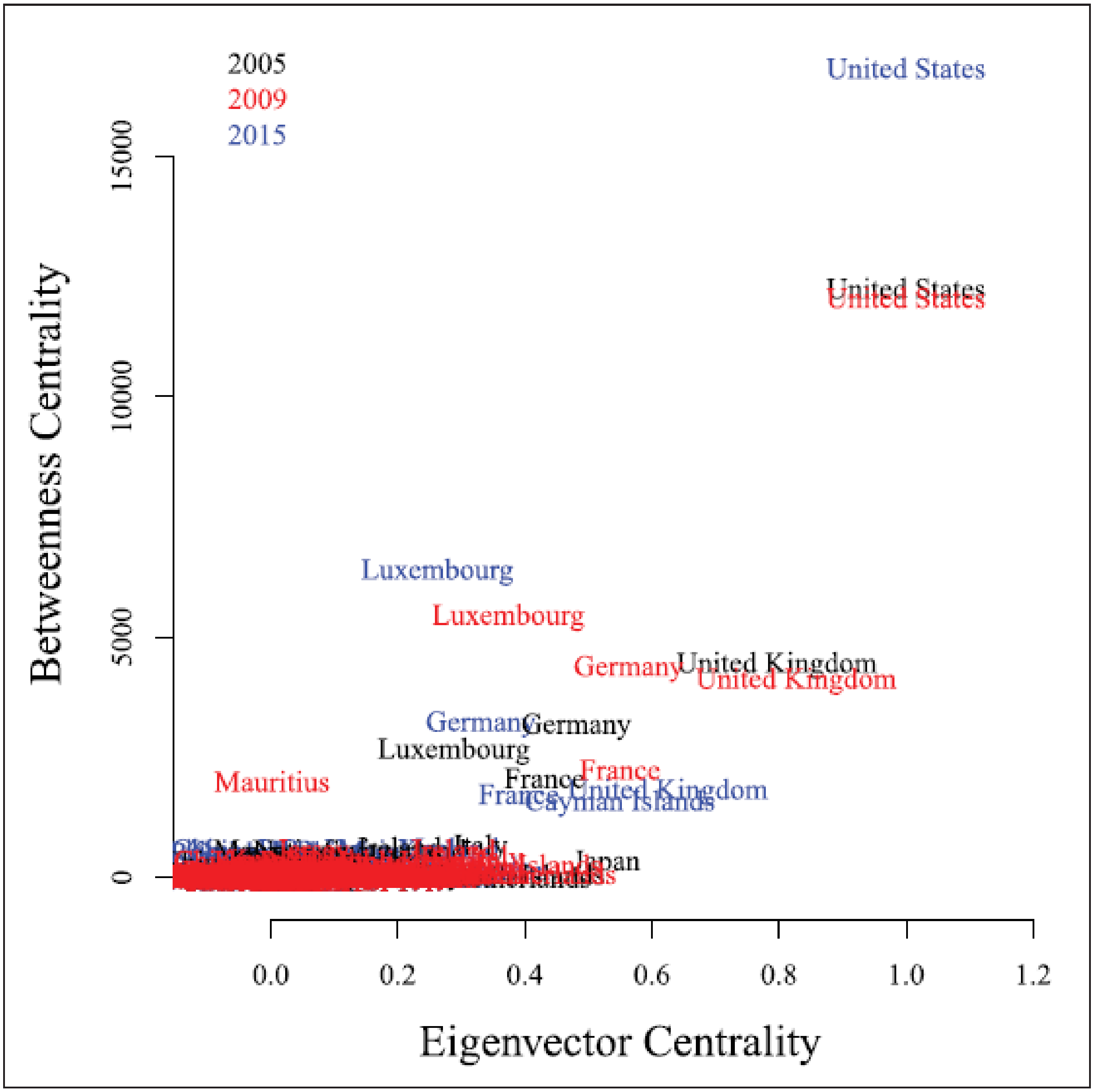
[1267] E.g., Winecoff. 2020; Fichtner. 2017; Oatley. 2017.

[1268] Norrlof, Carla, Paul Poast, Benjamin Cohen, Sabreena Croteau, Aashna Khanna, Daniel McDowell, Hongying Wang, and W. Kindred Winecoff. 2020. Global Monetary Order and the Liberal Order Debate. *International Studies Perspectives*, 21(2). Pp. 109–53.

[1269] Eigenvector centrality is a type of degree centrality measuring with how many edges a node has. But it also takes into consideration how well connected are those nodes to which the first node is connected to. Betweenness centrality measures the number of times a node lies on the shortest path between other nodes. It shows us, which nodes can serve as bridges between different clusters within a network. See e.g., Hanneman and Riddle. 2005.

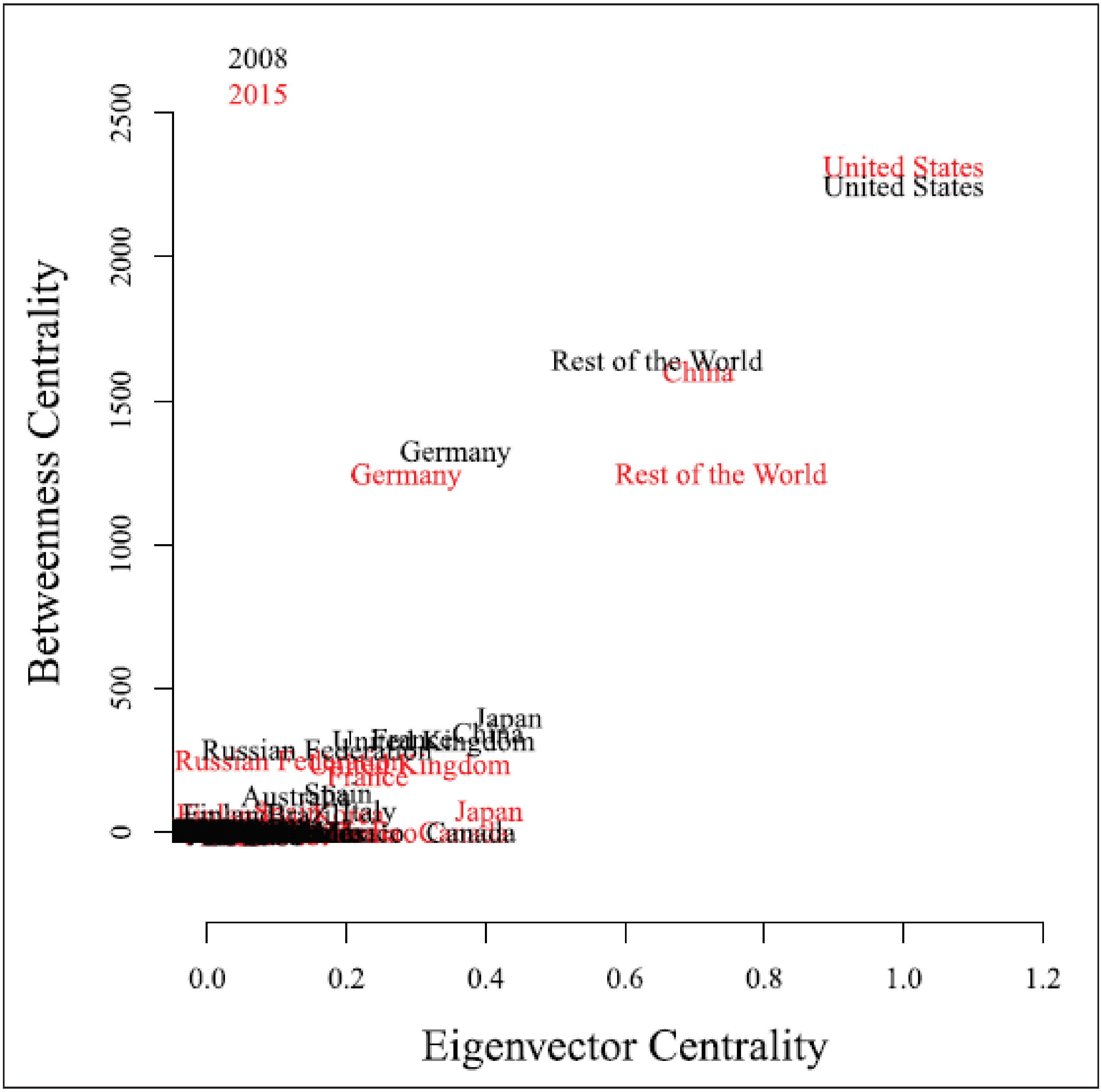
into the added value of trade); Figure 88 displays mutual defense alliances (Correlates of War, only for 2012); and Figure 89 demonstrates the amount of patent filings (World Intellectual Property Organization).

Figure 86: Eigenvector and Betweenness centrality of global portfolio investments[1270]



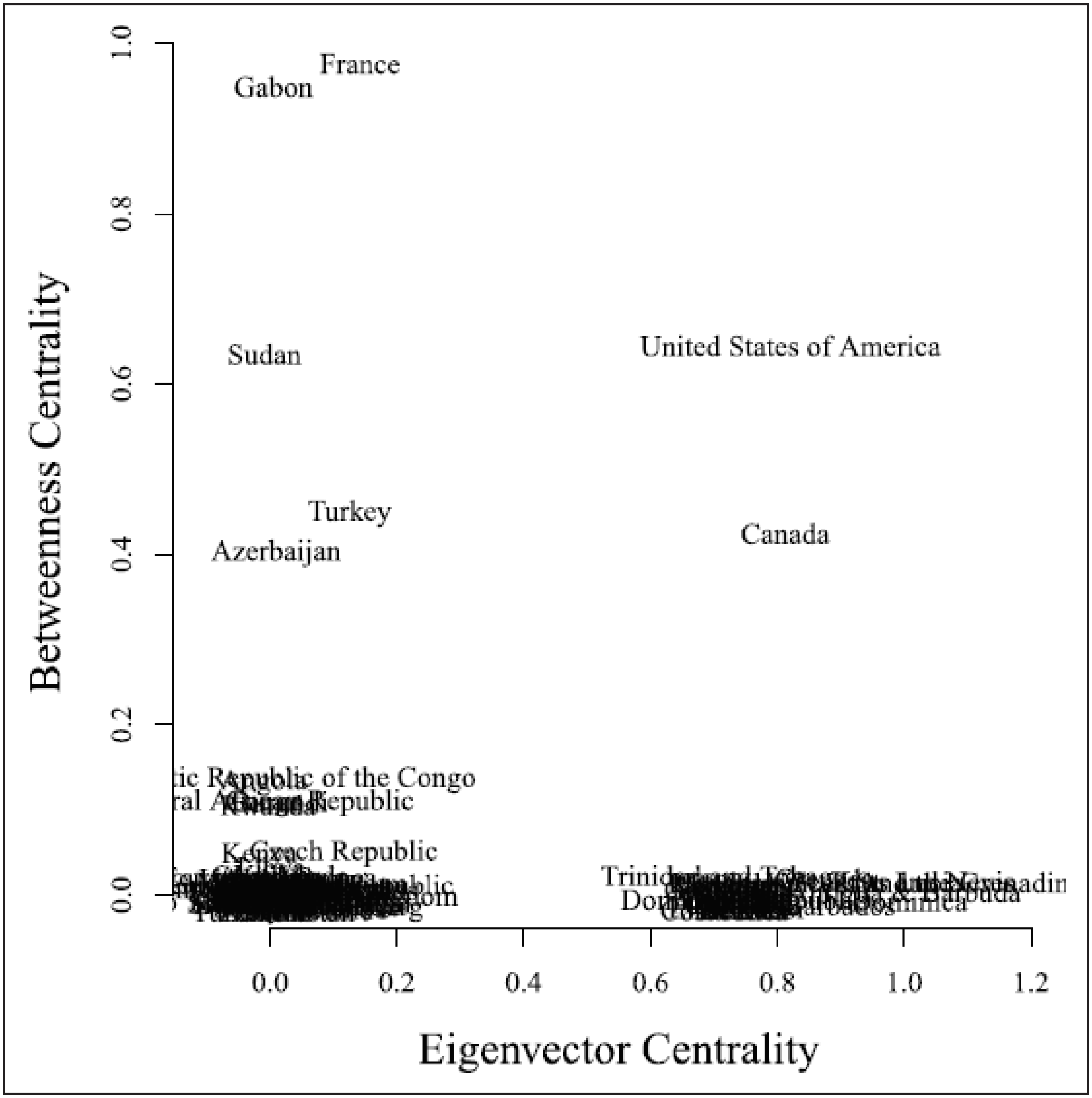
[1270] Winecoff. 2020. Pp. 228. See also Starrs, Sean. 2013. American economic power hasn't declined – it globalized! Summoning the data and taking globalization seriously. *International Studies Quarterly*, 57(4). Pp. 817–30.

Figure 87: Eigenvector and Betweenness centrality of trade's added value[1271]



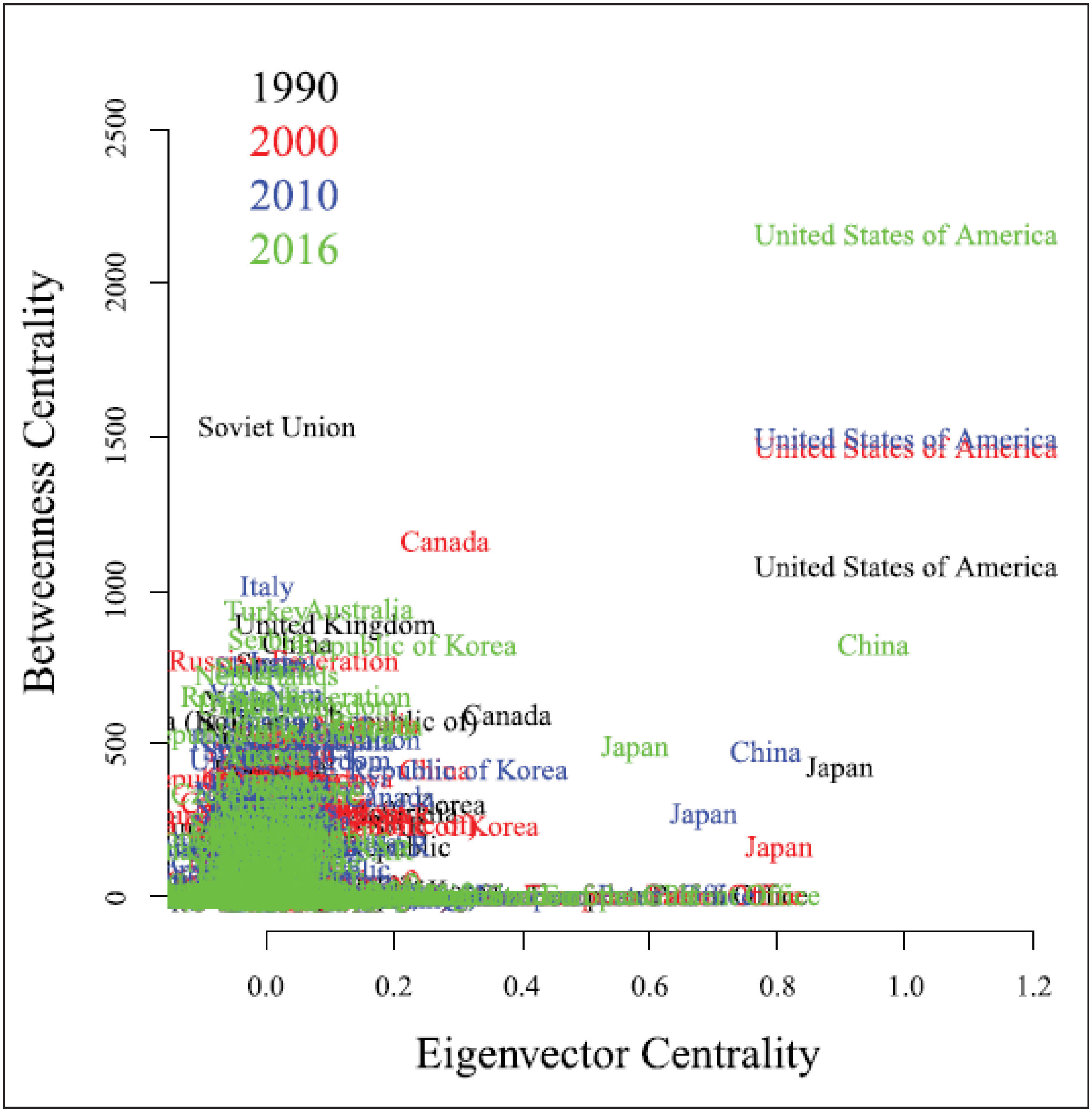
[1271] Winecoff. 2020. Pp. 232.

Figure 88: Eigenvector and Betweenness centrality mutual defense alliances[1272]



[1272] Winecoff. 2020. Pp. 235.

Figure 89: Eigenvector and Betweenness centrality of patent filings[1273]



[1273] Winecoff. 2020. Pp. 240.

Moreover, Fichtner (2017) disaggregates a variety of financial measures, to reach a conclusion that the US position in them is either stable or increasing. Figure 90 thus shows the network of global finances in 2012, while Figure 91, displays the breakdown of that network according to specific measurement.

Figure 90: 2012 global financial network[1274]

[1274] Fichtner. 2017. Pp. 24.

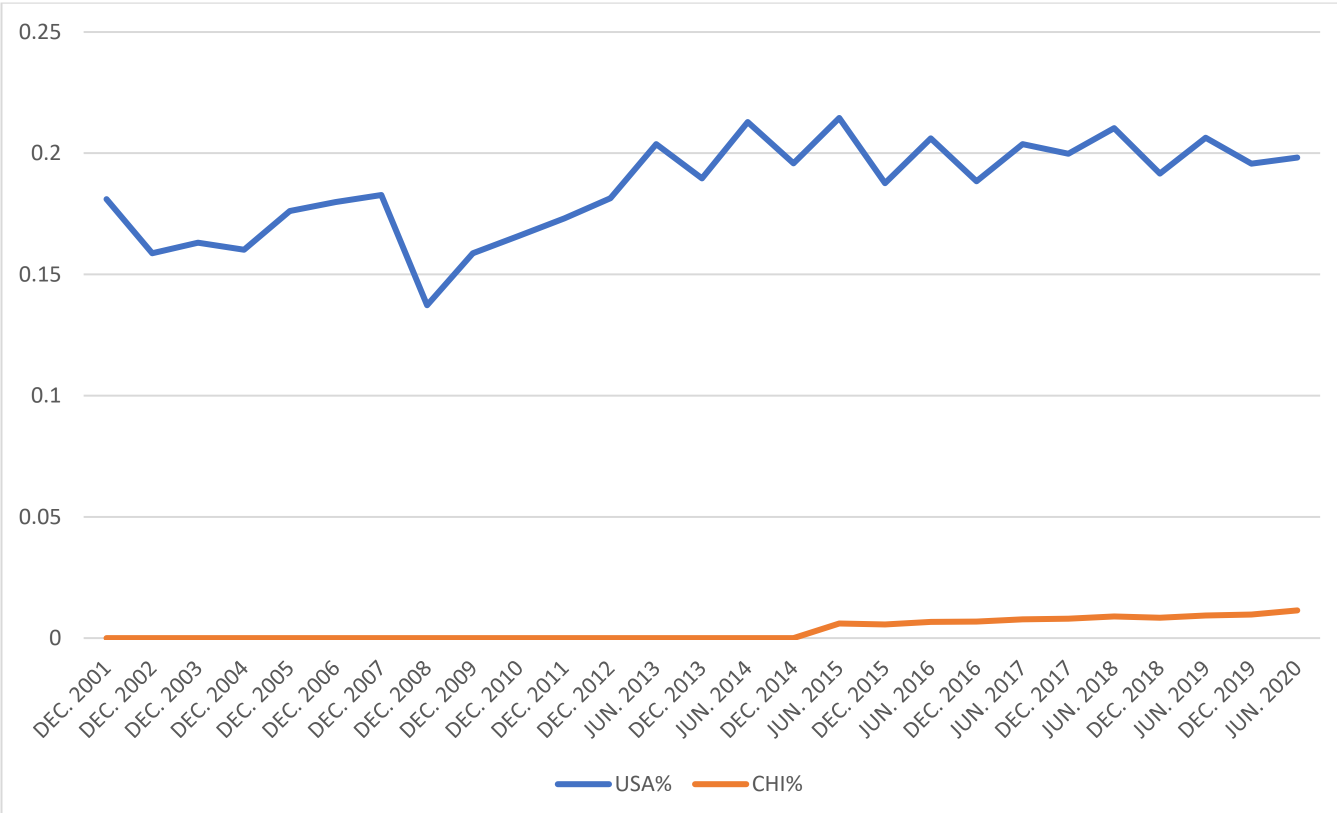
Figure 91: United States and Anglo-American 2012 global financial dominance[1275]

Segment	Anglo-Am.	(US)	(Other Anglo-Am.)	Trajectory
1. OTC Interest Rate Derivatives Market Turnover	75	23	52	Increasing
2. OTC Foreign Exchange Market Turnover	64	19	45	Increasing
3. Currency Composition of Foreign Exchange Reserves	69	61	8	Stable
4. Market Capitalisation of Publicly Listed Corporations	53	41	12	Stable
5. External Bank Deposits	53	19	34	Increasing
6. Inward Direct Investment	28	14	14	Stable
7. Outward Direct Investment	45	19	26	Stable
8. International Portfolio Investment	43	20	23	Stable
9. Global Financial Wealth	52	41	11	Stable

I think that the most interesting and relevant variables from both of these two studies are the portfolio investments and external bank deposits. Since the two papers were rather static, I have looked at these two variables to see their dynamics over time, although the spread of the latter is rather small. Nevertheless, Figure 92 shows the IMF Coordinated Portfolio Investments from 2001 through today. If we set aside the temporal limitation of this data, there is a more pressing issue of missing or unavailable data. Furthermore, due to states' manipulation, the IMF itself labels some of that data with 'C' – data that is "suppressed by the reporting economy to preserve confidentiality".[1276] Nevertheless, the time series clearly shows that the US share of global portfolio investments has increased after the Global Financial Crisis in 2008 and is stable after 2013. The Chinese share has also increased since 2013, but less than the US share. Hence, the United States has enhanced its relative position in this matter.

[1275] Fichtner. 2017. Pp. 27.
[1276] International Monetary Fund. 2021b. *Coordinated Portfolio Investments*. Accessibility: https://data.imf.org/?sk=B981B4E3-4E58-467E-9B90-9DE0C3367363 (5 March 2021).

Figure 92: Coordinated Portfolio Investments of United States and China as a global share

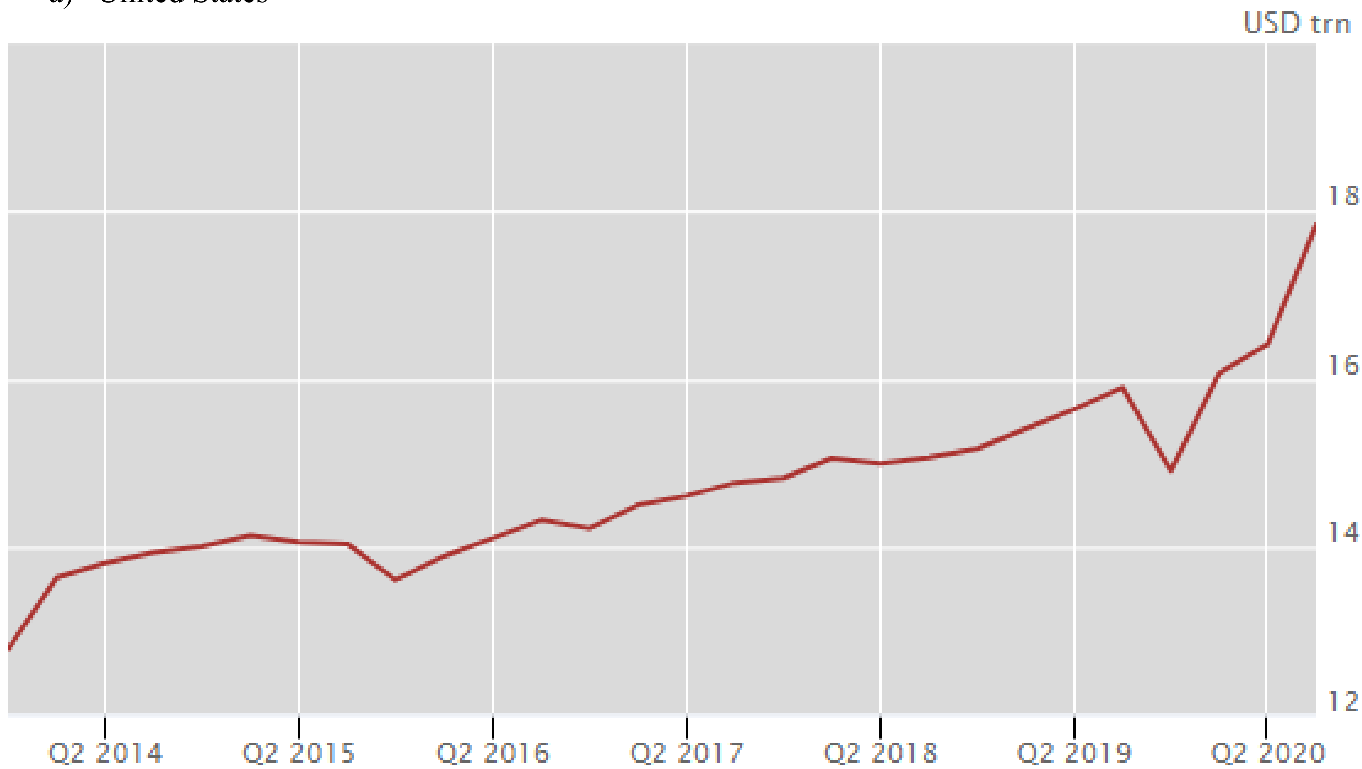


Second, Figure 93 looks at the Consolidated banking statistics and the share of foreign deposits in national banks. United States leads this statistic with 19%, which is more than double the share of the second state – UK with 8.5%.[1277] In fact, the US share has through the years increased from 18% to 19% – indicating that foreigners increasingly look favorably towards US banks and banking system. Figure 93 is divided into two levels: a) displays the absolute number of foreign deposits in US banks; b) shows global absolute number of foreign deposits.[1278]

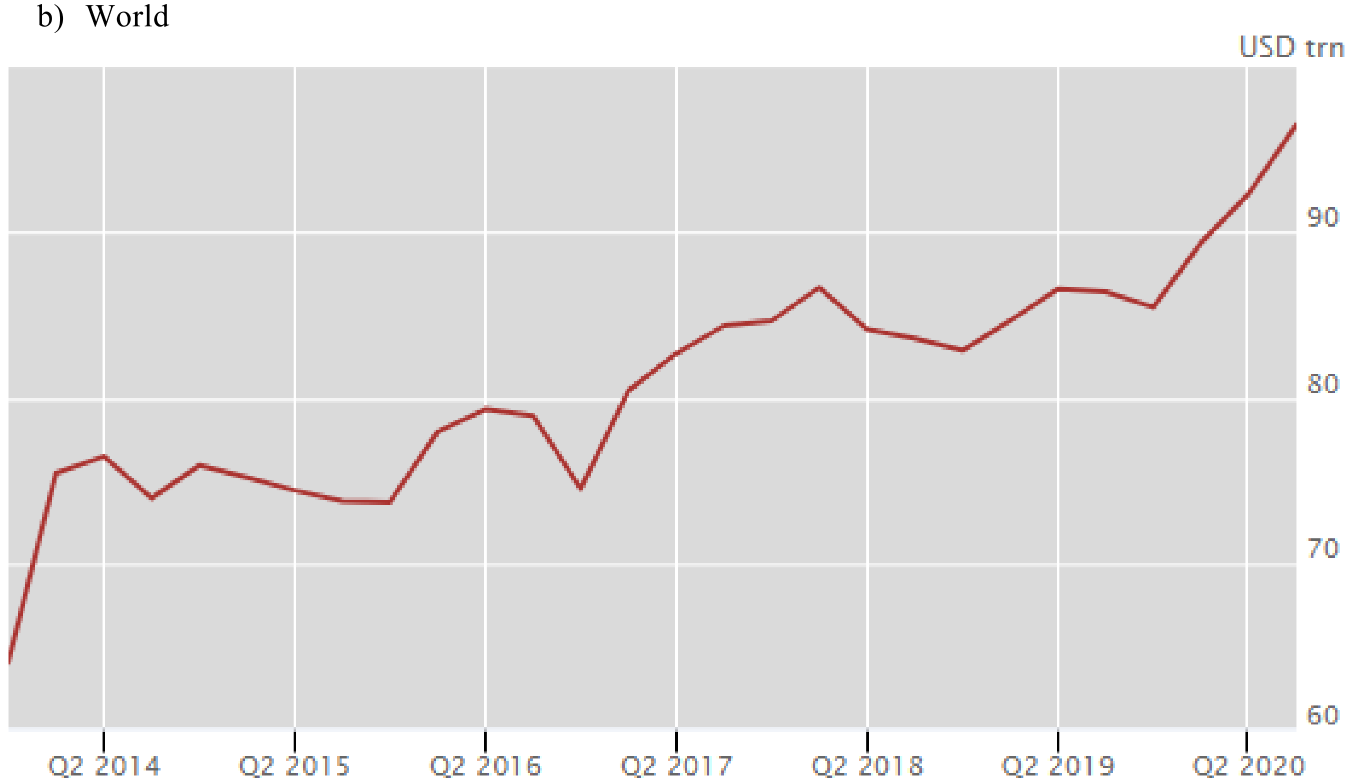
[1277] Bank for International Settlements. 2021. *Consolidated Banking Statistics*. Accessibility: https://stats.bis.org/statx/toc/CBS.html (30 April 2021).
[1278] Bank for International Settlements. 2021.

Figure 93: Foreign deposits in banks

a) United States



b) World



As in every decade so far, also in 2021 declinist arguments about US hegemony are not convincing.

> "With some exceptions, declinist writings do not elaborate testable propositions involving independent and dependent variables. With a rather broad brush, they tend to paint an impressionistic picture of economic decline, mixing references to economic trends and performance (economic growth, productivity), educational data (test scores, length of school year), fiscal matters (deficits), science and technology (R&D expenditures, output of engineers), international trade and capital flows, savings and investment, and other matters."[1279]

Rousseau asked, "If Sparta and Rome perished, what State can hope to endure forever?".[1280] Nothing is forever, so at some point also the US hegemony will end. Yet, little reason exists to subscribe to the repeated bellwether calls of US demise currently. But what is the over-the-horizon prospects of changed conditions in centrality? I have identified three crucial threats I believe can be significant challenges for the US hegemony in the future. For pervasive hegemony to succeed in its establishing, deepening, ad making the 'buy-in' behavior rational, the cost of currency regime change must be lower than the costs of sustaining it. This is a structural barrier to the Euro and the Renminbi. Yet, it seems that the crypto currencies challenge this logic. That is why, crypto currencies are the biggest threat to the US hegemony.

Namely, internal (political) weaknesses or challenges of both the Euro and Renminbi raise the risks and subsequently the costs of their greater global utility. They do not generate confidence, which is one of the three criteria for successful IMS, and which the US dollar has always displayed, already during the Bretton Woods IMS. Using either of the two, or both, for trade invoicing,

[1279] Huntington. 1988. Pp. 77.
[1280] Rousseau, Jean-Jacques. 1947. *The Social Contract*. London: J. M. Dent. Pp. 73.

reserves, or debt issuance, would be subject to great uncertainty.[1281] So great that states do not wish to bear it, and why the US dollar continues do dominate global economic relations. This lack of confidence and the uncertainty linked with it, results in their global liquidity shortage, which further enhances the difficulty of their global presence.[1282] Therefore, looking at the internal problems with the Euro and Renminbi, we are able to see why they can not generate confidence in the global IMS respectively.

On the other hand, crypto currencies pose a different threat to the US hegemony. They represent the fundamental change in the nature of the economy, akin to the transformation into the financial economy I have analyzed in my case studies. One aspect of this change is the decentralization and the blockchain technology associated with it. Its implications are that the economic system would no longer be dependent on central banks and other state institutions. This can potentially lead to the dissolution of a state. I am very skeptical that this would happen for two reasons. First, these crypto currencies are not replacing currencies but serve as a novel asset to invest in. Second, the state can regulate them and consequently also mitigate their impact. Since no state is suicidal, I doubt that they will let their dissolution to happen. Yet, there is another aspect of digital currencies that indeed does pose the greatest threat for the US dollar centrality – digital

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[1281] See, Eren, Egemen, and Semyon Malamud. 2021. Dominant currency debt. *Journal of Financial Economics*. Available online 18 July; Boz, Emine, Camila Casas, Georgios Georgiadis, Gita Gopinath, Helena Le Mezo, Arnaud Mehl, Tra Nguyen. 2020. *Patterns in Invoicing Currency in Global Trade*. Accessibility: https://www.imf.org/en/Publications/WP/Issues/2020/07/17/Patterns-in-Invoicing-Currency-in-Global-Trade-49574 (30 April 2021); Iancu, Alina, Gareth Anderson, Sakai Ando, Ethan Boswell, Andrea Gamba, Shushanik Hakobyan, Lusine Lusinyan, Neil Meads, and Yiqun Wu. 2020. *Reserve Currencies in an Evolving International Monetary System*. Accessibility: https://www.elibrary.imf.org/view/journals/087/2020/002/article-A001-en.xml (30 April 2021); Ito, Hiro, and Robert N. McCauley. 2019. *The currency composition of foreign exchange reserves*. Accessibility: https://www.bis.org/publ/work828.htm (30 April 2021); Ito, Hiro, and Robert N. McCauley. 2018. *A key currency view of global imbalance*s. Accessibility: https://www.bis.org/publ/work762.htm (30 April 2021); Gopinath and Stein (2018).

[1282] Ogawa, Eiji, and Makoto Muto. 2019. What determines utility of international currencies? *Journal of Risk and Financial Management*, 12(1). Pp. 1–31.

currencies issued by central banks. This new concept certifies the survival of the state and embraces the new technologies and the nature of the economy. As such, the key question for the US dollar is, can it deal with this challenge? I believe so.

6.1 THE EURO THREAT

The European Monetary Union and its currency – the Euro – was formed in 1999.[1283] Since this was a long-time coming project, observers were mostly optimists regarding the future global role of the Euro. However, the Euro fell far short of these expectations, as the empirics in this research project has demonstrated. In fact, since its inception, the Euro was muddling through a crisis after crisis to the point where optimism was replaced by pessimism and predictions of its dissolution.[1284] Nevertheless, there was a third camp of experts, which was focused on the strategic consequences of the introduction of the Euro and its relations to the US dollar. For them, the Euro meant economic war,[1285] although they disagreed on what would be the end result of this competition. Some argued that the Euro would immediately win over the dominant position in

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[1283] On its development see James. 2012b; Verdun. 2002; Szasz. 1999.

[1284] A good overview of these perspectives is Cohen, Benjamin J. 2009. Dollar dominance, euro aspirations: recipe for discord?. *Journal of Common Market Studies*, 47(4). Pp. 741–66.

[1285] E.g., Bergsten, C. Fred. 1997. The dollar and the euro. *Foreign Affairs*. Accessibility: https://www.foreignaffairs.com/articles/united-states/1997-07-01/dollar-and-euro (30 April 2021); Bergsten, C. Fred. 2002. *The euro versus the dollar: will there be a struggle for dominance?*. Accessibility: https://www.piie.com/publications/papers/bergsten0102-1.pdf (30 April 2021); Kenen, Peter B. 2002b. The euro versus the dollar: will there be a struggle for dominance?. *Journal of policy modeling*, 24(4). Pp. 347–54; Chinn, Menzie, and Jeffrey Frankel. 2008b. Why the Euro Will Rival the Dollar. *International Finance*, 11(1). Pp. 49–73.

global monetary relations[1286], some argued this would happen gradually[1287], while others were skeptical that the Euro will win at all.[1288]

The current empirical score is with the last group. The Euro did not reach beyond its region. Furthermore, the European financial system is still dependent on United States and the US dollar. “US financial markets explain, around 30% of movements in euro area financial markets, whereas euro area markets account only for about 6% of US asset price changes.”[1289] Yet, as with the US decline argument, the Euro rise narrative keeps on appearing. Recently with the COVID crisis, data came out that the Euro briefly overtook US dollar in SWIFT transactions (see Figure 94).[1290] However, this is not surprising at all. As I have explained already in the introduction – see Figure 5 – these numbers treat states within the Euro zone as separate entities, hence the number of Euro transactions is inflated. And since the COVID crisis severely impacted the supply chains and international trade, it is not surprising that states would trade more with their neighbors, which in the EU means that they most likely use the Euro. Other measurements of the Euro’s role in the global economy are far less convincing.

[1286] Alogoskoufis, George, and Richard Portes. 1997. The euro, the dollar, and the international monetary system. In Masson, Paul R., Thomas H. Krueger, and Bart G. Turtelboom (eds.), *EMU and the International Monetary System*. Washington: International Monetary Fund. Pp. 58–78.

[1287] E.g., Chinn, Menzie, and Jeffrey Frankel. 2008a. *The Euro May Over the Next 15 Years Surpass the Dollar as Leading International Currency*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w13909/w13909.pdf (30 April 2021).

[1288] E.g., Dehesa, Guillermo de la. 2009. *Will the Euro Ever Replace the US Dollar as the Dominant Global Currency?*. Accessibility: http://biblioteca.ribei.org/id/eprint/1793/1/WP-54-2009.pdf (30 April 2021).

[1289] Ehrmann, Michael, Marcel Fratzscher, and Roberto Rigobon. 2011. Stocks, bond, money markets and exchange rates: measuring international financial transmission. *Journal of Applied Econometrics*, 26(6). Pp. 948–74.

[1290] Society for Worldwide Interbank Financial Telecommunications (SWIFT) is used by more than 11,000 financial institutions in more than 200 countries and territories around the world (*Discover SWIFT*. 2021. Accessibility: https://www.swift.com/about-us/discover-swift/messaging-and-standards (30 April 2021)).

Figure 94: SWIFT transactions for US dollar and Euro[1291]

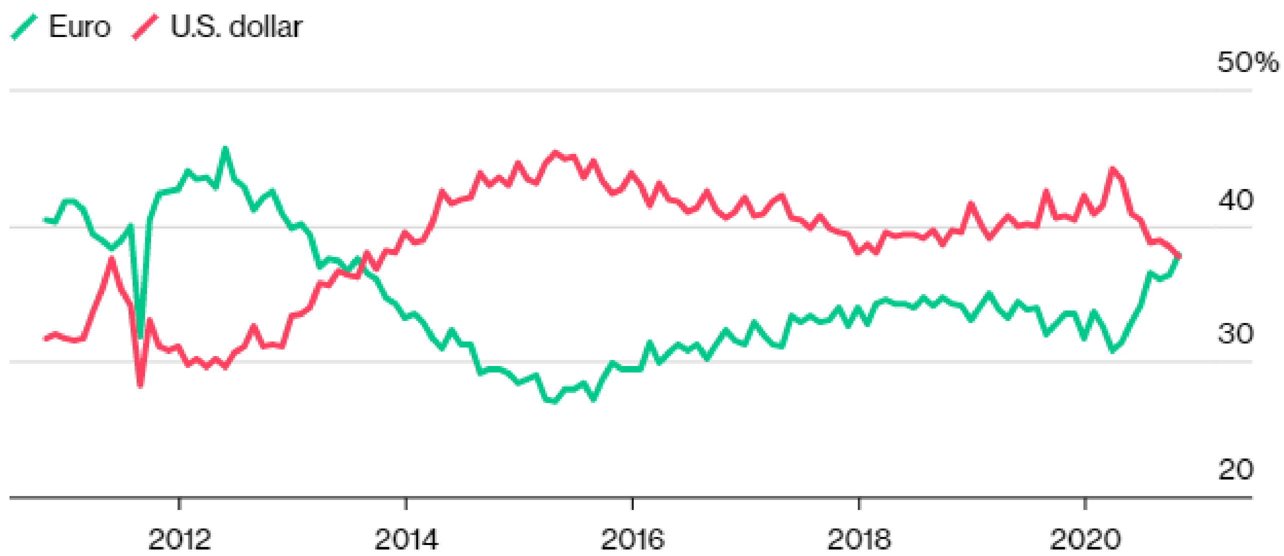
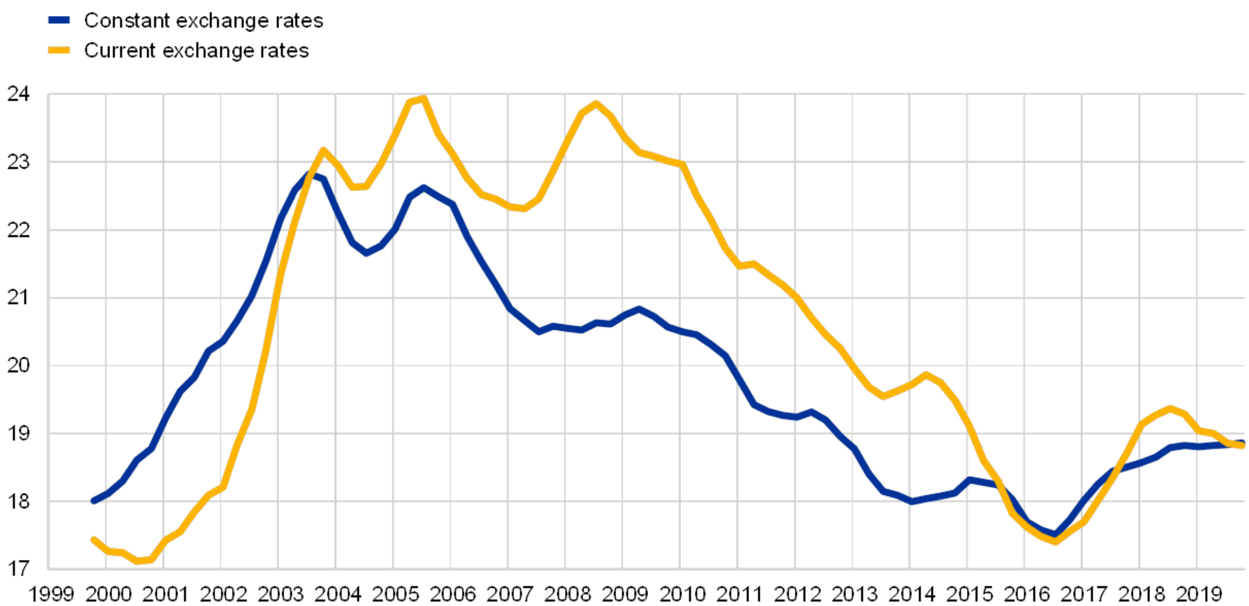


Figure 95 displays the Composite index of the international role of the Euro, published by European Central Bank. After the introduction in the start of the millennium, its international role has been steadily declining, while at the same time gaining only regional recognition and impact as shown on Figure 96. Thus, the Euro has entrenched itself on the European continent, but its reach does not go beyond it.

[1291] For the record, even during the COVID times, China-s Renminbi only comes in on fifth place according to the SWIFT data, furthermore, its numbers in fact fell from 2% to 1.66% (Tanzi, Alexandre. 2021. *Dollar Loses to Euro as Payment Currency for First Time in Years*. https://www.bloomberg.com/news/articles/2020-11-19/euro-tops-dollar-as-payments-currency-for-first-time-since-2013?utm_source=google&utm_medium=cpc&utm_campaign=dsa&utm_term=&gclid=EAIaIQobChMIo_Pm4aqo8AIVC853Ch00-w_BEAAYASAAEgKdHvD_BwE (30 April 2021)).

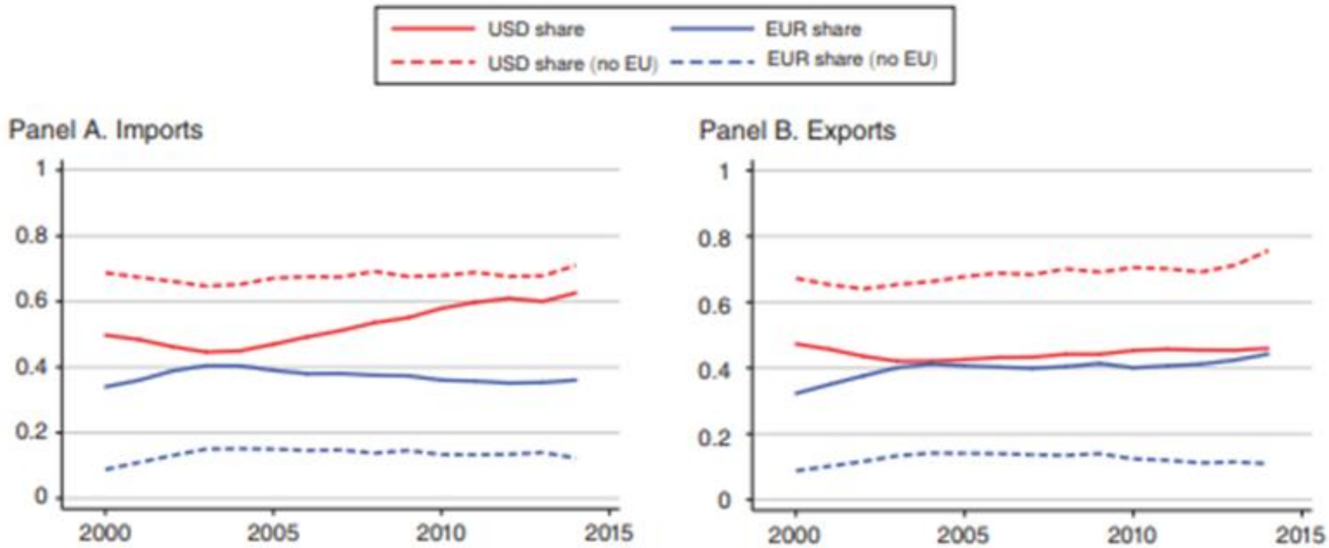
Figure 95: Composite index of the international role of the Euro[1292]



"The relatively low adoption rate of the euro internationally is primarily caused by macro policies, included large surpluses with the rest of the world. /…/ Falling valuations of EU firms during the crisis increased the risk of predatory takeover of some strategic companies, leaving the EU at risk of loss of technological know-how and value chain disruptions. The run to the US dollar at the onset of the pandemic /Figure 84/ and ensuing repo market dislocation also made it difficult and costly for non-US financial institutions to refinance their dollar operations."[1293]

[1292] European Central Bank. 2020a. *The international role of the euro*. Frankfurt am Mein: European Central Bank. Pp. 3.
[1293] *Eurointelligence*. 2021a. Daily Brief. 20 January.

Figure 96: Regional reach of the Euro[1294]



The constant public push for internationalization of the Euro in puzzling,[1295] since the European Central Bank has never really held such a policy or objective. In fact, in 1999 it wrote: "Since the internationalisation of the euro, as such, is not a policy objective, it will be neither fostered nor hindered by the Eurosystem."[1296] The report continues that the international role of the Euro will be therefore determined by global financial markets, and that the latter should not impair with the crucial objective of the ECB – price stability. Hence, "/T/he Eurosystem therefore adopts a neutral stance, neither hindering nor fostering the international use of its currency."[1297]

1294 Maggiori, Matteo, Brent Neiman, and Jesse Schreger. 2019. The rise of the dollar and fall of the Euro as international currencies. *AEA Papers and Proceedings*. Pp. 521–6. At Pp. 523.

1295 The most recent came from the EU Commission in January 2021. Namely, the EU Commission has presented 15 key actions on how to reduce global reliance on the US dollar. Most of them are old initiatives, which have been in the pipeline for years (banking union, capital markets union, euro-denominated commodity derivatives for energy and raw materials). But some are new – digital euro, green euro bonds. See European Commission. 2021. *The European economic and financial system: fostering openness, strength and resilience*. Accessibility: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0032&from=EN (30 April 2021).

1296 European Central Bank. 1999. *Monthly Bulletin*. August. Pp. 31.

1297 European Central Bank. 1999. Pp. 45.

The timing for the latest push could not be worse. The COVID crisis, during which the EU adopted its latest seven-year budget[1298], as well as the recovery plan[1299], is problematic enough in and of itself. Although if we combine the two, one can state that the EU has doubled its budget, but the latter is still minute compared to the United States. The new EU budget is slightly less than 2% of EU GDP, whereas US federal budget amounts to about 20% of its GDP.[1300] Furthermore, there are big open questions if the EU funds will be used for advancing competitiveness of the EU, or will they be used to buffer the COVID shock.[1301]

Being a bit sardonic, the EU cannot even reach its inflation target (Figure 97), how can it expect to reach a far greater and more difficult objective of being the global currency?[1302] Namely, the European Central Bank was tasked in the Maastricht Treaty, which established it, with taking care only of inflation.[1303] The US Federal Reserve, on the other hand is also tasked with considering unemployment as a financial stability factor.[1304] With its limited mandate the European Central bank struggled to respond to the Global Financial crisis, as well as to COVID crisis. Nevertheless, one must give credit to both Mario Draghi and Christine Lagarde, who both

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[1298] *Multiannual financial framework 2021-2027*. 2021. Accessibility: https://ec.europa.eu/info/strategy/eu-budget/long-term-eu-budget/2021-2027/documents_en (30 April 2021).

[1299] *Recovery Plan for Europe*. 2021. Accessibility: https://ec.europa.eu/info/strategy/recovery-plan-europe_en (30 April 2021).

[1300] *The World Bank Data*. 2020.

[1301] That is why the analysis of their impacts differ by a wide margin. See Alcidi, Cinzia, Daniel Gros, and Francesco Corti. 2020. *Who will really benefit from the Next Generation EU funds?* Centre for European Policy Studies. Accessibility: https://www.ceps.eu/ceps-publications/who-will-really-benefit-from-the-next-generation-eu-funds/ (30 April 2021); S&P Global. 2021. *Next Generation EU Will Shift European Growth Into A Higher Gear*. Accessibility: https://www.spglobal.com/ratings/en/research/articles/210427-next-generation-eu-will-shift-european-growth-into-a-higher-gear-11929949 (30 April 2021).

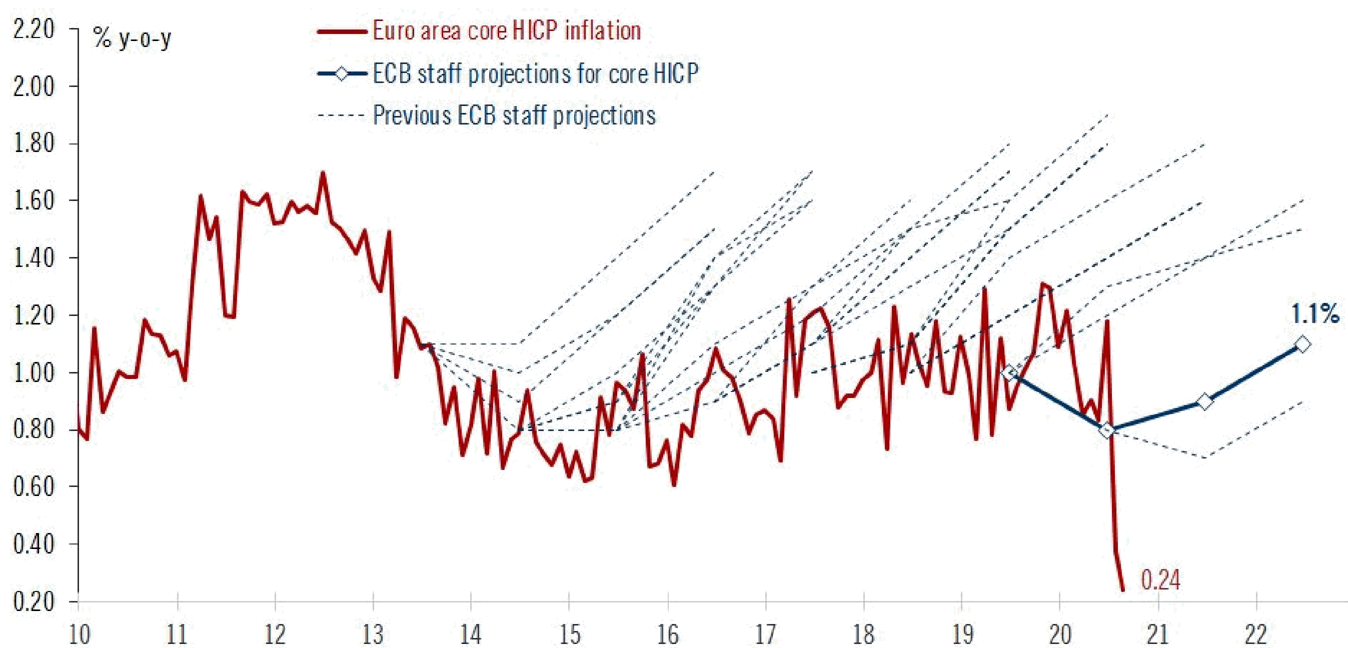
[1302] Similar illustrative sarcasm which reflects reality was also written by Eurointelligence (2021h. Daily Brief. 25 May) with the Ryanair grounding incident in Belarus in May 2021: "The US, China and Russia would by now have responded with a military strike. EU leaders, by contrast, have dinner."

