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Dollar Diminution and New Macroeconomic Constraints on American Power

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In the first chapter of this volume, Jeremi Suri and Benjamin Valentino proffer the eminently sensible (if all-too-commonly overlooked) admonition "America's national security strategy must be sustainable politically, as well as financial and militarily." Since the end of the Cold War at least, an era of US hegemony and the unquestioned role of the dollar as the world's money, the need for national security strategy to be "financially sustainable" was not much worried about by American planners. But this luxury, one virtually unprecedented in history, can no longer be taken for granted.

This chapter considers new macroeconomic constraints on American power. Those new constraints will derive from a basic and generally underappreciated shift in the US engagement with the global macroeconomic order. Since before the Second World War – that is, for the entirety of practical and institutional living memory—the international monetary and financial system had served to enhance US power and capabilities in its relations with other states. From the turn of the twenty-first century, however, underlying problems left unattended threatened the possibility that what had been a traditional (if implicit) source of strength might become instead a source of chronic weakness. The Global Financial Crisis of 2007-8 was an inflection point that has increased this risk. That crisis, the worst since 1931, is distinguished by the fact that the United States was at its epicenter. Since World War II financial crises were widely understood to be things that happened to *others* – that is, to countries other than the United States. As a result of the crisis, the United States will likely be confronted with new constraints on its power and from new complications regarding the management of the dollar as a global currency, problems compounded by the stripping away of its aura of financial invulnerability. Moreover, both these new constraints and the unfamiliarity of American elites and citizens in facing such constraints will matter. That is to say, new and real constraints will present themselves, but the domestic political process and domestic political choices will play a crucial role in determining the severity of those new constraints in practice.

I begin with a review of the setting on the eve of the global financial crisis, which is crucial to understanding its implications. Even before the crisis, many observers were anticipating a relative reduction in the dollar's role as an international currency, and for a number of reasons, the crisis has served as an accelerant of that process, increasing pressure on the dollar and heightening its vulnerability. In particular, a turning away from the American economic model, especially in Asia, and the encroachment on the international role of the dollar by the RMB (despite its relative immaturity) and Euro (despite its own considerable distress), will present new challenges to the greenback and to US macroeconomic management. This chapter elucidates the likely international political consequences of these developments for American power in particular but also for international politics more generally. In the abstract and with reference to historical parallels, I will explain two distinct types of challenges faced by states managing international currencies in relative decline: (1) the loss of the benefits associated with issuing international money, and (2) the difficulties associated with supervising a currency experiencing a contraction in its global use. As a practical matter, the principal consequences of international currency diminution include pressure on defense spending, reduced macroeconomic autonomy (and thus the ability to finance ambitious foreign policies), vulnerability to currency manipulation, and greater exposure to debilitating financial distress, especially during times of international political crisis. In contemporary politics, these difficulties are likely to be exacerbated by increased disagreement and contestation between states over the politics of international monetary relations and global financial governance.

Even without the financial crisis, the most likely scenario was for the dollar's international role to modestly diminish over time.[1] It was expected (and is still most likely) that for the foreseeable future, the dollar will remain the world's most widely used international currency. But it also should be clear that the greenback need not be supplanted for there to be a politically consequential contraction in its global role. Even as it remains the world's most widely used money, the dollar's use and influence will likely be encroached upon by the RMB in Asia, by the Euro (despite the daunting, politically vexing problems which have hobbled that currency) at the frontiers of the Eurozone and possibly the Middle East, and, perhaps most importantly (and least appreciated), by a greater *motivation* for diversity on the part of numerous and varied actors in the wake of the Global Financial Crisis. As Suri and Valentino argue, to understand world politics, material power remains of course enormously important, but it is also very much the case that states make strategic *choices* that reflect the policy preferences of various actors. Disenchantment with the American financial model will matter when it comes to choices about money (an area where ideas are especially consequential), affecting both state choices and international politics.