[1303] *Treaty on European Union*. Signed on 7 February 1992, entered into force 1 November 1993. Accessibility: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:11992M/TXT&from=EN (1 February 2020).

[1304] Federal Reserve. 2020. *What economic goals does the Federal Reserve seek to achieve through its monetary policy?*. Accessibility: https://www.federalreserve.gov/faqs/what-economic-goals-does-federal-reserve-seek-to-achieve-through-monetary-policy.htm (1 February 2021).

in their respective difficult positions as the heads of the European Central Bank, managed to do everything necessary in both crises.[1305] Yet, the fiscal end of the economic policies did not follow them, nor did it the political dimension of economic decisions.[1306] Therefore, the biggest challenge for the Euro is to match fiscal, monetary, and political dimensions of economic policies. Just as one does not understand or study supply without the demand, one must not treat fiscal and monetary policies independently.[1307]

Figure 97: Failed EU attempts to reach inflation targets[1308]



[1305] See, Draghi, Mario. 2012. *Speech at the Global Investment Conference in London, 26 July*. Accessibility: https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html (1 February 2020); Rettmann, Andrew. 2020. *ECB promises (almost) whatever it takes*. Accessibility: https://euobserver.com/coronavirus/147808 (18 July 2020).

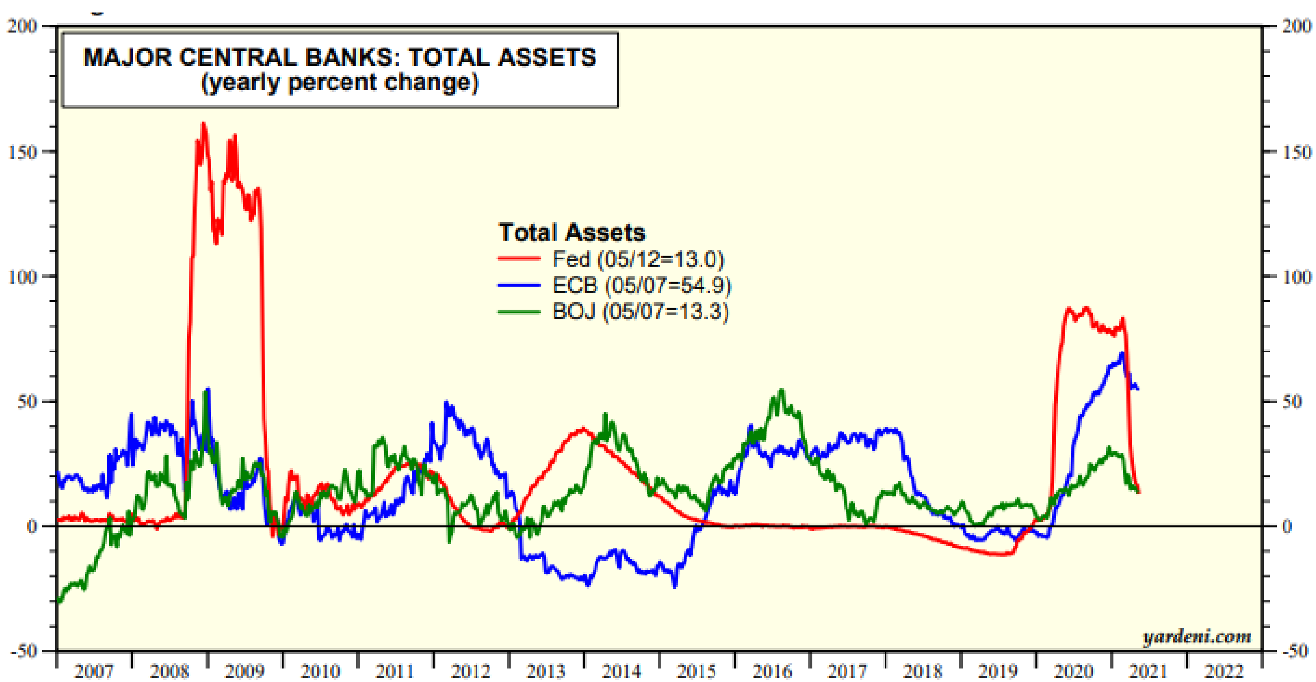
[1306] *Eurointelligence* (2021b. Daily Brief. 26 January) offered a better option for the EU within its political constraints: "Our view is that the EU should have agreed a discretionary €1-2tn fiscal stimulus rather than opt for a small, complex, multi-annual inter-governmental investment programme. What has not changed is that the EU always seeks a structural solution to a cyclical slump."

[1307] Bordo, Michael D., and Harold James. 2008. *A long term perspective on the euro*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w13815/w13815.pdf (1 February 2020).

[1308] *Eurointelligence*. 2020b. Daily Brief. 6 October.

Figure 98 shows the response of the three biggest central banks (FED, European Central Bank, Bank of Japan) to 2008 Global Financial Crisis and the COVID crisis. One can see that in 2008 neither Europe nor Japan acted remotely similar to United States. However, in 2020 they did, particularly notable is the similar action taken by FED and the European Central Bank – providing monetary stimulus to cushion the crisis. Moreover, Figure 99[1309] shows that Japan does not have any maneuverable space for expansionary monetary policy, whereas United States still has much bigger leverage than the Eurozone.

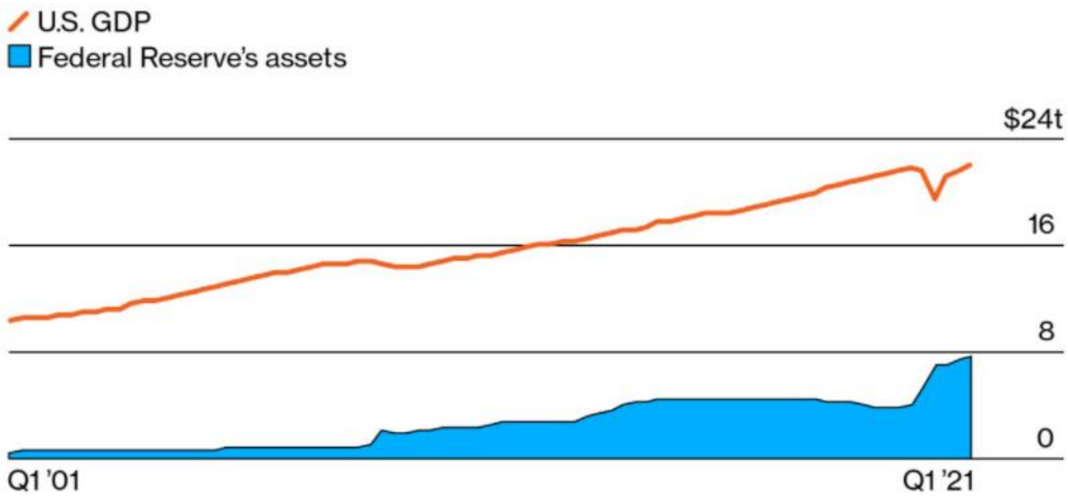
Figure 98: Central Bank balance sheets (FED, ECB, BOJ)[1310]



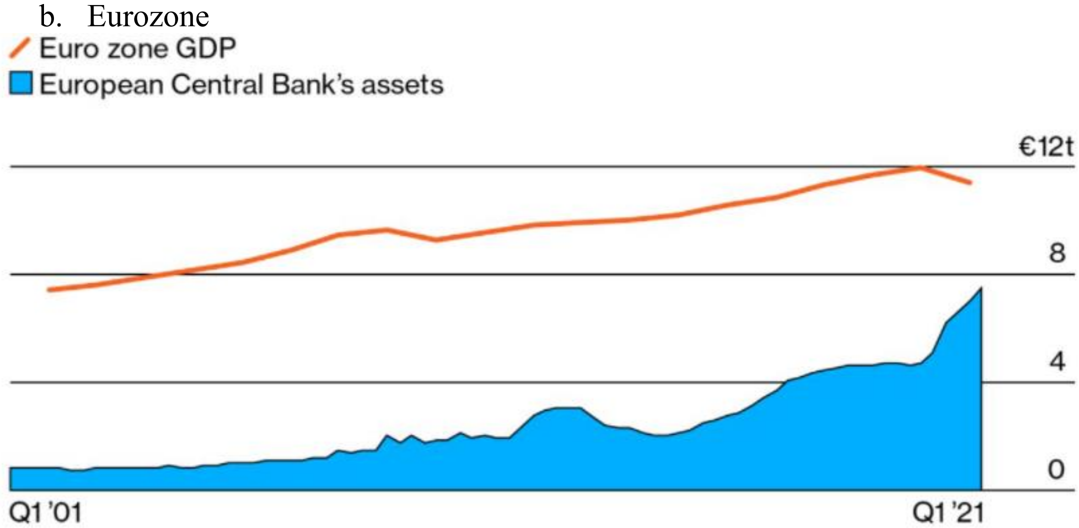
[1309] Black, Jeff. 2021. Central Banks Face New Balancing Act With Their Huge Asset Piles. Accessibility: https://www.bloombergquint.com/global-economics/central-banks-face-new-balancing-act-with-their-huge-asset-piles (26 May 2021).
[1310] Yardeni Research. 2021. *Central Banks: Fed, ECB & BOJ Weekly Balance Sheets*. Accessibility: https://www.yardeni.com/pub/balsheetwk.pdf (15 May 2021).

Figure 99: Monetary leverage of United States, Eurozone, and Japan

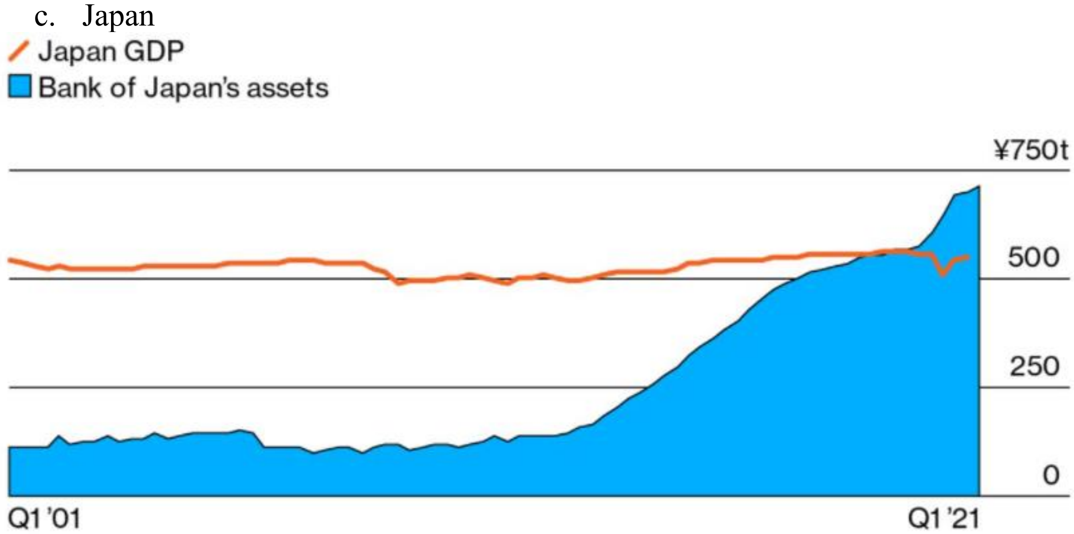
a. United States



b. Eurozone



c. Japan



Yet, the moral of the story is elsewhere. It is fiscal. The 2008 Global Financial Crisis was triggered by a sudden stop in financial flows. It hit those dependent on investments – construction and industry, but not services. The pandemic is different as it hits peoples' interactions – services. It is much more difficult to measure its impact (e.g., unemployment) since there are little reliable statistics on services.[1311] That is why, fiscal policy is more relevant today than in 2008. And yet, the EU is falling behind here.

> "The fundamental problem with the eurozone is an innate lack of robustness - a failure to rejoin its previous growth after a crisis. Of those we have had three in the last 20 years. Fiscal policy is a factor, but an equally important one is the failure to recognise insolvency and protect liquidity support to companies that are solvent. A lot of viable businesses are already perishing in this crisis, while dysfunctional airlines, for example, are kept alive with the help of government support. /…/ It is instructive, in our view, to compare the situation with the US, a country that has managed to rejoin its long-term growth path after the dotcom bubble in the early 2000s, the global financial crisis, and again now. The US provides a combination of greater fiscal support and less individual protection. In Europe we are fiscally conservative, yet we are happy to keep non-viable airlines and banks alive for political reasons."[1312]

With the COVID crisis the EU economy is falling further behind the United States. The recovery fund and the new EU budget may be a Pyrrhic victory – although the EU doubled its budget, this is still minute. Therefore, it may be portrayed as a political victory, but it is economically insufficient:

> "While Brussels was feting Next Generation EU, gross fixed-capital formation in the euro area fell by more than 10 per cent, compared with 'only' 1.7 per cent in the US. To put that in round figures, the European Commission and the EIB estimate that the shortfall in private investment will come to €831 billion in 2020

[1311] *Eurointelligence*. 2020c. Daily Brief. 13 October.
[1312] *Eurointelligence*. 2021d. Daily Brief. 29 April.

> and 2021—greater than the offsetting recovery package. It should be particularly concerning that investment slumped most severely in southern Europe, which has been suffering chronically low investment since 2010."[1313]

And this is the core problem for the Euro and the reason why it does not present a serious challenge for the US dollar. Everyone knows that behind the US dollar is a political entity and a political head that makes decisions and vouches for those decisions. The Eurozone is an artificial construct that lacks a clear authority. Although there is a European Central Bank, each member state still has its own national Central Bank, which co-governs that system. Furthermore, the federal governmental level of the United States is clear and powerful in comparison to its state units. In Eurozone, it is reversed. As Jean Claude Trichet, former president of the European Central Bank lamented: "We don't have a federal budget, we don't have a political federation so we have to fully respect the constraints and the mutual supervision rules that exist in the euro zone."[1314] Subsequently this also means that there cannot be any common Euro-bonds. Thus, the Euro does not project confidence in the international financial markets. This has long been apparent. "Effectively the euro is a currency without a country, the product of an international treaty rather than the expression of one sovereign power. For actors outside EMU, Europe's money can be considered only as good as the political agreement underlying it."[1315] Figure 100[1316] shows the shipments of Euro bank notes abroad, which in fact has not only stalled after 205, but actually decreased. Moreover, Figure 101 displays geographic distribution of these bank notes. Almost 2/3 of all 'banknotes exports' stay on the European continent as they are obtained by non-Eurozone

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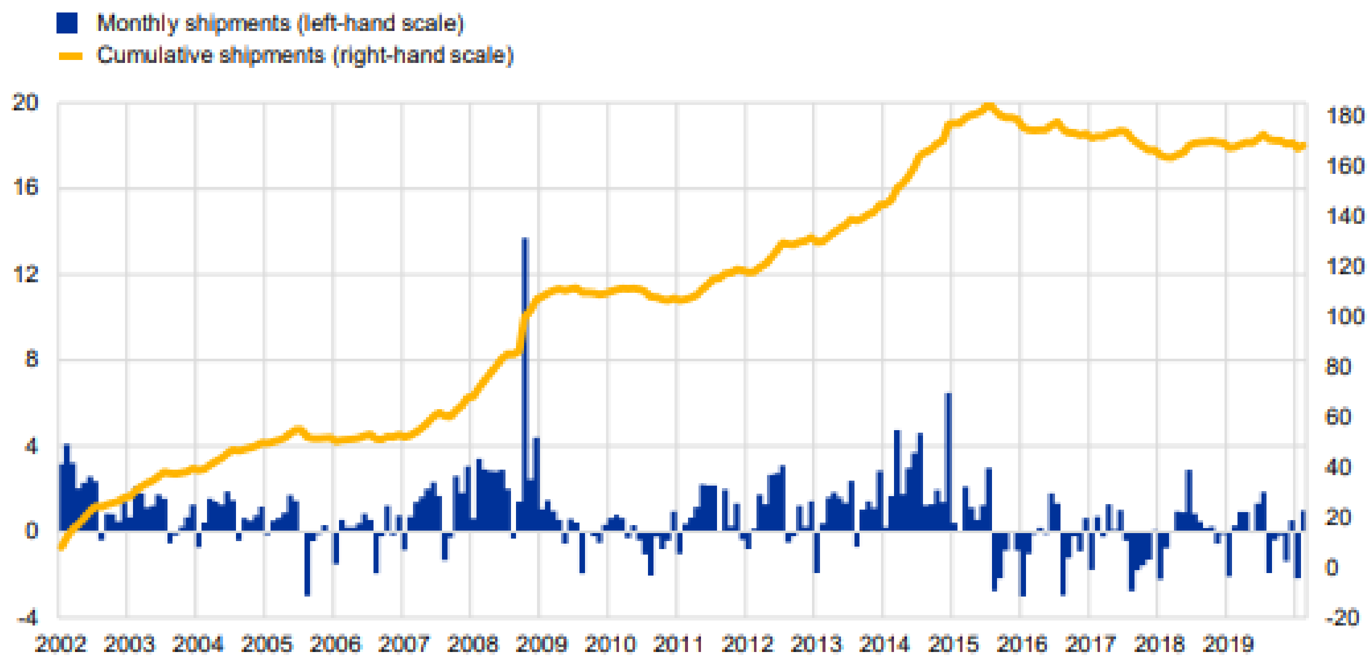
[1313] Tooze, Adam. 2021. *Europe's 'long-Covid' economic frailty*. Accessibility: https://www.socialeurope.eu/europes-long-covid-economic-frailty (12 February 2021).
[1314] De Clercq, Geert, and Gus Trompiz. 2011. *UPDATE 2-Change EU treaty to stabilise bloc, says Trichet*. Accessibility: https://www.reuters.com/article/ecb-trichet-idUSL5E7LG05S20111016 (1 February 2020).
[1315] Cohen. 2009. Pp. 744.
[1316] European Central Bank. 2020a. Pp. 28.

European states.[1317] Finally, Figure 102 demonstrates that only 50% of EU trade is invoiced in Euros.[1318]

Figure 100: Shipments of Euro bank notes abroad



[1317] European Central Bank. 2020a. Pp. 28.
[1318] European Central Bank. 2020a. Pp. 26.

Figure 101: Geographic distribution of the Euro banknotes leaving the Eurozone

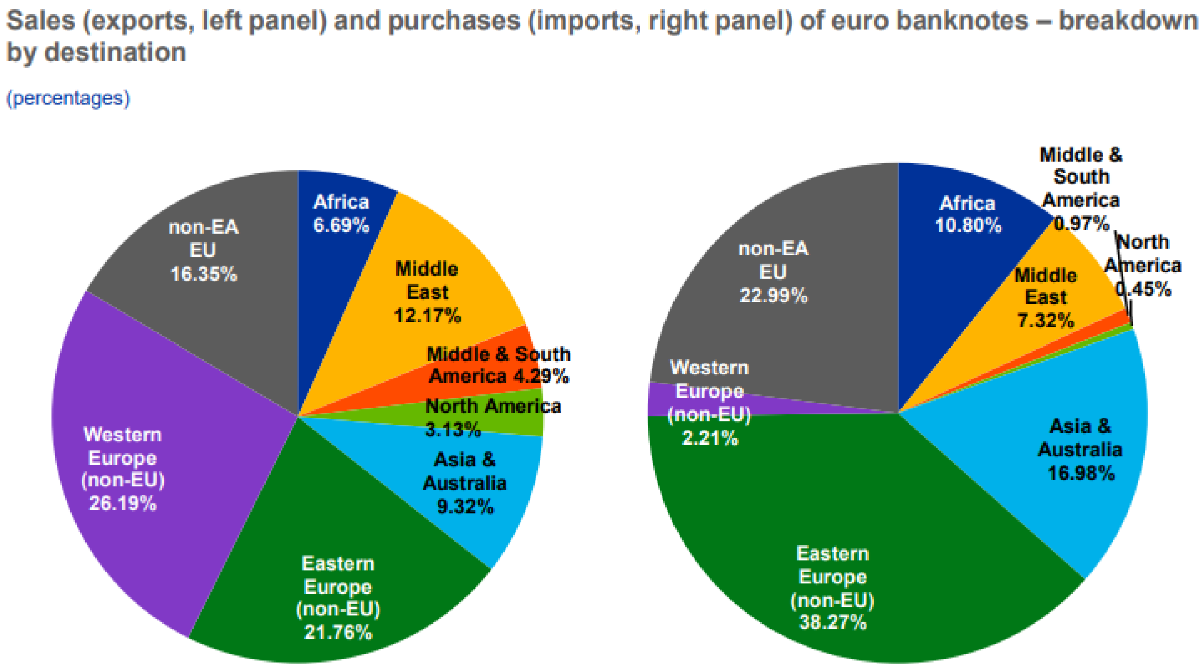
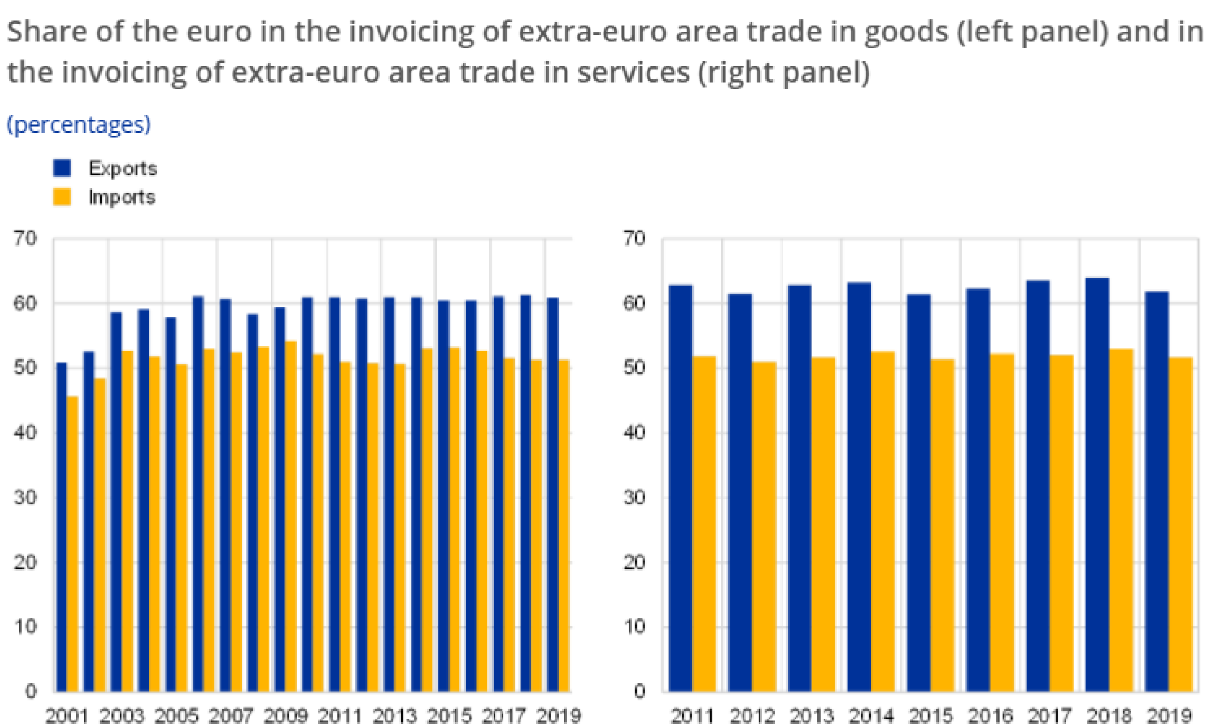


Figure 102: Share of the EU trade invoiced in Euros



These vices of the Eurozone have been made more obvious with the COVID pandemic. Furthermore, once the pandemic takes its toll in the engine behind the Euro – Germany – then the whole monetary union will get into trouble.

> “Among the long-run economic effects of the pandemic, the biggest one is the effect on innovation. This is where we expect the US and Asia to outpace Europe - and the eurozone average to outpace Germany. Our biggest concern about the German economy right now is the fall in spending on innovation - a barometer for future productivity growth. /…/ German companies spent 2.2% less on innovation last year than in 2019. /Also their efficiency had/ a 6.4% decline in 2019. The reason for this is increased global competition. /L/arge companies kept investing. Virtually all of the decline is due to small and medium sized companies, where investments in innovation fell by 9%. The rise in innovation investments from 2.4% of GDP in 2005 to 3.1% in 2019 was one of the engines behind Germany's strong economic performance. But one-third of that was due to the car industry alone - another indicator of Germany's vulnerability to that one sector. Another problem is the lack of digital investments. Germany's tendency to double down on analogue technologies, like diesel cars, and the failure to invest in digital technologies is showing through in the data. What we expect to see in Germany is a period of relative economic decline ahead - relative to the world, but also relative to other countries in the eurozone.”[1319]

What this report tells us is that Germany and hence the Eurozone is extremely vulnerable to economic warfare. Another report warns of German fiscal rigidness, which not only was uploaded onto the Eurozone and inhibits its recovery, but also narrows policy options for Germany – makes its economic growth uncertain and subdues investments.[1320] Hence, “Brussels faces a steep climb in its effort to boost the international role of the euro as part of its quest to strengthen

[1319] *Eurointelligence*. 2021c. Daily Brief. 15 February.
[1320] Dullien, Sebastian, Sabine Stephan, and Thomas Theobald. 2020. Transatlantischer Handelskonflikt und die deutsche Wirtschaft: Auf die Dauer kommt es an. *Wirtschaftsdienst*, 100(7). Pp. 524–30.

the EU's self-reliance, investors and analysts said after the bloc set out new ambitions for the single currency."[1321]

It is unlikely that the Convention on the future of the EU[1322] will resolve the question of the mandate of the European Central Bank, nor that it will resolve even deeper political difficulties of the EU – the nature of its decision making and the question of the EU's polity. Yet, if the latter at some point does happen than this would be the boost the EU needs to position the Euro as a real competitor to the US dollar. I do not see any indication that this is possible at the foreseeable future. As such, the only path I can identify of how the Eurozone can challenge the centrality of the US dollar in the global economy is with the digital Euro.

The European Central Bank has designed a plan of its implementation.[1323] Currently there is an ongoing public consultation on how to best introduce it.[1324] Furthermore, the Eurozone is also currently running three pilot projects of a digital Euro.[1325] However, this is a type of (broader category) threat that I will deal with in the third section – digital currencies. At this point, I would like to stress that digital Euro might be a path towards a greater role of the Euro in the world;

1321 Fleming, Sam, Tommy Stubbington, and Martin Arnold. 2021. *The EU faces barriers to raising the global status of a single currency*. Accessibility: https://www.ft.com/content/135742b0-e775-4a25-a1c6-d592678b0334 (29 March 2021).

1322 *Conference on the Future of Europe*. 2021. Accessibility: https://ec.europa.eu/info/strategy/priorities-2019-2024/new-push-european-democracy/conference-future-europe_en (15 May 2021).

1323 European Central Bank. 2020b. *Report on a digital euro*. Accessibility: https://www.ecb.europa.eu/pub/pdf/other/Report_on_a_digital_euro~4d7268b458.en.pdf (23 December 2020).

1324 *Introductory remarks by Fabio Panetta, Member of the Executive Board of the ECB, at the ECON Committee of the European Parliament*. 2021. Accessibility: https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210414_1~e76b855b5c.en.html (4 May 2021).

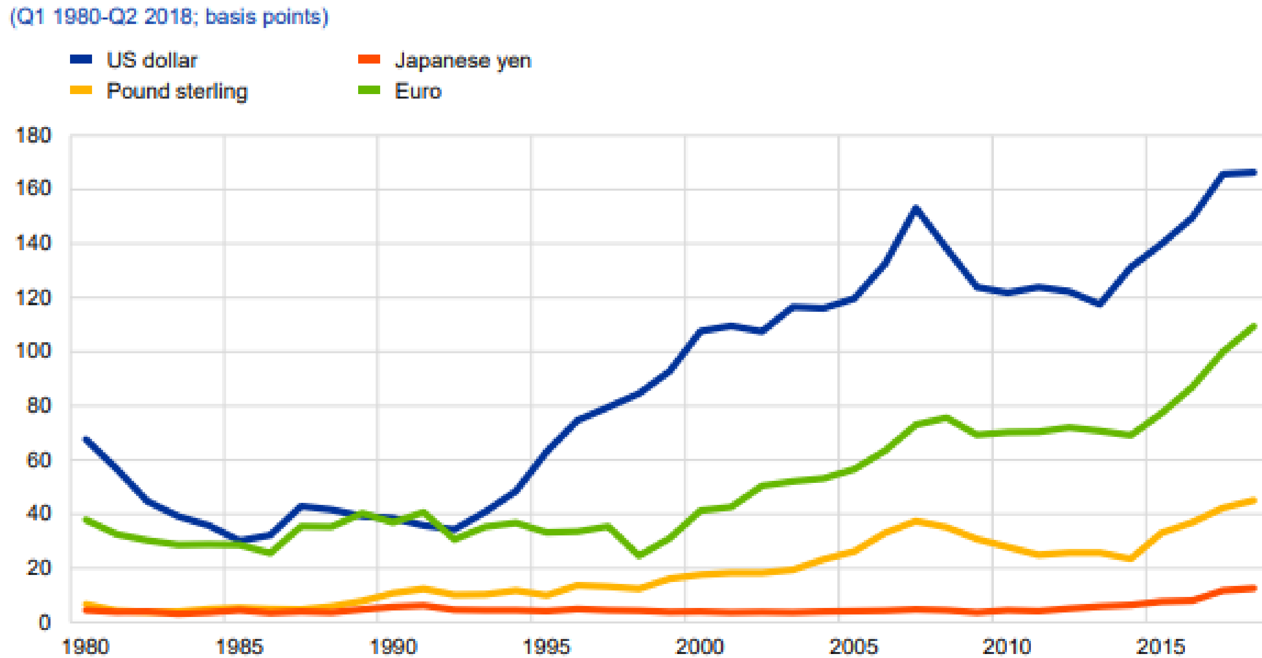
1325 See, *Al via progetto sperimentale su euro digitale*. 2020. Accessibility: https://www.abi.it/Pagine/news/EuroDigitale.aspx (23 December 2020).

however, it is far from sufficient condition for the latter. "Other architectural factors will be more important in advancing its international appeal."[1326]

As for the traditional Euro, Cohen phrased it well more than a decade ago: "Europe's money in a sense could turn out always to be the 'currency of the future' – forever aspiring to catch up with the dollar but, like an asymptote, destined never to quite get there."[1327] The Euro did carve out a geographic and economic space for itself. Still, it cannot reach beyond that. It does equip the EU with economic statecraft tool that it can use to advance its strategic autonomy idea, which is increasingly debated on the EU level since late 2010s.[1328] Nevertheless, to fully reap the advantages of the Euro's potential, the EU needs to reform its political structure. The 2019 European Central Bank Report quantified the 'Exorbitant Privilege' of different currencies.[1329] The Euro came in second, only after the US dollar (Figure 103).[1330] This supports the findings that the Eurozone is a regional currency – the Eurozone is financially autonomous.

[1326] Demertzis, Maria. 2021a. *Central bank currencies going digital*. Accessibility: https://www.bruegel.org/2021/04/central-bank-currencies-going-digital/ (30 April 2021).
[1327] Cohen. 2009. Pp. 746.
[1328] It is still not clear what this concept should mean and how 'strategic autonomy' differs from 'strategic sovereignty'. More on this debate, see European Parliament. 2021. *The EU strategic autonomy debate*. Accessibility: https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/690532/EPRS_BRI(2021)690532_EN.pdf (30 April 2021).
[1329] The report has defined Exorbitant Privilege as "benefits enjoyed by countries in the form of either external borrowing costs or net returns on their international investment position" (European Central Bank. 2019. *The international role of the euro*. Frankfurt am Mein: European Central Bank. Pp. 51).
[1330] European Central Bank. 2019. Pp. 60.

Figure 103: The level of Exorbitant Privilege of US dollar, Euro, Pound Sterling, and Yen



6.2 THE RENMINBI THREAT

With the economic rise of China, it comes naturally to address the potential global reach of Renminbi. Namely, if China accounts for about 15% of global output, the Renminbi only accounts for 1% of global foreign reserves, and 2% of global transactions.[1331] This could either indicate a huge potential for Chinese financial market and economy or it also may be a sign of a deep global mistrust of China. Both narratives have been advanced during the COVID pandemic.[1332]

[1331] McKinsey Global Institute. 2019. *China and the world: Inside the dynamics of a changing relationship*. Accessibility: https://www.mckinsey.com/~/media/mckinsey/featured%20insights/china/china%20and%20the%20world%20inside%20the%20dynamics%20of%20a%20changing%20relationship/mgi-china-and-the-world-full-report-june-2019-vf.ashx (24 May 2021).
[1332] E.g., Barton, Susanne. 2021. *Dollar Hegemony Is Under Fire From China's Rapid Growth Recovery*. Accessibility: https://www.bloomberg.com/news/articles/2021-01-07/china-s-rapid-recovery-puts-global-

The first narrative underlines China's rapid economic recovery and its financial opening that would both lead to the greater role of Renminbi in the world. Only in 2020 China fully opened its 15 trillion US dollar bond market[1333] to foreign investors, which was quickly compared to the 2001 entry of China into WTO that generated exponential growth of its exports and GDP.[1334] Since bonds had record low yields in the developed world for years, the investors were thirsty for a market that would provide them with higher rate of return, while also had similar level of security. As of mid-2020, overseas managers held 8.5% of central government bonds, up from just 2.4% in February 2016. By contrast, their share of corporate bonds, at 0.7%, was barely changed from 0.6%. One would expect that this number will also jump in the near future.[1335] Many perceive China bond and financial market to be an Eldorado they were waiting for. Hence, in London's foreign exchange Renminbi is more popular than ever. Options on it exceed those of the Yen, "and

dollar-hegemony-in-doubt?utm_source=google&utm_medium=cpc&utm_campaign=dsa&utm_term=&gclid=EAIaIQobChMItfHci62o8AIViOJ3Ch2yiw7ZEAAYASAAEgJpY_D_BwE (30 April 2021); Monderer, Michael. 2020. *China Lacks the Will to Usurp the U.S.'s Global Currency Dominance*. Accessibility: https://worldview.stratfor.com/article/china-lacks-will-usurp-uss-global-currency-dominance (12 April 2021).

[1333] In 2020 China also fully opened for foreign ownership of financial companies (Bloomberg. 2019. *China will scrap securities firm ownership limits by 2020, Li says*. Accessibility: https://www.bloomberg.com/news/articles/2019-07-02/china-to-scrap-securities-firm-ownership-limits-by-2020-li-says (12 April 2021)), and in 2019 it cleared the way for full takeovers of local banks by foreigners (Bloomberg. 2018. *China keeps promises to Wall Street even as trade war drags on*. Accessibility: https://www.bloomberg.com/news/articles/2018-08-24/china-removes-foreign-ownership-limits-in-banks-asset-managers (12 April 2021)). Still, forecasts indicate that foreign commercial bank assets in China could rise to 1.2% of the market up from 1.1% in 2020. This is minute, and it can either be that the already huge market will constantly grow at almost double digits pace, or that there are other barriers – for example Visa is waiting since 2015 for approval to enter Chinese market (Bloomberg. 2020. *China's finance world opens up to foreigners, sort of*. Accessibility: https://www.bloomberg.com/news/articles/2020-01-22/china-s-finance-world-opens-up-to-foreigners-sort-of-quicktake (12 April 2021)).

[1334] Anstey, Chris, and Enda Curran. 2020. *China Opens Its Bond Market—With Unknown Consequences for World*. Accessibility: https://www.bloomberg.com/news/features/2020-11-22/china-s-bond-market-opening-is-set-to-reshape-the-financial-world (2 February 2021).

[1335] Anstey, Chris, and Enda Curran. 2020.

buying or selling the yuan is now as cheap as trading the British pound."[1336] Similar dynamics are observed also in New York.

The second narrative about the rise of the Renminbi stresses the difficult path that still lies ahead of a global Renminbi: displaying political will, conducting domestic economic reforms, building international demand for Renminbi through political and economic credibility, dealing with US resistance towards such a move (e.g., limiting Chinese to global financial and stock markets), and managing domestic political and economic challenges such as water scarcity, demography, and the housing bubble to identify a few. Furthermore, there is also a fear that the financial opening of China will give their riskiest entities access to credits that they would otherwise not get?[1337] Something along the lines what happened in Greece, Spain, Portugal, and other periphery states in the Eurozone after they have entered it – interest rates fell, but the risk has not. Also, foreign investors may crowed-out domestic investors, hence disabling Chinese political control over its economy. The more open the market is, the more difficult it will be for Chinese policymakers to maintain their grip over their economy, and more susceptive they will be to foreign leverage and financial coercion. I claim that in the mid-term future it is highly possible that China will fall into 'liquidity trap'[1338], or 'middle-income trap'[1339] and will be therefore unable to challenge the centrality of the US dollar.

[1336] Barton, Susanne, and Robert Fullem. 2021. *World's Traders Catapult China to FX Big League on Yield Appeal*. Accessibility: https://www.bloombergquint.com/global-economics/china-s-yield-appeal-catapults-yuan-to-the-global-fx-big-league (24 April 2021).
[1337] Anstey, Chris, and Enda Curran. 2020.
[1338] Keynes (1936. Pp. 208) described it as: "/A/fter the rate of interest has fallen to a certain level, liquidity preference may become virtually absolute in the sense that almost everyone prefers holding cash rather than holding a debt which yields so low a rate of interest." Transposing this to China, this would mean that there will not be a global demand for Renminbi, which would offset for its enhanced liquidity.
[1339] The term describes states that are "squeezed between the low-wage poor-country competitors that dominate in mature industries and the rich-country innovators that dominate in industries undergoing rapid technological

Given that the COVID pandemic is not a structural crisis, only that it has and will expediate trends that were already in motion before the outbreak begun, the projections about Renminbi's global role made before the crisis are with this caveat still relevant today. Yet, those analysis show that the Renminbi will not close the gap to US dollar in the decades to come for domestic and international reasons. Namely, China lacks the political will to change its domestic policies that would enable Renminbi's greater global role: open financial account within the balance of payments, floating not managed exchange rates, full foreign access to China's asset market with legal and property rights, central bank independence.[1340] These challenges are vast, and the opening of the Chinese bond and stock markets are only, which happened during the COVID crisis, a part of these required steps. As such, "China's very low level of household consumption generates large trade surpluses; domestic consumption as a share of GDP must rise to eliminate those surpluses, as it did in Britain during the last quarter of the nineteenth century and in the US post-1945."[1341] It is difficult to see how China might move forward with necessary reforms since party elites, state-owned enterprises, and local governments that currently dominate China's political economy all have everything to lose with such relaxation.[1342] Although Xi Jinping, the current President of China, outlined in his recent plan that the fruits of Chinese growth need to be more equitably distributed, wealth inequality is getting worse.[1343] The bottom 50% of China's

change" and cannot move from this position into the group of developed countries (Gill, Indermit, Homi Kharas. 2007. *An East Asian Renaissance: Ideas for Economic Growth*. Washington: World Bank. Pp. 5).

[1340] Monderer. 2020.

[1341] Germain, Randall, and Herman Mark Schwartz. 2017. The political economy of currency internationalisation: the case of the RMB. *Review of international studies*, 43(4). Pp. 765–87. At Pp. 785.

[1342] Otero-Iglesias, Miguel, and Mattias Vermeiren. 2015. China's state-permeated market economy and its constraints to the internationalization of the renminbi. *International Politics*, 52(6). Pp. 684–703; Germain and Schwartz. 2017.

[1343] Tang, Frank, and Ji Siqi. 2020. *Xi Jinping has pledged to double the size of China's economy by 2035, but can he rein in inequality?*. Accessibility: https://www.scmp.com/economy/china-economy/article/3111016/xi-jinping-has-pledged-double-size-chinas-economy-2035-can-he (23 February 2021).

population owned the same amount of national income as the top 1%, whereas in 1978 this number was 27% – the contemporary level of Scandinavian countries.[1344] With such numbers, it is an illusion to expect a switch towards a consumer-led economy, a critical change that China needs to do to position Renminbi as the key global currency.

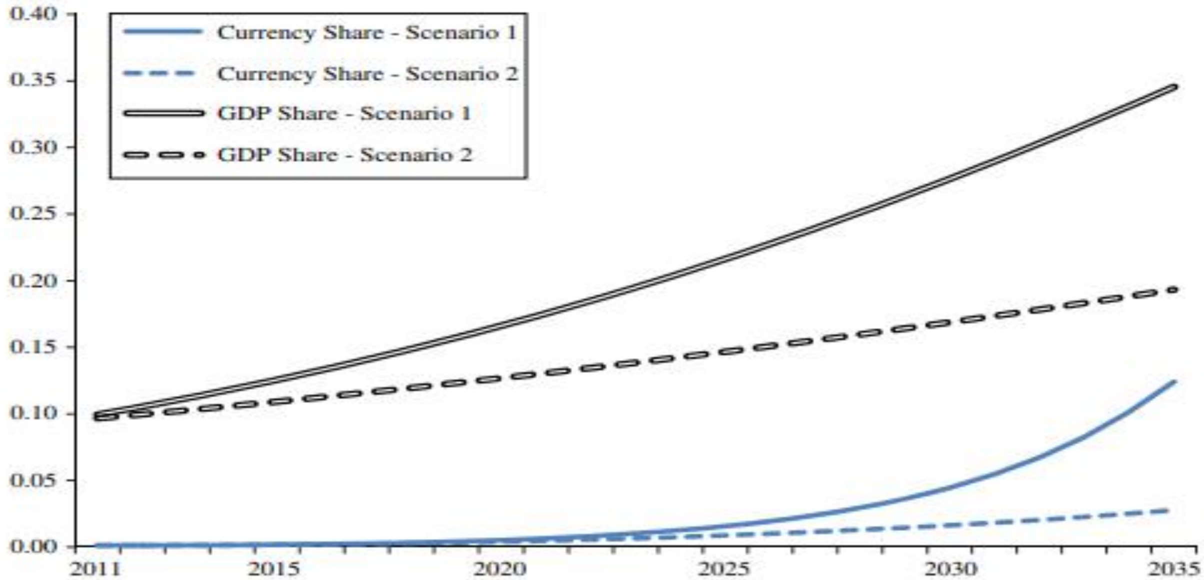
Therefore, I am convinced that a bit dated (made in 2014), but methodologically rigorous projection about the international role Renminbi, still holds today.[1345] Figure 104[1346] shows the global position of Renminbi according to two scenarios – high and low economic growth. The latter is not translated into the global position of Renminbi. Even if China would reach 35% of the global GDP by 2035, the amount of transactions in Renminbi would still remain low and far from the US dollar – potentially around 15%.

[1344] *World Inequality Database*. 2021. Accessibility: https://wid.world/data/ (24 September 2020).

[1345] For a 2021 projection of Chinese economic strength as a consequence of different technological decoupling scenarios see Appendix 10. In a nutshell: in all scenarios US economy and power is less impacted than Chinese or Japanese or EU's. See, Cerdeiro, Diego A., Johannes Eugster, Rui C. Mano, Dirk Muir, and Shanaka J. Peiris. 2021. *Sizing Up the Effects of Technological Decoupling*. Accessibility: https://www.imf.org/-/media/Files/Publications/WP/2021/English/wpiea2021069-print-pdf.ashx (4 May 2021).

[1346] Lee, Jong-Wha. 2014. Will the renminbi emerge as an international reserve currency?. *The world economy*, 37(1). Pp. 42–62. At Pp. 57

Figure 104: Projections of GDP and Global currency position China



Notes: (i) Scenario 1 denotes a high growth path for China; Scenario 2 denotes a low growth path for China. (ii) The high growth path assumes that the historical real GDP growth rate of 9.5 per cent for 1999–2008 and real exchange rate appreciation rate of about 3.4 per cent are maintained through 2035; and the low growth path assume a 6.0 per cent real GDP growth rate. (iii) In both scenarios, we also assume that China will achieve the same daily foreign exchange turnover and capital account openness as in the United States from 2011 to 2020. (iv) The estimates of GDP shares are in current US dollar.

Furthermore, in the aftermath of the Global Financial Crisis in 2008, China did make efforts to internationalize the Renminbi; yet, with little to show for and it can be argued that it has hence abandoned this endeavor. In 2016 IMF did include Renminbi in the basket of currencies based on which it calculates the value of SDR (11%).[1347] Nevertheless, SDR cannot be used internationally for trade or investment and is thus of minor importance in the global financial economy. Furthermore, Standard Chartered Bank's index of Renminbi globalization displays global stagnation of Renminbi since 2015.[1348] Therefore, there is no genuine global demand for

[1347] International Monetary Fund. 2016. *IMF Adds Chinese Renminbi to Special Drawing Rights Basket*. Accessibility: https://www.imf.org/en/News/Articles/2016/09/29/AM16-NA093016IMF-Adds-Chinese-Renminbi-to-Special-Drawing-Rights-Basket (12 December 2019).
[1348] Standard Chartered. 2020. *Renminbi tracker: How global is the renminbi?*. Accessibility: https://www.sc.com/en/trade-beyond-borders/renminbi-globalisation-index/ (23 November 2020).

Renminbi, which is a prerequisite for its enhanced role or centrality, and there is also significant doubt that the Chinese elites would be willing to make the tradeoffs necessary for such establishment. Instead, it seems that China seeks to maintain a permanent status of the potential challenger to the US dollar, without seriously making an effort to replace it. In the light of this we can also better understand the slightly loosened capital controls that I have mentioned. “Barring significant policy changes that seem implausible for now, the RMB will remain a second-tier (if not third-tier) currency for the foreseeable future.”[1349] In fact, I think what is more plausible is

> “a reversal of capital flows in and out of China. As the world's biggest exporter, China ends up lending a lot to other countries that buy its products. A decade ago it ran a current account surplus of 4% of GDP. But, since 2015, China's current account surplus has been declining and since 2018 it has been below 1%. Could it reverse and turn into a deficit? Opening up its bond markets to international investors would make that possible. And the initial gush of foreign money as investors jostle for first-mover advantage could cause just that. /…/ Opening up its bond markets makes China a challenger for the status of global reserve currency, because this would make it easier for foreigners to hold renminbi assets. If China shifts to running a modest current account deficit, the yuan's share of foreign reserves will rise.”[1350]

Moreover, the slight opening of the capital market in China may help China with its domestic issue of running out of labor force (consequence of 1 child policy) and maintaining its bullish housing market. Doing so, China would slowly shift to consumer let growth and has planned to double its GDP by 2035. This however is highly problematic.

> “To do so, the Chinese economy must grow annually by just over 4.7 per cent on average for the next 15 years. /…/ Between 1980 and 2010, Chinese GDP doubled four times, but debt levels were low and rose slowly. However, between 2010 and 2020 when GDP doubled again, China did so by tripling its total debt burden to $43tn, so that it now stands, officially, at over 280 per cent of GDP. Assume

[1349] Monderer.2020.
[1350] Eurointelligence. 2020d. Daily Brief, 25 November.

> conservatively that the relationship between debt and growth doesn't change, and China's debt-to-GDP ratio will have to rise to over 400 per cent by 2035 if it is to double GDP again. This is a level that would be unprecedented in history. Everywhere else, growth collapsed long before debts reached levels close to this. China can in principle reduce its dependence on debt by shifting domestic demand from investment to consumption, as Beijing has long proposed. Yet this requires that the household income share of GDP rise from roughly 50 per cent today to at least 70 per cent. /…/ There is also a demographic problem. From the late 1970s, China benefited from a rapidly rising working-age population, but this reversed around a decade ago. In fact, over the next 15 years, while China's population will grow by an estimated 1.5 per cent, its working population will decline by an astonishing 6.8 per cent and will continue to decline for the rest of the century. Achieving GDP growth of 4.7 per cent with a declining working population requires as much productivity growth per worker as 5.2 per cent GDP growth with a stable working population. Growth in Chinese labour productivity has in fact fallen steadily since 2010. Looking ahead, a declining working population requires that the pace of this decline in productivity drops by nearly two thirds if China is to double GDP by 2035."[1351]

Therefore, partial opening or even potential full opening of the financial market in China will not be able to offset its underlying issues: demography, housing and financial bubble, and rising debt, particularly of the local authorities. Figure 105[1352] shows the coming decline in China's working age population, as well as urban population, both measures are crucial for the future economic rise of China. Moreover, Figure 106 displays the exponential growth of elderly population in China and other developed countries, where China will catch United States by 2035.[1353] As such, China's future is contemporary Japan, with a slight caveat, which makes the threat worse for China. Namely, Japan solved its problem by globalizing and opening its markets, as well as integrating its economy into the global supply and added value chains. Whereas China so far is not doing so. In fact, it is doing the opposite – its policies are generating a decoupling from the Western world. Japan is trying to use artificial intelligence and robots to compensate for

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[1351] Pettis, Michael. 2020. *Xi's aim to double China's economy is a fantasy*. Accessibility: https://www.ft.com/content/8cc6f95e-89c2-4bf3-9db3-eafd481f1f37 (23 February 2021).
[1352] Goodhart and Pradhan. 2020. Pp. 33.
[1353] Goodhart and Pradhan. 2020. Pp. 74.

their lack of labor force. But this can not mitigate the social and service costs and challenges that are associated with the aging population. China might do the same and utilize new technologies to maintain its productivity or cheap labor force. Yet, this is not a measure to mitigate the expenditures for increased elderly services, which will only grow. Thus, applying new technology may buy China some time, but it will not resolve its internal societal problem of aging population.

Figure 105: China's demographic decline

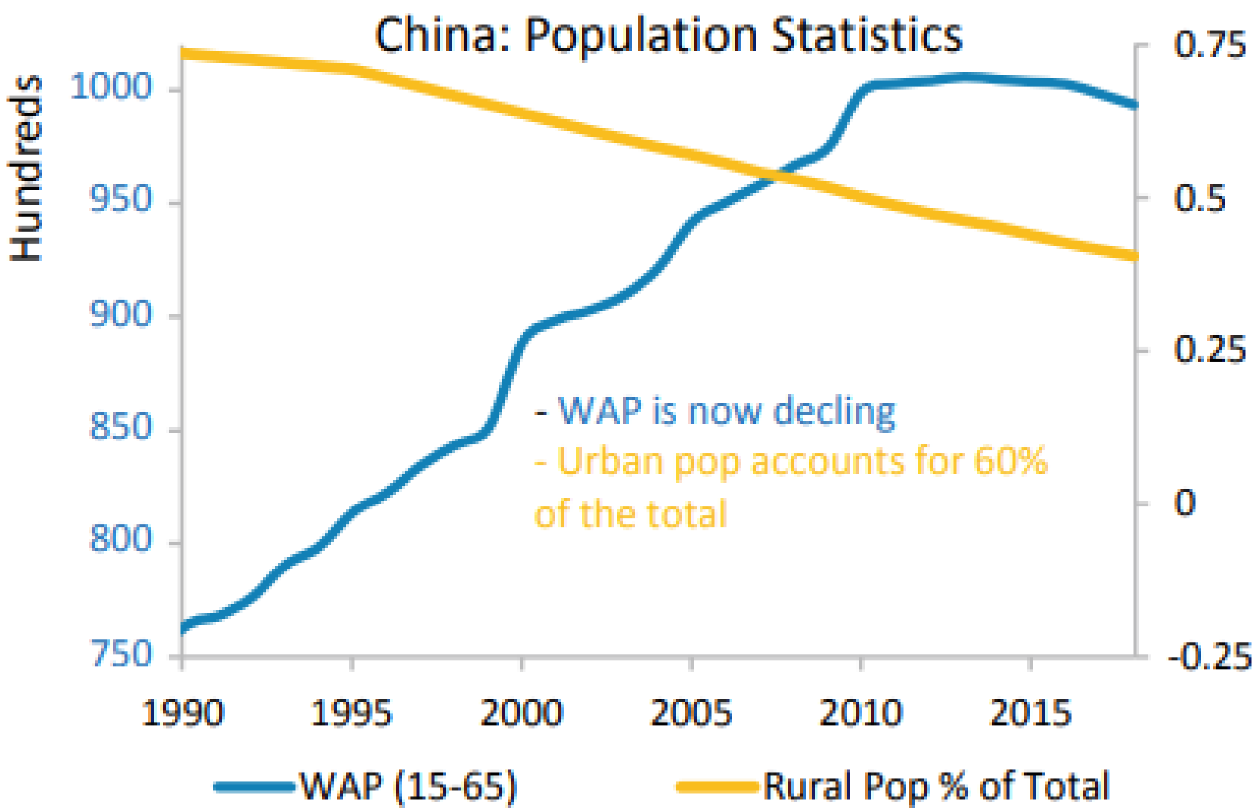
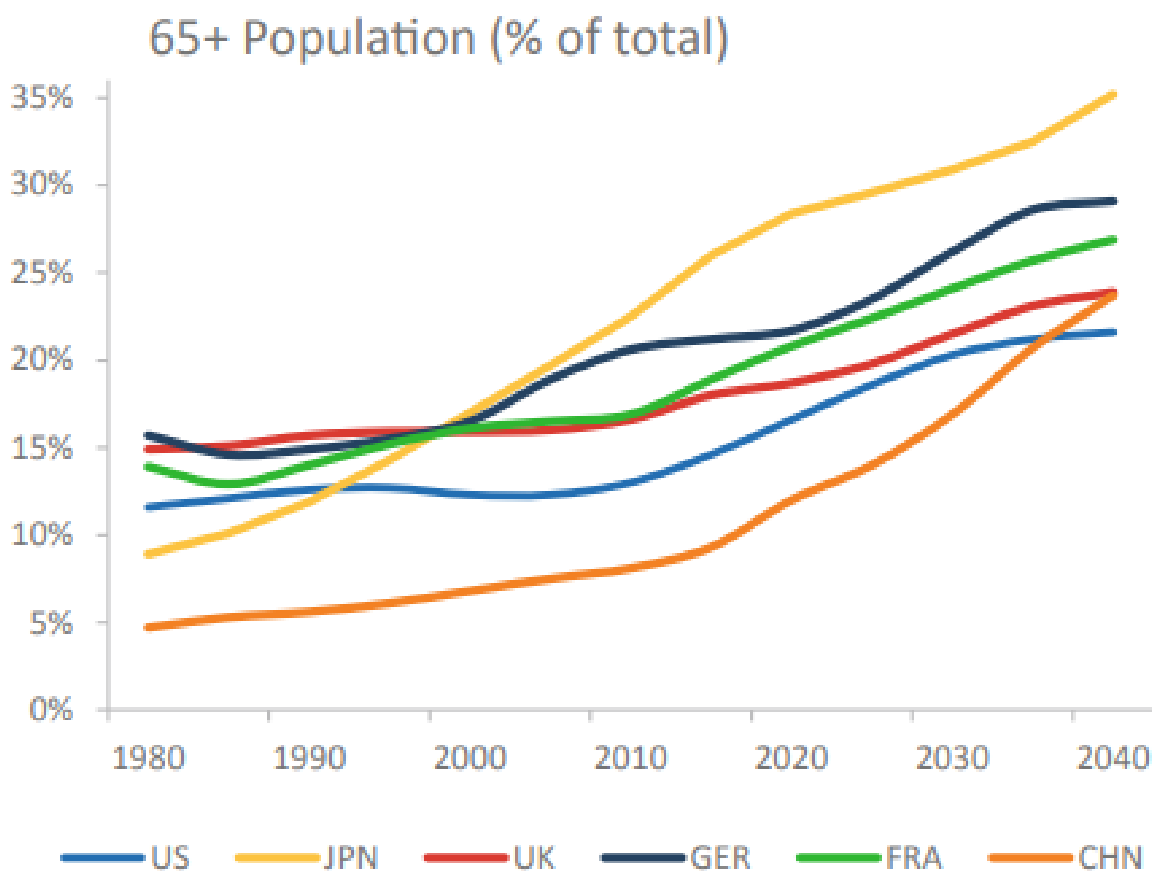


Figure 106: Elderly population in China and developed countries

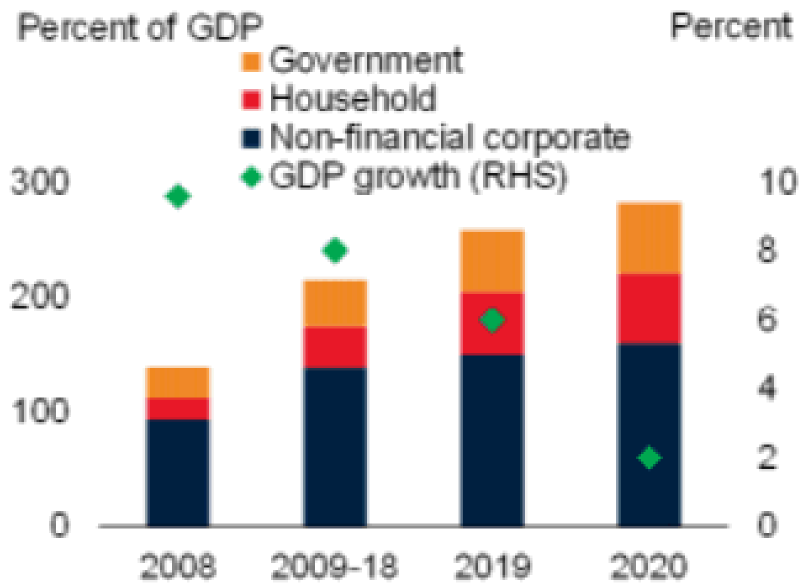


IMF has warned China in the beginning of 2021 of its growing debt risk.[1354] Its debt is rising by 20% on a yearly basis.[1355] "China's total debt hit 317% of GDP in Q1 2020, up from 300% in Q4 2019—the largest quarterly increase on record /…/ China has accounted for over 40%

[1354] Klein, Jodi Xu. 2021. *IMF urges China to reduce corporate debt risk made worse by heavy pandemic lending*. Accessibility: https://www.scmp.com/news/china/article/3128530/imf-urges-china-reduce-corporate-debt-risk-made-worse-heavy-pandemic (30 April 2021).
[1355] Choyleva, Diana. 2020. *China's local government debts should be the real worry*. Accessibility: https://asia.nikkei.com/Opinion/China-s-local-government-debts-should-be-the-real-worry (24 February 2021).

of the rise in global debt since 2007."[1356] Figure 107 displays the growing Chinese debt by sector.[1357] For comparison, US debt is half the size.[1358]

Figure 107: Composition of the Chinese debt



IMF projections are not encouraging for China. It is estimated that in the next 5 years, its fiscal balance will be negative 10% of its GDP on a yearly basis. This would skyrocket its governmental debt to 80% of its GDP.[1359] "The quality of corporate debt had also been deteriorating in many countries even before the pandemic. Corporate speculative-grade debt as a share of total corporate debt—a leading indicator of corporate sector distress—was nearly 50

[1356] Institute of International Finance. 2020. *Surging Global Debt: What's Owed to China?*. Accessibility: https://www.iif.com/Portals/0/Files/content/1_200514%20Weekly%20Insight.pdf (24 October 2020). Pp. 1.
[1357] World Bank. 2021. *Global Economic Prospects*. Washington: World Bank. Pp. 23.
[1358] FRED. 2021a. *Total Credit to Private Non-Financial Sector, Adjusted for Breaks, for United States*. Accessibility: https://fred.stlouisfed.org/series/QUSPAM770A (19 April 2021).
[1359] International Monetary Fund. 2020b. *Fiscal Monitor,* October. Washington: International Monetary Fund. Pp. 6–9.

percent in China."[1360] However, these numbers are based on an assumption of a continued almost double-digit growth of the Chinese economy. Yet, recent research leads us to doubt Chinese statistics and indicates that its economic growth is far from what is being reported. We were told by the Chinese authorities that during the first quarter in 2020 its

> "nominal GDP fell only 3.3 percent. /…/ Yet industrial and services production indexes, themselves unverifiable, were said to fall 8 and 9 percent, respectively. The expenditure side saw fixed investment drop 16 percent, retail sales 19 percent, and net exports 80 percent. The GDP figure only made sense if the rest didn't. A more accurate nominal decline of at least 8 percent would shift 2020 performance into the red (while making the recovery sharper)."[1361]

Also, debt of the local government in China has increased in recent years and is becoming a burden.[1362] Figure 108 presents Chinese government debt by type, and Figure 109 shows debt exposure of the local governments in China. This rise in debt and the problems it brings is spilled into State owned enterprises. The rates of bankruptcies have increased, also the level of insolvent companies that are being rescued by the government.[1363] Thus, foreign investors need to be careful, since the "cash flow analysis and other research won't get you anywhere with distressed companies in China, which can trip up even the most diligent treasure hunter. There, you've got to have an

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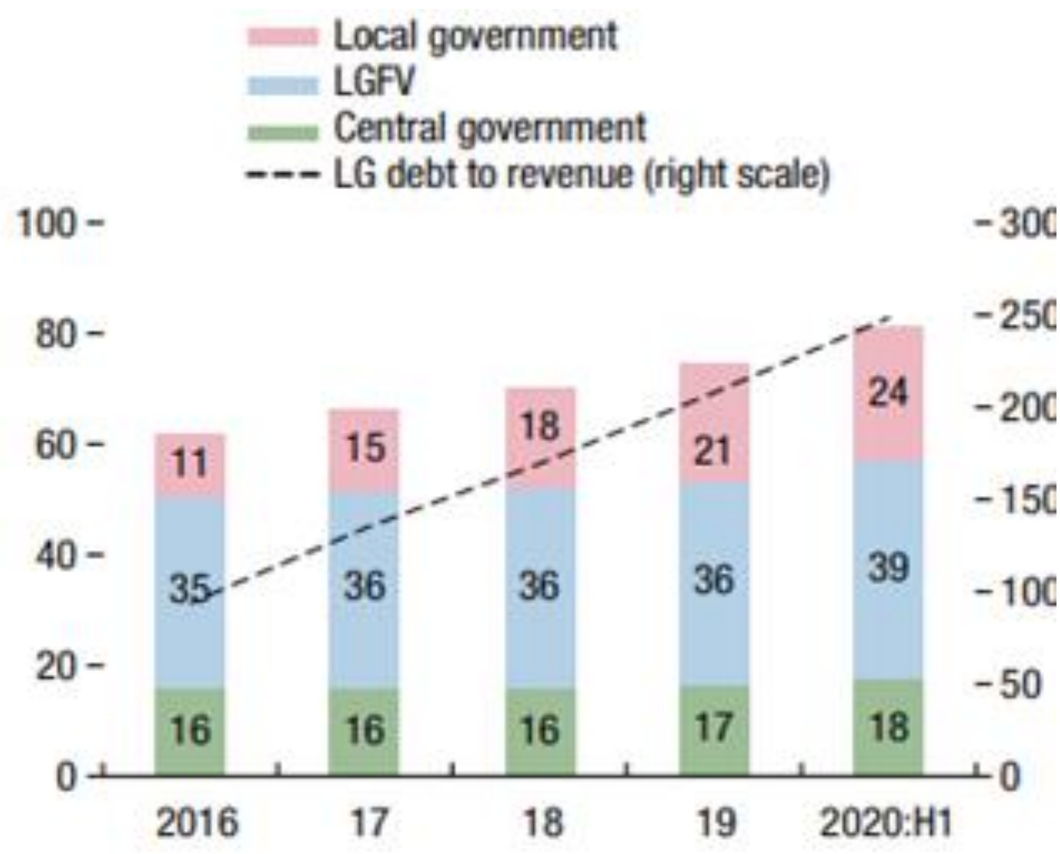
[1360] International Monetary Fund. 2020b. Pp. 23.
[1361] Scissors, Derek. 2021. *China's economy probably shrank in 2020*. Accessibility: https://www.aei.org/foreign-and-defense-policy/chinas-economy-probably-shrank-in-2020/ (30 April 2021).
[1362] More than a half of bonds sold by local governments in China in 2021 were a product of refinancing needs, indicating that these entities can not repay their debts even when the economy is growing, not contracting as in 2020, see Bloomberg. 2021b. *China's Local Governments Roll Over More Debt to Ease Risks*. Accessibility: https://www.bloomberg.com/news/articles/2021-07-04/china-s-local-governments-roll-over-more-debt-to-ease-risks (4 July 2021).
[1363] Wilkins, Rebecca Choong, and Molly Dai. 2021. *The Ticking Debt Bomb in China's $18.1 Trillion Bond Market*. Accessibility: https://www.bloomberg.com/news/storythreads/2020-12-03/the-ticking-debt-bomb-in-china-s-15-trillion-bond-market (2 February 2021).

in; access to company information is everything."[1364] This lack of transparency is also one of the factors why China cannot generate the demand United States can.

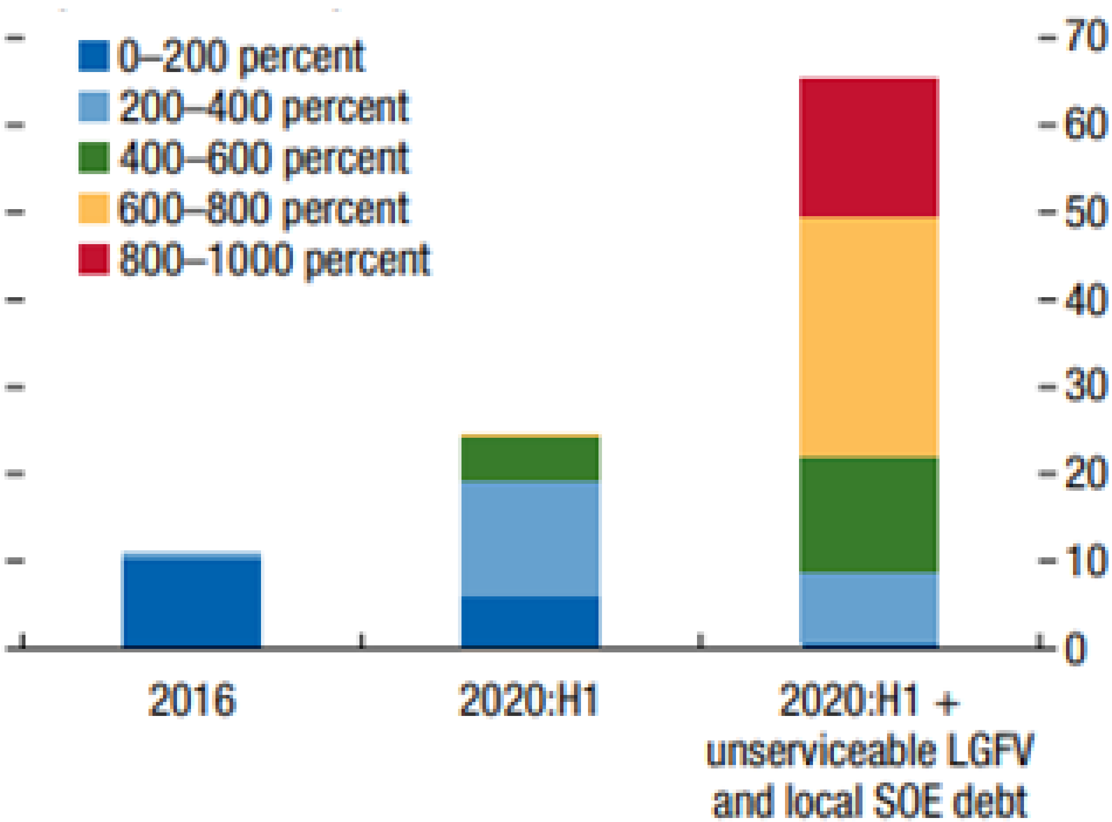
> "While providing additional support to the economy, credit support measures may be adding to nonfinancial sector vulnerabilities. China's corporate-debt-to-GDP rose 10 percentage points in the first quarter, against a backdrop of already very high debt servicing burdens. Household debt also continued to rise, with continued rapid growth in housing related debt and a rebound in retail stock market leverage."[1365]

Figure 108: Chinese government debt by type (percent of GDP, ratio)[1366]



[1364] Ren, Shuli. 2021. *Cash Flow Analysis Is a Losing Game in China*. Accessibility: https://www.bloombergquint.com/gadfly/distressed-companies-are-different-in-the-u-s-and-china-just-do-the-math (13 May 2021).
[1365] International Monetary Fund. 2020d. *Global Financial Stability Report, Online Annex 2.1. Technical Note*, October. Washington: International Monetary Fund. Pp. 15
[1366] International Monetary Fund. 2020c. *Global Financial Stability Report,* October. Washington: International Monetary Fund. Pp. 33

Figure 109: Debt exposure by the local governments in China (percent of GDP)[1367]

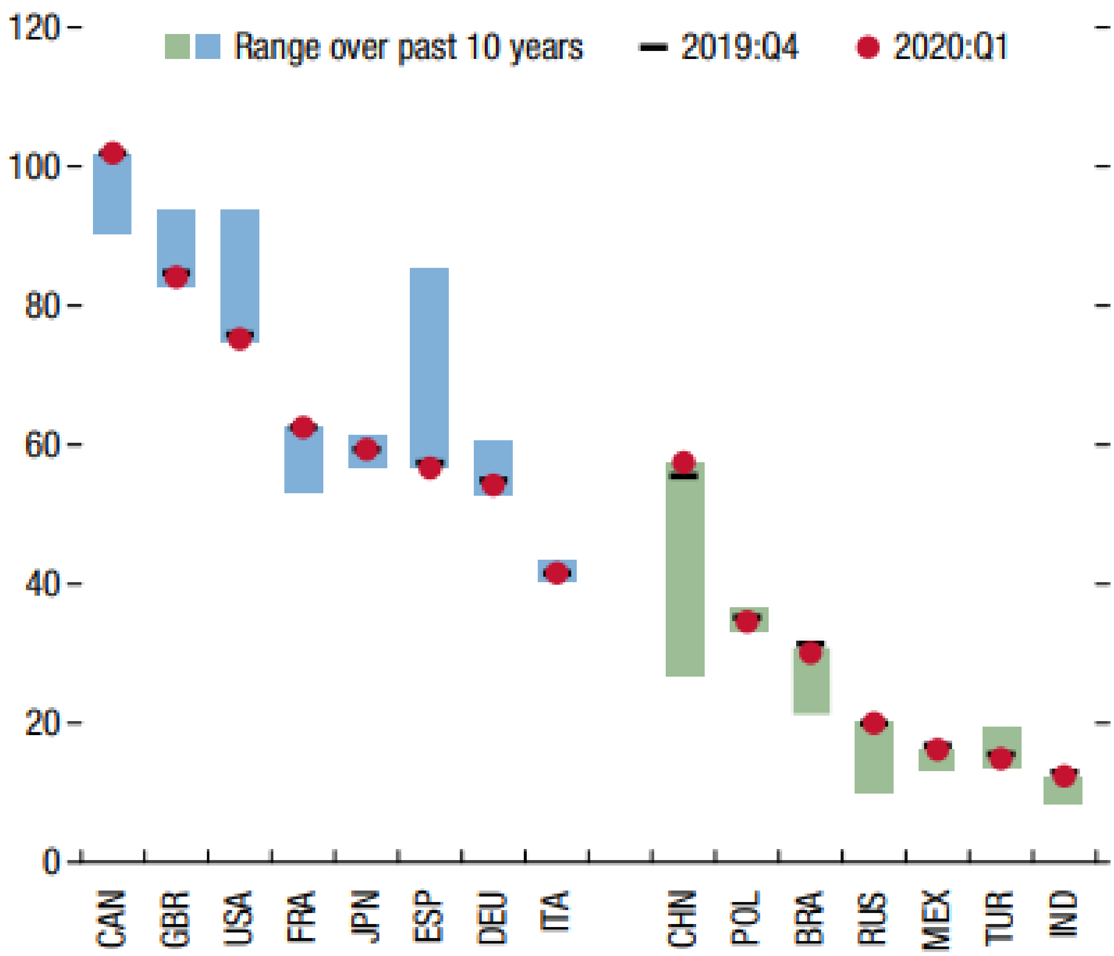


"Direct borrowing by local governments was first permitted in 2015 but has risen quickly to 24 percent of GDP, significantly outpacing growth in local government tax revenues. Direct borrowing growth has accelerated during the COVID-19 crisis as it became a key funding source for macroeconomic countercyclical measures. /…/ Roughly 75 percent (RMB 26 trillion) of outstanding local government financing vehicles debt is likely unserviceable. Local SOEs owe another RMB 10 trillion. If local governments assume this unserviceable debt, it will more than double existing debt loads and increase by tenfold the debt owed by provinces with debt-to-revenue ratios above 400 percent. The potential for spillovers to banks is also considerable."[1368]

[1367] International Monetary Fund. 2020d. Pp. 33
[1368] International Monetary Fund. 2020d. Pp. 32.

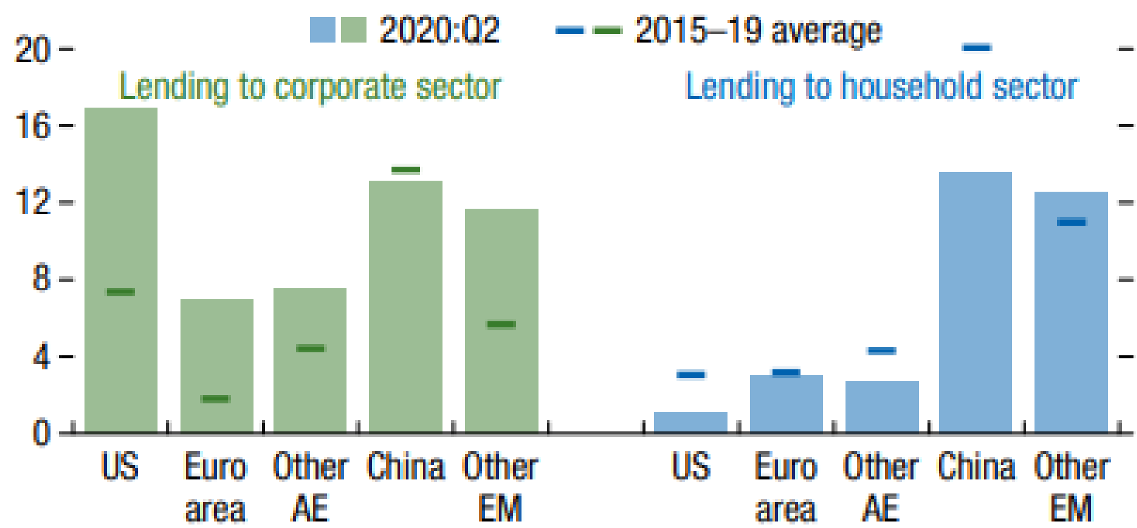
Finally, China's households have severely ramped up their debt as well. Nowadays it is on the same level as in United States, where in fact it is declining (see Figure 110). These funds are subsequently also invested into the housing market, which in China is a status symbol. Figure 111 displays the level of loans to households in United States, China, and the Eurozone, where China has much exceeded the other two big entities.[1369]

Figure 110: Household debt in different countries in the last decade (percent of GDP)[1370]



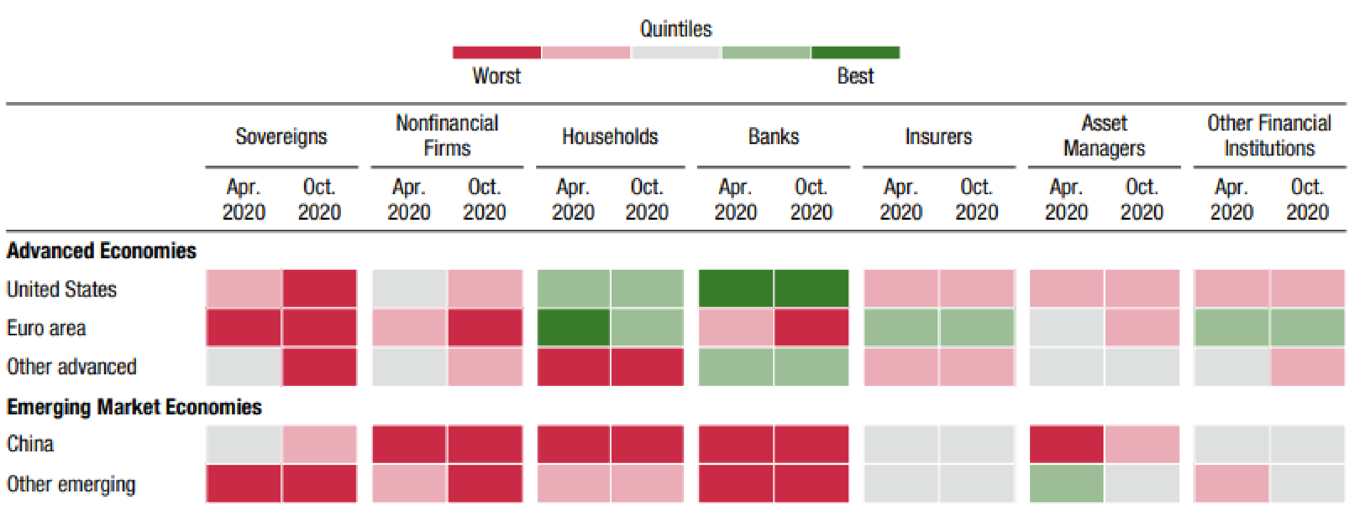
[1369] International Monetary Fund. 2020d. Pp. 13.
[1370] International Monetary Fund. 2020d. Pp. 15.

Figure 111: The level of loans to households in United States, China, and the Eurozone



All this leads to a gloomy outlook of the financial situation and potential of China compared to the one of United States and the Eurozone as well. Chinese vulnerabilities are higher on most criteria on Figure 112 indicates (including Banks and Households).[1371]

Figure 112: Financial vulnerabilities of United States, Eurozone, and China



[1371] International Monetary Fund. 2020d. Pp. 11.

In the last decade China has expediated its development loans sphere. The idea was not only to establish an alternative to the Washington consensus[1372] as a model for development, but to operationalize it without the Renminbi. Particularly the One belt and road initiative[1373] was designed with that purpose: to project Chinese power overseas, create new markets for Chinese companies, assure supply of raw materials, and strengthen Chinese financial leverage over other countries by exploiting their dependance on debt owed to China.[1374] Yet, although global bank loans of China have increased, the overall global debt to China has been decreasing since 2013 (Figure 113).[1375] However, as Figure 114 displays, China has a substantially different approach to loans in developed and developing countries. If portfolio investments are dominant in developed

[1372] A set of ten political-economic reforms advocated by IMF, World Bank, and the United States in their posture on financing development and help countries in crisis. See, Williamson, John. 1990. *What Washington Means by Policy Reform*. Accessibility: https://www.piie.com/commentary/speeches-papers/what-washington-means-policy-reform (30 August 2020).

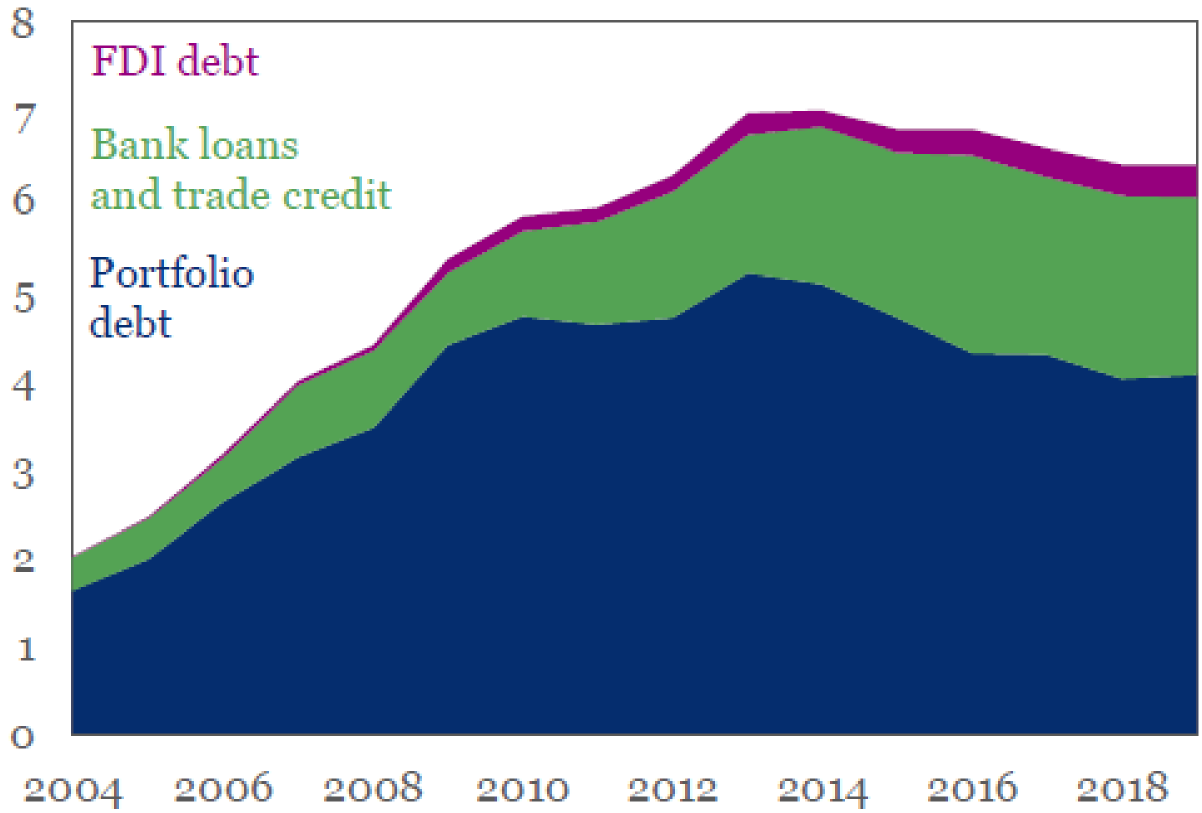
[1373] Introduced in 2013, the One Belt one road initiative includes 67 countries on Asia, Africa, and Europe, where China promotes infrastructure projects that would help in facilitating its interest and better connectivity of China with other countries. See, Steil, Benn, and Benjamin Della Rocca. 2019. *Belt and Road Tracker*. Accessibility: https://www.cfr.org/article/belt-and-road-tracker (30 August 2020).

[1374] A recent example of Chinese exploitation of the countries involved in the initiative is Montenegro and its highway to nowhere. See, Brelie, Hans von der. 2021. *The billion-dollar motorway leading Montenegro to nowhere*. Accessibility: https://www.euronews.com/2021/05/07/the-billion-dollar-motorway-leading-montenegro-to-nowhere (29 May 2021). As such, the initiative is not performing as China intended and participating states are turning against it. See, Shepard, Wade. 2020. *Is China's Belt And Road Already In Retreat?*. Accessibility: https://www.forbes.com/sites/wadeshepard/2020/01/30/is-chinas-belt-and-road-already-in-retreat/?sh=123900dc5ebe (23 March 2020). Because of many such deficiencies in the One belt and road initiative, there is a growing skepticism of a strategic nature of this initiative, or strategic miscalculation. However, I think that we should understand the One belt and road initiative differently, not in terms of projecting Chinese power, or enhancing its economic centrality, but as a dire search for demand for its construction sector. The story of Evergrande is not an outlier, but an indication of the state of the Chinese economy (see Yu, Sun, and Tom Mitchell. 2022. *China's economy: the fallout from the Evergrande crisis*. Accessibility: https://www.ft.com/content/13476bf7-a519-427c-afd8-06e5579539d8 (6 January 2022)). China is simply running out of places to build and people to resettle. Thus, they need to look abroad for construction markets, as this sector represents a third of their economic output, whereas in the United States below 20% (see, Rogoff, Kenneth S., and Yuanchen Yang. 2020. *Peak China Housing*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w27697/w27697.pdf (30 April 2021)). As such, they are willing to take on any big project, as this plays into their status narrative of big and best builders, regardless of its economic rentability. This also means that they are more concerned with economic growth than positioning itself in the center of the global economy. This also explains, why China is not actively pursuing to delegitimize the US dollar as the key global currency, be it with these infrastructure projects or with other financial means, as both are in the service of a different political goal.

[1375] Institute of International Finance. 2020. Pp. 2.

world, then direct loans are prevalent in developing countries.[1376] As such, China was pragmatic to tailor its approach to different states.

Figure 113: Chinese debt claims on the rest of the world (% of global GDP)



Additional concern for China is a fact that approximately 50% of China's lending to developing countries is not reported to IMF or World Bank. This hidden debt is entirely state sponsored and so its risk exposure of China is even more troublesome than the official statistics would make us believe.[1377] Furthermore, with the data we have, we can see that Chinese foreign

[1376] Horn, Sebastian, Carmen M. Reinhart, and Christoph Trebesch. 2019. *China's overseas lending*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w26050/w26050.pdf (24 October 2020). Pp. 37.
[1377] Horn, Reinhart, and Trebesch. 2019.

loans are by and large denominated in US dollars, not in Renminbi, what one would assume, as well as, practically all of it is state sponsored action – see Figure 115.[1378] Moreover, many projects within the One belt and road initiative are financed also with the help of the Asian Development Bank – where United States has dominant voting share.[1379] Also, the 2016 created Asian Infrastructure Investment Bank – the Chinese alternative to Asian Development Bank – has fallen flat during the pandemic, and its portfolio is only one sixth the size of Asian Development Bank.[1380] Therefore, with its opening to enhanced activity in the international financial markets, China is not undercutting US dollar, it is actually strengthening its centrality. China is 'buying-in'. However, this does not mean that it is not only biding time, but so far there are no empirics that would support the argument that the Renminbi is on the track of replacing the US dollar.

[1378] Horn, Reinhart, and Trebesch. 2019. Pp. 22.

[1379] *ADB president willing to engage in BRI projects, sees AIIB as partner*. 2019. Accessibility: http://www.china.org.cn/business/2019-05/29/content_74834692.htm (3 June 2020).

[1380] Kawase, Kenji. 2020. *China-led AIIB's troubled loans spike amid pandemic*. Accessibility: https://asia.nikkei.com/Economy/China-led-AIIB-s-troubled-loans-spike-amid-pandemic (4 October 2020). For comparing Asian Development Bank and Asia Investment Infrastructure Bank, see Sims, Kearrin. 2019. Cooperation and contestation between the ADB and AIIB. Accessibility: https://www.eastasiaforum.org/2019/10/24/cooperation-and-contestation-between-the-adb-and-aiib/ (4 October 2020); Runde, Daniel F., and Shannon McKeown. 2019. The Asian Development Bank A Strategic Asset for the United States. Accessibility: https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/191218_ADB%20WP_WEB_FINAL_UPDATED.pdf?2IXncUUQ2s0bACEMdVH0759DTjgC95df (4 October 2020).

Figure 114: Chinese tailored approach to foreign loans

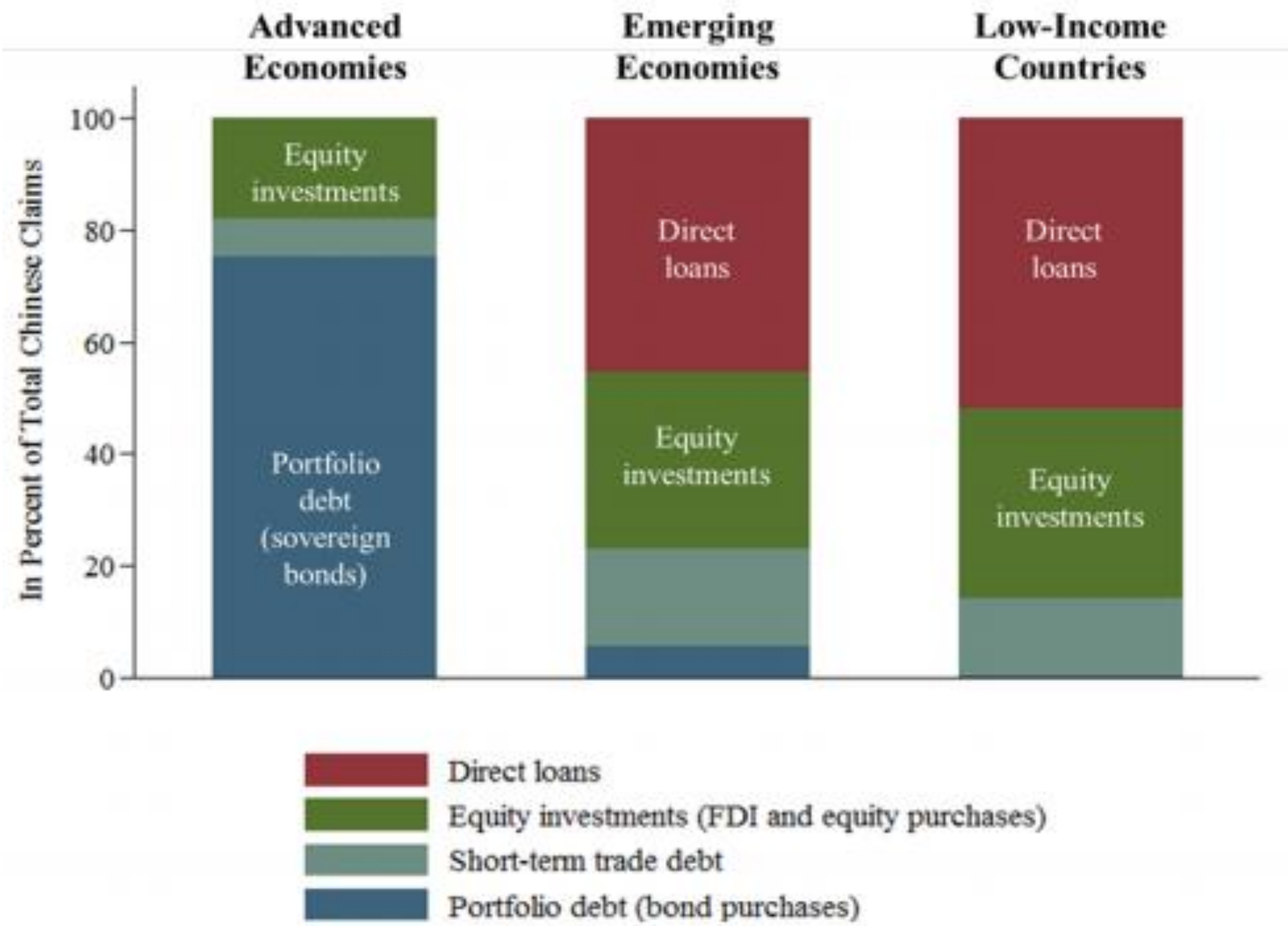
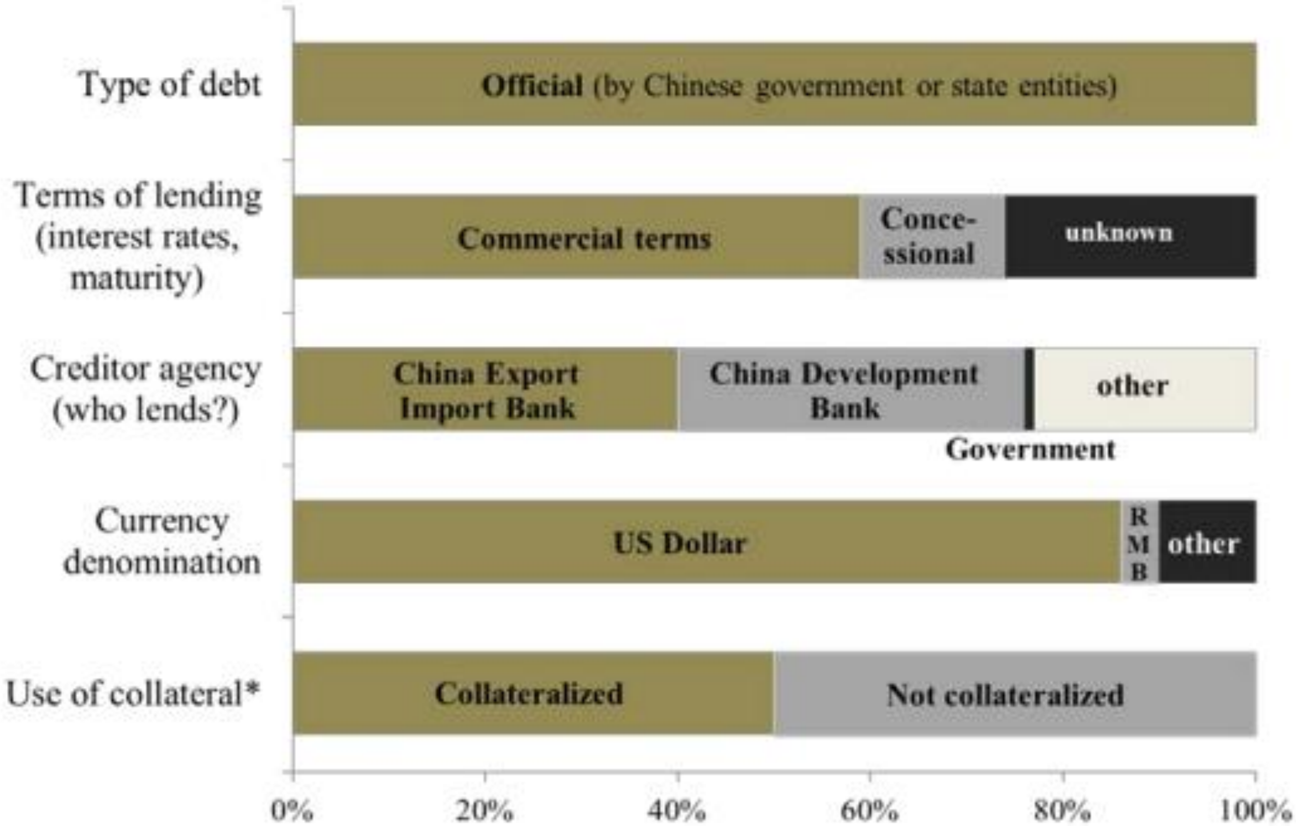


Figure 115: Characteristics of Chinese foreign loans

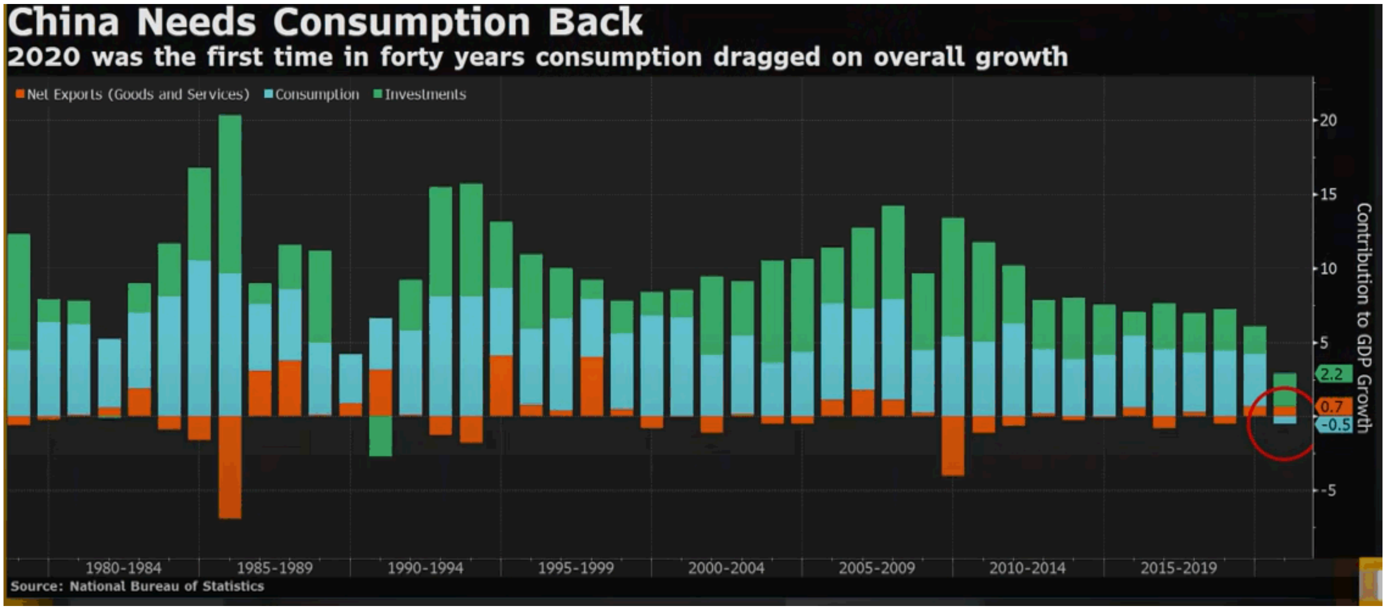


Finally, with the COVID pandemic the yields of Chinese short- and long-term bonds have declined, which indicates that their price have risen due to the higher demand. This is perfectly in-line with what we would expect: a growing and opening financial market, which has rebounded first from the pandemic. Nevertheless, short-term bonds have fallen much more than long-term.[1381] This indicates that China is approaching its threshold of how much it can borrow, since investors are less certain about Chinese future. Subsequently China cannot count to base its growth on foreign loans in the future, as it will come with a bigger price tag and hence counterproductive for economic growth. This is the biggest challenge China faces, since its domestic consumption is

[1381] *Market Watch*. 2021. Accessibility: https://www.marketwatch.com/ (23 March 2021).

nowhere near it could substitute this future gap. In fact, the pandemic has actually reduced Chinese consumption to the level where it was a drag on its growth – Figure 116.

Figure 116: Chinese consumption[1382]



Therefore, China is more vulnerable than one would assume from its economic growth and export statistics. It is a 'bank driven economy', which is prone to burst. It seems that the Biden administration is aware of this and has continued Trump's decoupling from China.[1383] The latter

[1382] Heath Michael, and Kathleen Hays. 2021. *IMF's Berger Warns China Tech Decoupling Would Slash Global GDP*. Accessibility: https://www.bloomberg.com/news/articles/2021-04-16/imf-s-berger-warns-china-tech-decoupling-would-slash-global-gdp?sref=hU9a6jCa (20 April 2021).
[1383] Wong, Catherine. 2021. *Joe Biden shows 'more continuity than expected' from Donald Trump policy on China*. Accessibility: https://www.scmp.com/news/china/diplomacy/article/3133105/biden-shows-more-continuity-expected-trump-policy-china (15 May 2021).

will in the long run hurt China much more than United States.[1384] Particularly, if other democracies of the world join in, which also seems to be the case.[1385]

As such, we may see a more crystalized fight for global governance between democratic capitalism and autocratic capitalism.[1386] It is somewhat natural that the ally here for China will be Russia. In fact, if the Chinese were not explicit so far in their discomfort with the US dollar, the Russians were. Russian Deputy Foreign Minister Sergei Ryabkov said in an interview: "We need to barricade ourselves against the U.S. financial and economic system to eliminate dependence on this toxic source of permanent hostile actions /…/ we need to cut back the role of the dollar in any operations."[1387] Furthermore, Russian president Putin holds a preference to reduce Russian exposure to US assets and obtain gold reserves; yet, so far he has failed as the Russian economy

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[1384] Trump's trade war with China first had a positive effect on United States, as it lowered Chinese exports to United States, preserved jobs, assured higher wages, and industry (Nicita, Alessandro. 2019. *Trade and trade diversion effects of United States tariffs on China*. Accessibility: https://unctad.org/system/files/official-document/ser-rp-2019d9_en.pdf (9 January 2020); Tang, Frank. 2019. *US trade war has cost China 'almost 2 million industrial jobs', investment bank CICC says*. Accessibility: https://www.scmp.com/economy/china-economy/article/3019916/us-trade-war-has-cost-china-almost-2-million-industrial-jobs (9 January 2020)). With the phase one trade deal (*Economic and Trade Agreement Between the Government of the United States and the Government of the People's Republic of China*. 2020. Signed on January 15. Accessibility: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/economic-and-trade-agreement-between-government-united-states-and-government-peoples-republic-china (13 April 2020)) and the pandemic this has changed. China did not stick to the agreement when it comes to imports from the United States, but it did push the gas throttle on its exports to United States (Bown, Chad B. 2020. *Trump's phase one trade deal with China and the US election*. Accessibility: https://www.piie.com/blogs/trade-and-investment-policy-watch/trumps-phase-one-trade-deal-china-and-us-election 13 April 2020)). Precisely these two features persuaded Biden administration to continue with decoupling from China. The latter will increasingly be under pressure as time rolls on due to Chinese lack of strategic industry, such as semiconductor capacities (Hodiak, Justin, and Scott W. Harold. 2020. *Can China Become the World Leader in Semiconductors?*. Accessibility: https://thediplomat.com/2020/09/can-china-become-the-world-leader-in-semiconductors/ (1 December 2020)). Moreover, recent research has shown that in there are cases, where tariffs make sense also in the long run (Dullien, Stephan, and Theobald. 2020).

[1385] E.g., Euronews. 2021. *EU suspends efforts to ratify controversial investment deal with China*. Accessibility: https://www.euronews.com/2021/05/04/eu-suspends-efforts-to-ratify-controversial-investment-deal-with-china (20 May 2021).

[1386] Pelanda. 2007.

[1387] Arkhipov Ilya, and Henry Meyer. 2021. *Russia Must 'Barricade' Itself Vs. Dollar, Senior Diplomat Says*. Accessibility: https://www.bloomberg.com/news/articles/2021-02-24/russia-must-barricade-itself-vs-dollar-senior-diplomat-says (20 April 2021).

and trade still by and large depends on the US dollar.[1388] Such a scenario was just made more realistic as the Chinese Foreign Minister Wang Yi met with his Russian counterpart Sergei Lavrov, immediately after he met US Secretary of State in Anthony Blinken in Alaska. Lavrov openly advocated for an autonomous scientific and technological sector of the two countries, as well as conducting their bilateral trade in local currencies. In fact, in 2020 25% of Russia-China bilateral trade was settled in local currencies, which may not seem much, but it is up from 2-3% in 2010s.[1389] We have seen similar calls in the past, but none has materialized since global markets are based on the US dollar and so one would have to detach itself completely from global supply chains to do what the aforementioned politicians suggested. This is highly unplausible. Thus, the last remaining path for Renminbi to dethrone US dollar is with digital currency.

I will devote the next passage to this question, but at this point, one must stress that omitting Bahamas, which have introduced a digital currency, China is in the lead when it comes to the introduction of the digital central bank currency of big powers – United States, EU, and Japan. As such, it has the first mover advantage. Moreover, it seems that it authentically is pushing other digital alternatives out. “A draft People’s Bank of China law setting the stage for a virtual yuan includes a provision prohibiting individuals and entities from making and selling tokens. In recent days, China’s Inner Mongolia banned the power-hungry practice of cryptocurrency mining.”[1390]

> “The launch of the digital yuan now allows CCP China to gain considerable market share over other CBDCs that might be launched in reaction, such as the Fed/MIT

[1388] Arkhipov and Meyer. 2021.
[1389] Leblanc, Claude. 2021. *Pékin et Moscou veulent réduire leur dépendance au dollar*. Accessibility: https://www.lopinion.fr/edition/international/pekin-moscou-veulent-reduire-leur-dependance-dollar-240017 (30 April 2021).
[1390] Ossinger, Joanna. 2021a. *China’s Plan for Digital Yuan Imperils Bitcoin’s Biggest Markets*. Accessibility: https://www.bloomberg.com/news/articles/2021-03-05/china-s-plan-for-digital-yuan-imperils-bitcoin-s-biggest-markets (15 March 2021).