ON THE EVE OF THE FINANCIAL CRISIS

Before the financial crisis, some scholars were raising alarms about the future of the dollar and the stability of the international financial system—concerns rooted in the dismantling of international capital controls and the unsustainability of enormous, historically unprecedented deficits on US external accounts. Given the large number of dollars held abroad and anxiety about large US budget deficits, a small crisis threatened to mushroom into a large one, implicating the dollar and its role as an international currency. In 2004, I wrote that "America is . . . at greater risk for a major financial crisis than at any other time since the Second World War," which I thought would be sparked by a "medium sized financial disturbance that emerges in the US [and] work[s] its way through the system via the recently deregulated US financial economy and high flying international capital markets." I argued further that as "a few firms were pulled down by the undertow, a full blown panic would emerge. In the United States, the paper losses would be enormous; the contraction of wealth and instinct for caution would throw the economy into recession. The elements that make this scenario more rather than less likely are in place."[2]

Although alarmists were correct about the risk of financial crisis and the factors that contributed to it, the 2007–8 meltdown—rooted in the house-of-cards collapse of the American banking system and then transmitted abroad—actually bolstered the dollar in the short run as investors fled in panic for the (comparatively) safest haven. But the long run implications of the crisis leave the US economy (and the greenback) weaker than before, and magnify real concerns about a debt-addled America and a dollar in (relative) decline.

To understand the implications of the crisis, it is necessary to consider its origins. The Global Financial Crisis of 2007–8, the worst economic catastrophe since the Great Depression, whose aftershocks still ripple, was a fundamental disturbance of what I call the "Second US Post-War International Economic Order." This order, the "globalization project" of 1994–2007, is distinct from the first order forged by the United States—the Bretton Woods system of 1948–1973—in its political, ideational, domestic and international manifestations. In contrast with the "embedded liberalism" of the first project, which was market-oriented but, chastened by the failures of the depression, skeptical of unmediated market forces, the second order had as its touchstone the liberation of finance, at home and abroad.

Brimming with post-Cold War confidence, America embarked on a dramatic acceleration of the domestic financial deregulation that had been initiated in the 1980s. At home, the Clinton Admin led a bipartisan charge to dismantle the Depression-era firewalls that had been designed to contain instability in the domestic financial sector. These trends were, if anything, accelerated by the transition to the Bush Administration (coupled with continuity at Greenspan's Federal Reserve). Two signature pieces of legislation codified these changes. First was the repeal of Glass-Steagall, the Banking Act of 1933 that regulated and compartmentalized the reckless financial order that contributed so fundamentally to the Depression. This effort, in particular to dismantle the firewalls between commercial and investment banking (and insurance), was led from the Clinton White House by Treasury Secretary (and former Goldman Sachs Co-Chair) Robert Rubin, in close partnership with Senate Banking Committee Chair Phil Gramm, and with the blessing of Federal Reserve Board Chair Alan Greenspan. Writing on the eve of the financial crisis, Greenspan called the repeal (The Gramm-Leach Bliley Act) "a milestone of business legislation" from which "we dare not go back."[3]

Dismantling existing regulations was only half of the story of the great 1990s financial liberalization project. The other half was the fight *not* to supervise and regulate new and fantastically expanding sectors of the financial economy, which produced massive wealth, fueled the rapid growth of industry—and were inherent carriers of systemic risk. The interrelated phenomena of securitization (the repackaging, blending and resale of bundles of financial assets such as mortgages) and the astonishing growth of trading in derivatives (any asset whose value "derived" from another asset, from simple futures and options to extremely complex, enmeshed, risk and insurance dispersal exotica) forged the financialization of the American economy. These activities were largely unsupervised by an oversight and regulatory apparatus that was designed long before such products came on the scene.

A few voices were raised in concern, such as the that of the US Government Accountability Office, which warned that "the size and concentration of derivatives activity, combined with derivatives-related linkages, could cause any financial disruption to spread faster and be harder to contain." The GAO was worried this could lead to "systemic crisis" and urged modernization of the regulatory structure. But the report elicited a fierce industry push back and massive lobbying effort; its allies in government were also mobilized. Key players included Larry Summers (who would become Treasury Secretary in 1999) and Alan Greenspan, who insisted that "regulation of derivatives transactions that are privately negotiated are unnecessary." Expressing confidence in the self-interest of private actors, Greenspan saw "no reason to question the underlying stability" of derivatives markets. (Greenspan, technically in charge of the oversight of the US financial system, saw little attractive in that responsibility. But as it turned out, he was "delighted that being a regulator was not the burden I had feared.") With this wind at his back, Gramm took the ball and ran with it, championing the Commodity Futures Modernization Act, which prohibited the regulation of derivatives, including the credit-default swaps that would play a central role in the 2007-8 financial crisis.[4]

Not surprisingly, the US financial sector became larger, more concentrated, and riskier in this environment. From 1980 to 2002, as manufacturing in the United States fell from twenty-one percent of GDP to fourteen percent, finance, the biggest and fastest growing sector in the American economy, grew from fourteen percent to twenty-one percent. In 2007, finance accounted for 47% of US corporate profits; from 1981 to 2008, financial sector debt increased from twenty-two to 117 percent of GDP, the tip of an iceberg of risk that metastasized in the wake of deregulation.[5]