> US program when it is used in the 2022 Beijing Olympics. Now, imagine the global attendees of the Olympics to have that technology, tied to a digital yuan account, and taking it home around the world, especially if the digital yuan could be translated to the Olympic guest's own country's currency instantaneously by the payee's device in his or her own country. It will be as if yuan were a global currency, a no-fee American Express debit card, accepted everywhere without transaction or exchange fees to customer or merchant. All this presents a significant geostrategic and political threat to Western-style democracies because of its risk to the USD's "exorbitant privilege" as the world's reserve currency."[1391]

6.3 THE DIGITAL CURRENCY THREAT

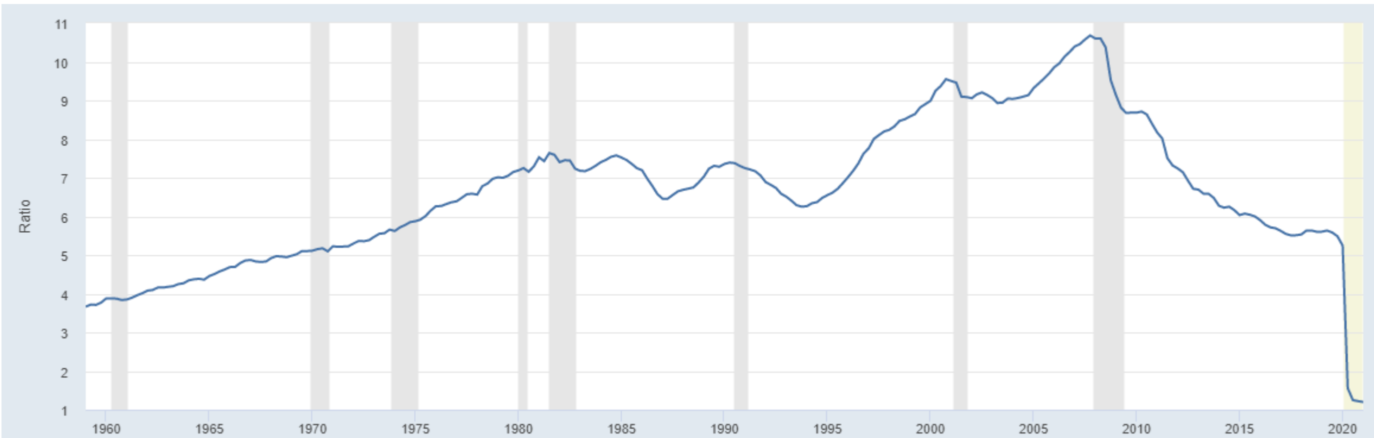
There is ample data and evidence to make an informed conclusion about the previous two threats to the US hegemony. On the other hand, digital currencies open a new dimension of economic interactions and subsequently strategic interactions among states. Since this is a brand-new phenomenon, we do not have a framework to speak with confidence which data is relevant when it comes to digital currencies and their impact on monetary relations. Potentially they can present a fundamental change in the nature of the economy, but potentially they can also burst like a 'dot-com' bubble.[1392] It seems that this threat does have an element of changing nature of the economy within it, which is why it should be of particular importance for the United States. One such indication is a gradual decrease in money velocity since the global financial crisis and the introduction of crypto currencies. As Figure 117 displays the pre-pandemic level of M1 velocity in United States was at the level of the mid-1970s. Part of this decline may be attributed to a decreased utility of cash (see Figure 118), but this in and of itself may be a token of not only

[1391] Collins, James G. 2021. *Buh-Bye, Bitcoin: The PRC (China) Has Launched A Digital Yuan. And It Will Change Everything*. Accessibility: https://seekingalpha.com/article/4418567-bitcoin-china-launched-digital-yuan-and-will-change-everything (30 April 2021).

[1392] Digital currencies may lead to an unbundling of the separate roles of money, creating fiercer competition among specialized currencies, and encourage differentiation but discourage interoperability between platforms. See, Brunnermeier, Markus K., Harold James, and Jean-Pierre Landau. 2019. *The digitalization of money*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w26300/w26300.pdf (20 June 2020).

changing preferences of consumers, but of a deeper shift when it comes to the nature of the economy.

Figure 117: Velocity of M1 in United States[1393]



Based on what we know about crypto currencies and the data that is available to us about their nature and technology, I think that the threat for US hegemony comes through the digital central bank currencies. Therefore, I will focus this chapter on the latter, while also explain why I think that Bitcoin and other digital currencies do not have the potential to replace US dollar in the center of global economic relations – become digital gold as sometimes referred to.[1394] Yet, the central bank digital currencies have a more threatening ring to it. Particularly, in the economic uncertain aftermath of the COVID pandemic, where a different nature of the economy might be in the making: the rise of retail investors,[1395] a decoupling between the stock market and real economy

[1393] FRED. 2021b.
[1394] Reuters. 2021. *Bitcoin emergence as 'digital gold' could lift price to $146,000, says JPM*. Accessibility: https://www.reuters.com/article/us-crypto-currencies-jpm-idUSKBN29A1IF (15 April 2021).
[1395] Martin, Katie, and Robin Wigglesworth. 2021. *Rise of the retail army: the amateur traders transforming markets*. Accessibility: https://www.ft.com/content/7a91e3ea-b9ec-4611-9a03-a8dd3b8bddb5 (15 March 2021).

performance became absurd,[1396] interest rates have been low (almost 0%) for very long (more than a decade),[1397] and inflation looms.[1398]

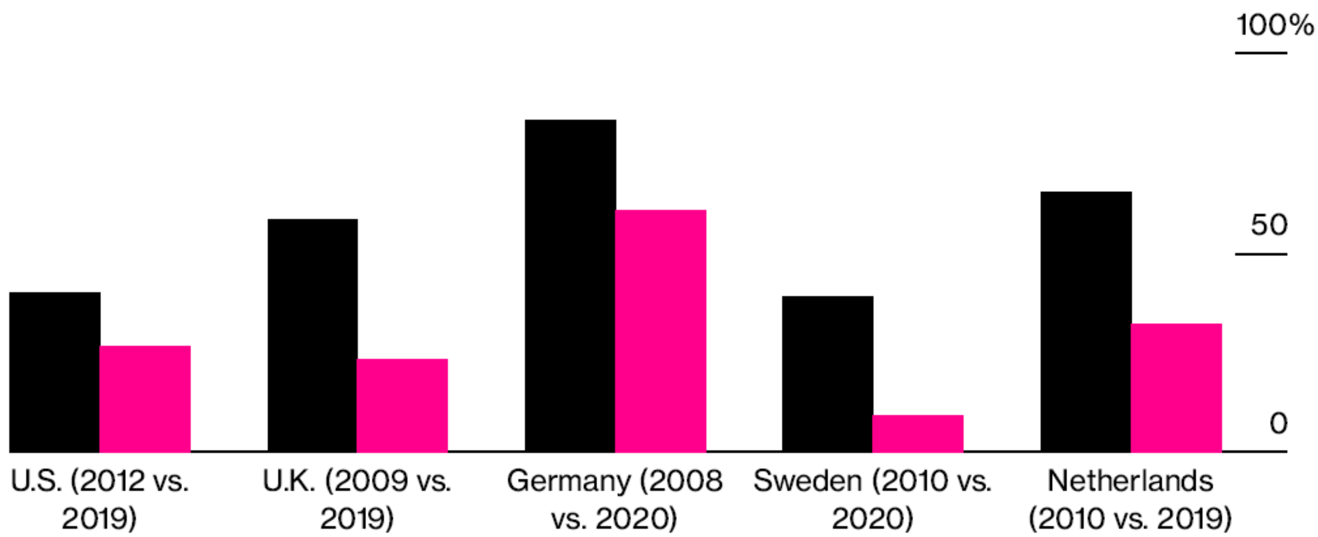
It was the COVID pandemic and the exponential rise of the value of Bitcoin and other digital currencies that came with it that brought this issue to the forefront of political-economic debates. Moreover, there is also a demographic story to tell here. Namely, 3% of baby boomers said that they own a cryptocurrency, while 27% of millennials said the same. In fact, both numbers are rising.[1399] With the rising indebtedness of developed nations, fiat currency, and historically low interest rates, people are seeking something that would not depreciate over time and that they can store their value in it. "The price of bitcoin has soared 300 per cent over the past 12 months, despite its recent sell-off. The ECB noted that the surge in bitcoin prices had eclipsed previous financial bubbles such as "tulip mania" and the South Sea Bubble in the 17th and18th centuries."[1400]

> "Europe had hopes for the euro, introduced in 1999. But the currency has failed to gain the world's trust, owing to doubts about the effectiveness of the eurozone's multi-state government. China's aspirations for the renminbi have been stymied for the opposite reason: concern about the arbitrariness of a one-party state. /…/ The pandemic has made those crypto-pitches sound less like pure digital hype. Fearful that central banks led by the US Federal Reserve are debasing the value of their currencies, many people have bought bitcoin in bulk. Its price has more than quadrupled since March, making it one of the hottest investments of 2020."[1401]

[1396] Igan, Deniz, Divya Kirti, and Soledad Martinez Peria. 2020. *The Disconnect between Financial Markets and the Real Economy*. Accessibility: https://www.imf.org/-/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-the-disconnect-between-financial-markets-and-the-real-economy.ashx (3 October 2020).
[1397] OECD. 2020a.
[1398] Holland, Ben 2021. *With no inflation in sight, why the inflation debate?*. Accessibility: https://www.bloombergquint.com/global-economics/with-no-inflation-in-sight-why-the-inflation-debate-quicktake-kl0ods5m (12 February 2021).
[1399] Shevlin, Ron. 2020. *The Coronavirus Cryptocurrency Craze: Who's Behind The Bitcoin Buying Binge*?. Accessibility: https://www.forbes.com/sites/ronshevlin/2020/07/27/the-coronavirus-cryptocurrency-craze-whos-behind-the-bitcoin-buying-binge/?sh=5d130a122abf (30 April 2021).
[1400] Hale, Thomas, Tabby Kinder, and Philip Stafford. 2021. *Bitcoin gyrates on fears of regulatory crackdown*. Accessibility: https://www.ft.com/content/c4c29bb3-c8ee-454c-a2dd-eac9f644007f (20 May 2021).
[1401] Sharma, Ruchir. 2020. *Will bitcoin end the dollar's reign?*. Accessibility: https://www.ft.com/content/ea33b688-12e0-459c-80c5-2efba58e6f1a (30 April 2021).

Figure 118 displays how the usage of cash has fallen in recent years – a phenomenon that was exacerbated by the COVID pandemic.[1402] "If you look at the history of money, you had Phase One with the gold and silver coins of the Greek Islands, Phase Two was book money with the Amsterdam Exchange Bank, Phase Three was banknotes, /and/ digital currencies /can be/ fourth form of money in human civilization", said Wouter Bossu, deputy head of the International Monetary Fund's Financial and Fiscal Law Unit.[1403]

Figure 118: Decline of the usage of cash



However, it would be false to claim that the era of cash is over and that it will be entirely replaced by digital currencies. "/C/ash needs to continue to be available in case of problems with electronic technology /…/ Other issues to be considered include the need for trusted forms of ID,"

[1402] Look, Carolynn, Joanna Ossinger, and Christopher Condon. 2021. *Central Banks Edge Toward Money's Next Frontier in Digital World*. Accessibility: https://www.bloomberg.com/news/articles/2021-02-05/central-banks-edge-toward-money-s-next-frontier-in-digital-world (25 February 2021).
[1403] Look, Ossinger, and Condon. 2021

and other privacy issues that are linked to terrorism and money laundering.[1404] Looking at the subject from a historical perspective, digital currencies might be the continuation of the economic revolution that began with establishment of central banking at the turn of the last century. Figure 119 shows the number of central banks over time, where an explosion of these institutions appears after World War One and particularly after World War Two. This goes hand in hand with the argument of a changing nature of the economy that further materialized with the end of the Bretton Woods IMS and the introduction of the free-floating exchange rates. There is a speculation that blockchain technology[1405] is the ultimate step in this transformation from real economy into a digital-financial economy.[1406] Some have stated that we are at the verge of the biggest reinvention of money.[1407] Furthermore, Scott Mainwaring has termed this step as a 'Cambrian explosion in payments': "a blossoming of myriad technologies, using different platforms, devices, and networks, to help people pay."[1408] However, this last step may in fact undermine the first – central banks. Free flow of capital and liberalized exchange rates reduces the people's need of a central monetary authority, as well as state authority. Yet, I argue that it is precisely because of this feature of digital currencies – undermining state sovereignty – that they will not be able to survive. Simply put, states will not want to commit suicide.[1409] Thus, it is the central bank digital currencies that

[1404] *Eurointelligence*. 2020f. Daily Brief. 17 December.

[1405] On explaining what is blockchain technology, how it works, and its benefits, see IBM. 2021. *What is blockchain technology?*. https://www.ibm.com/topics/what-is-blockchain (15 May 2021).

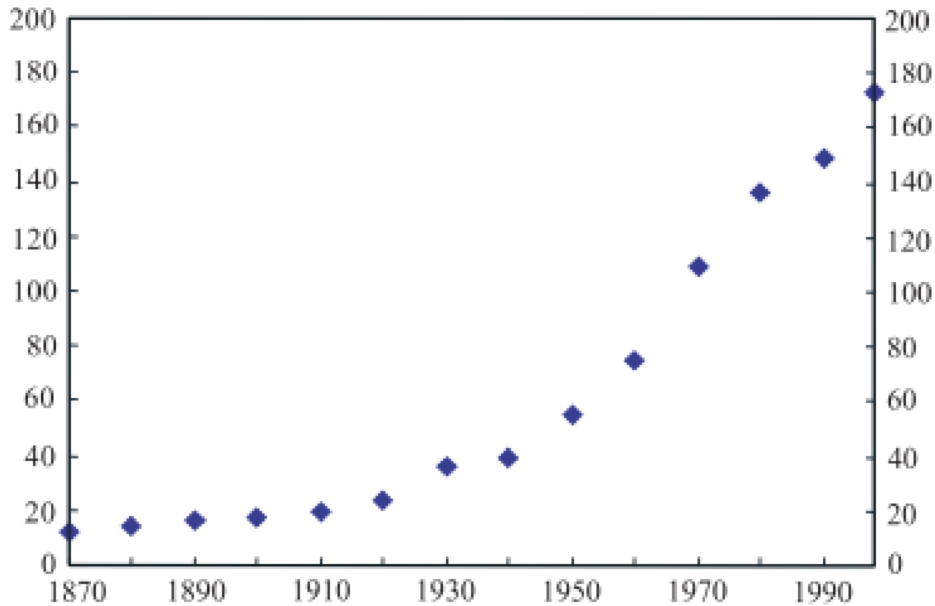
[1406] It may not be a straight line, but the trends that led to one and the other are the same. See, Eichengreen, Barry. 2019 b. *From commodity to fiat and now to crypto: what does history tell us?*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w25426/w25426.pdf (20 June 2020). Pp. 12–3.

[1407] Look, Ossinger, and Condon. 2021.

[1408] Maurer, Bill. 2017. Blockchains Are a Diamond's Best Friend, Zelizer for the Bitcoin Moment. In Bandelj, Nina, Frederick F. Wherry, and Viviana A. Zelizer (eds.), *Money talks: explaining how money really works*. Princeton: Princeton University Press. Pp. 215–29. At Pp. 216.

[1409] Nor will people let it. A very simple fact explains why: with private crypto currencies, there is no authority that can guarantee or secure your portfolio. If you lose your access key or if your account gets hacked, your money is gone. However, with the state-controlled accounts, there is a deposit guarantee scheme, which in the case of the EU is up to 100,000 Euros (Directive 2014/49/EU). The point is: faith, confidence, and security motives contributed to the creation of state. These motives are not gone, nor has the creation of the blockchain technology made them we have to look most closely as they will not come under fire from states but will be used (or are used) as a tool in their strategic interactions.[1410]

Figure 119: Number of central banks over time[1411]



> "At present, central banks are the monopoly supplier of base money cash and bank reserves. Because base money is the ultimate medium of exchange and of final settlement, central banks have enormous leverage over the value of transactions in the economy, even though the size of their balance sheet is very small in relation to those of the private sector. /…/ Electronic transactions in real time hold out that possibility. There is no reason, in principle, why final settlements could not be carried out by the private sector without the need for clearing through the central

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moot. Hence, people may indeed embrace a new technology, a new nature of economy, but they will still prefer if those things are nested in a framework of a state that can provide legal and other type protection.

1410 "Cryptocurrencies are here to stay /…/ But they cannot be considered good alternatives to money for three main reasons. First, they are not accepted universally. Second, cryptocurrencies are not a good store of value. Third, cryptocurrencies are private currencies. /…/ But if you are prepared to accept that cryptocurrencies are more like an asset rather than a means of payment, they offer another type of investment, albeit a very risky one. This raises the question of the extent to which consumers need to be protected from excessive risk-taking. This is where the issue of regulation of cryptocurrencies arises," and subsequently also the role of the state (Demertzis, Maria. 2021b. *Crypto… mania*. Accessibility: https://www.bruegel.org/2021/05/crypto-mania/ (15 May 2021)).

1411 King, Mervyn. 1999. *Challenges for monetary policy: new and old*. Accessibility: https://web.stanford.edu/~johntayl/PolRulLinkpapers/Challenges_for_Monetary_Policy-New_and_Old_King.pdf (30 April 2021). Pp. 12.

bank. The practical implementation of such a system would require much greater computing power than is at present available. But there is no conceptual obstacle to the idea that two individuals engaged in a transaction could settle by a transfer of wealth from one electronic account to another in real time. Pre-agreed algorithms would determine which financial assets were sold by the purchaser of the good or service according to the value of the transaction. And the supplier of that good or service would know that incoming funds would be allocated to the appropriate combination of assets as prescribed by another pre-agreed algorithm. Eligible assets would be any financial assets for which there were market-clearing prices in real time. The same system could match demands and supplies of financial assets, determine prices, and make settlements. /…/ The need to limit excessive money creation would be replaced by a concern to ensure the integrity of the computer systems used for settlement purposes. A regulatory body to monitor such systems would be required. Existing regulators, including central banks, would, no doubt, compete for that responsibility. Moreover, in just the same way as the Internet is unaware of national boundaries, settlement facilities would become international."[1412]

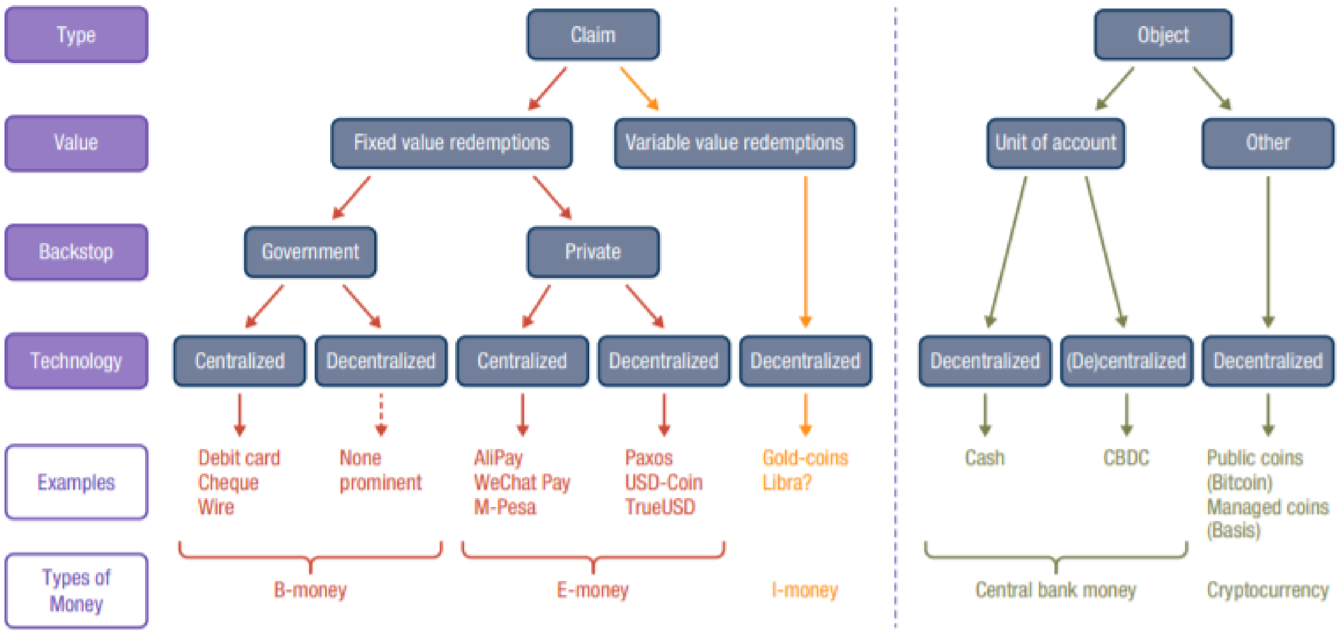
However, Eichengreen disagrees with this narrative of the future, for a very simple reason: Monopoly over seigniorage is a source of political power and a valuable lifeline when sovereignty is threatened.[1413] States will not let this happen to them as in the financial economy this would mean their defeat. As such, we should not dismiss the tendency of having one currency per political jurisdiction and common economic space also when we are analyzing the impact of crypto currencies. Or in other words, we should not take the politics out of economic issues, since the two are interrelated. Hence, stemming from this argument, we should expect a continuation of relations between currencies into the digital sphere and digital dollarization, as well as a competition between public and private crypto currencies.[1414] Yet, such a conclusion is premature, as establishing a digital economy is not a simple transformation of the 'real' into 'digital'. Instead, within this process, the monetary relations will be draw anew, and there lies the threat for the US hegemony.

[1412] King, Mervyn. 1999. Pp. 48–9.
[1413] Eichengreen. 2019b.
[1414] Brunnermeier, James, and Landau. 2019.

So, what is the difference between private and public crypto currencies? Figure 120 display a 'money tree' based on four criteria or attributes that characterize different forms of digital money.[1415] Figure 121 shows a similar classification, only that it is more transparent when it comes to the central bank digital currency (CBDC).[1416] Therefore, private cryptocurrencies are peer-to-peer mechanism of payments without any guarantees other than trust of both parties involved. CBDC on the other hand is a universally acceptable mean of payment that is backed by the authority of a central bank.[1417] Figure 122 displays such an understanding.[1418] A sovereign digital currency could have profound implications for the banking system, narrowing the relationship between citizens and central banks and removing the need for the public to keep deposits in fractional reserve commercial banks.[1419]

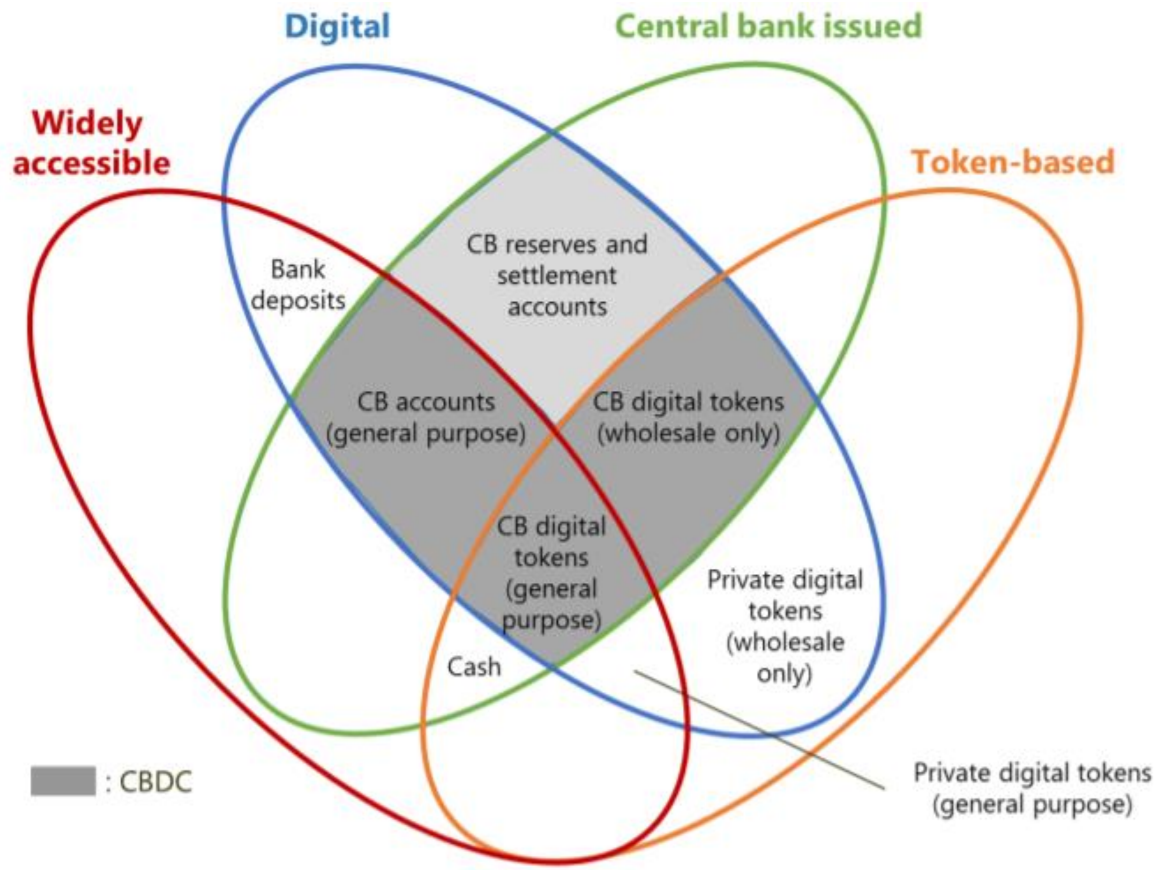
[1415] Adrian, Tobias, and Tommaso Mancini Griffoli. 2019. *The Rise of Digital Money*. Accessibility: https://www.imf.org/en/Publications/fintech-notes/Issues/2019/07/12/The-Rise-of-Digital-Money-47097 (30 April 2021). Pp. 3.
[1416] Barontini, Christian, and Henry Holden. 2019. *Proceeding with caution-a survey on central bank digital currency.* Accessibility: https://www.bis.org/publ/bppdf/bispap101.pdf (30 April 2021). Pp. 2.
[1417] See, Bjerg, Ole. 2017. Designing new money – the policy trilemma of central bank digital currency. *Copenhagen Business School*. Accessibility: https://research-api.cbs.dk/ws/portalfiles/portal/58550948/Designing_New_Money_The_policy_trilemma_of_central_bank_digital_currency.pdf (30 April 2021); Bank for International Settlements. 2015. *Digital currencies*. *Committee on Payments and Market Infrastructures*, November. Accessibility: https://www.bis.org/cpmi/publ/d137.pdf (30 April 2021).
[1418] Bech, Morten L., and Rodney Garratt. 2017. Central bank cryptocurrencies. *BIS Quarterly Review*, September. Pp. 55–70. At Pp. 59.
[1419] Raskin, Max, and David Yermack. 2016. *Digital currencies, decentralized ledgers and the future of central banking*. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w22238/w22238.pdf (23 February 2020).

Figure 120: Money tree



Elements	CBDC	Cryptocurrency	B-money	E-money	I-money
Type	Object	Object	Claim	Claim	Claim
Value	Unit of account	Other	Fixed value redemptions	Fixed value redemptions	Variable value redemptions
Backstop	n/a	n/a	Government	Private	n/a
Technology	Centralized & blockchain	Blockchain	Centralized & blockchain	Centralized & blockchain	Blockchain

Figure 121: Classification of money



As such, "the idea behind central-bank digital currencies is that, unlike conventional electronic money, they aren't bound up with regular banks. Nor are they debts, as on a credit card. And they certainly aren't a privately created currency like Bitcoin. They are cash - created by the state, just as notes and coins are - held directly in a citizen's electronic "wallet" or phone app."[1420] Figure 123 portrays the difference between central bank physical and digital money, where it becomes clear that digital currency can perform many more functions.[1421] "Any money issuance is a form of debt for the central bank, so it must have a solid basis to avoid legal, financial and

[1420] Look, Ossinger, and Condon. 2021.
[1421] Bank for International Settlements. 2018. *Central Bank Digital Currencies*. Accessibility: https://www.bis.org/cpmi/publ/d174.htm (19 April 2021). Pp. 6.

reputational risks for the institutions. Ultimately, it is about ensuring that a significant and potentially contentious innovation is in line with a central bank's mandate."[1422]

Figure 122: Private (first diagram) and Public (second diagram) digital currencies

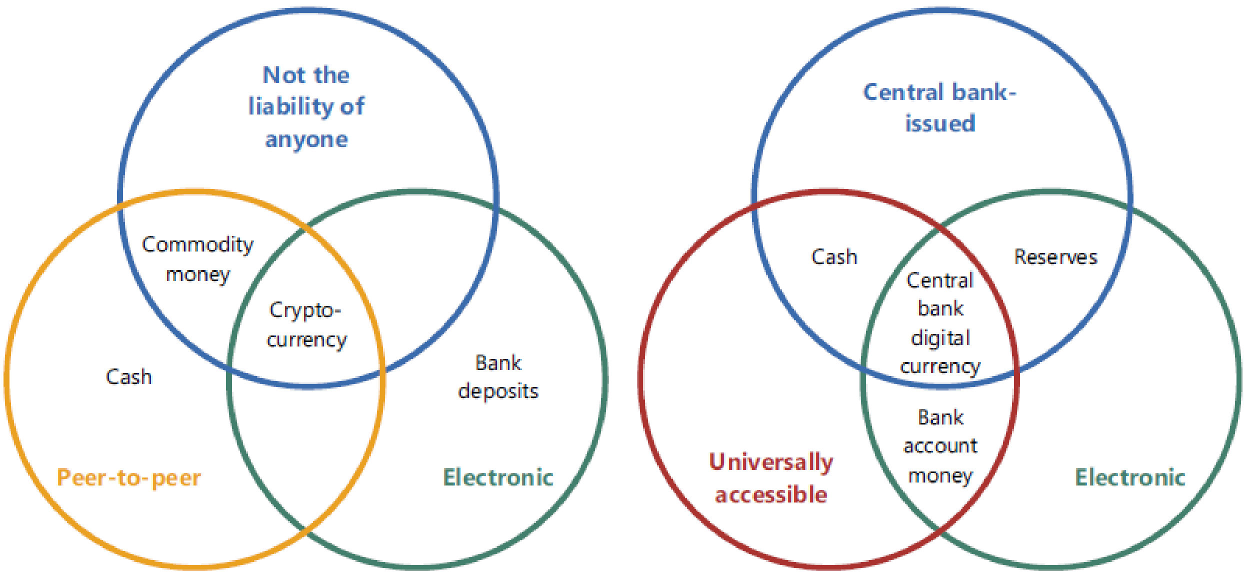


Figure 123: Features of central bank money

	Existing central bank money		Central bank digital currencies		
	Cash	Reserves and settlement balances	General purpose token	General purpose accounts	Wholesale only token
24/7 availability	✓	×	✓	(✓)	(✓)
Anonymity vis-à-vis central bank	✓	×	(✓)	×	(✓)
Peer-to-peer transfer	✓	×	(✓)	×	(✓)
Interest-bearing	×	(✓)	(✓)	(✓)	(✓)
Limits or caps	×	×	(✓)	(✓)	(✓)

✓ = existing or likely feature, (✓) = possible feature, × = not typical or possible feature.

[1422] Margulisand, Catalina, and Arthur Rossi. 2021. *Legally Speaking, is Digital Money Really Money?*. Accessibility: https://blogs.imf.org/2021/01/14/legally-speaking-is-digital-money-really-money/ (15 February 2021).

Both, private and public digital currencies can take different forms – 'account-based' or 'token-based.'

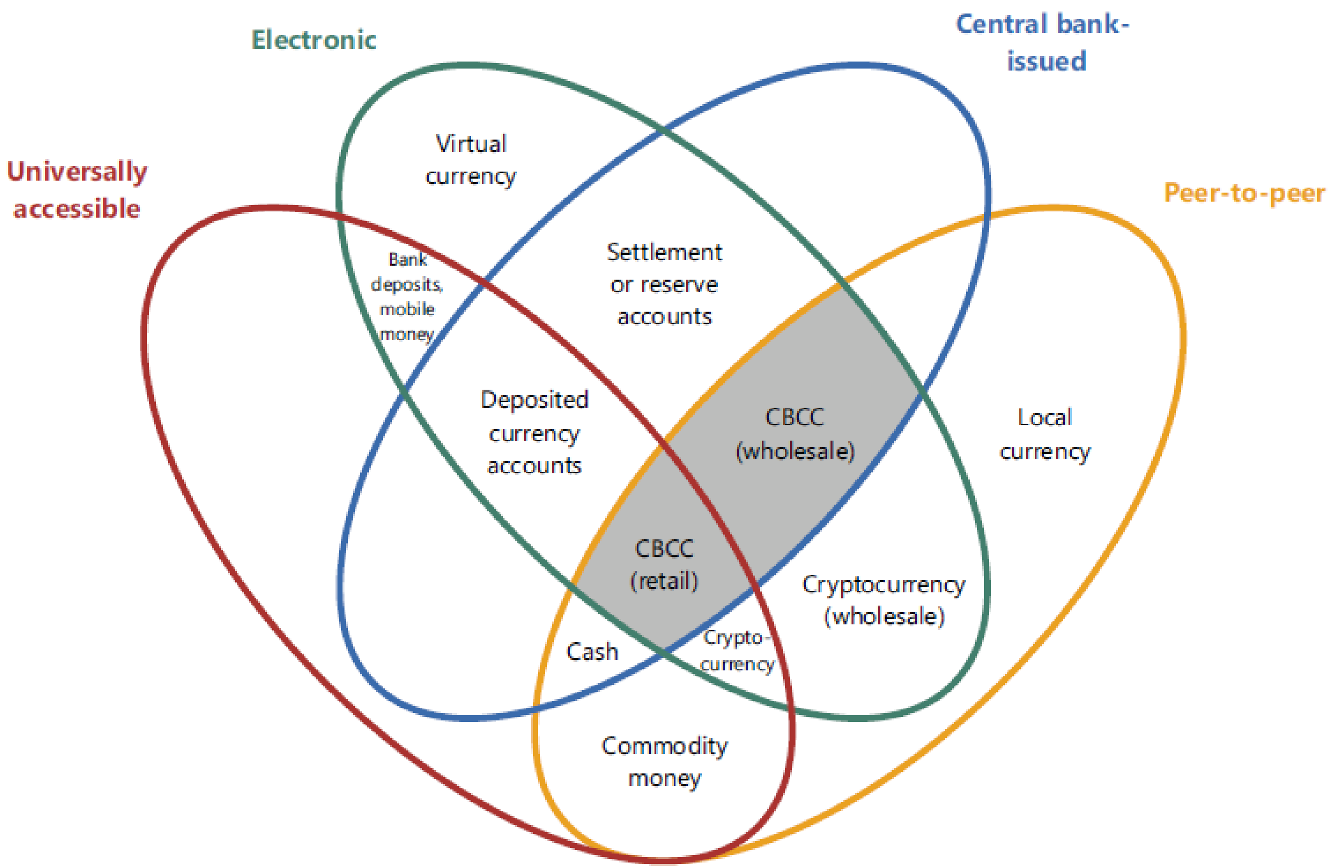
> "The first means digitalizing the balances currently held on accounts in a central banks' books; while the second refers to designing a new digital token not connected to the existing accounts that commercial banks hold with a central bank. From a legal perspective, the difference is between centuries-old traditions and uncharted waters. The first model is as old as central banking itself, having been developed in the early 17th century by the Exchange Bank of Amsterdam—considered the precursor of modern central banks. Its legal status under public and private law in most countries is well developed and understood. Digital tokens, in contrast, have a very short history and unclear legal status. Some central banks are allowed to issue any type of currency (which could include digital forms), while most (61 percent) are limited to only banknotes and coins. Another important design feature is whether the digital currency is to be used only at the "wholesale" level, by financial institutions, or could be accessible to the general public ("retail"). Commercial banks hold accounts with their central bank, being therefore their traditional "clients." Allowing private citizens' accounts, as in retail banking, would be a tectonic shift to how central banks are organized and would require significant legal changes. /…/The creation of central bank digital currencies will also raise legal issues in many other areas, including tax, property, contracts, and insolvency laws; payments systems; privacy and data protection; most fundamentally, preventing money laundering and terrorism financing."[1423]

Figure 124[1424] clarifies these differences, while Figure 125 offers specific examples of different currencies with these characteristics.[1425] Hence, CBDC needs a legal tender, that means that the debtors pay their obligations by transferring it to creditors.[1426] "Therefore, legal tender

[1423] Margulisand, and Rossi. 2021.
[1424] Bech and Garratt. 2017. Pp. 60.
[1425] Bech, and Garratt. 2017. Pp. 61.
[1426] More on the legal questions regarding CBDC issuance, see Bossu, Wouter, Masaru Itatani, Catalina Margulis, Arthur Rossi, Hans Weenink, and Akihiro Yoshinaga. 2020. *Legal Aspects of Central Bank Digital Currency: Central Bank and Monetary Law Considerations*. Accessibility: https://www.imf.org/en/Publications/WP/Issues/2020/11/20/Legal-Aspects-of-Central-Bank-Digital-Currency-Central-Bank-and-Monetary-Law-Considerations-49827 (30 April 2021).

status is usually only given to means of payment that can be easily received and used by the majority of the population."[1427]

Figure 124: Taxonomy of money



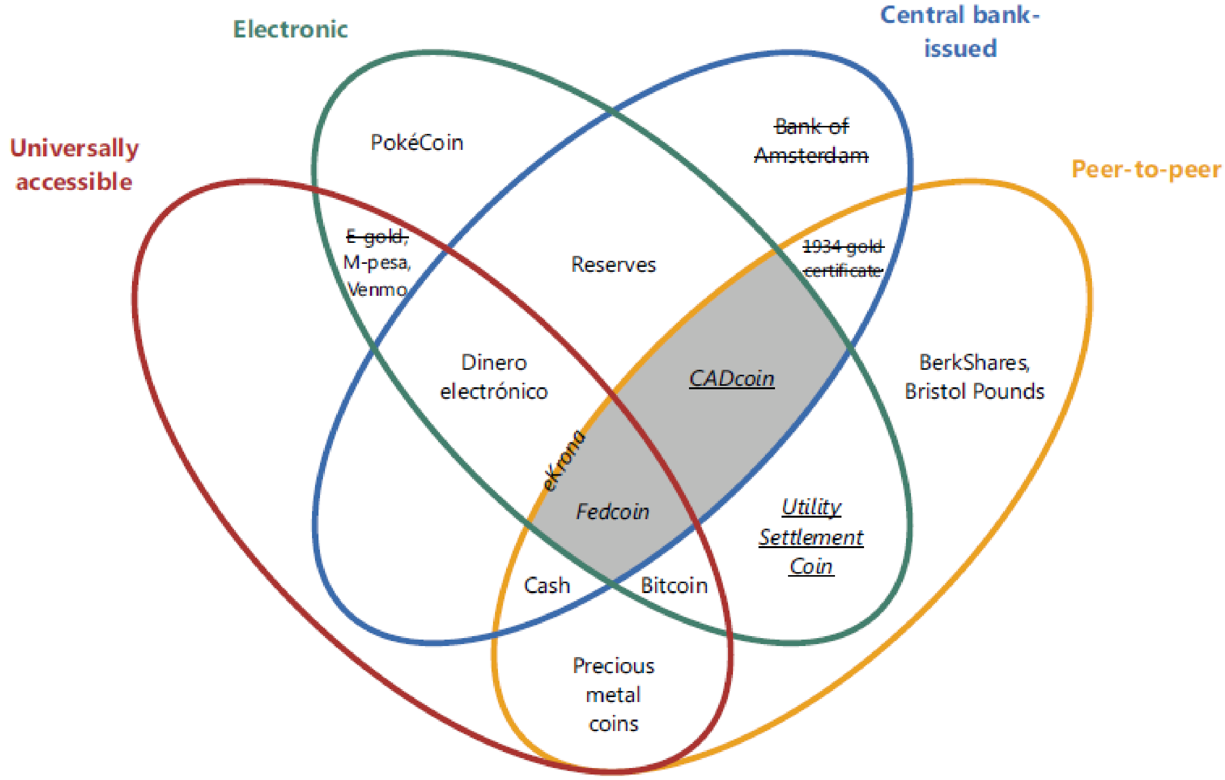
Private digital currencies do not enjoy this and are as such subject to greater risks and manipulations. For example, 2% of all accounts in Bitcoins own 95% of all Bitcoins.[1428] This

[1427] Margulisand, and Rossi. 2021.
[1428] Kharif, Olga. 2020. *Bitcoin Whales' Ownership Concentration Is Rising During Rally*. Accessibility: https://www.bloomberg.com/news/articles/2020-11-18/bitcoin-whales-ownership-concentration-is-rising-during-rally (15 May 2021).

brings doubts to the decentralization argument in favor of Bitcoin.[1429] Furthermore, most of Bitcoin miners are located in Russia, Iran, and China, which further brings doubts of their independence.[1430] A fact that speaks against the narrative of Bitcoin proponents that the currency gives the users freedom from state-controlled economy. Furthermore, “Bitcoin /…/ is too volatile to be a store of value and insufficiently widely accepted to be useful for payments. It’s more in the realm of a speculative asset.”[1431] Therefore, private digital currencies do not perform or assure three characteristics of money[1432] and as such, should not be considered as money at all. Christine Lagarde said: "*le Bitcoin, ce n'est pas une monnaie!*”[1433]

[1429] Moreover, the account holders are not transparent, which is not the cease in the global financial system, where bank accounts can not only be traced, but are or can be made public. This enhances the speculative nature of Bitcoin and crypto currencies in general, as well as increases the pushback from the central political authorities.
[1430] Statista. 2021a. *Distribution of Bitcoin mining hashrate as of April 2020, by country*. Accessibility: https://www.statista.com/statistics/1200477/bitcoin-mining-by-country/ (2 July 2020). Even if the algorithm can not be hacked, the miners can manipulate which transactions to process first, subsequently controlling the transactions and their network or system.
[1431] Look, Ossinger, and Condon. 2021.
[1432] Roubini, Nouriel. 2021. *Nouriel Roubini: bitcoin is not a hedge against tail risk*. Accessibility: https://www.ft.com/content/9be5ad05-b17a-4449-807b-5dbcb5ef8170 (30 April 2021).
[1433] Leroy, Thomas. 2021. *Christine Lagarde: "Le Bitcoin, ce n'est pas une monnaie"*. Accessibility: https://www.bfmtv.com/economie/christine-lagarde-le-bitcoin-ce-n-est-pas-une-monnaie_AV-202102070217.html (23 March 2021).

Figure 125: Examples of different moneys



A standard font indicates that a system is in operation; an *italic* font indicates a proposal; an *italic and underlined* font indicates experimentation; a ~~strikethrough~~ font indicates a defunct company or an abandoned project.

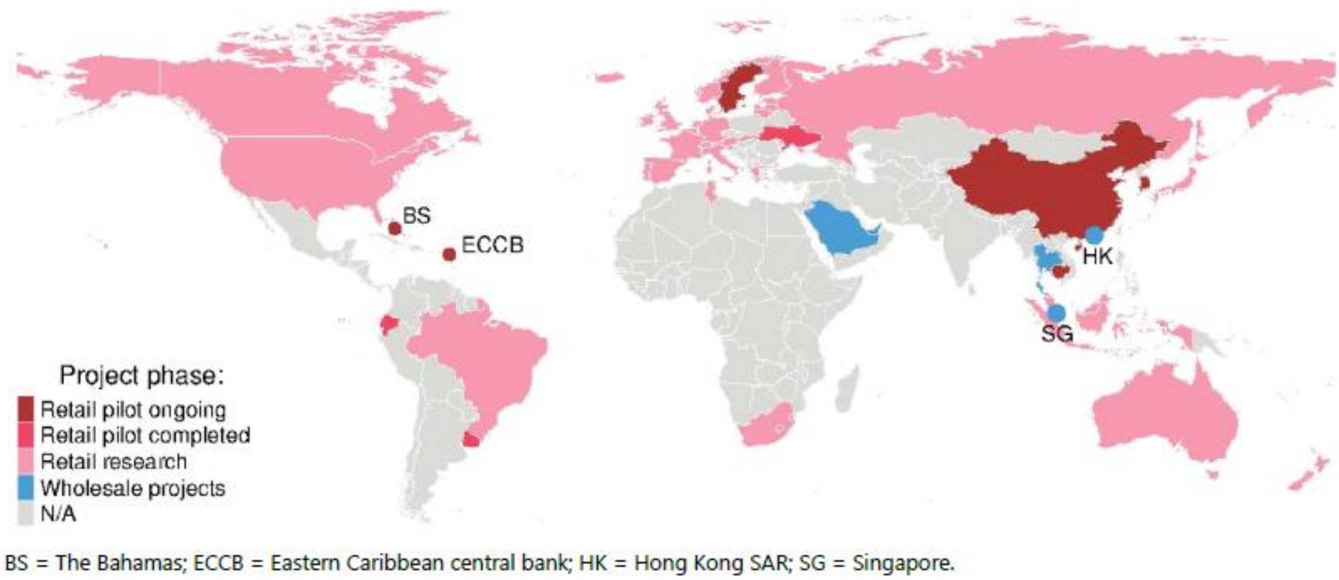
CBDCs are receiving more attention than ever before. “In emerging market and developing economies, where central banks report relatively stronger motivations, financial inclusion and payments efficiency objectives drive general purpose CBDC work.”[1434] So far, only Bahamas have implemented it fully (see Figure 126).[1435] Yet, the motivations vary across countries, as well as the approaches of implementing it (see Figure 127). It seems that “retail CBDC architectures in which

[1434] Boar, Codruta, and Andreas Wehrli. 2021. Ready, steady, go? – Results of the third BIS survey on central bank digital currency. *BIS Working Papers*, January. Accessibility: https://www.bis.org/publ/bppdf/bispap114.pdf (19 April 2021).

[1435] In fact, there is a special welfare appeal for developing countries to embrace digital currencies, see Raskin, Max, Fahad Saleh, and David Yermack. 2019. How do private digital currencies affect government policy?. National Bureau of Economic Research. Accessibility: https://www.nber.org/system/files/working_papers/w26219/w26219.pdf (30 April 2021).

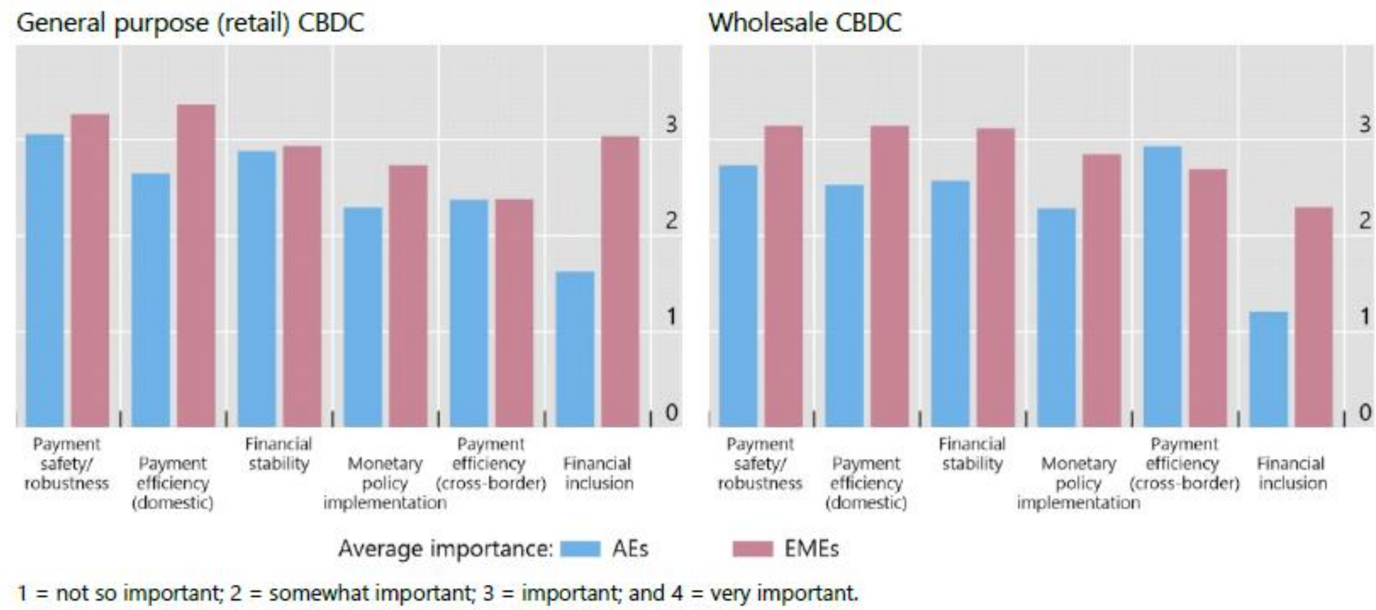
the CBDC is a direct cash-like claim on the central bank, but where the private sector handles all customer-facing activity," is becoming the most popular.[1436]

Figure 126: CBDC project status[1437]



[1436] Auer, Raphael A., Giulio Cornelli, and Jon Frost. 2020. Rise of the central bank digital currencies: drivers, approaches and technologies. *BIS Working Papers*, August. Accessibility: https://www.bis.org/publ/work880.pdf (19 April 2021).
[1437]Auer, Cornelli, and Frost. 2020. Pp. 7.

Figure 127: Motivation for issuing a CBDC [1438]



CBDC is not only an instrument of a general trend of digitalization of society, but also in fact state answer to the claims that it is becoming an obsolete institution. But the introduction of a CBDC does not come without challenges. I have already mentioned legal and technical, but there are also purely economic. Namely, CBDC coexistence and interactions with bank deposits, or more generally the role of commercial banks in the world where CBDC is implemented. "Like physical currency and unlike bank deposits, retail CBDCs will constitute a direct liability for the central bank, eliminating in principle any credit risk for the holder."[1439] Therefore, the relations between the central bank and the commercial bank are at stake.

> "A digital currency issued directly by the state however wouldn't necessarily use commercial banks, and that prospect is causing jitters. In the euro area alone,

[1438] Auer, Cornelli, and Frost. 2020. Pp. 9.
[1439] Tristan, Perrier. 2021. *New money and maybe new powers too: Central Bank Digital Currencies are coming*. Accessibility: https://research-center.amundi.com/article/new-money-and-maybe-new-powers-too-central-bank-digital-currencies-are-coming (24 April 2021).

lenders are sitting on some 11.4 trillion euros ($13.8 trillion) of household and corporate deposits, representing about a third of their funding. Migrating even a small portion of that to a central-bank currency would risk the stability of the banking sector and its ability to make loans to the economy."[1440]

The intermediary role of the commercial banks will be redefined in the future. So far central banks have not interacted with individuals, which they will now have to – if they introduce CBDC. The key source of revenue for commercial banks was the spread in interest rates that they obtained from the central bank and the ones that they were offering to their clients. This enabled them to seize the opportunity of the money multiplier and lower the deposit rate. Still, I do not think that commercial banks will go out of business, as this would be devastating for the banking and financial sectors that are crucial for wealth creation in the developed world. In fact, research has shown that incorporating intermediate banks into the CBDC architecture produces more benefits than if the architecture does not include them.[1441] Therefore, a new dynamic will have to be forged that will incorporate the possibilities that CBDC offers, for example "offering money for loans that carries a built-in expiry date, or limited to certain purposes desired by policy."[1442]

"Although not developed for this purpose at present, CBDC could serve as a new instrument of monetary policy. /…/ An initial aspect is that a CBDC could lower the "effective lower bound" of monetary policy if, for example, they carried negative interest rates or, by contrast, increase it to zero if they constituted zero-rate assets which are less costly to hold (in terms of storage and security) than physical currency. A second aspect is that a CBDC could, in theory, become a

[1440] Look, Ossinger, and Condon. 2021.
[1441] Auer, Raphael, and Rainer Böhme. 2020. The technology of retail central bank digital currency. *BIS Quarterly Review,* March. Pp. 85–100. It seems that this would also be beneficial for the Eurodollar markets that are the vehicle for the US dollar centrality. However, what would be the legal and economic consequences and frameworks for digital Eurodollars is unclear. Would they even exist under the architecture of no intermediate banks? What would that mean for the US dollar centrality? All these are important questions that have so far not been addressed in the literature. My take is that in all different versions of the architecture of the CBDC, there is a scenario where US dollar centrality is advanced and also it is challenged. This is due to the essence of the challenge – the new nature of the economy, where old notions may not apply. This is why this is the challenge for the US dollar – known unknowns and unknown unknowns.
[1442] Look, Ossinger, and Condon. 2021.

"programmable currency" whose possibilities of use (time-limited, restricted to certain expenditure, etc.) could be managed dynamically by the authorities. Other possibilities, such as new interactions between monetary policy and fiscal policy, are also envisageable."[1443]

As cryptocurrencies such as Bitcoin are volatile,[1444] another alternative challenges among the digital moneys for CBDC are stablecoins. These are "centralised or decentralised digital assets that are pegged to a traditional currency."[1445] Some claim that because of it, they will be welcomed and preferred in the future by the states and central banks.[1446] The problem with stablecoins is that there are pegged to a certain price of a currency, and when that moves, the situation is compensated by collateralization – increase the amount of unit that the stablecoin is pegged to. Thus, there are doubts if they can deliver when the situation will be dire and what stablecoins promises they will. Also, stablecoins lack transparency if these backings indeed exist.[1447] Thus, they suffer from the same problems as the Bretton Woods IMS.

Throughout the pandemic we have seen a soaring value of private cryptocurrencies in 2020 and then their rapid decline in 2021. Their volatility was also susceptible to variety of issues, some of them being trivial at best. Thus, these threats range from Chinese crackdown on Bitcoin miners,[1448] to an uncomfortable appearance of Elon Musk on SNL.[1449] This uneasiness led the

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1443 Tristan. 2021.
1444 Kharif, Olga. 2021. *Bitcoin's Volatility Spawns New Crypto Balance Sheet Alternative.* Accessibility: https://www.bloomberg.com/news/articles/2021-05-29/bitcoin-s-volatility-spawns-new-crypto-balance-sheet-alternative (29 May 2021).
1445 Tristan. 2021.
1446 Davies, Gavyn. 2021. *Bitcoin has ambitions for gold's role*. Accessibility: https://www.ft.com/content/625fbd5a-d90c-434f-998d-5e0eeb4c0f71 (30 April 2021).
1447 See, Arner, Douglas, Raphael Auer, and Jon Frost. 2020. *Stablecoins: risks, potential and regulation*. Accessibility: https://www.bis.org/publ/work905.pdf (29 May 2021).
1448 Hale, Thomas, Tabby Kinder, and Philip Stafford. 2021. *Bitcoin gyrates on fears of regulatory crackdown*. Accessibility: https://www.ft.com/content/c4c29bb3-c8ee-454c-a2dd-eac9f644007f (20 May 2021).
1449 Bentley, Alden, and Gertrude Chavez-dreyfuss. 2021. *Dogecoin tumbles after Elon Musk calls it a 'hustle' on 'SNL' show*. Accessibility: https://www.reuters.com/technology/dogecoin-spotlight-cryptocurrency-backer-musk-makes-snl-appearance-2021-05-07/ (8 May 2021).

General Manager of the Bank for International Settlements, Agustin Carstens, to claim that Bitcoin may well break down.[1450] Since during the pandemic the technological stocks have decoupled from others in S&P index,[1451] where some (Tesla Motors) have in 2020 increased more than 300% for no apparent reason then we should not think too much of the volatility of cryptocurrencies. Instead, we should treat them as we do with in the stock market and assets. Namely, people, particularly the younger generations, had extra cash available, and they started investing in assets, creating a bubble that deflated partly already in 2021.[1452]

> "Think of the reasons to hold gold. If inflation is coming (and it probably is) you want to hold a real asset that can hedge against it — one that can't be inflated away by relentless money creation and currency debasement. That's particularly the case in an era of very low interest rates. If governments work to keep interest rates lower than inflation in order to reduce the real value of their horrible debt burdens, everyone knows they need a safe haven, but everyone also knows the traditional ones (government bonds) no longer offer that safe haven."[1453]

So, can cryptocurrencies serve as a safe haven investment? Argument in favor is that they do not have the drawback that gold has, as they are easy to store, transfer, safe, fungible, resilient, verifiable, they come with inelastic supply, and are independent of any government or other interventions.[1454] However, cryptocurrencies need more than that if it wishes to be digital gold.[1455]

[1450] Bosley, Catherine. 2021. *Bitcoin 'Might Break Down Altogether,' BIS Head Carstens Warns*. Accessibility: https://www.bloomberg.com/news/articles/2021-01-27/bitcoin-might-break-down-altogether-bis-head-carstens-warns (15 March 2021).
[1451] S&P Global. 2020. *Top 5 tech stocks' S&P 500 dominance raises fears of bursting bubble*. Accessibility: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/top-5-tech-stocks-s-p-500-dominance-raises-fears-of-bursting-bubble-59591523 (2 August 2020).
[1452] Bloomberg. 2021a. *Global Technology Tracker*. Accessibility: https://www.bloomberg.com/graphics/global-technology-companies/ (29 May 2021).
[1453] Webb, Merryn Somerset. 2021. *Bitcoin: a symptom of market mania — or the new gold*. Accessibility: https://www.ft.com/content/608acefb-22ca-44e2-a438-2d874b37d695 (2 February 2021).
[1454] Webb. 2021.
[1455] "/G/old stocks held above ground amounted to 198,000 tonnes at the end of 2019, with about 57,000 tonnes of proven reserves below ground. This total stock would be valued at about $17tn in today's prices. The latest market value of bitcoin is about $0.6tn — bitcoin bulls see this as a gauge of how much further its price could rise" (Davies.

If we consider Bitcoin as a prime example, it "needs more active investors, it needs a much deeper and more liquid market (only a tiny part of the bitcoin market is ever traded—hence its volatility) and it needs wider acceptance."[1456] Moreover, the energy amount needed to mine a Bitcoin is at par with energy consumption of states such as Netherlands or Norway.[1457] The expense and slowness of Bitcoin transactions make it unsuitable as a medium of exchange.[1458] Moreover, the very technology it is based on – blockchain – creates bottle necks, where transactions that are paid more are process first (with Bitcoin you can do 5 transactions per second, while Visa network does 24,000).[1459] Nor are cryptocurrencies safe, which hacks on digital stock markets have proved.[1460] Hence, even if we look at cryptocurrencies as assets, which might be questionable as they do not have a stream of income in and of themselves, such as e.g., housing, we cannot reach other conclusion but to state that they are a financial bubble.[1461] Finally, cryptocurrencies do not have a driver behind them that would adjust its supply according to the international markets. "The "fundamental flaw" inherent in cryptocurrencies is that supply can't be reduced when demand is slumping in most cases."[1462] This is what gives confidence in the public-currencies: the ability to

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2021). However, I see this gap as an indication that even with pumped up bubble, Bitcoin currently cannot reach the extant required to be considered as a serious challenge to gold or US dollar.

[1456] Webb. 2021.

[1457] Hajric, Vildana, and Claire Ballentine. 2021. *Bitcoin Rally Stirs BofA Alarm on 'Enormous' Surge in Energy Use*. Accessibility: https://www.bloomberg.com/news/articles/2021-03-22/bitcoin-s-carbon-footprint-conveniently-downplayed-during-rally (22 April 2021).

[1458] Ossinger, Joanna. 2021b. *Bitcoin's Long-Term Value Doubted Due to ESG, Tighter Rules*. Accessibility: https://www.bloomberg.com/news/articles/2021-03-01/bitcoin-s-long-term-value-doubted-due-to-esg-tighter-regulation (30 April 2021).

[1459] Payspace. 2020. *Crypto vs Visa: transactions' speed compared*. Accessibility: https://payspacemagazine.com/cryptocurrency/crypto-vs-visa-transactions-speed-compared/ (30 April 2021).

[1460] Selfkey. 2020. *A Comprehensive List of Cryptocurrency Exchange Hacks*. Accessibility: https://selfkey.org/list-of-cryptocurrency-exchange-hacks/ (30 April 2021).

[1461] See also Roubini. 2021.

[1462] Cranfield, Mark. 2021. *Cryptos won't work as actual currencies, UBS economist says*. Accessibility: https://www.bnnbloomberg.ca/cryptos-won-t-work-as-actual-currencies-ubs-economist-says-1.1552260 (23 February 2021).

be guided, to reduce supply when demand is falling. There is no such mechanism when it comes to cryptocurrencies, and therefore, their value is much more prone to collapse.

> "For cryptocurrencies to replace official currencies they would have to overcome a triple challenge. First, the supply of cryptocurrency would need to act as an instrument (or identify a different instrument) that affects the economy. Second, in the presence of fractional reserve banking, the supply would need to respond to liquidity crises and act as a lender of last resort in order to safeguard financial stability. Third, there would need to be a system of checks and balances to keep the agent, i.e., the cryptocurrency issuer, accountable to the principal, i.e., society, which is not possible because cryptocurrencies are automatically and privately issued. For these reasons, official currencies controlled by inflation-targeting independent central banks still appear to be a far superior technology than cryptocurrencies to provide the money functions."[1463]

However, all these considerations might be worth nil if the consumers decide that Bitcoin and/or other cryptocurrencies are money. The question will be settled by those who use them.[1464] In fact, Bitcoin was not intended to rival US dollar or the Euro, but in fact to protect individual from state policies.[1465] Thus, it is embedded in the individual and the individual, not states, will determine its future. "Bitcoin prices have been skyrocketing this year because people believe it has value. In that sense, cryptocurrencies share some characteristics of fiat money. Money is a promise. That promise may be irrational. But only a fool would dismiss it."[1466] Nevertheless, strategic implications of cryptocurrency are independent of these preferences of individuals.

[1463] Claeys, Grégory, Maria Demertzis, and Konstantinos Efstathiou. 2018. *Cryptocurrencies and monetary policy*. Accessibility: https://www.bruegel.org/wp-content/uploads/2018/06/PC-10_2018_2.pdf (12 March 2021).

[1464] Leroy. 2021. Yet, if this happens, then this would also mean a rethinking of the very concept of state and subsequently hegemony. The source of wealth and power would for the first time in history not be based in something controlled by a political entity, be it a State, or an Empire, but an individual creating an algorithm. This would indeed be the greatest revolution in polity since the creation of the first polity entities. Such a scenario is in my opinion improbable. And if it does materialize then concepts such as hegemony would mean very little and societal relations would be drawn anew.

[1465] *Eurointelligence*. 2021e. Daily Brief. 9 February.

[1466] *Eurointelligence*. 2021f. Daily Brief. 8 April.

> "The fact that bitcoin and other crypto currencies do not fulfil the strict definitions of money is entirely irrelevant to the potential of such currencies to disrupt the money monopoly of the state. As crypto currencies become more widespread, we would expect to see closed digital crypto economies emerging - cycles of economic activity that will not be dependent on fiat money. This is also why the viability of crypto currencies will not be dependent on their dollar market value. A crash in the bitcoin dollar price - which is entirely possible - may constitute a potential source of financial instability, but not a threat to bitcoin itself."[1467]

As such, there were speculations that China might be using Bitcoin as a geopolitical weapon.[1468] I think the evidence is not pointing us in that direction,[1469] but in principle – private digital currencies are a danger to all fiat money generated by states.[1470] Hence, also the US dollar, as the central currency in global monetary relations. Yet, their market is minute to be considered as a danger, but that may change if the nature of the economy changes, and central banks become obsolete together with their currencies. I do not see that happening anytime soon, even with the new millennial generation coming to their prime.

Thus, the most sever and contemporary danger for the US dollar from the digital world and economy is a digital Renminbi. China is currently running a pilot project in four cities of their e-Yuan. This project is the most advanced of the big powers, and it seems that China has the first mover advantage in implementing a CBDC. Yet, what may be the most remarkable of the project

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[1467] *Eurointelligence*. 2021f.

[1468] *The Nixon seminar on conservative realism and national security, Big tech and China: what do we need from silicon valley?*. 2021. Accessibility: https://nixonseminar.com/2021/04/the-nixon-seminar-april-6-2021-transcript (30 April 2021).

[1469] Although I have stated that most Bitcoin miners are situated in China, the authorities have restricted the ability of its citizens to buy Bitcoin in 2017 (Deng, Chao. 2017. China's Interference on Bitcoin Tests Currency's Foundation. Accessibility: https://www.wsj.com/articles/china-widens-bitcoin-crackdown-beyond-commercial-trading-1505733976?mod=e2tw (30 April 2021)). Moreover, I have also stated that China is cracking down on the Bitcoin miners due to their energy voraciousness (see, Hale, Kinder, and Stafford. 2021).

[1470] "Cryptocurrencies threaten to change the way international financial regulations, practices, and norms have been traditionally built" (Myers, Adam, William Szymanski, Daniel Jackson, Ellen Wynkoop, Pete Heine, Tyler Hoffman, and Bri Mostoller. 2020. *Crypto-Controls: Harnessing Cryptocurrency To Strengthen Sanctions*. Accessibility: https://warontherocks.com/2020/12/crypto-controls-harnessing-cryptocurrency-to-strengthen-sanctions/ (23 January 2021)).

and what presents, I believe, the biggest threat for the US dollar, is the fact that Chinese central bank is "in active contact with other central banks to develop interoperability standards that would allow cross-border payments."[1471] If this materializes then China would be the rules setter in the world of CBDC dimension, and China would set the standards and trends. Thus, it would be the center of the digital currencies and that together with the digitalization of the economy may be the biggest danger for the centrality of the US dollar that the latter has ever seen.[1472] Nevertheless, this danger is not a consequence of 'being the first', but 'getting it right'. Security questions, personal freedom concerns, legal framework, and the very manner in which a CBDC is introduce (token or account based) outweigh the first mover advantage.

So far Chinese CBDC is only intended to be used in the domestic market.[1473] But that can quickly change with the forthcoming Beijing 2022 Olympic games, where tourists and visitors would be introduced to the e-Yuan and would take it back home.[1474] China would be then in a good position to invoice its trade in e-Yuan, which would further and instantly disrupt the structure of conducting international trade.[1475] Historian Niall Ferguson is calling the digital yuan a 'potentially fatal challenge' to decades of American financial hegemony. Focusing on an age-old Keynesian idea of investment spending, can only have results if the US dollar maintains its central position and US bonds remain the safest of all financial assets.[1476] It is precisely this what is

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[1471] *Eurointelligence*. 2020e. Daily Brief. 4 September.
[1472] See, Matthews, Barbara C., and Hung Tran. 2020. *Advanced economies under pressure in the central bank digital currency race*. Accessibility: https://www.atlanticcouncil.org/blogs/new-atlanticist/advanced-economies-under-pressure-in-the-central-bank-digital-currency-race/ (23 February 2021).
[1473] *Eurointelligence*. 2020e.
[1474] Some go as far as to claim that this is Chinese strategy of becoming global monetary leader, see Collins. 2021.
[1475] See, Auer, Cornelli, and Frost. 2020.
[1476] Ferguson, Niall. 2021. *Don't Let China Mint the Money of the Future*. Accessibility: https://www.bloomberg.com/opinion/articles/2021-04-04/don-t-let-china-mint-the-digital-currency-of-the-future (30 April 2021).

threatened by e-Yuan that would establish a parallel financial system – by-pass the oversight and financial regulations that are established and conducted by United States, which would also enable China and others to by-pass any financial sanctions.[1477]

Still, following the aforementioned scenario is not as easy as it sounds. Also, the Chinese Communist Party got scared by enhanced digital economy and consequences that came with it – the case of suspending public offering of Ant Group.[1478] Therefore, it is justified to question full-out commitment to digital and digital currencies what the Chinese need to challenge the US dollar.[1479] Moreover, "even if China gets there first, incumbents have time to react and maintain

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[1477] Hasenstab, Michael. 2021. *China's Digital Currency Is A Threat To Dollar Dominance*. Accessibility: https://www.franklintempleton.lu/investor/article?contentPath=html/ftthinks/common/fixed-income/chinas-digital-currency-is-a-threat-to-dollar-dominance.html (30 April 2021).

[1478] Curran, Enda, Sofia Horta e Costa, and Lulu Yilun Chen. 2020. *Derailing of Jack Ma's Ant IPO Shows Xi Jinping's in Charge*. Accessibility: https://www.bloombergquint.com/global-economics/derailing-of-jack-ma-s-mega-ant-ipo-shows-xi-jinping-s-in-charge (5 November 2020).

[1479] The way the e-Yuan will be designed speaks in favor of this claim and even questions the 'digitalness' of the e-Yuan, which may in fact not even be structured as a digital currency: "The PBOC has published few details of how its CBDC will work, which raises questions as to whether the project is as advanced as officials sometimes suggest /…/ The basic structure will be two tier. The first tier involves the PBOC issuing CBDCs to commercial banks (and possibly non-bank financial firms). In the second tier, banks will then provide CBDC to consumers and non-financial firms through digital wallets. The simplest analogy is perhaps banknotes: they are provided by the central bank to commercial banks and then offered by commercial banks to customers, with ATMs standing in this analogy for digital wallets. People will add funds to their digital wallets by transferring from normal bank accounts. The two-tier structure is reflected in how the PBOC refers to it: a Digital Currency / Electronic Payment (DC/EP) system. /…/ One virtue of the two-tier system is that account management and clearing functions sit with commercial banks and payment providers who are better qualified to perform them. The PBOC also apparently hopes to foster innovation. It may simply set standards and leave implementation of the second tier entirely to wallet providers. The key point still unclear is the precise role that commercial banks play /…/ If eCNY isn't a claim on the central bank, it isn't strictly a CBDC at all /…/ This is the model by which commercial banks in Hong Kong, Scotland and Northern Ireland are allowed to issue banknotes /…/ Meanwhile, none of the structural forces that have held back the renminbi's adoption abroad would be addressed by the introduction of eCNY /Therefore/ eCNY wouldn't transform the renminbi's use globally" (Williams, Mark. 2021. *The implications for China and the world of eCNY*. Accessibility: https://www.capitaleconomics.com/clients/publications/china-economics/china-economics-focus/the-implications-for-china-and-the-world-of-ecny/?tk=3d7b4ea4fe9291ba585d438e40a1f262f736a8bf&utm_source=Sailthru&utm_medium=email&utm_campaign=China%20Economics%20Focus%20270521&utm_term=ce_publication (30 May 2021)). As such, it seems that e-Yuan will have a similar status than Hong Kong dollar – a synthetic central bank digital currency issued by banks and payment firms (Mukherjee, Andy. 2021b. *Digital Yuan May Prove the Hong Kong Dollar's Cousin*. Accessibility: https://www.bloombergquint.com/opinion/china-s-digital-currency-may-prove-the-hong-kong-dollar-s-cousin (7 June 2021)) – or a dual nature like onshore and offshore Renminbi (Pinto, Pedro. 2020. *CNY vs CNH: what are the differences between the two Chinese Renminbi?*. Accessibility:

their dominance, but they cannot rest on their laurels indefinitely."[1480] It seems that the Biden administration is aware of this and have accelerated its own studies of Chinese project, its own CBDC, and alternative roads of e-Dollar implementation.[1481] Furthermore, people who've actually used the digital yuan in China, are more likely to have negative opinion or experience of it.[1482] As well as the Chinese plan for its CBDC is rather modest – to comprise 9% of China's domestic digital payments by 2025.[1483] I underline again, this is only regarding digital payments, not overall payments, which may seem a lot in absolute number, but nowhere near to challenge online payment platforms such as Alipay and WePay (90% of Chinese market), and subsequently also very far from challenging the US dollar.[1484] If the Chinese cannot persuade their own people to use e-Yuan than why should the rest of the world?

Governments will have to react to the latest technological development tangent to monetary relations – digital currencies. But they will remain in the control. Therefore, the same questions of power will apply to this realm. China has the first mover advantage, yet analysis made shows skepticism that it can dethrone the US dollar with the e-Yuan. In the very near future once the e-Dollar is introduced we will be able to observe if the dynamics of the fiat currencies will be transposed onto digital ones as well. Either way, I do believe that digital monetary relations will be a dimension of great power competition, and where United States will have to act in order to

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https://www.neatcommerce.com/blog/differences-in-chinese-renminbi/ (1 December 2020)). Either way, China first mover advantage is far from clear cut.

1480 Matthews and Tran. 2020.

1481 Mohsin, Saleha. 2021. *Biden Team Eyes Potential Threat From China's Digital Yuan*. Accessibility: https://www.bloombergquint.com/china/biden-team-eyes-potential-threat-from-china-s-digital-yuan-plans (30 April 2021).

1482 Bloomberg News. 2021. *China's Much-Hyped Digital Yuan Fails to Impress Early Users*. Accessibility: https://www.bloomberg.com/news/articles/2021-05-09/china-s-much-hyped-digital-yuan-fails-to-impress-early-users (15 May 2021).

1483 Bloomberg News. 2021.

1484 Bloomberg News. 2021.

generate the ‘buy-in’ behavior, while China will struggle to do the same.[1485] For the first time in its hegemony, United States is faced with a vulnerability, where a new nature of the economy is paired with a viable alternative to the US dollar. We will have to wait and see how United States, China, and let us not also forget e-Euro, set their relations between their respective CBDCs, private cryptocurrencies, assets, and fiat currencies. Also, how states will manage their additional role in monetary politics, where their right as currency issuer will be paired also with a role of service provider, and we know that states usually are not that good in providing services.

> “The real reason why a currency is used globally has more to do with the value and stability it represents, not only its availability. A currency like the digital yuan, which is currently the most advanced digital currency in this respect, stands no chance of displacing the dollar as a global leader because the underlying currency, the renminbi, is not even convertible.”[1486]

6.4 PERVASIVE HEGEMONY GRAND STRATEGY

Finally, given that I have established the nature of the US hegemony, identified its mechanism of endurance, and outlined three key threats, I have to address what should be US grand strategy to maintain its hegemony and to deal with the aforementioned threats?

[1485] See, Mukherjee, Andy. 2021a. *The Future of Money Is Digital, But Is It Bitcoin?*. Accessibility: https://www.bloombergquint.com/opinion/bitcoin-s-future-may-be-dwarfed-by-interoperable-central-bank-digital-currencies (20 April 2021)
[1486] Demertzis. 2021a.

Although there are numerous definitions and conceptualizations of grand strategy in the literature,[1487] we can identify two trends[1488] – one narrower, which understands grand strategy in terms of military and security,[1489] and another, which sees grand strategy broader – in terms of implementing national interest, which can also be economic or cultural.[1490] However, I will follow a third option that recently some scholars advanced, and which understands grand strategy as a state of mind of the statesmen.[1491] "A conscious attempt to look beyond the confines of short-term requirements of national defense or day-to-day, immediate foreign policy, and to the pursuit of national interests in a more systematic and synchronized way."[1492] It is an intellectual architecture,[1493] which is a:

> "way of thinking about the world that amounts to much more than the writing of elaborate strategic blueprints or the search for neat "containment"-esque slogans easily packaged for public approval. Instead, grand strategic thinking should be the very essence of foreign policymaking, an approach that emphasises the need to first reflect on the nature and pace of change within the international environment and a country's place within that system, and second, to act in a way which values

[1487] See Dueck, Colin. 2008. *Reluctant crusaders: power, culture, and change in American grand strategy*. Princeton: Princeton University Press. Ch. 1; Silove, Nina. 2018. Beyond the buzzword: the three meanings of "grand strategy". *Security Studies*, 27(1). Pp. 27–57; Lissner, Rebecca Friedman. 2018. What Is Grand Strategy? Sweeping a Conceptual Minefield. *Texas National Security Review*, 2(1). Pp. 52–73.

[1488] Taliaferro, Jeffrey W., Norrin M. Ripsman, and Steven E. Lobell (Eds.). 2012. *The Challenge of Grand Strategy: The Great Powers and the Broken Balance between the World Wars*. Cambridge: Cambridge University Press. Pp. 14.

[1489] E.g., Posen, Barry. 1986. *The sources of military doctrine: France, Britain, and Germany between the world wars*. Ithaca: Cornell University Press. Pp. 13.

[1490] E.g., Kennedy, Paul M. 1992. Grand strategies in war and peace: toward a broader definition. In Kennedy, Paul M. (ed.), *Grand strategies in war and peace*. New Haven: Yale University Press. Pp. 1−7.

[1491] This definition is opposite to what some authors have called for – to abandon grand strategic thinking altogether, see Drezner, Daniel W., Ronald R. Krebs, and Randall Schweller. 2020. The End of Grand Strategy: America Must Think Small. *Foreign Affairs*. Accessibility: https://www.foreignaffairs.com/articles/world/2020-04-13/end-grand-strategy (5 June 2020).

[1492] Ehrhardt, Andrew, and Maeve Ryan. 2020. *Grand strategy is no silver bullet, but it is indispensable*. Accessibility: https://warontherocks.com/2020/05/grand-strategy-is-no-silver-bullet-but-it-is-indispensable/ (4 July 2020).

[1493] Brands, Hal. 2014. *What good is grand strategy?: Power and purpose in American statecraft from Harry S. Truman to George W. Bush*. Ithaca: Cornell University Press. See also Morgan-Owen, David. 2020. *It Was Grand, But Was it Strategy? Revisiting the Origins Story of Grand Strategy*. Accessibility: https://thestrategybridge.org/the-bridge/2020/5/4/it-was-grand-but-was-it-strategy-revisiting-the-origins-story-of-grand-strategy (12 November 2020).

> initiative and innovation, as opposed to reaction and listlessness. Its crucial ingredient is a “historical sensibility” — that is, an informed understanding of the nature and pace of change in the international environment — because only with this deep foundation is it possible to craft a set of durable policies that are suitably responsive to the changeability of any present set of conditions, but without being thrown off long-term goals by the gusts and eddies of short-term crises.”[1494]

Recalling two facts, which I have previously established, such a choice becomes reasonable. First, my definition of hegemony – rules, norms, and principles to center the economy around itself – calls for a broader understanding of grand strategy, one that would be close to the second trend in the grand strategy literature.[1495] The 2017 US National Security Strategy states: “Economic security is national security.”[1496] Still, maximizing one’s trade surplus is not a strategy. Also, securing any other economic benefit is in and of itself a strategy. “Strategy is not doing what you want to do when you want to do it. Strategy involves sacrifice in exchange for the greater goal, with uncertain paths in between.”[1497] Even centrality of the US dollar is not a strategy *per se*, it is a statecraft objective to be assured in a broader strategic interaction in order to facilitate enduring hegemony. Thus, preserving centrality may be done through different policies. The latter is a choice of statesmen, as such a product of their thinking and understanding of the situation. Hence, the third framework of how to conceptualize grand strategy becomes logical.[1498]

[1494] Ehrhardt and Ryan. 2020.
[1495] See also, Blackwill and Harris. 2016; Gaiser, Laris. 2016. *Economic Intelligence and World Governance*. San Marino: Il cerchio; Baru, Sanjaya. 2012. Geo-economics and Strategy, *Survival*, 54(3). Pp. 47–58.
[1496] *The National Security Strategy of the United States*. 2017. Accessibility: https://trumpwhitehouse.archives.gov/wp-content/uploads/2017/12/NSS-Final-12-18-2017-0905.pdf (30 October 2020).
[1497] *Eurointelligence*. 2021g. Daily Brief. 8 January.
[1498] See also Tuathail, Ó Gearóid. 1994. *Problematizing Geopolitics: Survey, Statesmanship and Strategy. Transactions* of the Institute of British Geographers, 19(3). Pp. 259–72; Mansbach, Richard in Edward Rhodes. 2007. The National State and Identity Politics: State Institutionalisation and 'Markers' of National Identity. *Geopolitics*, 12(3). Pp. 426–58.

Second, my empirical work has shown that grand strategy depends on more than just capabilities and the environment one is situated in. In August 1971 United States did not have a strategic blueprint where it wanted to go, yet it did have clear strategic interests based on which it had acted. "By early 1972, the U.S. administration had a strategy. Key officials such as Shultz, backed to a certain extent by Nixon, knew what they were doing."[1499] Therefore, it was by thinking through different options that a clear strategic road map was designed. US hegemony has not only survived the change of IMS, but the United States actively shaped the change without having a clear grand strategy. The specific policies how to maintain the centrality of the US dollar had to be changed fundamentally after 1971. At the end of the Cold War Huntington wrote: "The ultimate test of a great power is its ability to renew."[1500] The United States example proves this statement right; it was able to renew its policies, which assured its endurance. Furthermore, we can understand this renewal only if we look at the thinking of the decision-makers. The policy questions the United States was faced with after the 1971 Nixon shock were unscripted and it acted based on its strategic maps of its leaders.

There are different classifications of grand strategy options for United States moving forward.[1501] Yet, they all agree that restraint is one such option and I argue that it is restraint which is the preferred grand strategic framework for United States and its pervasive hegemony.[1502]

[1499] Trachtenberg. 2011. Pp. 16.
[1500] Huntington. 1988. Pp. 90.
[1501] See Posen, Barry R., and Andrew L. Ross. 1996/1997. Competing visions for US grand strategy. *International Security*, 21(3). Pp. 5−53, Pp. 4; Art, Robert. 2003. *A Grand Strategy for America*. Ithaca: Cornell University Press. Pp. 84; Avey, Paul C., Jonathan N. Markowitz, and Robert J. Reardon. 2018. Disentangling Grand Strategy: International Relations Theory and US Grand Strategy. *Texas National Security Review*, 2(1). Pp. 28–51.
[1502] More on restraint see, Gholz, Eugene, Daryl G. Press, and Harvey M. Sapolsky. 1997. Come home, America: The strategy of restraint in the face of temptation. *International Security*, 21(4). Pp. 5−48; Posen, Barry R. 2014. *Restraint: A new foundation for US grand strategy*. Ithaca: Cornell University Press; Thrall, A. Trevor, and Benjamin H. Friedman (Eds.). 2018. *US Grand Strategy in the 21st Century: The Case for Restraint*. London: Routledge; Priebe, Miranda, Bryan Rooney, Nathan Beauchamp-Mustafaga, Jeffrey Martini, and Stephanie Pezard.

However, if the hegemon's grand strategy does not reside within the idea of restraint, it will not automatically bring down its pervasive hegemony or change its nature – force other non-hegemonic states to stop 'buying-in' – instead, it will increase the risk of non-hegemonic balancing behaviors and subsequent change of hegemonic nature. Subsequently, this also means increasing the risk of hegemonic downfall. Following restraint, these risks are limited. Namely, United States can reduce its forward military presence, security commitments, resolve conflicts of interest and cooperate more with other great powers, and have a higher threshold for the use of military force.[1503]

My argument for restraint is slightly different than what existing restraint literature offers. First, pervasive hegemony restraint grand strategy is not optimal for other types of hegemony that I have listed – coercive, cooperative, cultural, opportunist. In fact, I would oppose such statement. It would be safe to assume that each hegemonic nature would have its default preferential grand strategy. Second, if ordering of military relations is in the core of existing justifications for restraint, I position my argument in the economy. There are two dimensions to the economic aspect of restraint. One is economic rationale for restraint in the military domain. Although my version still argues in favor of maintaining offensive military capabilities, preferably keeping them at home, its fundamental claim is engaging with the world economically. The other is preferred activities within the economic realm of the pervasive hegemon. Here the pervasive hegemon needs to be proactive in deepening the 'buy-in' behavior. This is particularly the case when it comes to

2021. *Implementing Restraint: Changes in U.S. Regional Security Policies to Operationalize a Realist Grand Strategy of Restraint*. Santa Monica: RAND Corporation.
[1503] Priebe, Rooney, Beauchamp-Mustafaga, Martini, Stephanie Pezard. 2021.

the ‘new nature of the economy’ challenges (e.g., CBDCs). It needs to identify how its national interest is best assured and communicate this to the non-hegemonic states.

Pervasive hegemony bears significant implications for defining US national interest, identifying its threats, and consequently shaping US grand strategy and foreign policy. Assuming that maintaining its hegemony is a vital US national interest, then the core objective of US foreign policy is to sustain its central position in the global economy. It can do so by maintaining US dollar as the central global currency. This means that the United States needs to focus on centrality within the global monetary relations – global reserves denominated in US dollars, and global transactions denominated in US dollars. Therefore, national interest is not defined in terms of capacities of the United States, but in terms of the nature of relations that other non-hegemonic states have towards the United States, and more specifically their utility of the US dollar. The crucial US national interest is therefore to facilitate deepening and furthering of the ‘buy-in’ behavior. Only in such a case, a military intervention would make sense for the hegemon. Consequently, the underlining objective of the pervasive hegemony restraint grand strategy is instead of fighting off decline and preventing effective balancing, what other grand strategies would argue, to engage in deepening of the ‘buy-in’. As such, the United States should nurture in a star-shaped multiple bilateral relations with the non-hegemonic states through which it can deepen their respective ‘buy-in’.

By pursuing a grand strategy of restraint, the hegemon signals to the non-hegemonic states that it deeply cares about the underlying fundamental condition of its hegemony – centrality in the global economy, and that it will intervene military only if the states engage actively in undercutting this central position. Such grand strategy prevents two dangerous behaviors of non-hegemonic states that could eventually bring down the hegemony. First, if the non-hegemonic state engages in the repeated and multiple balancing efforts on several fronts and loses on all of them, it may be prone to further take risks and balance against the hegemon also in the issue of global economic centrality, as it may feel that its survival is at risk and that it is faced with only bad options and results. Such action derives from Prospect Theory, where actors value loses more than gains. By pursuing grand strategy of restraint, the hegemon signals that it is committed to the benefits that flow from its centrality, and that this issue is strategically clearly separated from other issues. Providing such assurance, non-hegemonic states need not to fear for their survival. Namely, pending the 'buy-in' behavior, non-hegemonic states are autonomous in choosing their policies in all other issues. Therefore, restraint dissuades non-hegemonic states to pursue erratic behavior.

Second, restraint also prevents the hegemon to provoke non-hegemonic states in pursuing risky actions. Namely, non-hegemonic states may feel very strongly about an issue, and their resolve about it might be unwavering. Again, such a situation derives from Prospect Theory, where different issues would have different value curves. As such, they may be willing to cause similar pain to the hegemon, if it initiates actions to undercut states' position. Thus, they may decide to balance against the hegemon also when it comes to global economic centrality. Therefore, the best thing to do for the hegemon is not to provoke other states if they 'buy-in'. Hegemon's core interest is to assure the 'buy-in' and when this is the case it is prudent not to endanger such stability. Namely, restraint assures the hegemon to avoid unnecessary entanglements as well as it provides assurance for other non-hegemonic states that their autonomy will be respected if they 'buy in'. Nevertheless, if the non-hegemonic state still escalates the situation and starts balancing against the hegemon when it comes to the global economic centrality, such action is a consequence of that state's strategic intent, and not strategic necessity. Thus, this state is fully aware what such action means and what it can lead to – hegemon's military intervention – and likely its ultimate defeat. Hence, pursuing restraint enables the hegemon to facilitate clarity and predictability in the international system and so control risky behavior of non-hegemonic states. In crucial moments, the hegemon needs to display its strength, but it is through restraint that the hegemon is able to deepen the 'buy-in' dynamic.

Nonetheless, in tackling some threats to the US pervasive hegemony, namely, challenges that are tangent to the nature of the economy, i.e., new technologies such as crypto-currencies, pervasive hegemon needs to be active in facilitating the 'buy-in'. As such, restraint does not mean passiveness, but active engagement with the objective of deepening and reinventing 'buy-in' behavior. In the aforementioned example, where centrality is not fully fleshed out, one may argue that this is an example of neo-primacy strategy.[1504] However, neo-primacy grand strategy makes an argument that there is no hegemony and that the dominant power needs to reestablish it. What I am talking about is an introduction of a new domain of strategic interactions that may have impact on the established centrality of the hegemon. As such, the underlining features are different and the aforementioned Huntington's quote about renewing is a more adequate description. Moreover, also the hegemon's actions are different when it comes to these two different systemic situations. Namely, in tackling the crypto-currency challenge, United States does not have to challenge anyone, as it is the case in neo-primacy. It only needs to introduce the new type of currency, which can be ameliorated along the way of further development and research on this technology. Doing

[1504] This "strategy calls for the United States to compete /…/ in order to reclaim US dominance in world politics by reversing current trends in the distribution of power, bolstering existing US strengths where possible" (Itzkowitz Shifrinson, Joshua R. 2020. Neo-Primacy and the Pitfalls of US Strategy toward China. *The Washington Quarterly*, 43(4). Pp. 79–104. At Pp. 80).

so, it needs to prevent decoupling of the crypto-currency relations from physical monetary relations. This will assure the continuation of the 'buy-in' dynamic into the digital monetary domain. United states can do the latter by conditioning the physical US dollar with the 'buy-in' towards digital US dollar, i.e., by following the causal mechanism of the Pervasive Hegemony. It seems that the United States is fully aware of this challenge, and it is moving forward with the introduction of its 'e-dollar'.[1505]

> "Treasury Secretary Janet Yellen recently mentioned the idea of creating a so-called digital dollar— a new form of electronic currency that would make the payment system easier for Americans and presumably compete with Bitcoin and other cryptocurrencies. /There is / no need for the Fed to create its own proof-of-work system for Fedcoin. Proof of work is an expensive way to establish trust in a decentralized world; the Fed, which is a centralized and already trusted entity, doesn't need to spend massive amounts of electricity reestablishing trust every time someone wants to spend a digital dollar. Instead, it could just clear the transaction like any bank does, cheaply and easily. As long as people trust the Fed not to steal their money (and why would it, when it can print as much as it likes?), a Fed payments system could be incredibly cheap without relying on any cryptocurrency technology at all."[1506]

Another similar but distinct strategy to restraint, which has so far not been a part of International Relations discourse, but of Economics and Social Policy, is benign neglect. In economics it is often defined as an "approach to the management of the international economic conditions which takes no account of the external parity of the country's currency."[1507] This means

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[1505] The Federal Reserve Board. 2020a. *Federal Reserve announces details of new 24x7x365 interbank settlement service with clearing functionality to support instant payments in the United States*. Accessibility: https://www.federalreserve.gov/newsevents/pressreleases/other20200806a.htm (30 April 2021); The Federal Reserve Board. 2020b. *Federal Reserve highlights research and experimentation undertaken to enhance its understanding of the opportunities and risks associated with central bank digital currencies*. Accessibility: https://www.federalreserve.gov/newsevents/pressreleases/other20200813a.htm (30 April 2021).

[1506] Smith, Noah. 2021. *Fed's Digital Dollar Would Look Nothing Like Bitcoin*. Accessibility: https://www.bloomberg.com/opinion/articles/2021-02-25/fed-s-digital-dollar-would-look-nothing-like-bitcoin (30 April 2021).

[1507] Moles, Peter, and Nicholas Terry. 1997. *The handbook of international financial terms*. Oxford: Oxford University Press. Pp. 43.

that a country should let the supply and demand deal with financial instability, where government should only interject when a deep crisis or crash occurs and its intervention should not happen in the boom phase – meaning no Keynesian counter-cyclical action.[1508] It was often argued that the Bretton Woods IMS collapsed due to such US strategy, however, this is a gross misreading of history, since United States was not neglecting monetary affairs, not even benignly.[1509] Maybe the best example of the difference between restraint and benign neglect is the contemporary debate regarding inflation. While the first would advise caution when it comes to stimulating the economy and advise preventive actions so that United States avoids a reprise of inflation abundant 1970s. The second would warn not to move hastily until there actually is inflation that is troublesome. Furthermore, it would also be reluctant to advocate for government intervention altogether until a long-term inflation would be a reality. Restraint is underlined with prudence as a cornerstone of its strategic thinking, whereas benign neglect follows a particular economic idea. Therefore, following restraint, pervasive hegemon understands long-term inflation as a potential threat, since it is a risk multiplier and generator of dissatisfaction that may lead to lowering confidence in the US dollar.

However, it seems that on the inflation issue contemporary United States does not follow pervasive hegemony restraint grand strategy, nor benign neglect.[1510] Namely, the pandemic has accelerated trends in international economic relations, which independently of other factors, have mixed effects for our inflation expectations. The main argument in favor of higher inflation is

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[1508] See, Bordo and Jeanne. 2002; Turner, Philip. 2013. *Benign neglect of the long-term interest rate*. Accessibility: https://www.bis.org/publ/work403.pdf (28 October 2020).
[1509] More on this see, Eichengreen. 2000.
[1510] Many point to an obscure economic idea that guides this administration – Modern Monetary Theory (see Raposo Goncalves, Inês. 2019. *On Modern Monetary Theory*. Accessibility: https://www.bruegel.org/2019/02/on-modern-monetary-theory/ (5 April 2021).

increase of money supply. Figure 128 shows annual change in money supply in the United States.[1511] However, a similar trend may be observed in other countries as well.[1512] Additional reasons for these expectations are loose central banks policies in regards of price stability, supply shocks, and decoupling in the future (reshoring international trade)[1513] – expected economic tensions over rare earth metals and semiconductors. Yet, we have seen similar situations in the past and no inflation occurred, last time in the aftermath of 2008 Global Financial Crisis.[1514] Hence, counter to these arguments is the fact that money velocity has decreased in United States (Figure 129).[1515] Furthermore, labor markets are loose and so states are far from full employment, so there is capacity room for demand to grow.[1516] Lastly, stimulus checks for households in United States are not being spent, but rather saved (Figure 130).[1517]

[1511] Holland. 2021.

[1512] "Between March and November, the measure of broad-based money supply, M2, jumped by a sharp 24 per cent. Shockingly, the money supply surge in 2020 exceeded any in the one-and-a-half centuries for which we have data" (Siegel, Jeremy. 2021. *Higher inflation is coming and it will hit bondholders*. Accessibility: https://www.ft.com/content/6536113f-f509-41e2-bee0-597ed90843b6 (20 February 2021)).

[1513] E.g., Dezenski, Elaine, and John C. Austin. 2021. *Rebuilding America's economy and foreign policy with 'ally-shoring'*. Accessibility: https://www.brookings.edu/blog/the-avenue/2021/06/08/rebuilding-americas-economy-and-foreign-policy-with-ally-shoring/ (10 June 2021).

[1514] "However, there was a fundamental difference between what happened during the financial crisis and what is happening now. The money created by the Fed during the last financial crisis found its way into excess reserves in the banking system. Little of it was lent out to the private sector. This happened because, before the Lehman collapse, banks did not hold excess reserves. At that time, reserves paid no interest and prudent reserve management dictated that banks keep the absolute minimum to satisfy reserve requirements. All excess reserves were lent into the money market. The financial crisis changed all of that. Following the crisis, interest rates collapsed. The Fed started paying interest on reserves, and regulators imposed liquidity requirements that could be satisfied with these reserves. The banks easily absorbed the extra reserves created by the Fed and quantitative easing led to only a modest increase in lending. /…/ But the actions of the Fed and Treasury in response to the Covid-19 crisis are producing a very different outcome. The money created by the Fed is not going only into excess reserves of the banking system. It is going directly into the bank accounts of individuals and firms through the US Paycheck Protection Program, stimulus cheques, and grants to state and local governments" (Siegel. 2021).

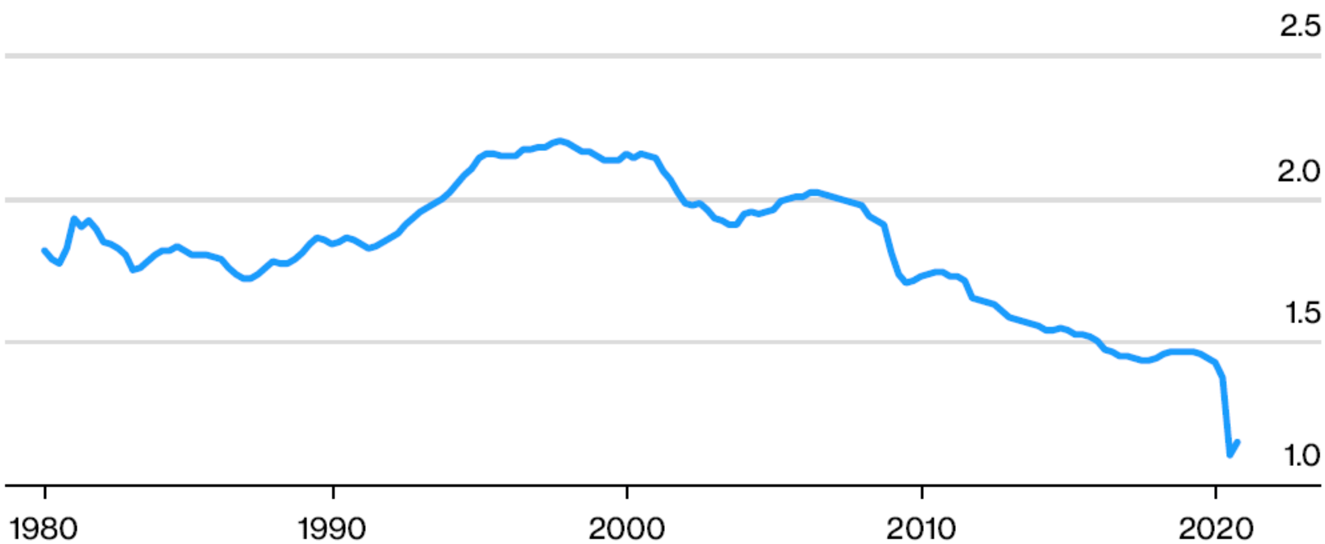
[1515] Holland. 2021.

[1516] Holland. 2021.

[1517] Holland. 2021.

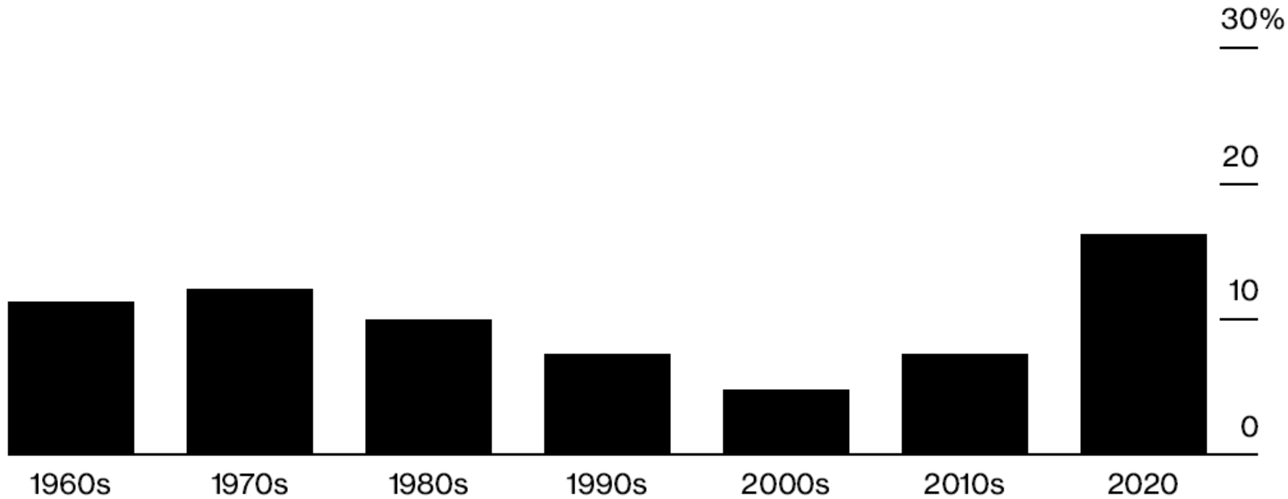
Figure 128: Annual change in money supply in the United States

Figure 129: Money velocity (M2) in the United States[1518]



[1518] Recalling footnote 440 and Figures 57 and 58, the exact ratio is subject to the definition of money supply (M1, M2, MZM). Yet, the story is the same no matter what which definition we use – the pandemic has severely decreased money velocity.

Figure 130: US savings rate (share of disposable income)



Yet, Biden administration displays irresponsible economic policies that put additional arguments in favor of inflation. It is its expansionary fiscal policies that are worrisome also for US deficit and debt. It is one thing to stimulate the economy, but Biden administration went in my mind overboard. And I am not alone in this analysis. Former treasury secretary Larry Summers said that the Biden administration is pursuing "the least responsible fiscal macroeconomic policy we've have had for the last 40 years."[1519] Namely, with increased money supply (see Figure 128), another key ingredient of inflation has also appeared – currency devaluation.[1520] The US dollar has devalued to its 2018 level in 2021 (see Figure 84). Albeit for different reasons, this is exactly what happened in 1970s and was amplified by oil shocks and increased money supply of non-hegemonic states.[1521] It is similar culmination of different factors that today can have the same effect. So, the

[1519] Financial Times. 2021. *Larry Summers: 'I'm concerned that what is being done is substantially excessive'*. Accessibility: https://www.ft.com/content/380ea811-e927-4fe1-aa5b-d213816e9073 (2 May 2021).
[1520] See, Brown, Brendan. 2021. *This Is What Could Trigger Big Growth in CPI Inflation*. Accessibility: https://mises.org/wire/what-could-trigger-big-growth-cpi-inflation?fbclid=IwAR0BkbDK_7KLV8EEKVVCnnKwOv3p8hACYK8s7Kb9-3-h6wPeGF-6EiffMLE (15 June 2021).
[1521] See also Harvey, John T. 2011. *Money Growth Does Not Cause Inflation!*. Accessibility: https://www.forbes.com/sites/johntharvey/2011/05/14/money-growth-does-not-cause-inflation/?sh=19a182d542f5 (2 May 2021).

warning signs for inflation are clear, and prudence of pervasive hegemony restraint grand strategy would advise the Biden administration to be more cognizant about it. Instead, it opts for an expansionary fiscal policy, or a better way to put would be expansionary fiscal policy on steroids. Namely, although the existing stimulus package has not yet been fully used, the administration is seeking an additional almost 2 trillion US dollar stimulus.[1522] Instead of such nonchalant policies that can not only cause inflation, but can cause a sequence of events that can endanger confidence in the US dollar and subsequently its centrality and therefore US hegemony, the United States government should focus on smaller crucial investments that will not have potential negative and uncontrollable side effects.[1523] Furthermore, another related prudent policy would be to tackle governmental expenditure.

"Even prior to the outbreak of the pandemic, America's long-term spending commitments — including government and private debt, and pension and entitlement liabilities — totaled roughly 10 times the country's GDP. These developments, combined with growing political polarization, have contributed to domestic unease, something the pandemic may worsen."[1524] However, it would only take three years to balance the budget by fixing the expenditures in the pre-pandemic United States.[1525] This further indicates the fundamental good health of the US

[1522] Pramuk, Jacob. 2021. *Biden signs $1.9 trillion Covid relief bill, clearing way for stimulus checks, vaccine aid*. Accessibility: https://www.cnbc.com/2021/03/11/biden-1point9-trillion-covid-relief-package-thursday-afternoon.html (12 March 2021).
[1523] For example, semiconductors, see Gartenberg, Chaim. 2021. *IBM's first 2nm chip previews the processors of tomorrow*. Accessibility: https://www.theverge.com/2021/5/6/22422815/ibm-2nm-chip-processors-semiconductors-power-performance-technology (9 May 2021); Eisenstein, Paul A. 2021. *U.S. needs to invest in semiconductor 'infrastructure,' Biden tells business leaders facing crippling shortages*. Accessibility: https://www.nbcnews.com/business/business-news/biden-auto-executives-chip-makers-meet-bid-solve-crippling-shortages-n1263847 (13 April 2021).
[1524] McCormick, David H., Charles E. Luftig, and James M. Cunningham. 2020. Economic Might, National Security, and the Future of American Statecraft. *Texas National Security Review*, 3(3). Pp. 50–75. Pp. 52
[1525] Mitchell, Daniel J. 2015. *A Very Simple Plan to Balance the Budget by 2021*. Accessibility: https://www.cato.org/blog/very-simple-plan-balance-budget-2021 (4 April 2017).

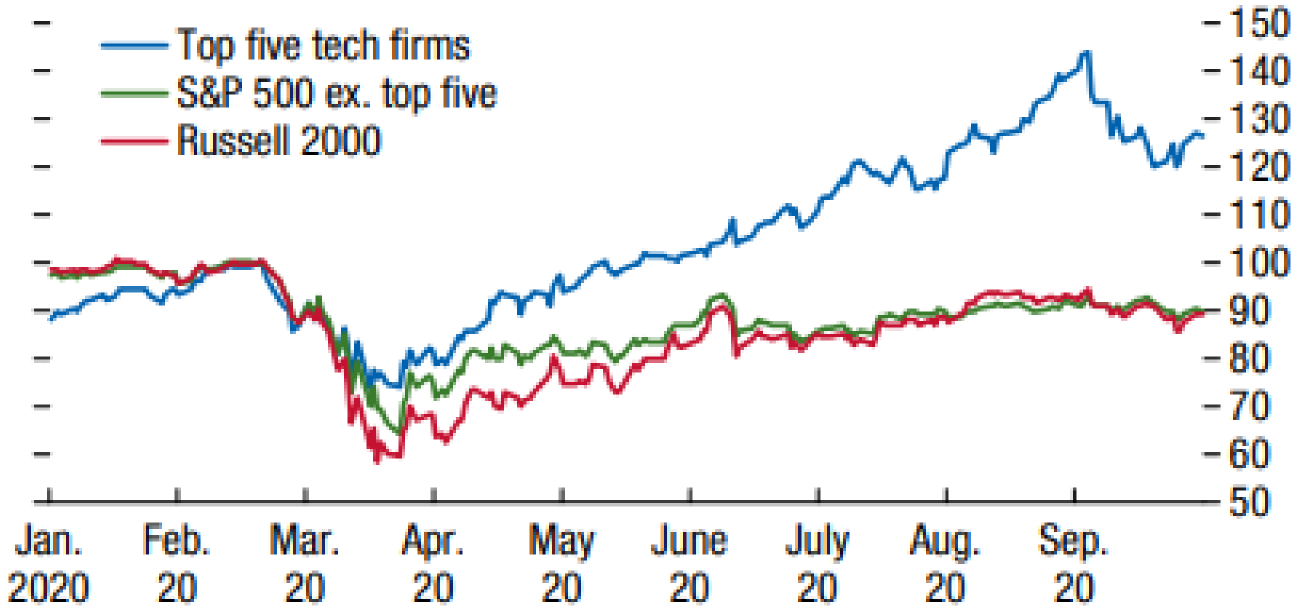
private sector and current unnecessary extraordinary expenditures of the US government. Thus, the proposed expansionary fiscal policy that does not make any economic sense, and it definitely cannot contribute to building confidence in the US dollar and serve as a tool to deepen the buy-in behavior in a time of potential inflation that this same policy helped create. In fact, it is more likely to have a counter effect than positive. United States should avoid unnecessary risks to its centrality and hegemony, which long term inflation is.

The excessive liquidity was indeed funneled into the stock market, which was growing more with unprecedented levels, particularly tech-stocks (see Figure 131). Yet, this is not good for bondholders, which means also the non-hegemonic states.

> "The huge demand for treasuries, which has kept their yields so low, is driven by their strong short-term hedge characteristics — their ability to cushion sharp declines in risk assets. But this insurance is going to get more and more expensive as higher consumer prices erode the purchasing power of these bonds. It is inevitable that bond rates will rise and rise far more than now envisioned by the Fed and most forecasters. It will be the Treasury bondholder, through rising inflation, who will be paying for the unprecedented fiscal and monetary stimulus over the past year."[1526]

[1526] Siegel. 2021.

Figure 131: Stock market performance during the pandemic[1527]



Namely, there is a discrepancy in the market, where expected break-even rates are rising well above 2%,[1528] while the 10-year US bonds are at about 1.5% yield.[1529] As such, one would expect market adjustment and continuums rise of both these measures once inflation starts picking up. Moreover, if the latter will not be transitory than non-hegemonic and investors states that bought US bonds or treasuries in early 2021 and late 2020, will not be happy about performance of their assets, which may cause some disturbance and presents a risk for the 'buy-in' behavior.[1530]

[1527] International Monetary Fund. 2020c. Pp. 7
[1528] Stanton, Elizabeth, Stephen Spratt, and John Ainger. 2021. *Global Markets See Inflation Breaking Out to Multiyear Highs*. Accessibility: https://www.bloombergquint.com/business/u-s-10-year-inflation-breakeven-advances-to-highest-since-2014 (11 February 2021)
[1529] *Market Watch*. 2021.
[1530] For example, Asian governments and firms have in record sprint issued dollar bonds. "Borrowers from the region have raised $354bn in debt denominated in US currency this year. Issuers in Asia, excluding Japan, have sold $354bn worth of dollar bonds in the year to date, up 13 per cent from a year ago and a record high for the period" (Lockett, Hudson, and Thomas Hale. 2020. *Asian governments and firms in record sprint to issue dollar bonds*. Accessibility: https://www.ft.com/content/68ae800e-d130-4458-a108-cfb4339ae507 (20 February 2021)).

One can also make additional domestic step in analyzing the importance of inflation and the troublesome ignorance of the Biden administration of that problem. Rome rotted from within. And higher inflation might be followed by higher interest rates and higher unemployment to tackle it. Both may have dire internal political consequences generating unrest. Political instability can drive investors away, and even more importantly – generate confidence questions in the US dollar. The very thing that makes the competitors of the US dollar unattractive, may also become US dollar problem. This scenario is reinforced with contemporary delegitimating of state institutions, such as police, watering down of the historical memory of United States as the land of the free, and deconstructing of the social fabric or the glue that ties United States together as a nation. Thus, one can easily pose the question, if such a state can generate international confidence in its currency? Also, these trajectories decrease US wherewithal and motivation to be the hegemon. Being bogged down in self-flagellation of a cultural civil war can be a source of changing the nature of the United States into a political unit that does not wish to be the hegemon or takes all the wrong steps to exercise its hegemony. Or in other words, a hegemon with an internal turmoil, cannot exercise its hegemony, no matter what the nature of that hegemony.

Hence, thinking about inflation is important as potential risk amplifier for the US hegemony. For 30 years US hegemony has faced a deflationary pressure and decreasing interest rates, which have generated enormous economic growth across the globe, as well as its unequal distribution, and reproduced the centrality of the US dollar.[1531] If this environment shifts, then US operationalization of assuring US dollar centrality will have to change with it. Particularly if the

[1531] See, Ocampo, José Antonio. 2009. Reforming The Global Reserve System. In Griffith-Jones, Stephany, José Antonio Ocampo, and Joseph E. Stiglitz (eds.), *Time for a Visible Hand: Lessons from the 2008 World Financial Crisis*. Oxford: Oxford University Press. Pp. 289–313.

nature of the economy further changes due to the crypto currencies. United Sates will have to rethink its interests and reinvent the envelope in which the US dollar will be provided to the non-hegemonic states.

Here lies the challenge. We do not have a good theory of inflation.[1532] In fact, theories of inflation have been proven wrong on several occasions in the past – ranging from useful policy tools or correlations such as the Philips curve,[1533] Fisher Equation,[1534] and Taylor Rule,[1535] to Quantitative Theory of Money.[1536] This is why we cannot trust economic models of predicting inflation – they have constantly been wrong in the past. For example, recall Figure 97 and useless inflation predictions and targets in the EU. Interest rates have been falling for three to four decades

[1532] For an overview of different theories of inflation see Nordhaus, William D. 1976. Inflation theory and policy. *The American economic review*, 66(2). Pp. 59–64. See also Tarullo. 2017

[1533] Named after William Phillips the curve describes an inverse relation between unemployment and inflation, see, Phelps, Edmund S. 1968. Phillips curves, expectations of inflation and optimal unemployment over time: Reply. *Economica*, 35(139). Pp. 288–96. Since this is not much of a causal theory of inflation, but a theory how to mitigate inflation deriving from empirical observation, it does not come as a surprise that there are multiple issues with it. Namely, it cannot explain stagflation, nor the reversal occurrence, which we have been living in in the past few decades (low inflation and low unemployment), see Islam, Faridul, Kabir Hassan; Mustafa Muhammad; and Rahman Matiur. 2003. The empirics of US Phillips curve: A revisit. *American Business Review*, 21(1). Pp. 107–12.

[1534] Named after Irving Fisher, the equation states that the real interest rate equals the nominal interest rate minus the expected inflation rate, see Fisher, Irving. 1907. *The Rate of Interest*. New York: Macmillan. The significance of this equation is that it theoretically brings into consideration perceptions. Namely, expected inflation is by design a part of calculating the interest rate and subsequently interest rates shape inflationary perceptions and expectations. Considering that Fisher lived during a period of economic rationalism, his work was visionary and anticipated behavioral economics. Yet, the equation has limited empirical support, see Crowder, William J., and Dennis L. Hoffman. 1996. The long-run relationship between nominal interest rates and inflation: the Fisher equation revisited. *Journal of money, credit and banking*, 28(1). Pp. 102–18.

[1535] Named after John B. Taylor, the rule states that by interest rate adjustment, the central bank can control inflation, as well as output, see Taylor, John B. 1979. Estimation and control of a macroeconomic model with rational expectations. *Econometrica*, 47(5). Pp. 1267–86. In the past 20 years, monetary situation has deviated from this rule, see Hofmann, Boris, and Bilyana Bogdanova. 2012. Taylor rules and monetary policy: a global 'Great Deviation'?. *BIS quarterly review*, September. Pp. 37–49.

[1536] In one way or the other this theory has been a part of the economic cannon since the Salamanca School in 16th Century. Its "proposition states that the rate of inflation is equal to the excess of the rate of growth of money over real incomes — although more sophisticated interpretations take into account other variables such as interest rates and inflationary expectations" (Siegel. 2021). The problem is that this relationship does not hold for low inflation countries and periods, see Grauwe and Polan. 2005; Cline, William R. 2015. *Quantity theory of money redux? Will inflation be the legacy of quantitative easing?*. Accessibility: https://www.piie.com/sites/default/files/publications/pb/pb15-7.pdf (27 May 2021).

and have not caused an inflation problem. If inflation indeed occurs now, we do not have a good explanation why, and if it does not occur, we do not have a good explanation why not. Deflationary pressures – globalization, population growth, offshore investments and manufacture, increasingly complex supply chains – are losing their grip over the economic environment we live in. All these features seem to be shifting towards, and the pandemic has accelerated this trend, the other end of the pendulum and thus creating an inflationary environment. As such, expansionary policies will, in this new environment, create inflation. By and large labor will gain importance as factor of production. Not in 19th Century sense, but high skill labor with high added value. Yet, this in and of itself will put pressure on higher prices and higher interest rates.[1537]

Finally, if inflation indeed gets out of hand, United States still has the potential to deepen the buy-in. If there will be inflation, there will be inflation for everyone. As such, United States could facilitate informal conversations how to deal with the issue similar to the conduct of summit diplomacy between 1971 and 1973. The key non-hegemonic, particularly European states and Japan, actors would be interested in such consultations, as their exposure to inflation is higher than the one of United States. Moreover, the Chinese threat and competition in regards of setting the rules of the game would also contribute to non-hegemonic states to be more willing to associate with the United States. China's real GDP in current prices in comparison is approximately 35 percent of the transatlantic economy.[1538] Counting exports and imports of goods and services, the US-EU bilateral trade is as big as the sum of US-China and EU-China activities.[1539] "When it

[1537] See Goodhart and Pradhan. 2020.
[1538] International Monetary Fund. 2020e. *World Economic Outlook, A Long and Difficult Ascent*. Accessibility: https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020 (27 December 2020).
[1539] *World Integrated Trade Solutions (WITS)*. 2020.

comes to transatlantic trade, we have seen sustainable growth. Volumes have more than doubled since 2000 ($566 billion) and grown by over 50 percent since 2009 ($834 billion)."[1540] The latter is a product of constant beneficial negotiations aimed at improving the regulatory process and increasing transatlantic trade and investment. At 6.2 trillion US dollars in mutual investment, the United States and the EU are each other's primary source and destination of FDI, employing directly more than 16 million workers. The United States and Europe together accounted for 58 percent of inward stock of FDI and 63 percent of outward stock of FDI, compared to China's 5 percent of inward stock of FDI and 6.2 percent of outward stock.[1541]

> "To put it into perspective, U.S. investment in Europe makes up roughly 60 percent of the total stock of U.S. outward investment globally. U.S. investment in Europe is four times U.S. investment in the Asia-Pacific region, and 31 times higher than U.S. investment in China. As a symbol of deepest economic integration, the stock of U.S. investment in Europe has increased much faster than trade levels, increasing 5 times since 2000."[1542]

This trend continued also after the 2008 Global Financial Crisis. In fact, since 2009 investment has doubled in the Transatlantic region, reaching $3.6 trillion in 2019.[1543] European investments add to 68% of the total FDI in the United States, compared to 16% coming from Asia-Pacific. Moreover, Chinese FDI in the United States is only 0.9% of its total stock, and the size of German FDI in United States alone is more than eight times bigger than Chinese investments.[1544]

[1540] Zeneli, Valbona, and Joseph Vann. 2020. *The Real Strategic End Game in Decoupling From China: Going all-in on the transatlantic economy is the only serious option for Western democracies seeking to counter China*. Accessibility: https://thediplomat.com/2020/09/the-real-strategic-end-game-in-decoupling-from-china/ (30 April 2021).
[1541] Hamilton, Daniel S. and Joseph P. Quinlan. 2020. *The Transatlantic Economy, 2020 Annual Survey of Jobs, Trade and Investment between the United States and Europe*. Washington: Johns Hopkins University
[1542] Zeneli and Vann. 2020.
[1543] Statista. 2021b. *Direct investment position of the United States in Europe from 2000 to 2019*. Accessibility: https://www.statista.com/statistics/188579/united-states-direct-investments-in-europe-since-2000/ (1 March 2021).
[1544] Bureau of Economic Analysis. 2021. *Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data*. Accessibility: https://www.bea.gov/international/di1fdibal (23 May 2021).

These are all encouraging thoughts for the US hegemony even if we get to a stage of high inflation and the world blames US policy for it, the hegemon still has the leverage of its centrality to reengage with the non-hegemonic states and set new rules of relations to assure its hegemonic endurance. And this is the very essence of the pervasive hegemony.

6.5. FUTURE RESEARCH ON PERVASIVE HEGEMONY

Lastly, the present research has opened additional potential research questions that I intend to address in my future academic endeavors. Some of them are empirical in their nature, while others are theoretical. Here I will list five of them that are directly linked to the research question at hand. Therefore, I am not addressing spin-off research projects and ideas that occurred to me while working on this project.

1. Look into past hegemonies and identify if any were pervasive, or if they present any evidence against Pervasive Hegemony – e.g., Netherlands (16th Century), Portugal (15th Century), Ming China, Qing China, Byzantine Empire, Roman Empire.
2. A counterfactual analysis of a possibility of preserving Bretton Woods IMF changing the willingness of the non-hegemonic states to adjust. Would there be a different Nixon Shock, if a shock at all? Could such action withhold the problem of changing of the nature of the economy? Would US hegemony then still be labeled as a pervasive hegemony?
3. Perform an experimental study using simulations of implementing pervasive hegemony grand strategy using different designs: Agent-Based Modeling, Dynamic Systems

Modeling, and Red Team Simulation. A comparison of their results can better inform us on the desired policies that United States should pursue.

4. A more detailed study on the origins of US pervasive hegemony, since the assumption of this project was that there is an imbalance, and the hegemony is pervasive only that it needs to be fully fleshed out. However, another study should look into this assumption. Namely, look into the era prior 1945, particularly after 1897 (start of the McKinley administration).
5. Develop a relational theory of pervasive hegemony, which would also be the first realist relational theory of international relations.

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APPENDIX 1

Unit root tests results for international reserves denominated in US dollars – data from Eichengreen, Chiţu and Mehl (2014).

Dickey-Fuller test for unit root — Number of obs = 66

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-4.144	-3.558	-2.917	-2.594

MacKinnon approximate p-value for Z(t) = 0.0008

Phillips-Perron test for unit root — Number of obs = 66, Newey-West lags = 3

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-8.933	-19.188	-13.428	-10.796
Z(t)	-3.989	-3.558	-2.917	-2.594

MacKinnon approximate p-value for Z(t) = 0.0015

```
DF-GLS for shares                                        Number of obs =    56
Maxlag = 10 chosen by Schwert criterion

               DF-GLS tau      1% Critical       5% Critical      10% Critical
  [lags]     Test Statistic        Value             Value             Value
------------------------------------------------------------------------------
    10           -1.076           -3.705            -2.739            -2.461
    9            -0.978           -3.705            -2.788            -2.510
    8            -1.122           -3.705            -2.837            -2.558
    7            -1.044           -3.705            -2.887            -2.605
    6            -0.891           -3.705            -2.935            -2.652
    5            -1.110           -3.705            -2.982            -2.696
    4            -0.909           -3.705            -3.026            -2.737
    3            -1.016           -3.705            -3.067            -2.775
    2            -0.862           -3.705            -3.104            -2.809
    1            -0.810           -3.705            -3.136            -2.837

Opt Lag (Ng-Perron seq t) = 0 [use maxlag(0)]
Min SC   =  2.824828 at lag  1 with RMSE  3.821078
Min MAIC =  2.741791 at lag  1 with RMSE  3.821078
```

APPENDIX 2

Unit root tests results (dfuller, pperron, dfgls) for international reserves denominated in US dollars measured in two separate methods for constant exchange rates data from Eichengreen, Chiţu and Mehl (2014).

- Shares_const

```
Dickey-Fuller test for unit root                   Number of obs   =        65

                               ---------- Interpolated Dickey-Fuller ---------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(t)             -3.275            -3.559            -2.918            -2.594
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0160
```

```
Phillips-Perron test for unit root                 Number of obs   =        65
                                                   Newey-West lags =         3

                               ---------- Interpolated Dickey-Fuller ---------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(rho)          -11.482           -19.170           -13.420           -10.790
 Z(t)             -3.266            -3.559            -2.918            -2.594
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0164
```

```
DF-GLS for shares_const                              Number of obs =    55
Maxlag = 10 chosen by Schwert criterion
```

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
10	-1.154	-3.709	-2.736	-2.457
9	-1.062	-3.709	-2.785	-2.506
8	-1.166	-3.709	-2.835	-2.556
7	-1.186	-3.709	-2.885	-2.604
6	-1.513	-3.709	-2.935	-2.651
5	-1.771	-3.709	-2.983	-2.697
4	-1.369	-3.709	-3.028	-2.739
3	-1.344	-3.709	-3.070	-2.778
2	-1.414	-3.709	-3.108	-2.812
1	-1.466	-3.709	-3.140	-2.842

```
Opt Lag (Ng-Perron seq t) =  5 with RMSE  3.715273
Min SC    =  2.856892 at lag  1 with RMSE  3.879031
Min MAIC =  2.831161 at lag  1 with RMSE  3.879031
```

- Shares_const_bis

```
Dickey-Fuller test for unit root                    Number of obs   =        65
```

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-3.051	-3.559	-2.918	-2.594

```
MacKinnon approximate p-value for Z(t) = 0.0304
```

```
Phillips-Perron test for unit root                   Number of obs   =        65
                                                     Newey-West lags =         3

                               ---------- Interpolated Dickey-Fuller ---------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(rho)          -11.586           -19.170           -13.420           -10.790
 Z(t)             -3.104            -3.559            -2.918            -2.594
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0262
```

```
DF-GLS for shares_const_bis                               Number of obs =    55
Maxlag = 10 chosen by Schwert criterion

               DF-GLS tau      1% Critical       5% Critical      10% Critical
  [lags]     Test Statistic        Value             Value             Value
------------------------------------------------------------------------------
    10           -1.477           -3.709            -2.736            -2.457
    9            -1.184           -3.709            -2.785            -2.506
    8            -1.089           -3.709            -2.835            -2.556
    7            -1.179           -3.709            -2.885            -2.604
    6            -1.568           -3.709            -2.935            -2.651
    5            -1.786           -3.709            -2.983            -2.697
    4            -1.312           -3.709            -3.028            -2.739
    3            -1.371           -3.709            -3.070            -2.778
    2            -1.487           -3.709            -3.108            -2.812
    1            -1.439           -3.709            -3.140            -2.842

Opt Lag (Ng-Perron seq t) =  7 with RMSE  3.584054
Min SC   =  2.938966 at lag  1 with RMSE  4.041527
Min MAIC =  2.882282 at lag  7 with RMSE  3.584054
```

APPENDIX 3

1. Legend for polishing criteria for trade datasets

Legend:	**Correlates of War**
Initial full data:	no. of data entries from dyadic dataset for the observed period
After merging 1:	no. of data entries after merging initial data with data on total imports and exports of country A (from National data)
After merging 2:	no. of data entries after merging initial data with data on total imports and exports of country B (from National data)
1. criteria:	flow1/imports1 < 1
2. criteria:	flow2/exports1 < 1
3. criteria:	flow1/exports2 < 1
4. criteria:	flow2/imports2 < 1
5. criteria:	flow1 > 0
6. criteria:	flow2 > 0

Legend:	**International Monetary Fund**
Initial full data:	no. of data entries from dataset for the observed period
After merging 1:	no. of data entries after merging initial data with data on total imports and exports of Counterpart countries
After merging 2:	no. of data entries after merging initial data with data on total imports and exports of Countries
1. criteria:	Imports/Country_Imports < 1
2. criteria:	Exports/Country_Exports < 1
3. criteria:	Imports/Counterpart_Exports < 1
4. criteria:	Exports/Counterpart_Imports < 1
5. criteria:	Imports > 0
6. criteria:	Exports > 0

Legend:	**WITS**
Initial full data:	no. of data entries from dataset for the observed period
After merging 1:	no. of data entries after merging initial data with data on total imports and exports of Reporter countries
After merging 2:	no. of data entries after merging initial data with data on total imports and exports of Partner countries
1. criteria:	Imports/ReporterCountry_Imports < 1
2. criteria:	Exports/ReporterCountry_Exports < 1
3. criteria:	Imports/PartnerCountry_Exports < 1
4. criteria:	Exports/PartnerCountry_Imports < 1

5. criteria:	Imports > 0
6. criteria:	Exports > 0

Legend:	**Gleditsch Dataset**
Initial full data:	no. of data entries from the dataset for the observed period
After merging 1:	no. of data entries after merging initial data with data on total imports and exports of country A
After merging 2:	no. of data entries after merging initial data with data on total imports and exports of country B
1. criteria:	imports A from B / total imports A < 1
2. criteria:	exports A to B / total exports A < 1
3. criteria:	imports A from B / total exports B < 1
4. criteria:	exports A to B / total imports B < 1
5. criteria:	imports A from B > 0
6. criteria:	exports A to B > 0

2. VARSOC and Granger Causality test results performed on COW dataset for maximum lag of 10

```
Selection-order criteria
Sample:  1956 - 2014                               Number of obs      =        59
```

lag	LL	LR	df	p	FPE	AIC	HQIC	SBIC
0	202.855				3.8e-06	-6.80865	-6.78116	-6.73822
1	313.779	221.85	4	0.000	1.0e-07	-10.4332	-10.3507	-10.2219
2	318.886	10.213	4	0.037	9.7e-08	-10.4707	-10.3333	-10.1186
3	323.533	9.2951	4	0.054	9.5e-08	-10.4927	-10.3002	-9.99968
4	342.661	38.255	4	0.000	5.7e-08	-11.0055	-10.758	-10.3716*
5	343.441	1.5608	4	0.816	6.4e-08	-10.8963	-10.5939	-10.1216
6	351.11	15.338	4	0.004	5.7e-08	-11.0207	-10.6633	-10.1052
7	356.554	10.888	4	0.028	5.5e-08	-11.0696	-10.6573	-10.0133
8	360.803	8.4977	4	0.075	5.5e-08	-11.0781	-10.6107	-9.88085
9	370.808	20.01*	4	0.000	4.5e-08*	-11.2816*	-10.7593*	-9.94356
10	373.973	6.3298	4	0.176	4.7e-08	-11.2533	-10.676	-9.7744

```
Endogenous:  usa chn
 Exogenous:  _cons
```

Granger causality Wald tests

Equation	Excluded	chi2	df	Prob > chi2
usa	chn	.73534	1	0.391
usa	ALL	.73534	1	0.391
chn	usa	.00754	1	0.931
chn	ALL	.00754	1	0.931

3. Granger Causality test including Chinese membership in the WTO

Selection-order criteria
Sample: 1950 - 2014 Number of obs = 65

lag	LL	LR	df	p	FPE	AIC	HQIC	SBIC
0	220.027				2.5e-07	-6.67775	-6.63815	-6.57739
1	365.97	291.89*	9	0.000	3.7e-09*	-10.8914*	-10.733*	-10.49*
2	372.598	13.255	9	0.151	4.0e-09	-10.8184	-10.5412	-10.1159
3	378.36	11.525	9	0.241	4.5e-09	-10.7188	-10.3228	-9.71521
4	385.795	14.87	9	0.095	4.7e-09	-10.6706	-10.1559	-9.36598

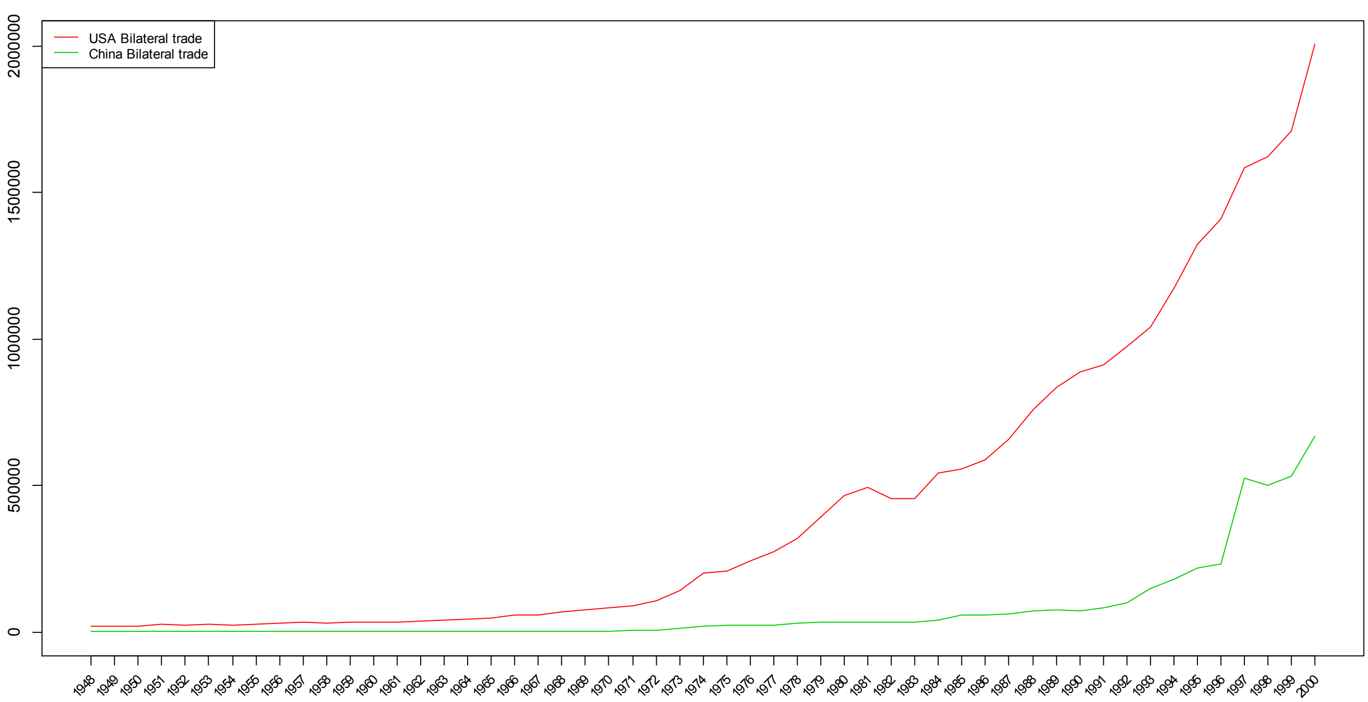
Endogenous: usa chn wto
Exogenous: _cons

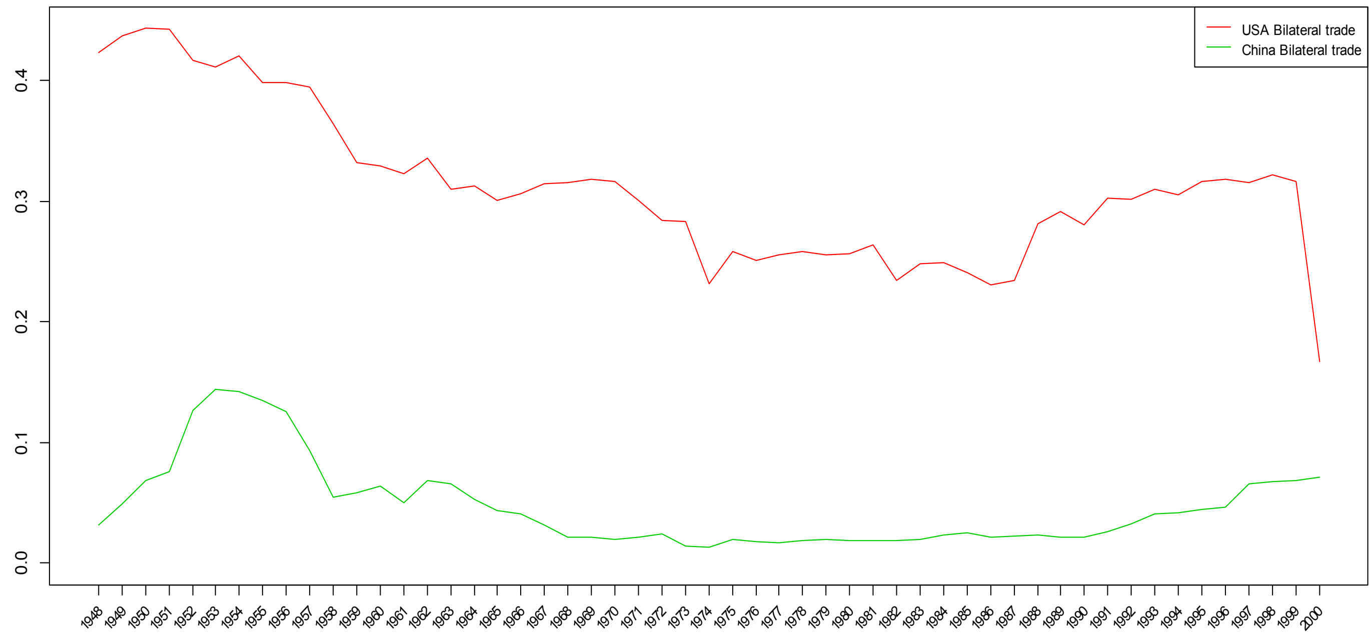
Granger causality Wald tests

Equation	Excluded	chi2	df	Prob > chi2
usa	chn	1.1367	2	0.566
usa	wto	3.7474	2	0.154
usa	ALL	3.9617	4	0.411
chn	usa	1.0929	2	0.579
chn	wto	14.497	2	0.001
chn	ALL	15.93	4	0.003
wto	usa	4.3994	2	0.111
wto	chn	.79218	2	0.673
wto	ALL	6.4744	4	0.166

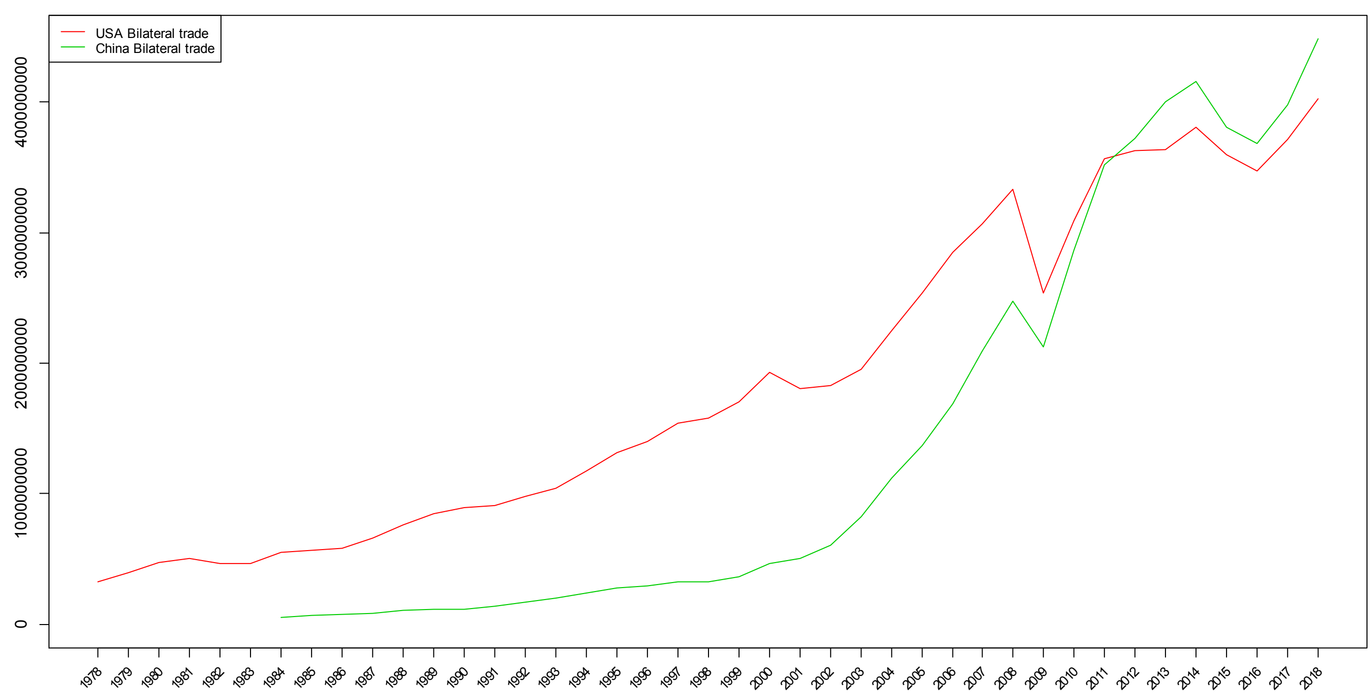
4. US and China absolute trade and network centrality calculations according to other trade databases

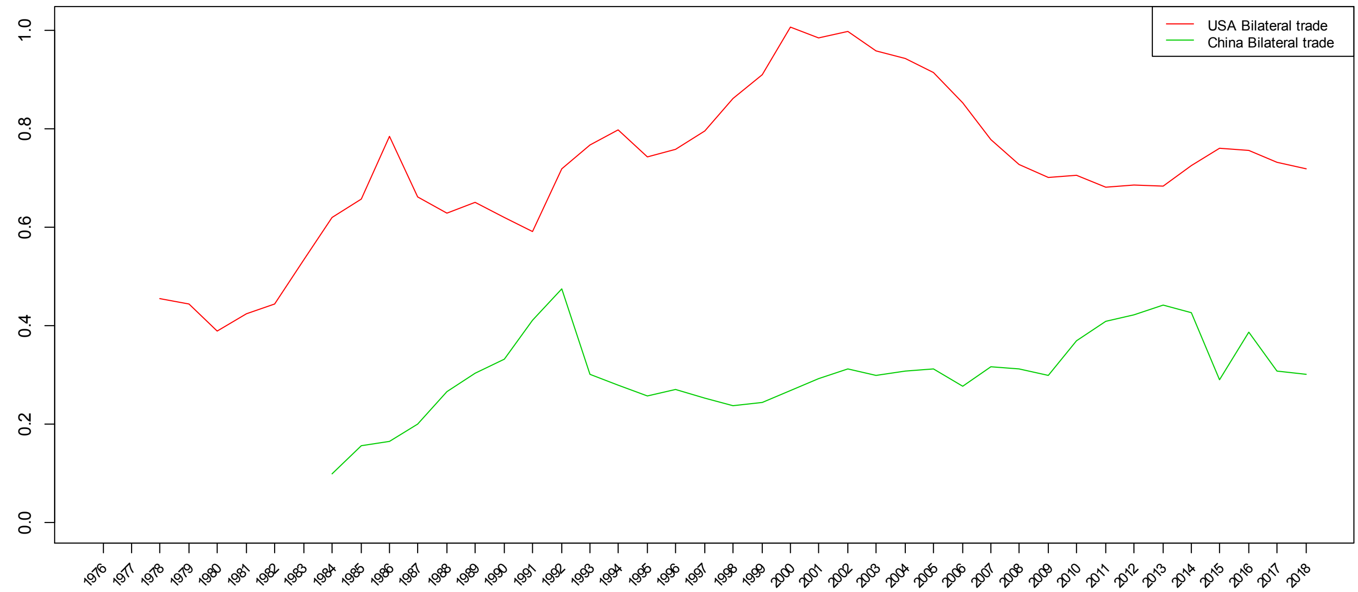
- Gleditsch



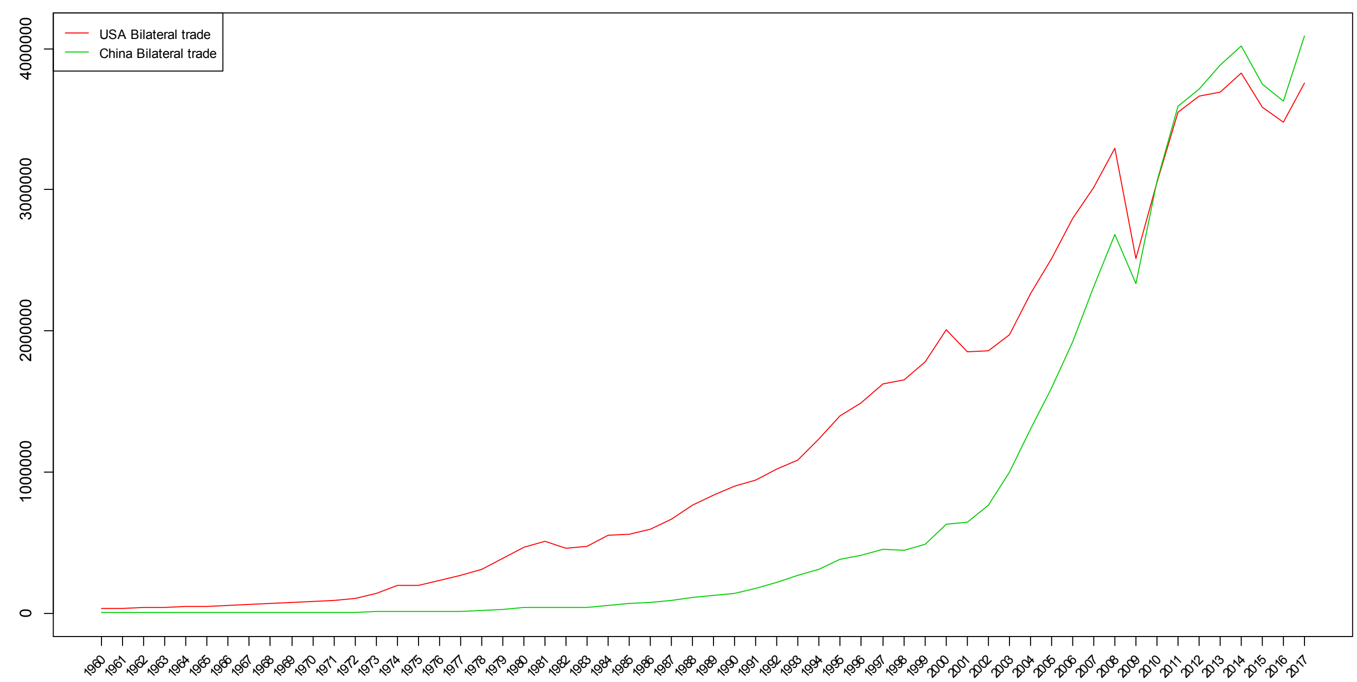

USA Bilateral trade
China Bilateral trade

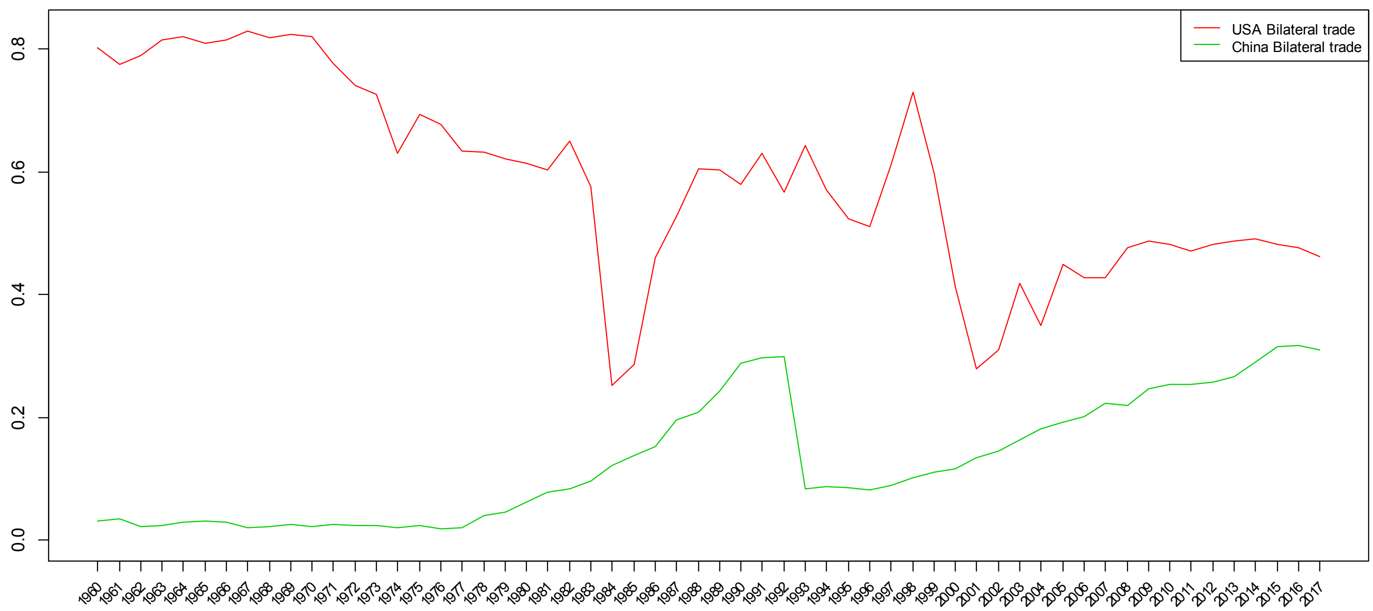
- WITS


USA Bilateral trade
China Bilateral trade


USA Bilateral trade
China Bilateral trade
0.0
0.2
0.4
0.6
0.8
1.0
1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018

- IMF


USA Bilateral trade
China Bilateral trade
0
1000000
2000000
3000000
4000000
1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017


USA Bilateral trade
China Bilateral trade
0.0
0.2
0.4
0.6
0.8
1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017

APPENDIX 4

- BCI Unbalanced panel

```
Im-Pesaran-Shin unit-root test for value
----------------------------------------
Ho: All panels contain unit roots            Number of panels       =     42
Ha: Some panels are stationary               Avg. number of periods = 427.00

AR parameter: Panel-specific                 Asymptotics: T,N -> Infinity
Panel means:  Included                                        sequentially
Time trend:   Not included

ADF regressions: No lags included
------------------------------------------------------------------------------
                                               Fixed-N exact critical values
                    Statistic      p-value          1%       5%       10%
------------------------------------------------------------------------------
 t-bar               -1.3871                            (Not available)
 t-tilde-bar         -1.3827
 Z-t-tilde-bar        1.0629        0.8561
------------------------------------------------------------------------------
```

For the next two tests, I need to determine if the series is autocorrelated first, which is the case:

```
Wooldridge test for autocorrelation in panel data
H0: no first-order autocorrelation
    F(  1,      41) =   4823.397
           Prob > F =      0.0000
```

```
Fisher-type unit-root test for value
Based on augmented Dickey-Fuller tests
--------------------------------------
Ho: All panels contain unit roots           Number of panels       =     42
Ha: At least one panel is stationary        Avg. number of periods = 427.00

AR parameter: Panel-specific                Asymptotics: T -> Infinity
Panel means:  Included
Time trend:   Not included
Drift term:   Not included                  ADF regressions: 1 lag
------------------------------------------------------------------------------
                                  Statistic      p-value
------------------------------------------------------------------------------
 Inverse chi-squared(84)   P      1440.8380       0.0000
 Inverse normal            Z       -33.7065       0.0000
 Inverse logit t(214)      L*      -61.4290       0.0000
 Modified inv. chi-squared Pm      104.6823       0.0000
------------------------------------------------------------------------------
 P statistic requires number of panels to be finite.
 Other statistics are suitable for finite or infinite number of panels.
------------------------------------------------------------------------------
```

```
Fisher-type unit-root test for value
Based on Phillips-Perron tests
------------------------------------
Ho: All panels contain unit roots           Number of panels       =     42
Ha: At least one panel is stationary        Avg. number of periods = 427.00

AR parameter:    Panel-specific             Asymptotics: T -> Infinity
Panel means:     Included
Time trend:      Not included
Newey-West lags: 1 lag
------------------------------------------------------------------------------
                                  Statistic      p-value
------------------------------------------------------------------------------
 Inverse chi-squared(84)   P       152.3562       0.0000
 Inverse normal            Z        -5.0107       0.0000
 Inverse logit t(214)      L*       -5.0991       0.0000
 Modified inv. chi-squared Pm        5.2738       0.0000
------------------------------------------------------------------------------
 P statistic requires number of panels to be finite.
 Other statistics are suitable for finite or infinite number of panels.
------------------------------------------------------------------------------
```

- CCI Unbalanced panel

```
Im-Pesaran-Shin unit-root test for value
----------------------------------------
Ho: All panels contain unit roots           Number of panels       =     39
Ha: Some panels are stationary              Avg. number of periods = 389.31

AR parameter: Panel-specific                Asymptotics: T,N -> Infinity
Panel means:  Included                                       sequentially
Time trend:   Not included

ADF regressions: No lags included
------------------------------------------------------------------------------
                                              Fixed-N exact critical values
                    Statistic      p-value          1%       5%       10%
------------------------------------------------------------------------------
 t-bar               -1.4735                                (Not available)
 t-tilde-bar         -1.4656
 Z-t-tilde-bar        0.3973        0.6544
------------------------------------------------------------------------------
```

For the next two tests, I need to determine if the series is autocorrelated first, which is the case:

```
Wooldridge test for autocorrelation in panel data
H0: no first-order autocorrelation
    F(  1,       38) =  39383.854
           Prob > F =      0.0000
```

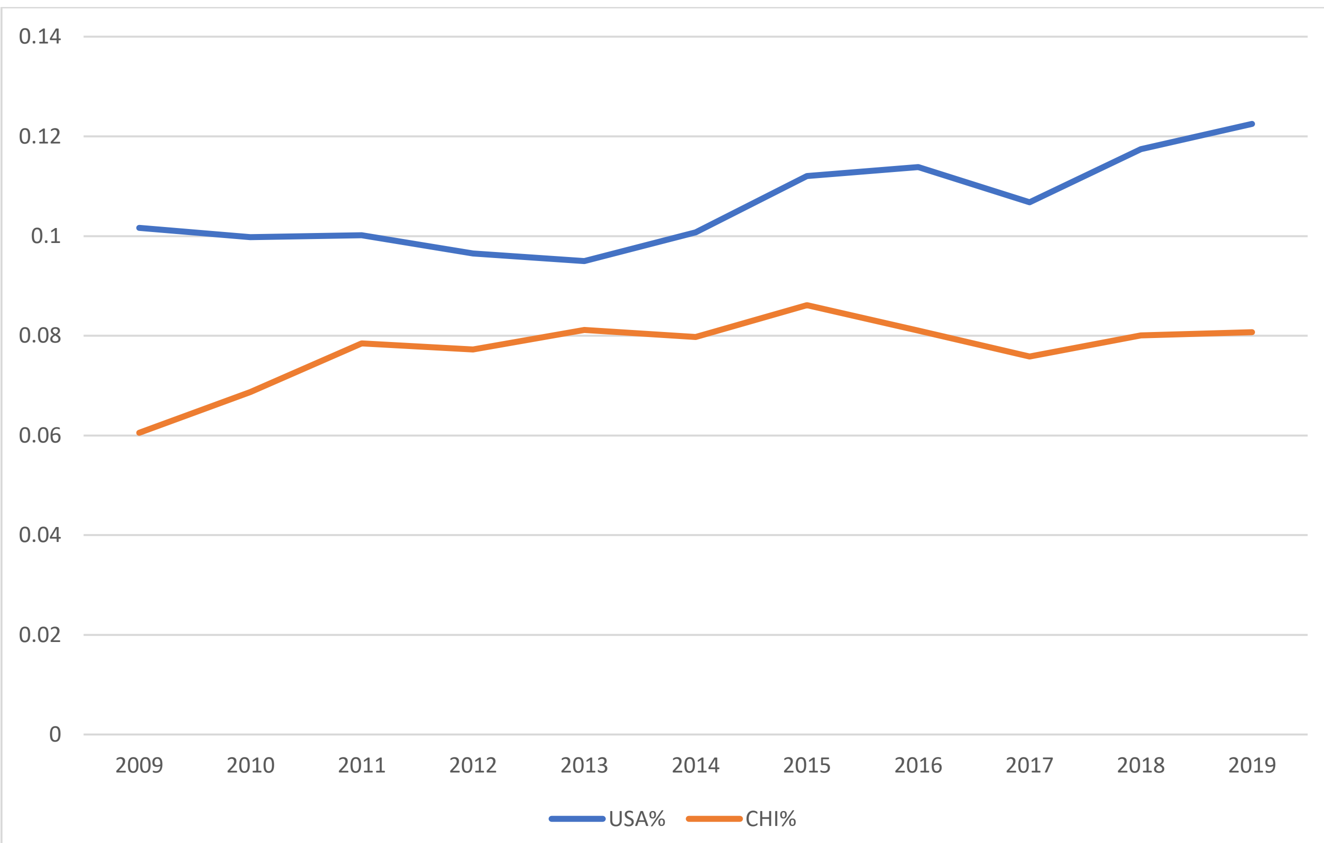
```
Fisher-type unit-root test for value
Based on augmented Dickey-Fuller tests
---------------------------------------
Ho: All panels contain unit roots           Number of panels       =     39
Ha: At least one panel is stationary        Avg. number of periods = 389.31

AR parameter: Panel-specific                Asymptotics: T -> Infinity
Panel means:  Included
Time trend:   Not included
Drift term:   Not included                  ADF regressions: 1 lag
------------------------------------------------------------------------------
                                  Statistic      p-value
------------------------------------------------------------------------------
 Inverse chi-squared(78)   P       724.8495       0.0000
 Inverse normal            Z       -21.5530       0.0000
 Inverse logit t(199)      L*      -31.9889       0.0000
 Modified inv. chi-squared Pm       51.7894       0.0000
------------------------------------------------------------------------------
 P statistic requires number of panels to be finite.
 Other statistics are suitable for finite or infinite number of panels.
------------------------------------------------------------------------------
```

```
Fisher-type unit-root test for value
Based on Phillips-Perron tests
-------------------------------------
Ho: All panels contain unit roots           Number of panels       =     39
Ha: At least one panel is stationary        Avg. number of periods = 389.31

AR parameter:    Panel-specific             Asymptotics: T -> Infinity
Panel means:     Included
Time trend:      Not included
Newey-West lags: 1 lag
------------------------------------------------------------------------------
                                  Statistic      p-value
------------------------------------------------------------------------------
 Inverse chi-squared(78)   P       119.3400       0.0018
 Inverse normal            Z        -3.3550       0.0004
 Inverse logit t(199)      L*       -3.3607       0.0005
 Modified inv. chi-squared Pm        3.3098       0.0005
------------------------------------------------------------------------------
 P statistic requires number of panels to be finite.
 Other statistics are suitable for finite or infinite number of panels.
------------------------------------------------------------------------------
```

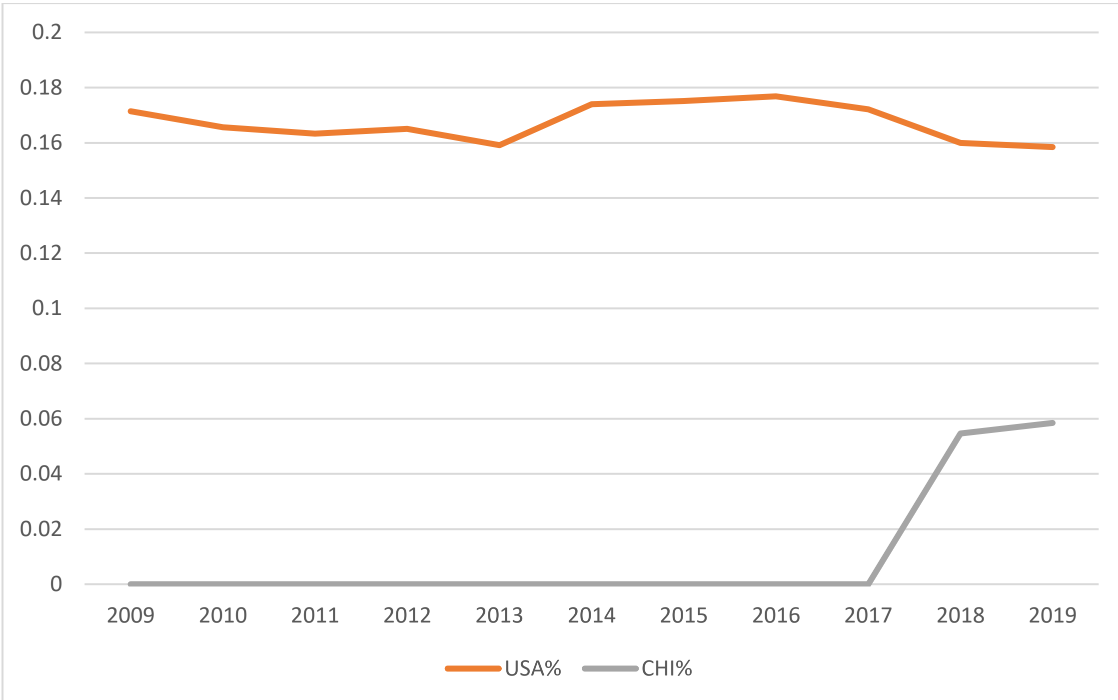
APPENDIX 5

IMF bilateral FDI data is not appropriate for a network analysis for the reasons listed in chapter 3. Furthermore, since its time span is also only 10 years, it is also too small of a spread to perform a unit root test. As such, we are left with qualitative interpretation of the graphs bellow, which indicate a stabile lead of the United States over China. The rise of the later in 2017 is due to the fact that its Outward FDI data only starts in that year.

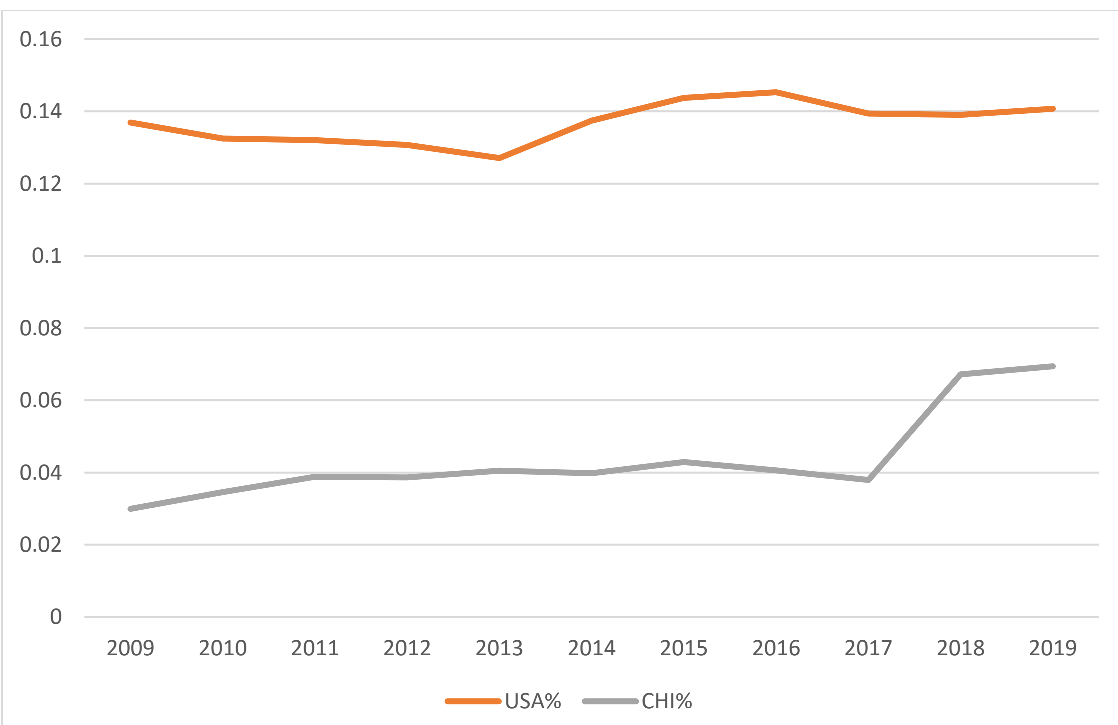
Global Share of Inward FDI



Global Share of Outward FDI

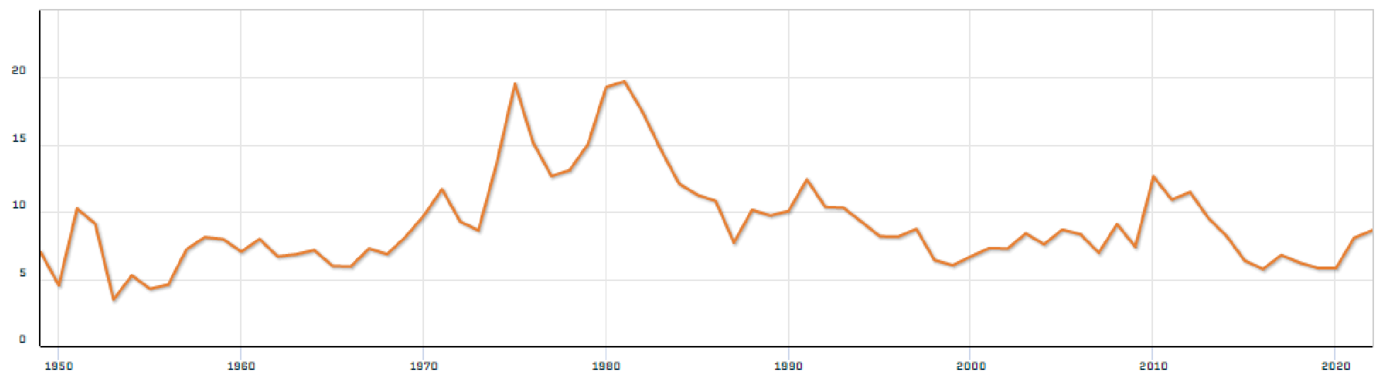


Global Share of total FDI



APPENDIX 6

- US Misery Index[1545]



The misery index was introduced by Arthur Okun, an adviser to President Lyndon Johnson in the 1960's. It is calculated as a sum of unemployment rate and inflation rate.[1546] Steve Hanke has added bank lending rates and subtracted the rate of real GDP per capita.[1547] Its pivotal downside is that it is calculated for each state individually. Therefore, if we were to average it, the score would be susceptible to skewedness by extreme values, such as Venezuela, Zimbabwe, and Sudan.[1548] Moreover, it does not measure sentiment about the markets directly.

[1545] Data from *Quandl*. 2021. Accessibility: https://www.quandl.com/data/USMISERY/INDEX-United-States-Misery-Index (30 April 2021).
[1546] *Quandl*. 2021.
[1547] Hanke, Steve H. 2021. *Hanke's 2020 Misery Index: Who's Miserable and Who's Happy?*. Accessibility: https://www.cato.org/commentary/hankes-2020-misery-index-whos-miserable-whos-happy (30 April 2021).
[1548] In 2020, all of them had scores over a 100, Venezuela even 3827.6 (Misery index scores for the most miserable countries in the world 2020. 2021. Accessibility: https://www.statista.com/statistics/227162/most-miserable-countries-in-the-world/ (30 April 2021)).

As such, the above graph only shows the scores for the United States. I have run the unit root tests, to see if the time series is stationary.[1549] Yet the results are not significant at the 5% level. Subsequently, I have subtracted the mean of the time series values to determine that there is a slight upwards trend. This would indicate that the confidence in the US hegemony is diminishing.

Dickey-Fuller test for unit root   Number of obs   =   72

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-2.709	-3.549	-2.912	-2.591

MacKinnon approximate p-value for Z(t) = 0.0725

Phillips-Perron test for unit root   Number of obs   =   72
Newey-West lags =   3

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-12.545	-19.296	-13.476	-10.832
Z(t)	-2.619	-3.549	-2.912	-2.591

MacKinnon approximate p-value for Z(t) = 0.0892

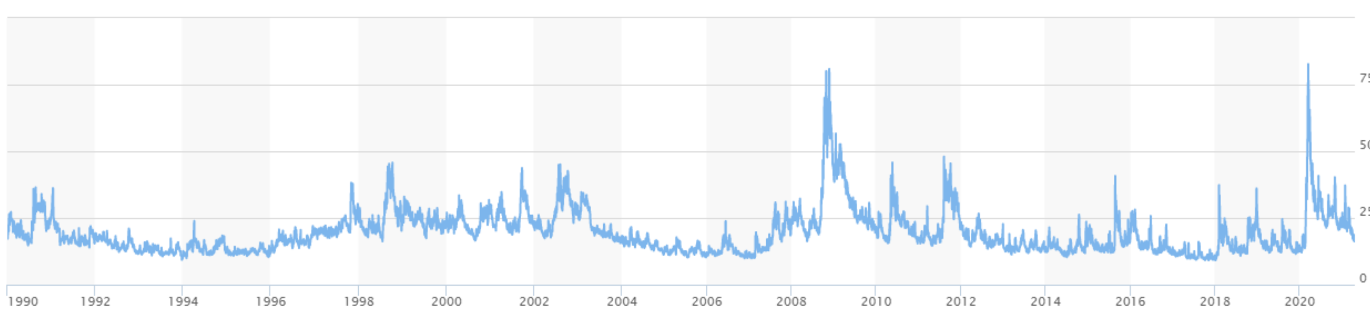
[1549] Stationarity or downward trend would indicate a growing confidence.

```
DF-GLS for miseryindex                                    Number of obs =    61
Maxlag = 11 chosen by Schwert criterion
```

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
11	-1.785	-3.683	-2.711	-2.435
10	-1.621	-3.683	-2.756	-2.479
9	-1.636	-3.683	-2.801	-2.523
8	-1.641	-3.683	-2.846	-2.567
7	-1.779	-3.683	-2.891	-2.610
6	-1.818	-3.683	-2.935	-2.652
5	-1.795	-3.683	-2.977	-2.691
4	-1.588	-3.683	-3.016	-2.728
3	-1.620	-3.683	-3.053	-2.762
2	-1.989	-3.683	-3.086	-2.792
1	-2.266	-3.683	-3.114	-2.818

```
Opt Lag (Ng-Perron seq t) = 0 [use maxlag(0)]
Min SC   =  1.430491 at lag  1 with RMSE  1.911435
Min MAIC =  1.485614 at lag  3 with RMSE  1.885958
```

- Chicago Board Options Exchange Volatility Index[1550]



[1550] Data from Marketwatch. 2021. *CBOE Volatility Index*. Accessibility: https://www.marketwatch.com/investing/index/vix/charts?mod=mw_quote_advanced (30 April 2021).

The Chicago Board Options Exchange Volatility Index, commonly known as the 'VIX Index', "is a financial benchmark designed to be an up-to-the-minute market estimate of the expected volatility of the S&P 500 Index and is calculated by using the midpoint of real-time S&P 500 Index (SPX) option bid/ask quotes. More specifically, the VIX Index is intended to provide an instantaneous measure of how much the market expects the S&P 500 Index will fluctuate in the 30 days from the time of each tick of the VIX Index."[1551] Thus, the VIX Index is a forward-looking measure, in contrast to realized (or actual) volatility, which measures the variability of historical prices. It is often seen as a way to gauge market sentiment, and in particular the degree of fear among market participants.[1552]

The basic problem with the index is that it anticipates volatility; thus, it does not anticipate confidence, it may only derive from it. Furthermore, it only focuses on United States stock market. Using unit root tests, I confirm that the series is stationary, hinting at stable confidence in the US hegemony.

```
Dickey-Fuller test for unit root                   Number of obs   =      7876
```

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-9.009	-3.430	-2.860	-2.570

MacKinnon approximate p-value for Z(t) = 0.0000

[1551] *Cboe Volatility Index*. 2021. Accessibility: https://cdn.cboe.com/api/global/us_indices/governance/VIX_Methodology.pdf (30 April 2021).
[1552] *VIX Index*. 2021. Accessibility: https://markets.cboe.com/tradable_products/vix/ (30 April 2021).

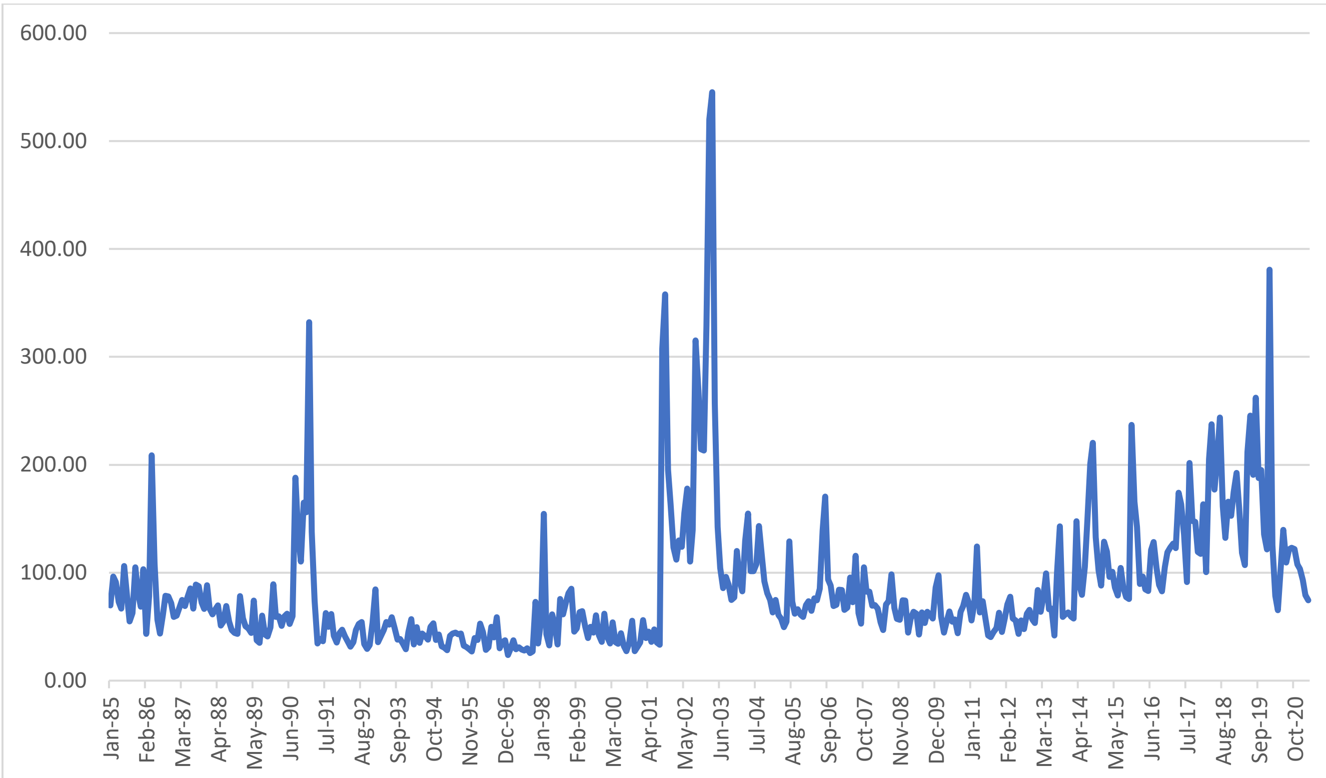
```
Phillips-Perron test for unit root                  Number of obs   =      7876
                                                    Newey-West lags =        10

                               ---------- Interpolated Dickey-Fuller ----------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(rho)         -105.843           -20.700           -14.100           -11.300
 Z(t)             -7.326            -3.430            -2.860            -2.570
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0000
```

DF-GLS for VIX   Number of obs = 7843
Maxlag = 35 chosen by Schwert criterion

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
35	-5.226	-3.480	-2.835	-2.547
34	-5.328	-3.480	-2.835	-2.547
33	-5.603	-3.480	-2.835	-2.548
32	-5.633	-3.480	-2.835	-2.548
31	-5.619	-3.480	-2.835	-2.548
30	-5.603	-3.480	-2.836	-2.548
29	-5.616	-3.480	-2.836	-2.548
28	-5.737	-3.480	-2.836	-2.548
27	-5.742	-3.480	-2.836	-2.549
26	-5.607	-3.480	-2.836	-2.549
25	-5.801	-3.480	-2.836	-2.549
24	-5.826	-3.480	-2.837	-2.549
23	-5.777	-3.480	-2.837	-2.549
22	-5.835	-3.480	-2.837	-2.549
21	-5.997	-3.480	-2.837	-2.549
20	-6.029	-3.480	-2.837	-2.550
19	-6.049	-3.480	-2.837	-2.550
18	-6.004	-3.480	-2.838	-2.550
17	-6.036	-3.480	-2.838	-2.550
16	-6.030	-3.480	-2.838	-2.550
15	-6.003	-3.480	-2.838	-2.550
14	-6.068	-3.480	-2.838	-2.551
13	-6.042	-3.480	-2.838	-2.551
12	-6.121	-3.480	-2.839	-2.551
11	-6.104	-3.480	-2.839	-2.551
10	-6.192	-3.480	-2.839	-2.551
9	-5.974	-3.480	-2.839	-2.551
8	-5.823	-3.480	-2.839	-2.551
7	-6.066	-3.480	-2.839	-2.552
6	-6.303	-3.480	-2.840	-2.552
5	-6.545	-3.480	-2.840	-2.552
4	-6.716	-3.480	-2.840	-2.552
3	-7.120	-3.480	-2.840	-2.552
2	-7.290	-3.480	-2.840	-2.552
1	-7.657	-3.480	-2.840	-2.552

Opt Lag (Ng-Perron seq t) = 34 with RMSE 1.672824
Min SC   = 1.047452 at lag 4 with RMSE 1.683487
Min MAIC = 1.045914 at lag 35 with RMSE 1.672566

- Geopolitical Risk (GPR Index)[1553]



"We define geopolitical risk as the risk associated with wars, terrorism, and tensions among states that affect the normal course of international relations. Geopolitical risk captures both the risk that these events materialize, and the new risks associated with an escalation of existing events."[1554] The data uses 11 newspapers and starts in 1985. It "reflects automated text-search results of the electronic archives of 11 national and international newspapers: The Boston Globe, Chicago Tribune, The Daily Telegraph, Financial Times, The Globe and Mail, The Guardian, Los

[1553] Caldara, Dario, and Matteo Iacoviello. 2019. *Measuring geopolitical risk*. Board of Governors of the Federal Reserve Board. Accessibility: https://www.matteoiacoviello.com/gpr_files/GPR_PAPER.pdf (30 April 2021).
[1554] Caldara, and Iacoviello. 2019. Pp. 2–3.

Angeles Times, The New York Times, The Times, The Wall Street Journal, and The Washington Post."[1555]

The fundamental issue of the index is that it is based on journalist perceptions, which are often guided by the push for sensationalism and ratings. Nevertheless, when running unit root tests, we again see that this time series is stationary, meaning that the geopolitical risk is not increasing through time and would reflect a stable US hegemony.

Dickey-Fuller test for unit root — Number of obs = 434

	Test Statistic	Interpolated Dickey-Fuller: 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-7.855	-3.445	-2.873	-2.570

MacKinnon approximate p-value for Z(t) = 0.0000

Phillips-Perron test for unit root — Number of obs = 434; Newey-West lags = 5

	Test Statistic	Interpolated Dickey-Fuller: 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-99.093	-20.447	-14.000	-11.200
Z(t)	-7.558	-3.445	-2.873	-2.570

MacKinnon approximate p-value for Z(t) = 0.0000

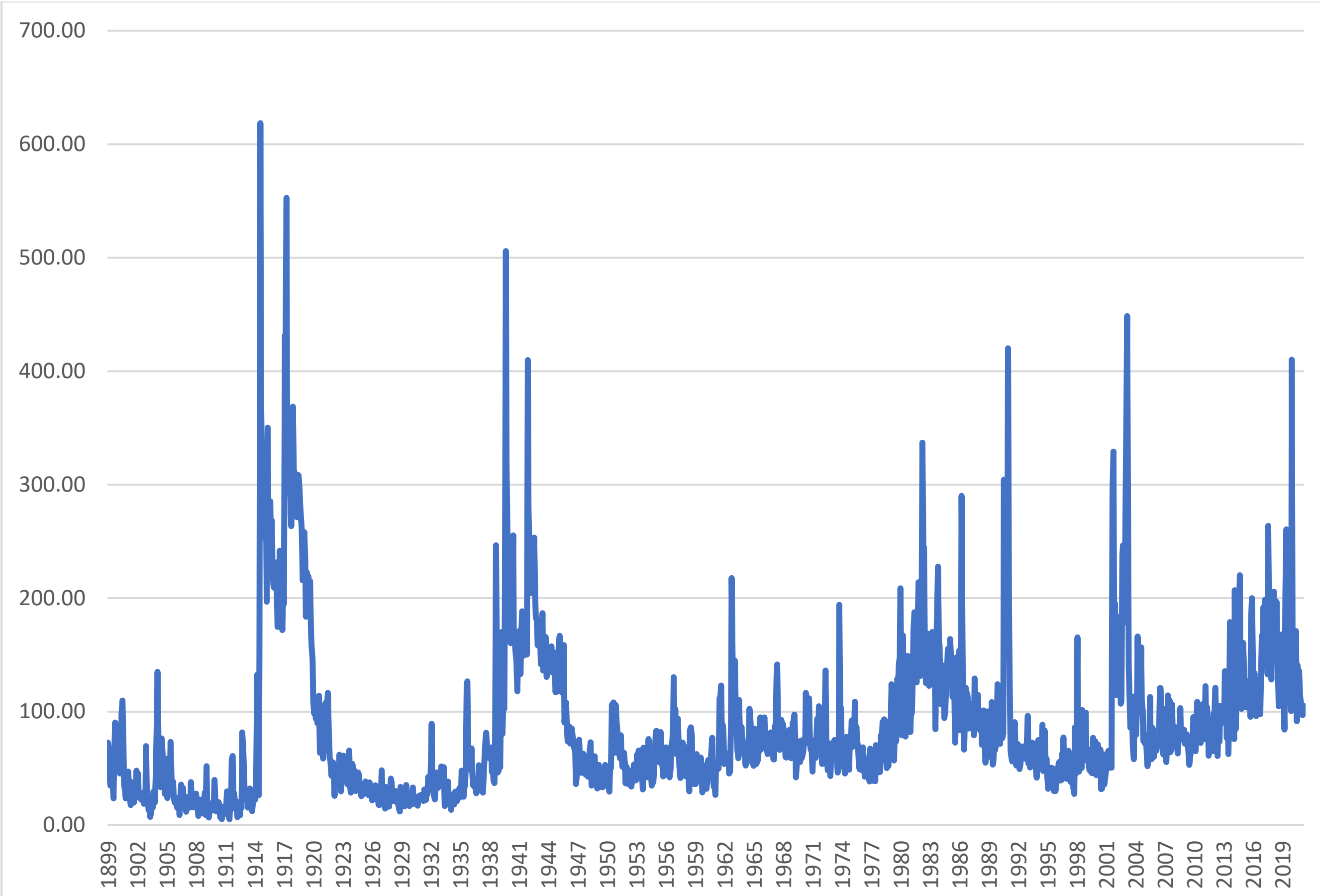
1555 *Geopolitical Risk (GPR) Index*. 2021. Accessibility: https://www.matteoiacoviello.com/gpr.htm#description (30 April 2021).

```
DF-GLS for gpr                                           Number of obs =   417
Maxlag = 17 chosen by Schwert criterion

               DF-GLS tau      1% Critical       5% Critical      10% Critical
  [lags]     Test Statistic        Value             Value             Value
------------------------------------------------------------------------------
    17           -2.973           -3.480            -2.819            -2.536
    16           -2.561           -3.480            -2.823            -2.541
    15           -2.650           -3.480            -2.828            -2.545
    14           -2.781           -3.480            -2.833            -2.549
    13           -2.992           -3.480            -2.837            -2.553
    12           -3.161           -3.480            -2.841            -2.557
    11           -3.202           -3.480            -2.846            -2.561
    10           -3.371           -3.480            -2.850            -2.565
    9            -3.884           -3.480            -2.854            -2.569
    8            -4.162           -3.480            -2.858            -2.572
    7            -4.254           -3.480            -2.862            -2.576
    6            -4.418           -3.480            -2.866            -2.579
    5            -4.684           -3.480            -2.869            -2.583
    4            -4.493           -3.480            -2.873            -2.586
    3            -5.260           -3.480            -2.876            -2.589
    2            -6.067           -3.480            -2.880            -2.592
    1            -7.525           -3.480            -2.883            -2.595

Opt Lag (Ng-Perron seq t) = 17 with RMSE  39.36841
Min SC   =  7.470212 at lag  2 with RMSE  40.99313
Min MAIC =  7.520881 at lag 15 with RMSE  39.86179
```

- Geopolitical Risk (GPRH Index)[1556]

Similarly constructed as the GPR, the Historical Index (GPRH) uses 3 newspapers (The New York Times, the Chicago Tribune, and the Washington Post) and starts in 1899.[1557]

[1556] Caldara, and Iacoviello. 2019.
[1557] *Geopolitical Risk (GPR) Index*. 2021.



Performing the unit root tests from 1945 onwards, i.e., from the start of US hegemony onwards, we get similar results as with GPR, the US hegemony is stable.

Dickey-Fuller test for unit root — Number of obs = 913

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-11.997	-3.430	-2.860	-2.570

MacKinnon approximate p-value for Z(t) = 0.0000

```
Phillips-Perron test for unit root                Number of obs   =       913
                                                  Newey-West lags =         6

                         ---------- Interpolated Dickey-Fuller ----------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(rho)        -244.218          -20.700           -14.100           -11.300
 Z(t)           -11.917           -3.430            -2.860            -2.570
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0000
```

```
DF-GLS for gprh                                          Number of obs =   893
Maxlag = 20 chosen by Schwert criterion

               DF-GLS tau      1% Critical       5% Critical      10% Critical
  [lags]     Test Statistic        Value             Value             Value
------------------------------------------------------------------------------
    20           -2.388           -3.480            -2.827            -2.542
    19           -2.382           -3.480            -2.829            -2.544
    18           -2.208           -3.480            -2.831            -2.546
    17           -2.117           -3.480            -2.833            -2.547
    16           -2.089           -3.480            -2.835            -2.549
    15           -2.240           -3.480            -2.836            -2.551
    14           -2.370           -3.480            -2.838            -2.552
    13           -2.587           -3.480            -2.840            -2.554
    12           -2.625           -3.480            -2.842            -2.555
    11           -2.660           -3.480            -2.843            -2.557
    10           -2.874           -3.480            -2.845            -2.558
    9            -3.162           -3.480            -2.847            -2.560
    8            -3.404           -3.480            -2.848            -2.561
    7            -3.679           -3.480            -2.850            -2.563
    6            -3.781           -3.480            -2.852            -2.564
    5            -3.966           -3.480            -2.853            -2.566
    4            -4.020           -3.480            -2.855            -2.567
    3            -4.646           -3.480            -2.856            -2.568
    2            -5.416           -3.480            -2.858            -2.570
    1            -6.477           -3.480            -2.859            -2.571

Opt Lag (Ng-Perron seq t) = 19 with RMSE  33.18138
Min SC   =  7.090899 at lag  4 with RMSE  34.00228
Min MAIC =   7.06103 at lag 16 with RMSE  33.30993
```

- Economic Policy Uncertainty Index[1558]

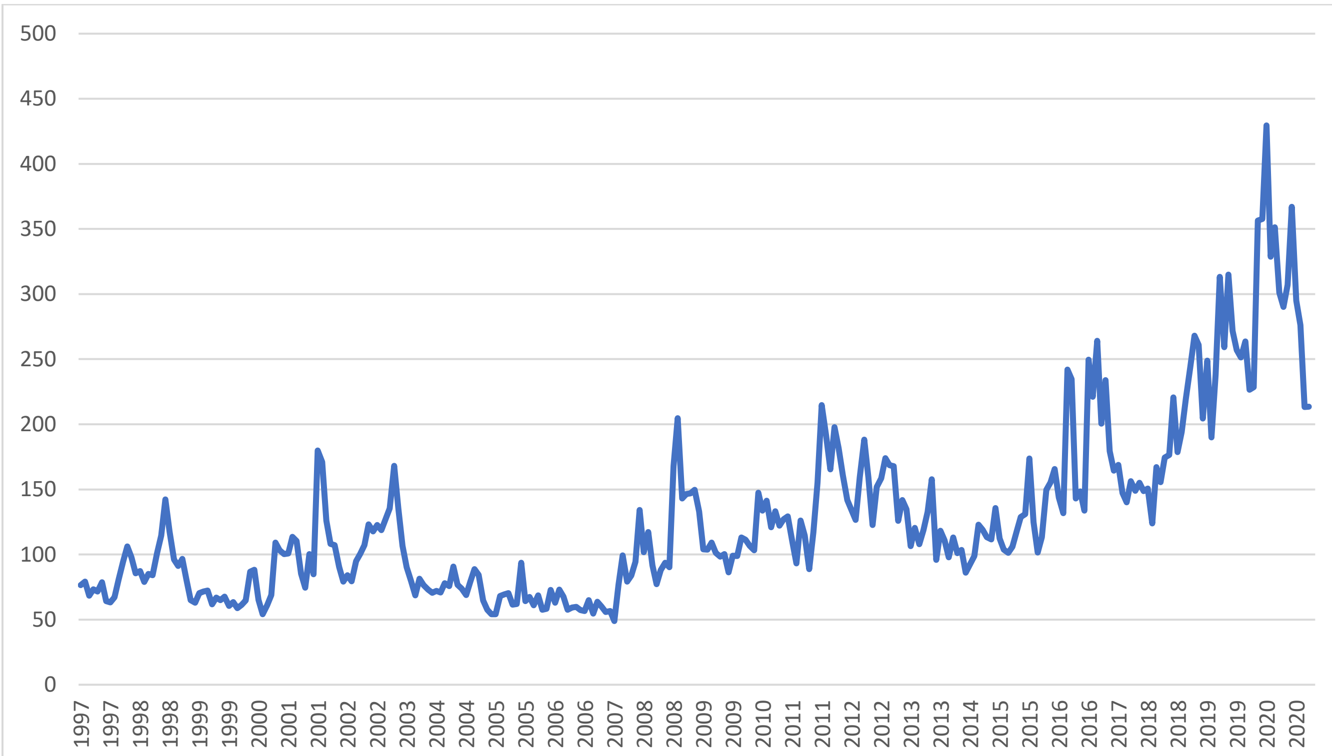
Economic Policy Uncertainty Index is also a country-based index, where 21 countries are included, which account about 71% of global output in PPP or 80% in terms of market adjusted exchange rates.[1559] In the case of United States, it "relies on ten leading newspapers: USA Today, Miami Herald, Chicago Tribune, Washington Post, Los Angeles Times, Boston Globe, San Francisco Chronicle, Dallas Morning News, New York Times, and Wall Street Journal."[1560] It starts with 1985, and it has two versions – one based on current-price GDP measures, and on based on PPP-adjusted GDP.[1561]

Among the policies assessed are: fiscal Policy (taxes, governmental spending), monetary policy, healthcare, national security, regulation (financial regulation), sovereign debt and currency crisis, trade policy, and entitlement policy.[1562] The higher the score the more political uncertainty, and the more uncertainty the less confidence. However, the crucial downside of the index is that it is country specific and country oriented. Although it offers a global mean the latter does not reflect the actual state of international system, since the international system is not just a sheer (weighted) amalgamation of the state the countries are in, but it rather has a life of its own.

[1558] Baker, Scott R., Nicholas Bloom, and Steven J. Davis. 2016. Measuring economic policy uncertainty. *The quarterly journal of economics*, 131(4). Pp. 1593–636.
[1559] *Global Economic Policy Uncertainty Index*. 2021. Accessibility: https://www.policyuncertainty.com/global_monthly.html (30 April 2021)
[1560] Baker, Bloom, and Davis. 2016. Pp. 1599.
[1561] *Global Economic Policy Uncertainty Index*. 2021.
[1562] Baker, Bloom, and Davis. 2016. Pp. 1603.

Performing the unit root tests on both versions of the index, we concluded that the index is stationary. Nevertheless, the results are less convincing as there are with other indexes.

Global Economic Policy Uncertainty Index, Current Price



Dickey-Fuller test for unit root   Number of obs = 290

	Test Statistic	——— Interpolated Dickey-Fuller ——— 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-3.446	-3.457	-2.878	-2.570

MacKinnon approximate p-value for Z(t) = 0.0095

Phillips-Perron test for unit root　　Number of obs = 290
Newey-West lags = 5

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-15.308	-20.332	-14.000	-11.200
Z(t)	-2.791	-3.457	-2.878	-2.570

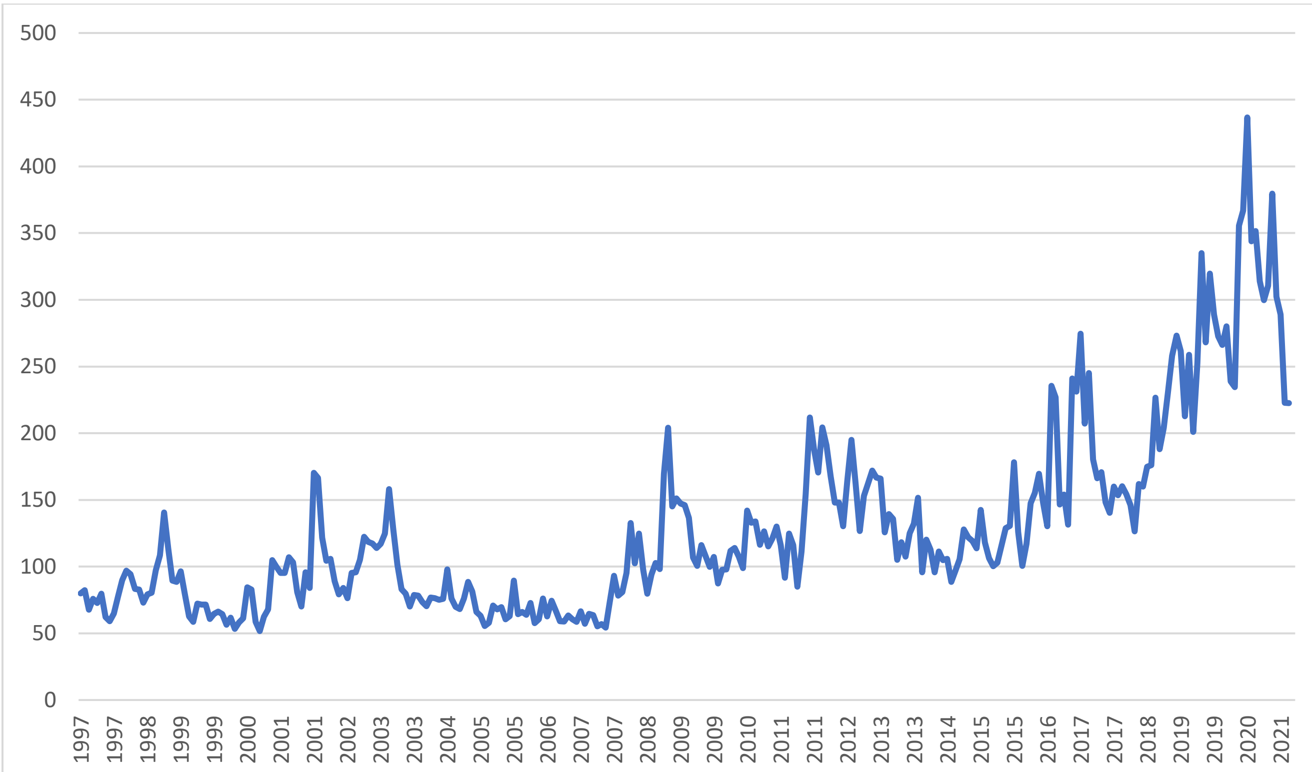
MacKinnon approximate p-value for Z(t) = 0.0596

DF-GLS for gepu_current　　Number of obs = 275
Maxlag = 15 chosen by Schwert criterion

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
15	-1.656	-3.480	-2.814	-2.534
14	-1.927	-3.480	-2.822	-2.541
13	-1.938	-3.480	-2.829	-2.548
12	-2.391	-3.480	-2.837	-2.555
11	-2.217	-3.480	-2.844	-2.562
10	-2.293	-3.480	-2.851	-2.568
9	-2.235	-3.480	-2.858	-2.574
8	-1.998	-3.480	-2.865	-2.581
7	-2.283	-3.480	-2.872	-2.586
6	-2.502	-3.480	-2.878	-2.592
5	-2.481	-3.480	-2.884	-2.598
4	-2.741	-3.480	-2.890	-2.603
3	-3.116	-3.480	-2.895	-2.608
2	-3.880	-3.480	-2.901	-2.613
1	-3.942	-3.480	-2.906	-2.617

Opt Lag (Ng-Perron seq t) = 13 with RMSE 25.46232
Min SC = 6.59724 at lag 1 with RMSE 26.52785
Min MAIC = 6.606606 at lag 8 with RMSE 25.83956

Global Economic Policy Uncertainty Index PPP




```
Dickey-Fuller test for unit root                   Number of obs   =       290

                       ---------- Interpolated Dickey-Fuller ---------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(t)             -3.220            -3.457            -2.878            -2.570
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0188
```

```
Phillips-Perron test for unit root                 Number of obs   =       290
                                                   Newey-West lags =         5

                              ---------- Interpolated Dickey-Fuller ----------
                  Test          1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(rho)          -12.971           -20.332           -14.000           -11.200
 Z(t)             -2.541            -3.457            -2.878            -2.570
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.1059
```

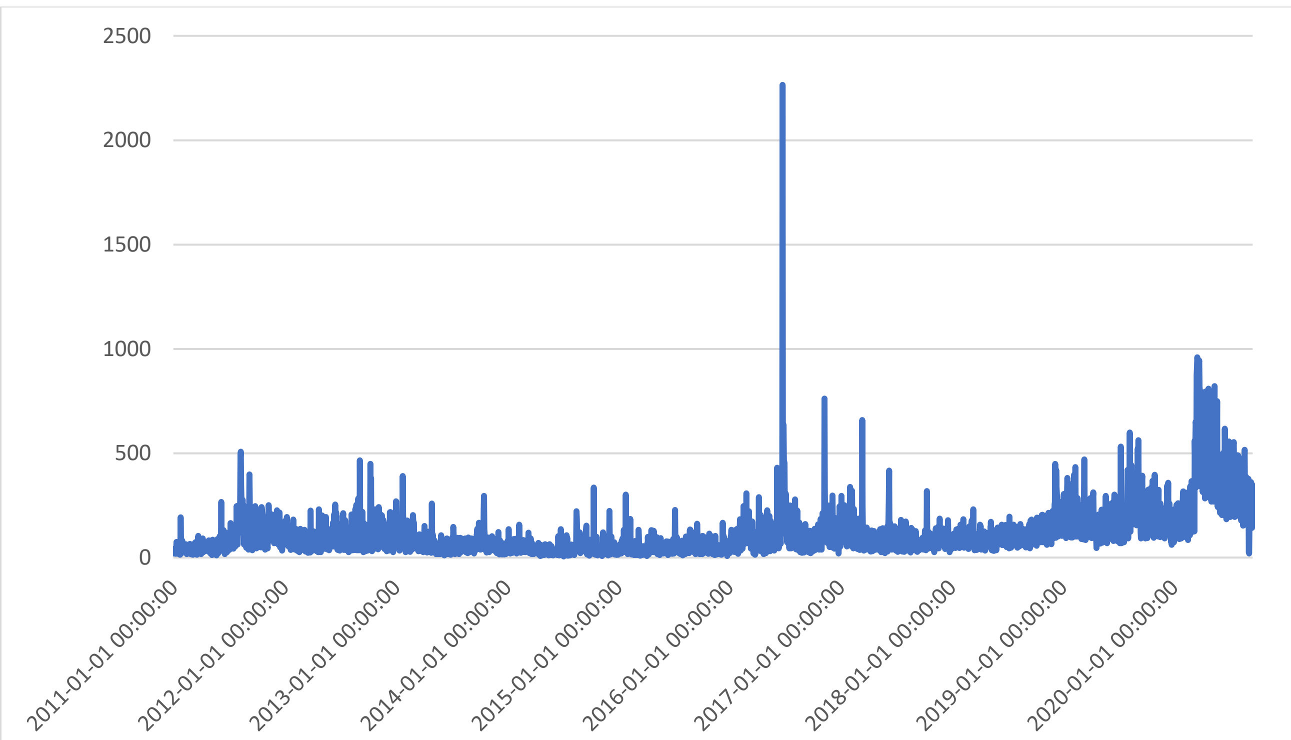
```
DF-GLS for gepu_ppp                                     Number of obs =   275
Maxlag = 15 chosen by Schwert criterion

               DF-GLS tau      1% Critical       5% Critical      10% Critical
  [lags]     Test Statistic        Value             Value             Value
------------------------------------------------------------------------------
    15           -1.757           -3.480            -2.814            -2.534
    14           -2.008           -3.480            -2.822            -2.541
    13           -2.003           -3.480            -2.829            -2.548
    12           -2.405           -3.480            -2.837            -2.555
    11           -2.224           -3.480            -2.844            -2.562
    10           -2.094           -3.480            -2.851            -2.568
    9            -2.077           -3.480            -2.858            -2.574
    8            -1.870           -3.480            -2.865            -2.581
    7            -2.146           -3.480            -2.872            -2.586
    6            -2.334           -3.480            -2.878            -2.592
    5            -2.204           -3.480            -2.884            -2.598
    4            -2.582           -3.480            -2.890            -2.603
    3            -2.981           -3.480            -2.895            -2.608
    2            -3.572           -3.480            -2.901            -2.613
    1            -3.749           -3.480            -2.906            -2.617

Opt Lag (Ng-Perron seq t) = 13 with RMSE  25.15449
Min SC   =  6.571525 at lag  1 with RMSE  26.18896
Min MAIC =  6.571451 at lag  5 with RMSE  25.63856
```

- Twitter-based Uncertainty Indices

Twitter-based Economic Uncertainty (TEU) Index and a new Twitter-based Market Uncertainty (TMU) Index cover all English-language tweets, including from users located outside the United States from 2010.[1563]

The key downside of the index is rather obvious – it is limited only to the twitter users. Performing unit root tests on both versions – TEU and TMU – we get the same result: both time series are stationary.

TEU



1563 *Twitter-based Economic Uncertainty*. 2021. Accessibility: https://www.policyuncertainty.com/twitter_uncert.html (30 March 2021).

Dickey-Fuller test for unit root   Number of obs   =   3545

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(t)	-21.625	-3.430	-2.860	-2.570

MacKinnon approximate p-value for Z(t) = 0.0000

Phillips-Perron test for unit root   Number of obs   =   3545
Newey-West lags =   8

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-833.128	-20.700	-14.100	-11.300
Z(t)	-21.682	-3.430	-2.860	-2.570

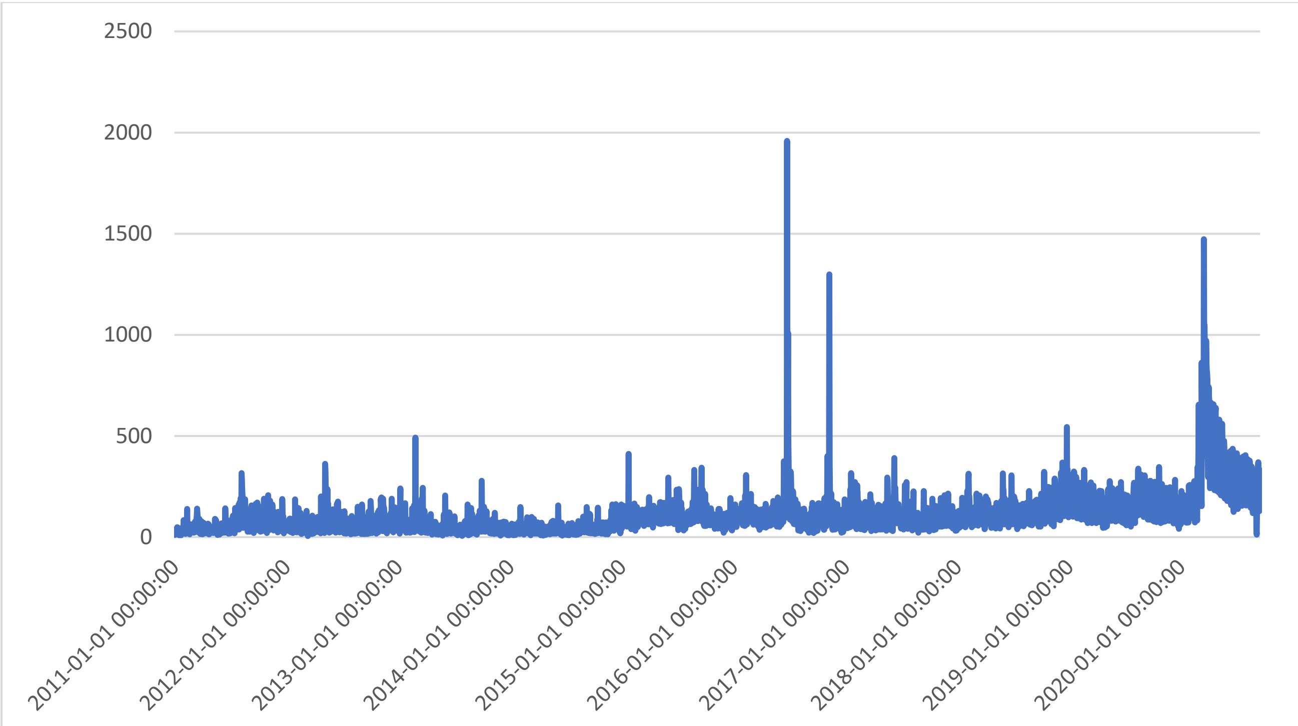
MacKinnon approximate p-value for Z(t) = 0.0000

```
DF-GLS for teu                                          Number of obs =  3516
Maxlag = 29 chosen by Schwert criterion
```

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
29	-3.784	-3.480	-2.833	-2.546
28	-3.707	-3.480	-2.833	-2.546
27	-3.596	-3.480	-2.833	-2.546
26	-4.042	-3.480	-2.834	-2.547
25	-4.314	-3.480	-2.834	-2.547
24	-4.348	-3.480	-2.835	-2.548
23	-4.381	-3.480	-2.835	-2.548
22	-4.270	-3.480	-2.835	-2.548
21	-3.945	-3.480	-2.836	-2.549
20	-3.926	-3.480	-2.836	-2.549
19	-4.557	-3.480	-2.837	-2.549
18	-5.019	-3.480	-2.837	-2.550
17	-4.874	-3.480	-2.837	-2.550
16	-4.949	-3.480	-2.838	-2.550
15	-4.956	-3.480	-2.838	-2.551
14	-4.519	-3.480	-2.839	-2.551
13	-4.327	-3.480	-2.839	-2.551
12	-5.329	-3.480	-2.839	-2.552
11	-6.227	-3.480	-2.840	-2.552
10	-6.268	-3.480	-2.840	-2.552
9	-6.380	-3.480	-2.840	-2.553
8	-6.056	-3.480	-2.841	-2.553
7	-5.448	-3.480	-2.841	-2.553
6	-5.410	-3.480	-2.842	-2.554
5	-7.321	-3.480	-2.842	-2.554
4	-10.852	-3.480	-2.842	-2.554
3	-13.946	-3.480	-2.843	-2.555
2	-16.034	-3.480	-2.843	-2.555
1	-20.193	-3.480	-2.843	-2.555

```
Opt Lag (Ng-Perron seq t) = 28 with RMSE   61.0302
Min SC   =  8.288802 at lag 27 with RMSE  61.06198
Min MAIC =  8.252465 at lag 27 with RMSE  61.06198
```

TMU




```
Dickey-Fuller test for unit root                    Number of obs   =      3545

                               ---------- Interpolated Dickey-Fuller ---------
                  Test         1% Critical       5% Critical      10% Critical
               Statistic           Value             Value             Value
------------------------------------------------------------------------------
 Z(t)            -22.833            -3.430            -2.860            -2.570
------------------------------------------------------------------------------
MacKinnon approximate p-value for Z(t) = 0.0000
```

Phillips-Perron test for unit root

Number of obs = 3545
Newey-West lags = 8

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-966.666	-20.700	-14.100	-11.300
Z(t)	-23.425	-3.430	-2.860	-2.570

MacKinnon approximate p-value for Z(t) = 0.0000

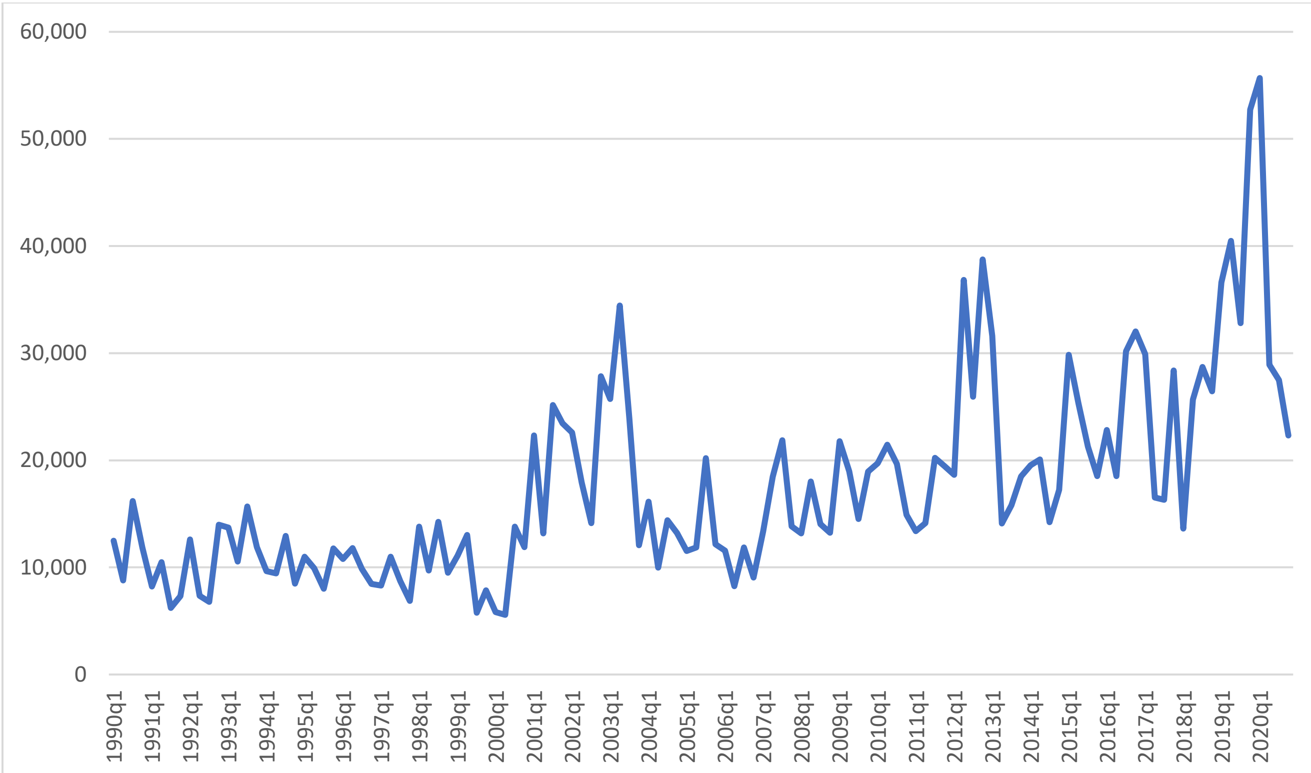
```
DF-GLS for tmu                                          Number of obs =  3516
Maxlag = 29 chosen by Schwert criterion

               DF-GLS tau      1% Critical       5% Critical      10% Critical
  [lags]     Test Statistic        Value             Value             Value
------------------------------------------------------------------------------
    29           -5.517           -3.480            -2.833            -2.546
    28           -5.282           -3.480            -2.833            -2.546
    27           -5.043           -3.480            -2.833            -2.546
    26           -5.487           -3.480            -2.834            -2.547
    25           -5.833           -3.480            -2.834            -2.547
    24           -6.018           -3.480            -2.835            -2.548
    23           -6.086           -3.480            -2.835            -2.548
    22           -5.863           -3.480            -2.835            -2.548
    21           -5.428           -3.480            -2.836            -2.549
    20           -5.202           -3.480            -2.836            -2.549
    19           -5.899           -3.480            -2.837            -2.549
    18           -6.373           -3.480            -2.837            -2.550
    17           -6.594           -3.480            -2.837            -2.550
    16           -6.646           -3.480            -2.838            -2.550
    15           -6.361           -3.480            -2.838            -2.551
    14           -5.652           -3.480            -2.839            -2.551
    13           -5.230           -3.480            -2.839            -2.551
    12           -6.217           -3.480            -2.839            -2.552
    11           -7.069           -3.480            -2.840            -2.552
    10           -7.256           -3.480            -2.840            -2.552
    9            -8.001           -3.480            -2.840            -2.553
    8            -7.773           -3.480            -2.841            -2.553
    7            -6.620           -3.480            -2.841            -2.553
    6            -6.000           -3.480            -2.842            -2.554
    5            -8.934           -3.480            -2.842            -2.554
    4           -13.075           -3.480            -2.842            -2.554
    3           -15.805           -3.480            -2.843            -2.555
    2           -17.397           -3.480            -2.843            -2.555
    1           -22.366           -3.480            -2.843            -2.555

Opt Lag (Ng-Perron seq t) = 29 with RMSE  57.60381
Min SC   =   8.17679 at lag 28 with RMSE  57.66915
Min MAIC =    8.1592 at lag 27 with RMSE  57.74135
```

- World Uncertainty Index[1564]

The World Uncertainty Index is a new measure that tracks uncertainty across the globe by text mining the country reports of the Economist Intelligence Unit. The index is available for 143 countries. Yet, it also offers an overall global uncertainty variable. The latter is unbalanced GDP weighted average for 142 countries.[1565]

The higher the index, the more uncertainty and the less confidence would there be in a system. However, its major downside is that it measures the situation in a country not in a system. Running the unit root tests for stationarity, the results are persuasive that the time series is stationary. Hence, the uncertainty does not have an upward trend.

[1564] *World Uncertainty Index*. 2021. Accessibility: https://worlduncertaintyindex.com/ (30 April 2021).
[1565] Ahir, Hites, Nicholas Bloom, and Davide Furceri. 2018. *The world uncertainty index*. Accessibility: https://www.policyuncertainty.com/media/WUI_mimeo_10_29.pdf (30 April 2021).




```
Dickey-Fuller test for unit root                     Number of obs   =       123
```

	Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
		Interpolated Dickey-Fuller		
Z(t)	-4.340	-3.502	-2.888	-2.578

MacKinnon approximate p-value for Z(t) = 0.0004

Phillips-Perron test for unit root

Number of obs = 123
Newey-West lags = 4

	Test Statistic	Interpolated Dickey-Fuller 1% Critical Value	5% Critical Value	10% Critical Value
Z(rho)	-30.610	-19.877	-13.746	-11.031
Z(t)	-4.196	-3.502	-2.888	-2.578

MacKinnon approximate p-value for Z(t) = 0.0007

DF-GLS for wui

Number of obs = 111

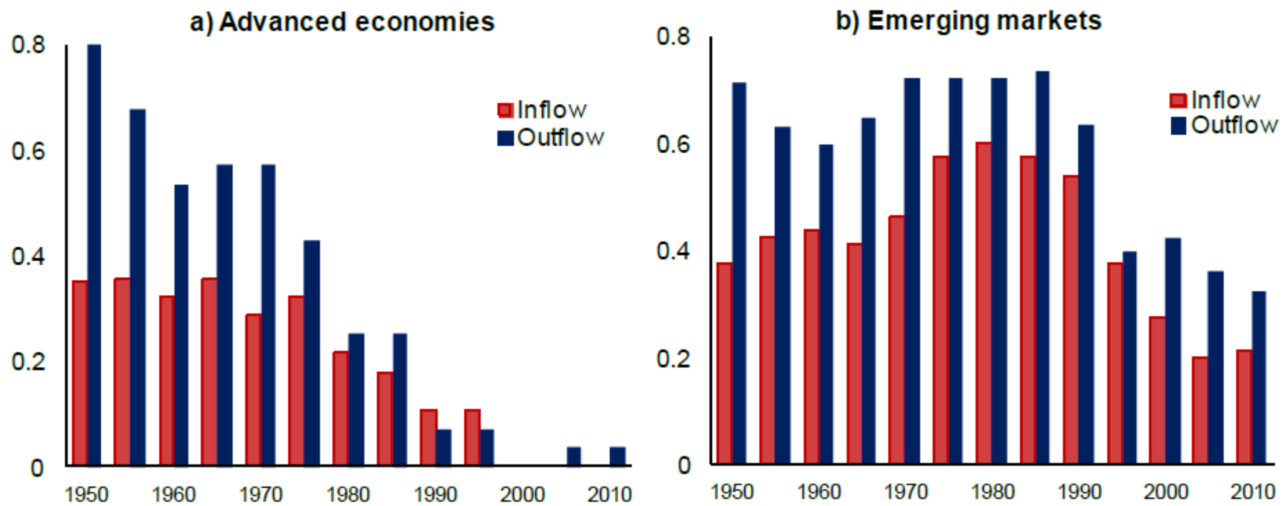
Maxlag = 12 chosen by Schwert criterion

[lags]	DF-GLS tau Test Statistic	1% Critical Value	5% Critical Value	10% Critical Value
12	-2.230	-3.551	-2.782	-2.508
11	-2.211	-3.551	-2.806	-2.530
10	-2.184	-3.551	-2.829	-2.552
9	-2.289	-3.551	-2.852	-2.574
8	-2.298	-3.551	-2.874	-2.594
7	-3.088	-3.551	-2.895	-2.614
6	-3.180	-3.551	-2.916	-2.632
5	-3.248	-3.551	-2.935	-2.650
4	-3.506	-3.551	-2.953	-2.666
3	-4.245	-3.551	-2.970	-2.682
2	-3.872	-3.551	-2.985	-2.696
1	-4.445	-3.551	-2.999	-2.708

Opt Lag (Ng-Perron seq t) = 8 with RMSE 5888.696
Min SC = 17.51161 at lag 1 with RMSE 6083.744
Min MAIC = 17.88075 at lag 2 with RMSE 6076.126

APPENDIX 7

Capital Controls in Advanced and Emerging Market Economies, 1950-2010[1566]



Source: Authors' estimates based on IMF's AREAER (various issues).
Note: Advanced countries include the G7 countries (Canada, France, Germany, Italy, Japan, United Kingdom, and United States). Emerging markets include those that were IMF members in 1950 (Argentina, Brazil, Chile, Colombia, Ecuador, Egypt, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, South Africa, Thailand, Tunisia, Turkey, Uruguay, and Venezuela). Indices are averages for the country groups (where for each country, the restrictions are coded as 0: none, 0.25: mild, 0.75: significant, 1: extreme).

Regarding the differences in controls of the inflow and outflow of capital, Ghosh and Qureshi state:[1567]

> "Our reading of the history yields several conjectures why inflow controls now evoke such visceral opposition. The simplest explanation is that, in the minds of many, inflow and outflow controls have become inextricably linked. Traditionally, the latter were more prevalent, more stringent, and typically associated with autocratic and repressive regimes preventing capital flight; governments trying to prop up failed macroeconomic policies; and financial crisis. The word "controls" thus brings to mind outflow controls, and inflow measures are often damned by this "guilt by association." This is also obvious from some of the typical criticisms on inflow controls, which are actually much more pertinent to outflow controls (for instance, that they are persistent and pervasive; encourage poor macroeconomic

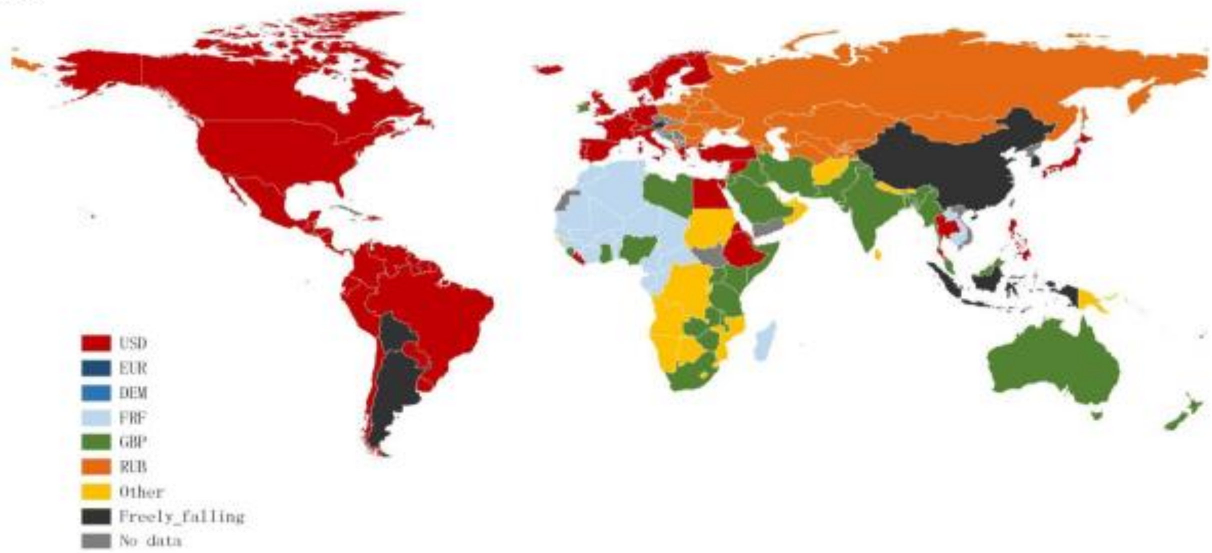
[1566] Ghosh, Atish R., and Mahvash Saeed Qureshi. 2016. *What's in a name? That which we call capital controls*. https://www.imf.org/external/pubs/ft/wp/2016/wp1625.pdf (16 April 2021). Pp. 17.
[1567] Ghosh and Qureshi. 2016. Pp. 37.

policies; and are ineffective). Thus, when countries embraced more market-friendly policies, and liberalized their capital accounts in the 1980s and 1990s, they often jettisoned both outflow and inflow controls at the same time, without fully taking into account prudential considerations."

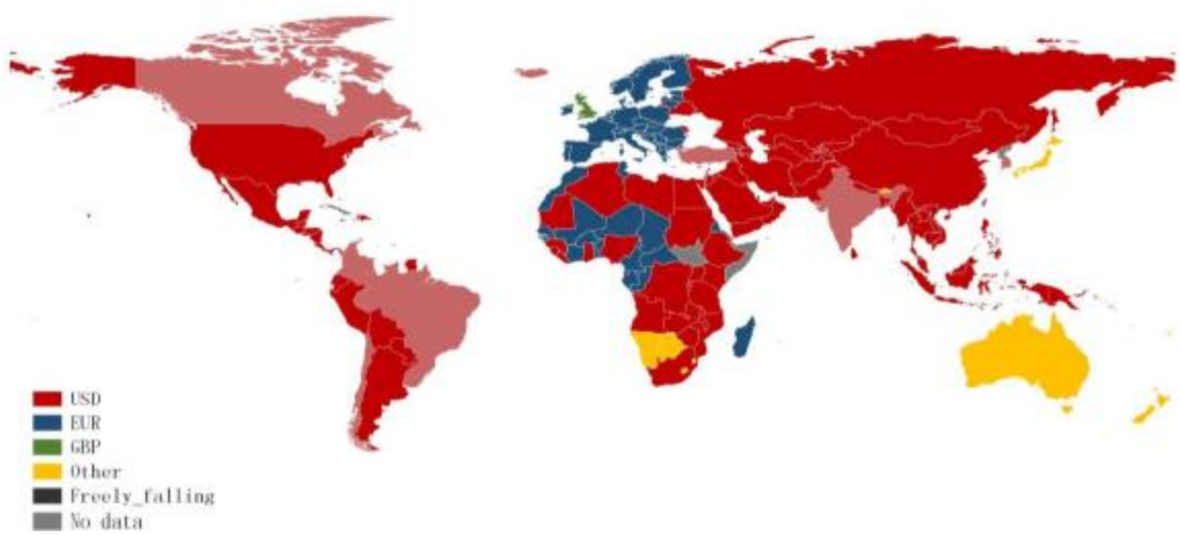
APPENDIX 8

1. The Geography of Anchor Currencies, 1950 and 2015[1568]

1950

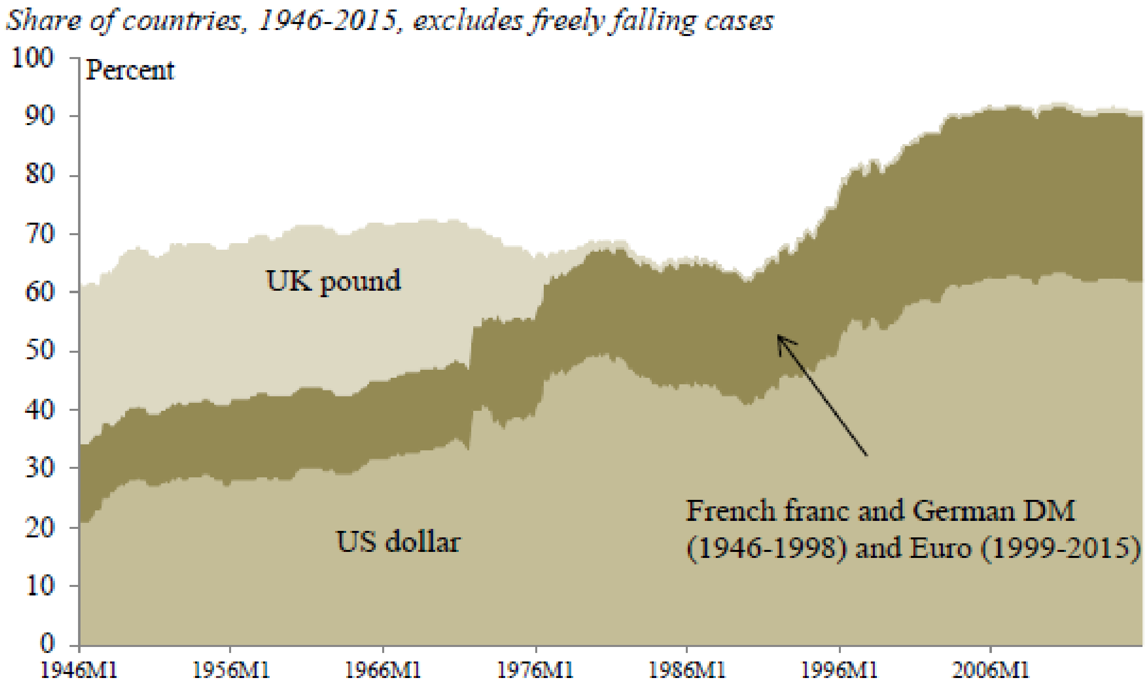


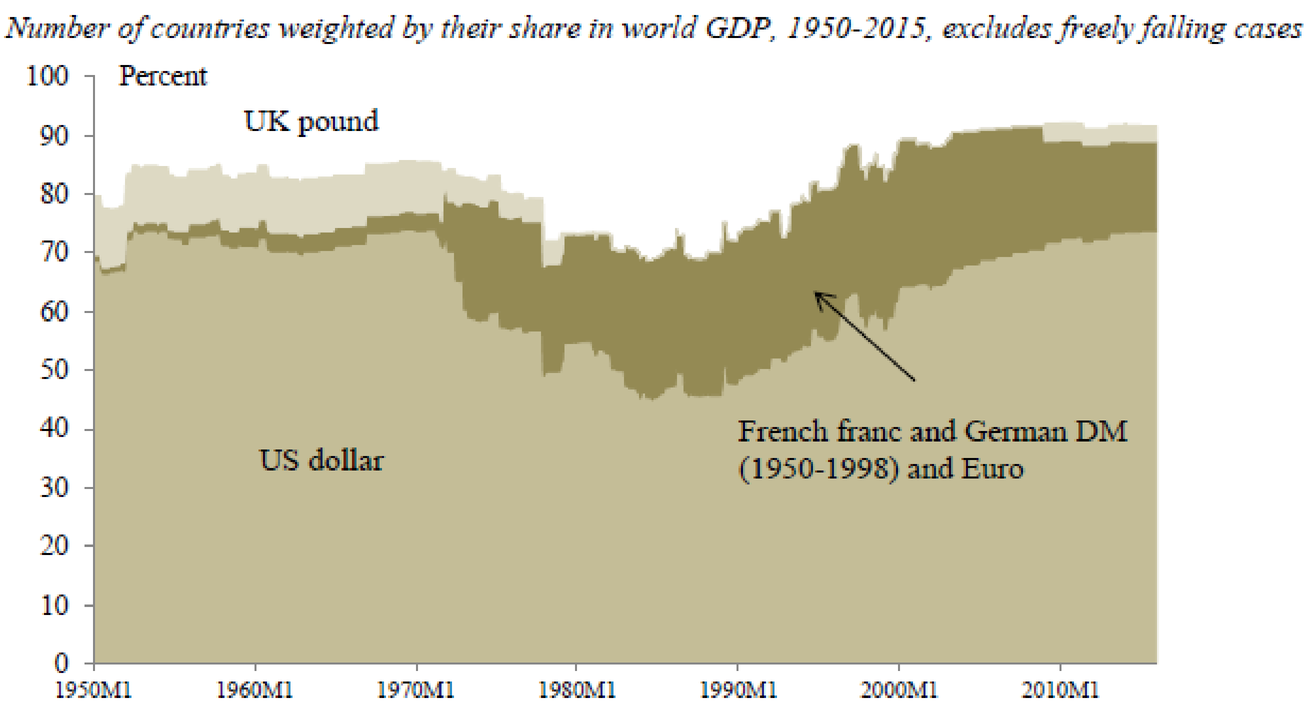
2015



1568 Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 27.

2. The Share of global anchor currencies since 1945[1569]

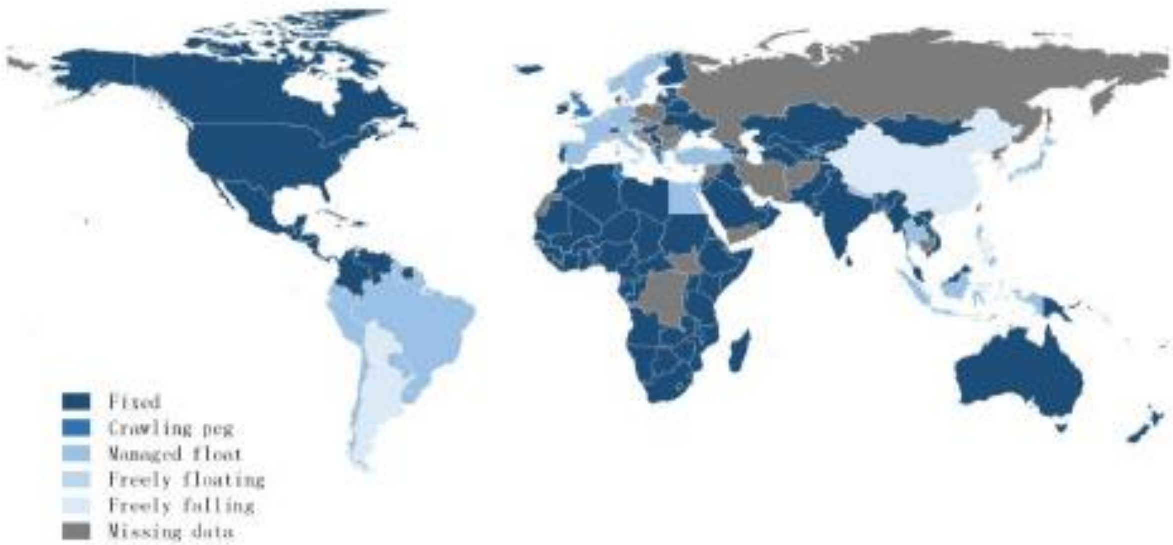




[1569] Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 28.

3. The Geography of Exchange Rate Arrangements, 1950 and 2015[1570]

1950

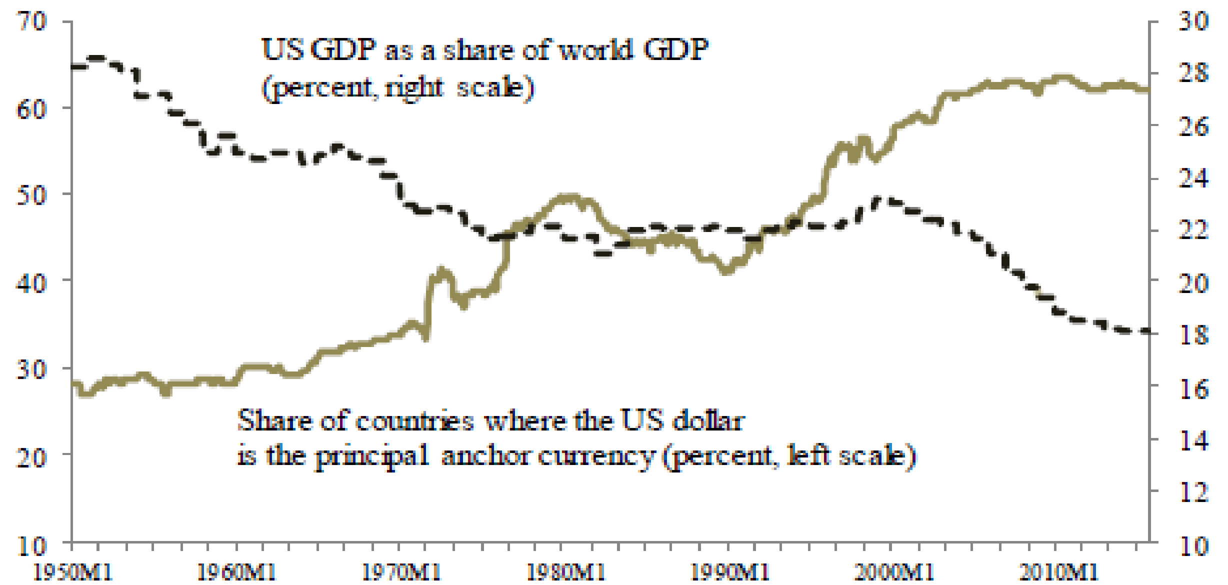


2015

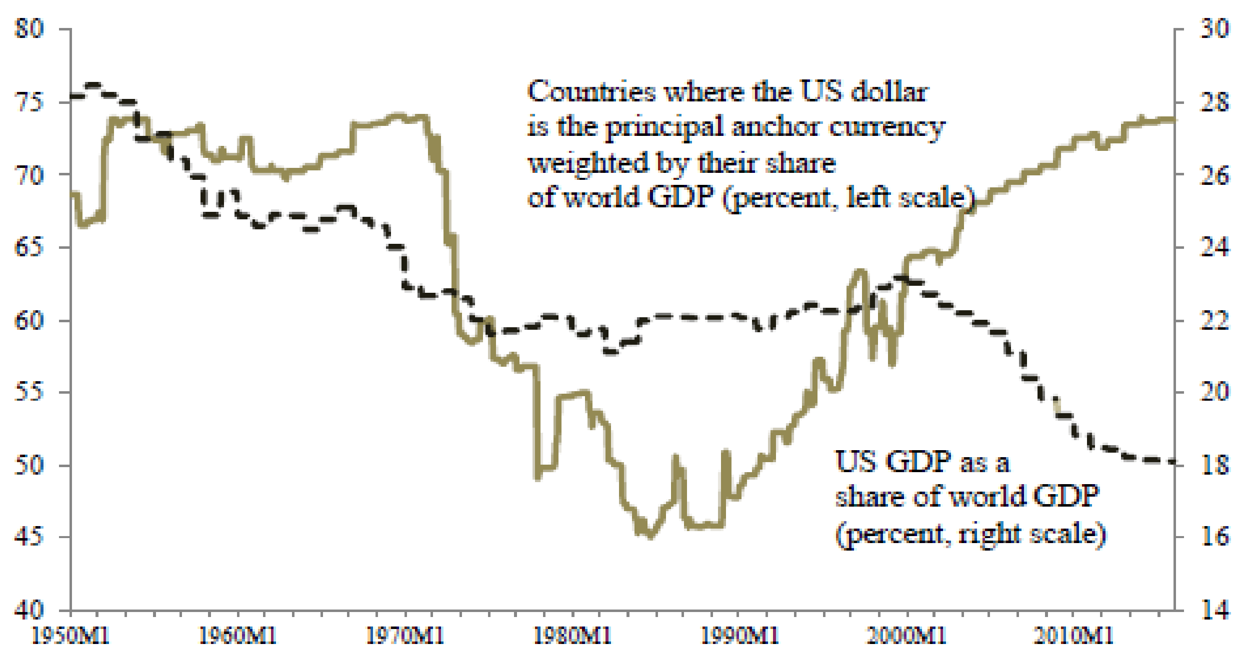
[1570] Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 34.

4. The Role of the Dollar and US Economy in a Global Context, 1950-2015[1571]

Share of countries measure

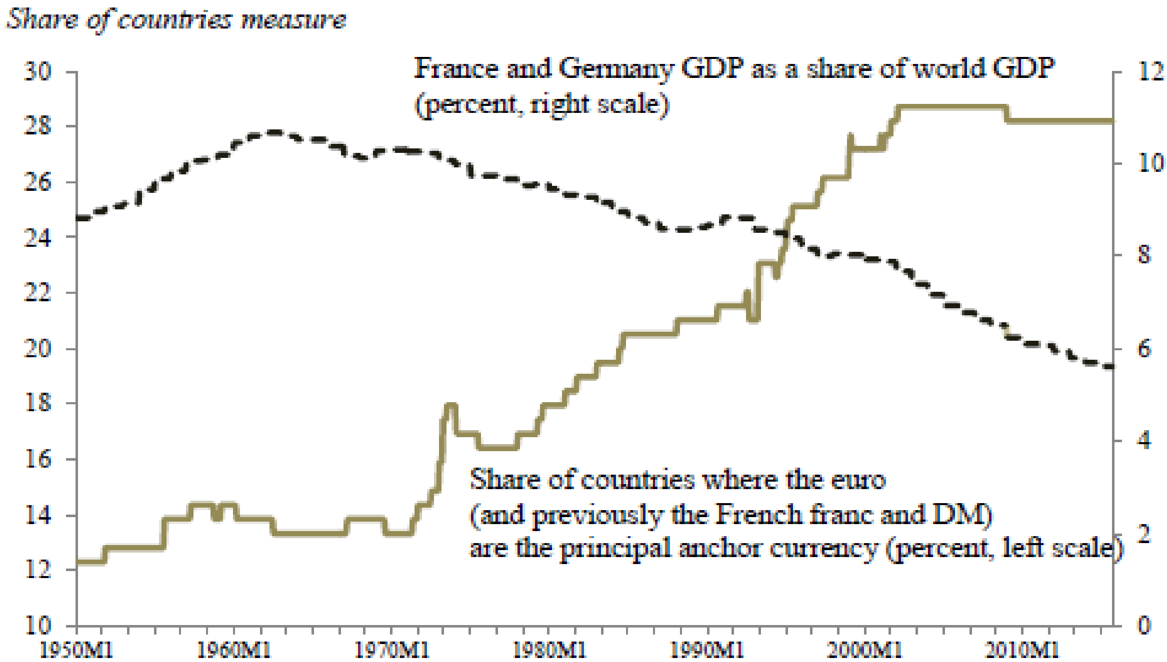


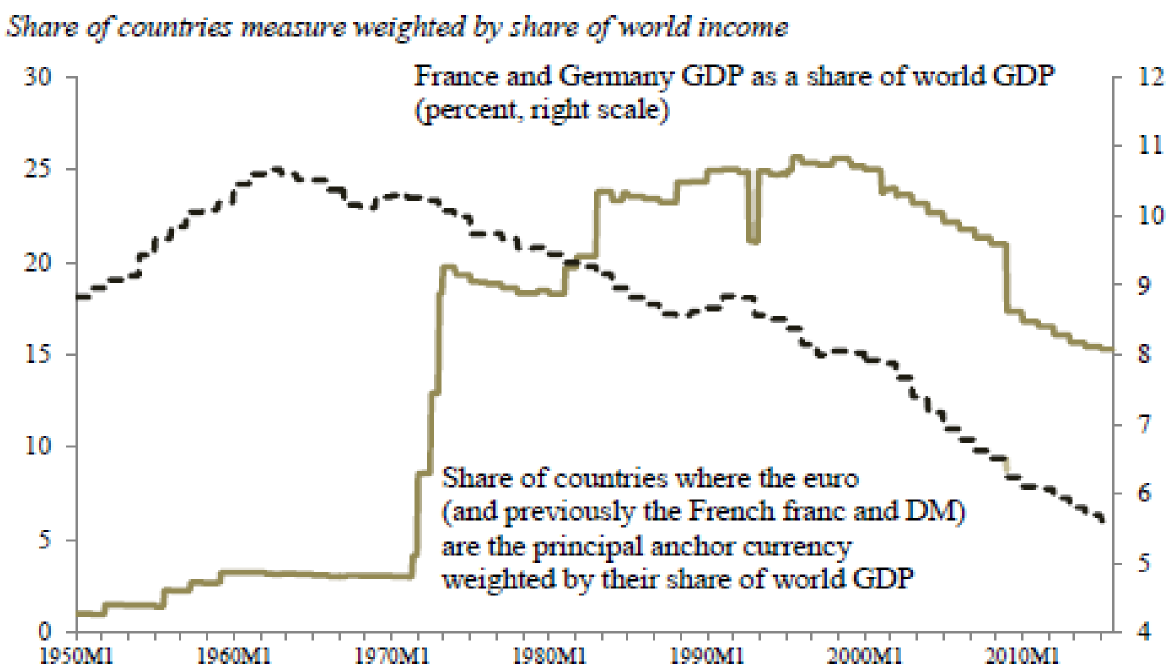
Share of countries measure weighted by share of world income



[1571] Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 56.

5. The Role of the French Franc, Deutschmark (1950-1998), and Euro (1999-2015) and their respective Economies in a Global Context 1950-2015[1572]

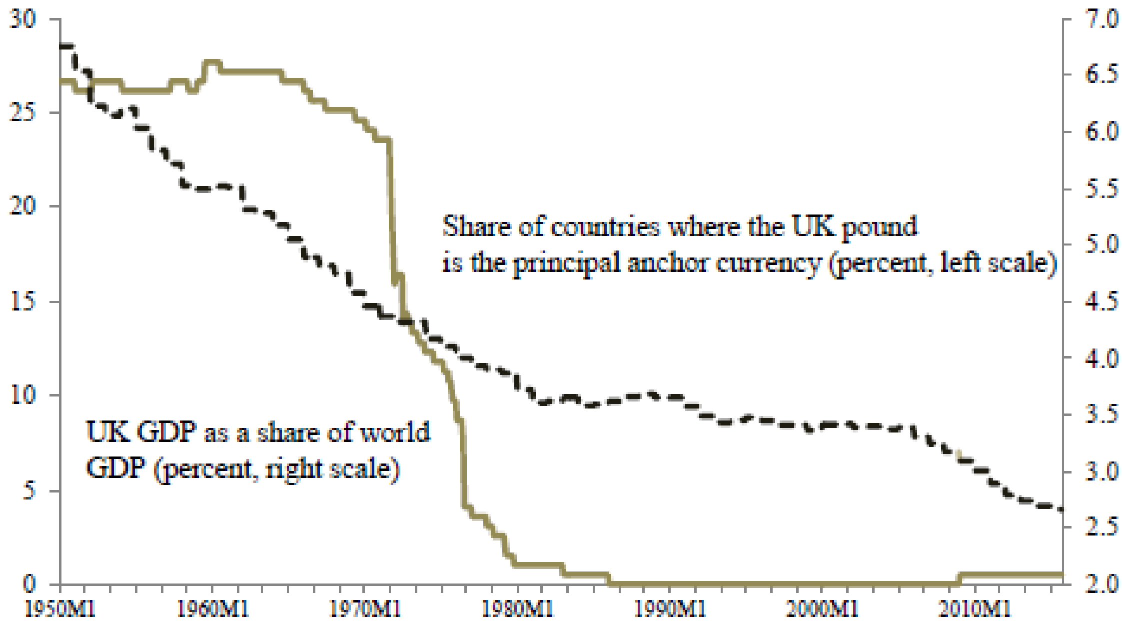




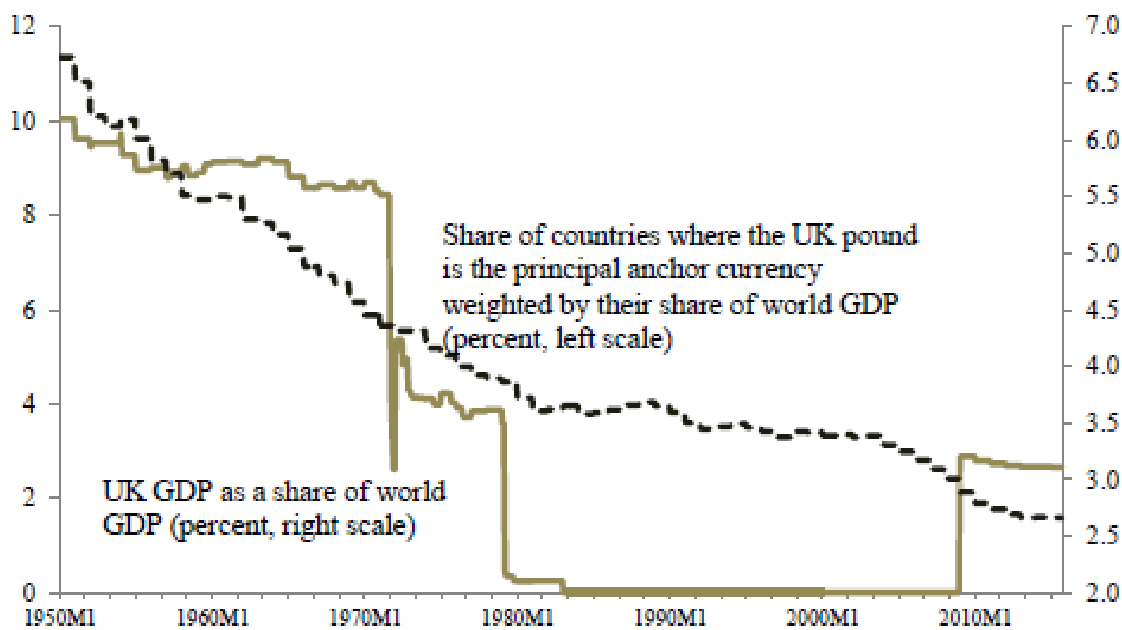
[1572] Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 57.

6. The Role of the Sterling and the UK Economy in a Global Context, 1950-2015[1573]

Share of countries measure



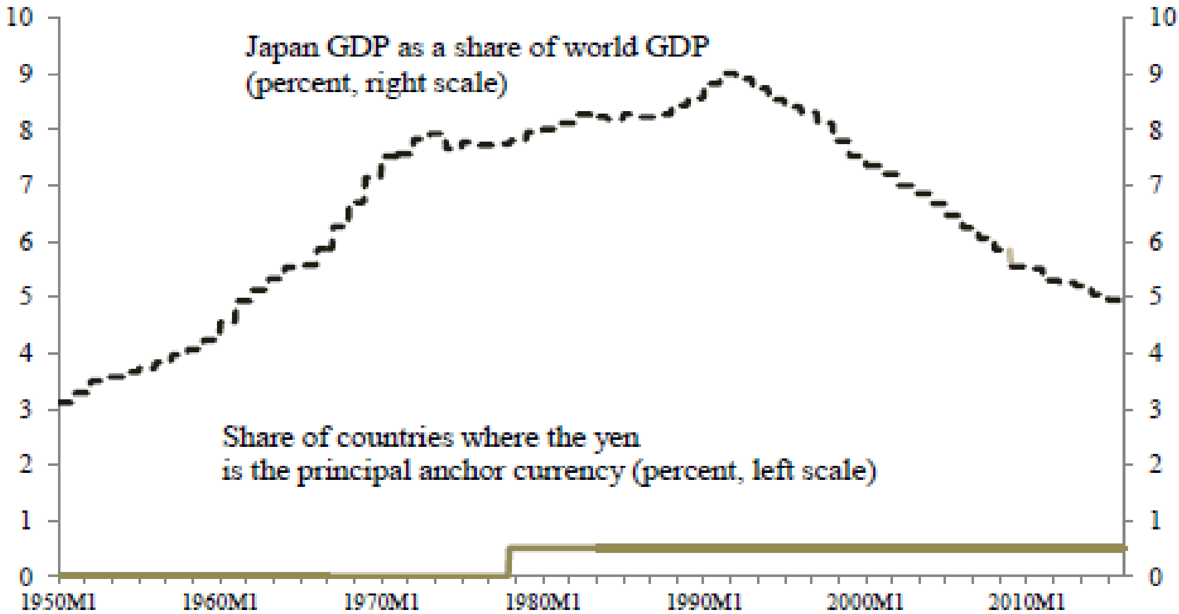
Share of countries measure weighted by share of world income



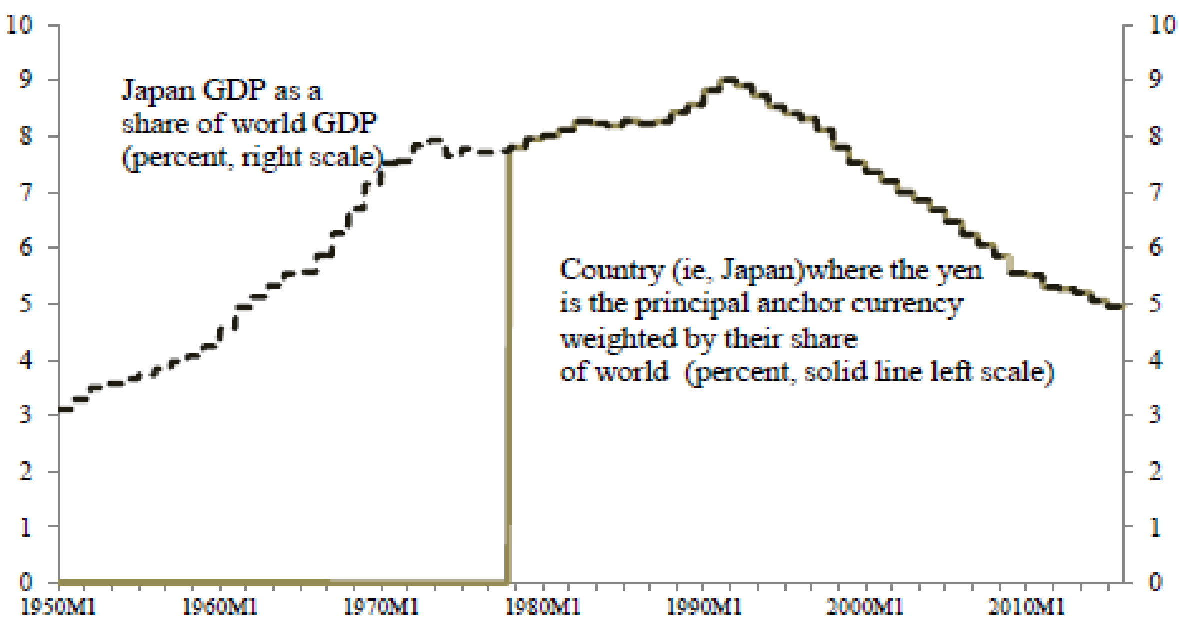
[1573] Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 58.

7. The Role of the Yen and the Japanese Economy in a Global Context, 1950-2015[1574]

Share of countries measure



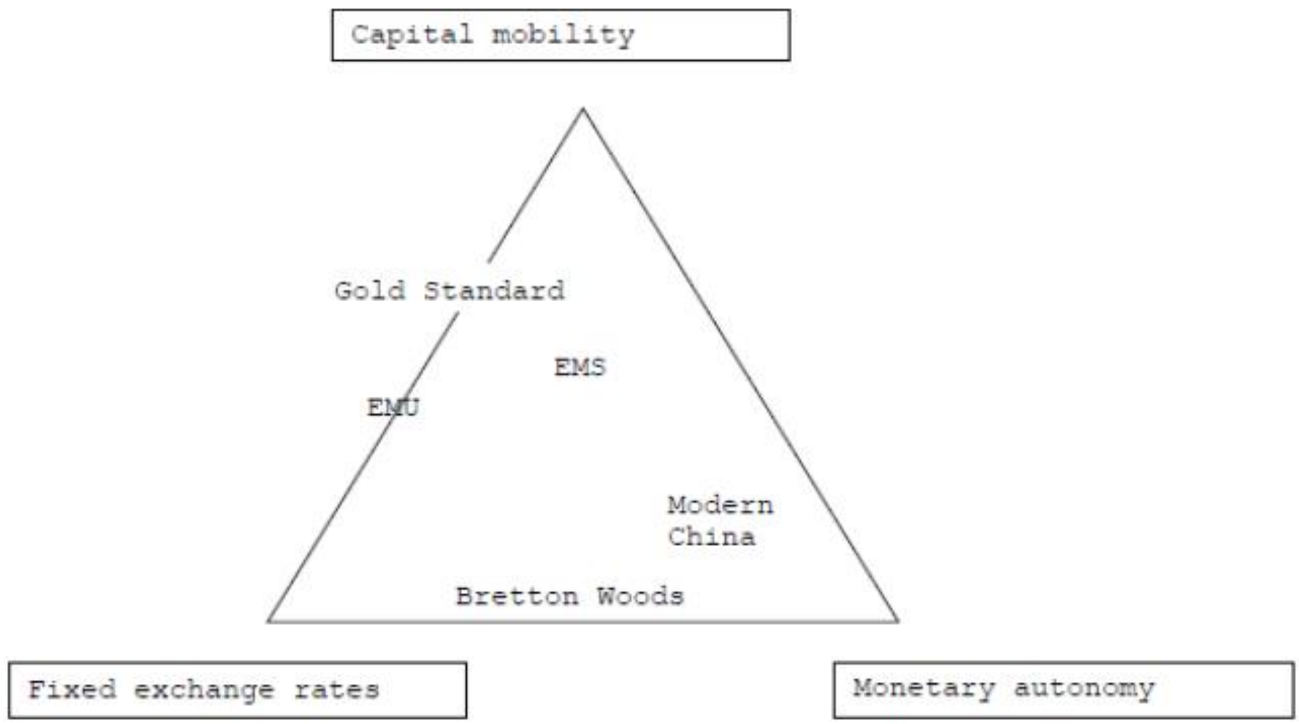
Share of countries measure weighted by share of world income



1574 Ilzetzki, Reinhart, and Rogoff. 2017. Pp. 59.

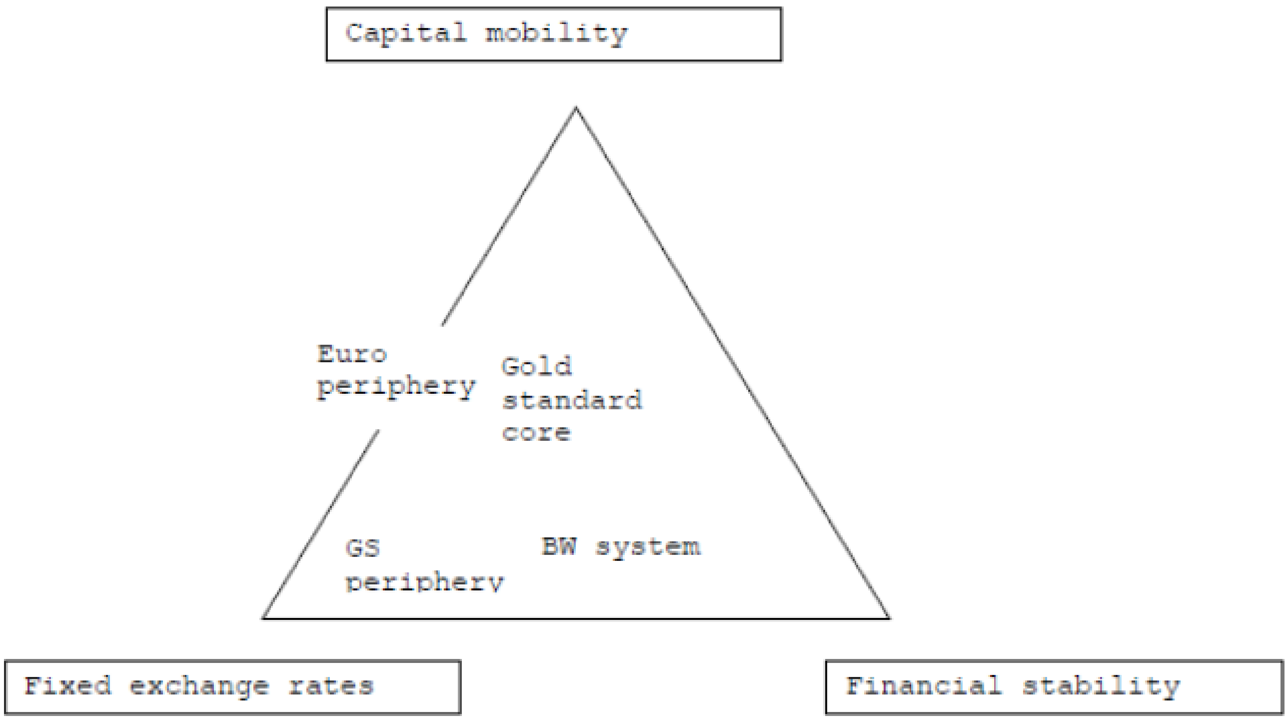
APPENDIX 9

1. Standard Monetary Trilemma[1575]



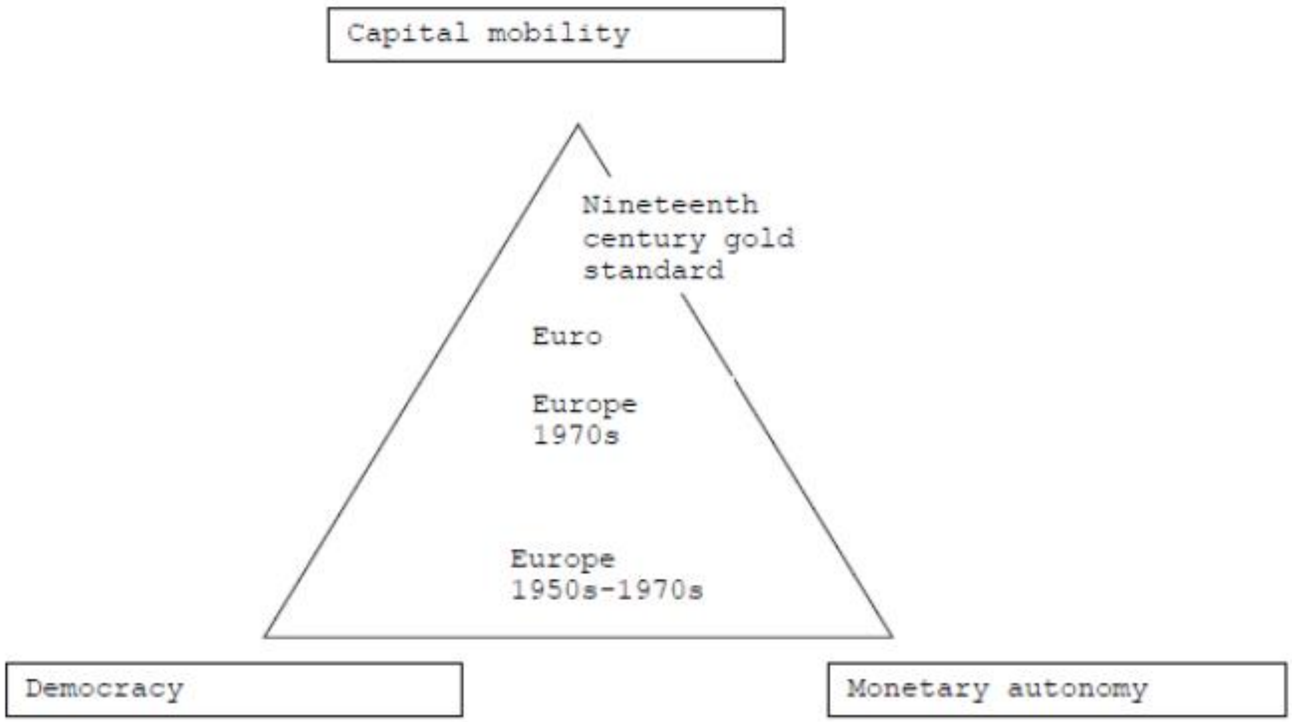
[1575] Bordo and James. 2015. Pp. 4.

2. The financial stability trilemma[1576]



[1576] Bordo and James. 2015. Pp. 11.

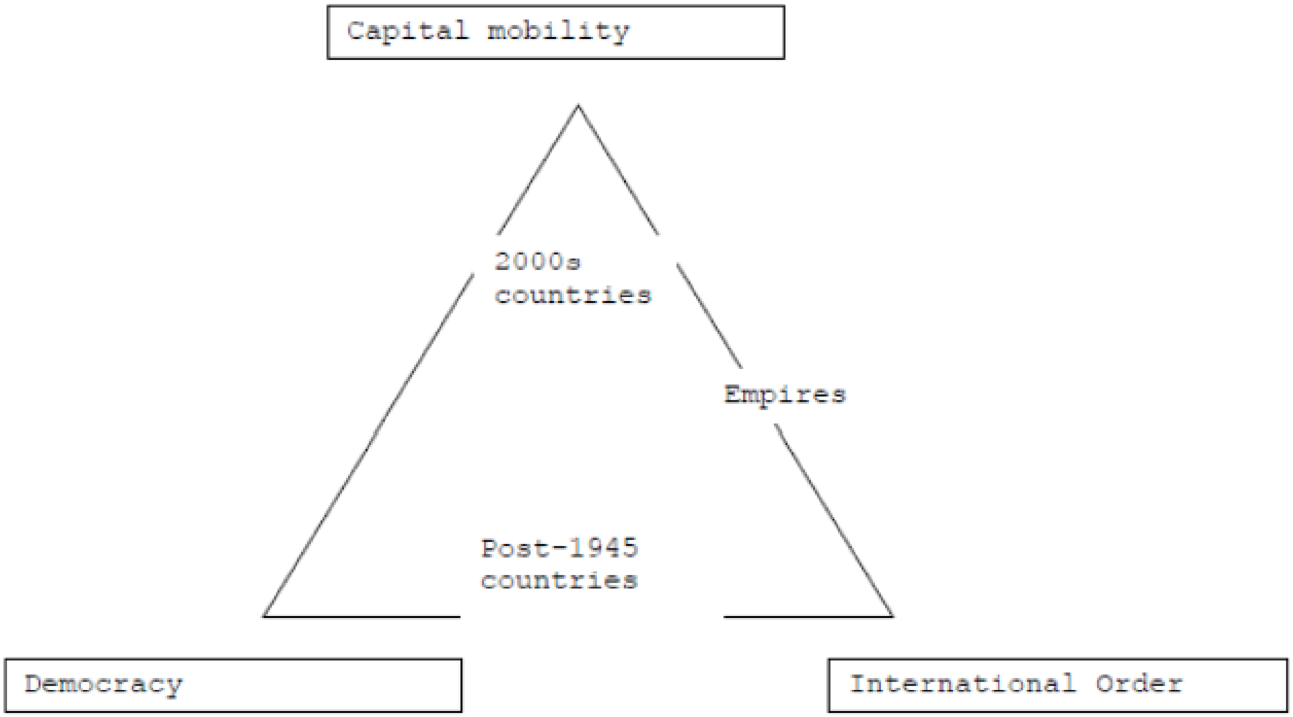
3. The political economy trilemma[1577]



I think that this is the least empirically persuasive extension of the monetary trilemma. Great Britain, United States, Switzerland, and also the Euro zone as an agent paint a different picture.

[1577] Bordo and James. 2015. Pp. 18.

4. The international relations trilemma[1578]



The experience with US hegemony contradicts this trilemma, as it assures all three corners. However, it may be the case that it is a unique type of international system, which is in fact the purpose of the Pervasive Hegemony Theory – show that US hegemony is different from what we have seen in the past.

[1578] Bordo and James. 2015. Pp. 22.

APPENDIX 10

An IMF study analyzed 6 scenarios of technological decoupling between great powers.[1579] Bottom line of these projections is that China is much more vulnerable to any type of decoupling under any conditions than United States. This speaks in favor of US hegemonic resilience and endurance.

1. Scenarios of technological decoupling

Scenario #	Global hubs	Preferential attachment by non-hub countries?
1	China | U.S.	No
2		Yes
3	China | OECD	No
4		Yes
5	China | U.S. | Germany	No
6		Yes

Notes: In all scenarios, non-tariff barriers are raised so as to nearly eliminate trade in high-tech sectors.

2. Output effects of these scenarios (potential output)

Hubs	Preferential attachment?	Country														
		Asia					Americas					Europe				
		CHN	JPN	KOR	MYS	VNM	USA	CAN	MEX	BRA	ARG	DEU	FRA	GBR	POL	CZE
China | U.S.	No	-0.6	0.1	0.1	0.4	0.0	-0.4	0.3	0.4	0.0	0.0	0.0	0.0	0.1	0.0	0.0
	Yes	-1.4	-1.0	-2.0	-1.5	-0.6	-0.7	0.1	0.8	-0.4	-0.5	-3.3	-1.5	-1.3	-1.2	1.8
China | OECD	No	-2.8	-0.7	-2.9	4.4	0.4	-0.3	-0.2	0.3	0.0	0.0	-0.9	-0.2	-0.2	-0.2	0.8
	Yes	-3.9	-0.6	-3.0	-0.5	-0.6	-0.3	-0.2	0.3	-0.1	-0.2	-0.5	-0.2	-0.2	-0.2	0.8
China | U.S. | Germany	No	-0.9	0.2	0.5	1.1	0.1	-0.4	0.4	0.6	0.0	0.0	-2.0	0.2	0.3	0.1	1.8
	Yes	-2.0	-1.1	-2.3	-2.1	-0.5	-0.9	-0.1	1.2	-0.7	-0.8	-2.7	-1.3	-2.5	-0.5	1.4

[1579] See Cerdeiro, Eugster, Mano, Muir, and Peiris. 2021.

3. Export effects of these scenarios (real exports)

Hubs	Preferential attachment?	Country														
		Asia					Americas					Europe				
		CHN	JPN	KOR	MYS	VNM	USA	CAN	MEX	BRA	ARG	DEU	FRA	GBR	POL	CZE
China | U.S.	No	-3.3	0.8	-0.1	0.8	-0.4	-3.4	1.5	3.4	0.1	0.2	0.0	0.1	0.4	0.2	0.0
	Yes	-6.5	-8.5	-5.8	0.3	5.1	-7.2	6.4	13.1	-2.9	-1.1	-9.5	-7.8	-6.6	-7.5	12.7
China | OECD	No	-14.3	-4.7	2.9	9.7	-3.9	-1.7	-0.8	3.5	1.5	0.2	-1.0	-0.8	-1.0	-1.1	1.7
	Yes	-21.2	-3.9	1.2	2.5	3.8	-2.0	-0.9	3.6	-1.1	-1.0	-0.8	-1.2	-1.1	-2.0	0.9
China | U.S. | Germany	No	-4.6	2.2	-1.4	1.5	-3.9	-3.5	2.9	6.5	1.7	0.6	-2.5	1.6	1.7	1.4	5.4
	Yes	-10.0	-10.4	-9.0	-1.2	6.1	-8.4	8.5	20.7	-4.8	-0.5	-5.9	-5.0	-11.5	-0.6	6.5

4. Temporal dynamics of real GDP reduction due to technological decoupling