The continuing financialization of the American economy was buttressed by a fundamentalist ideology that "markets always know best," which created the permissive environment of unsupervised securitization and the housing bubble. Reinforcing this was the rise of a Washington-Wall Street culture, whereby bankers, politicians, and regulators became so enmeshed that the metaphor of the revolving door is inadequate. This was also an era, as Simon Johnson argued, when Wall Street "translated its growing economic power into political power" and "the ideology of financial innovation became conventional wisdom in Washington." The financial sector invested $5 billion in the political process from 1998 to 2008.[6] Wall Street kingpins like Robert Rubin and Henry Paulson took on senior positions in government and – especially eyebrow-raising for a country that commonly castigated other cultures for something called "crony capitalism" – government officials and regulators could anticipate lucrative industry positions. Summers was paid over $5 million for a part-time job at the hedge fund D. E. Shaw and received $135,000 from Goldman Sachs in exchange for a personal appearance a few months before joining Obama Administration. Friend-of-finance Phil Gramm left the Senate in 2002 and immediately took a lucrative perch at the financial giant UBS.

FALLOUT FROM THE CRISIS: MATERIAL, IDEATIONAL AND STRATEGIC

The purpose of this narrative is not to assign blame, but to emphasize that the crisis will have both material *and* ideational consequences and to argue that both will matter. As a material phenomenon, the crisis will create new American vulnerabilities and accelerate two pre-existing trends: reduced U.S international political capacity and the continuing emergence of China.

Although the United States will emerge from this crisis still as the world's preeminent economic and military power, what is particularly novel about the great financial crisis of 2007-8 is not so much its "novelty"—international financial crises are very common phenomenon—but the fact that it "hit home." During the age of regulation—the 1940s, 1950s, 1960s, and 1970s—the United States experienced no major financial crisis. These only occurred (with regularity) in the unregulated 19th and early 20th centuries, and reemerged in the 1980s in the age of de-regulation. This crisis, then, is distinguished mostly by the fact that the United States was at its epicenter, and that it bore many of its costs.[7] This is suggestive more generally of a new, and, importantly, unfamiliar level of exposure of the US economy to external financial pressures. (Unfamiliar to be sure, but in fact not so much "new" as a "return to normal.")

One challenge to American power concerns the long run trajectory of the dollar as an international currency. Despite the fact that the dollar has served as a safe haven during this crisis, the longer run prospects are more alarming. As before the crisis, the dollar remains, by any objective account, vulnerable to a crisis of its own. Paradoxically, one legacy of the dollar's historical attractiveness is that it has increased its vulnerability. Because the dollar has served as the world's "key currency," there are an enormous amount of dollars held abroad. Thus if there was a spark, somewhere, that touched off a financial crisis that implicated the dollar, given the state of underlying expectations about its future value, a sudden reversal of the dollar's fortunes is not inconceivable. In sum, the United States emerges from the crisis with sluggish economic growth, exposed economic weaknesses, and a more suspect dollar (an area where perceptions matter).

All this contrasts with China's relatively rapid recovery in the years following the crisis. Despite facing formidable economic challenges of its own, and even with its rate of growth slowing, differential rates of recovery from the Global Financial Crisis still markedly accelerated pre-existing trends of China's relative economic rise. To a large extent, China is not "rising" so much as it *has risen*. As Suri and Valentino observe, handicapping if and when China's economy might (or might not) overtake the US economy is irrelevant to the more important implications of general trends in the global economy for international politics. With the emergence of China and others, "the United States will have less freedom to act unilaterally to protect its interests around the globe."

Continued stability of the Chinese economy, of course, is by no means a sure thing.[8] Nevertheless, whatever the future holds, a larger Chinese economy will surely support a more formidable military; of even greater significance are the profound international *political* consequences of China's economic importance. The People's Republic is now the world's second largest importer, taking on over $1 trillion worth of other countries' goods each year. As a result China's status and influence have been enhanced. This does not much affect China's military prowess; but it does mean that China's international political influence will increase, and this will matter, as states that trade with China come to identify their own their interests with a sensitive eye to how foreign policy choices they consider might affect their relations with China.

Beyond these adjustments to the balance of power and influence, world politics will also be affected by the ideational consequences of the crisis – and in particular, the implications of a new divergence of opinion regarding global finance. Venerable old banks were not the only things that came crashing down in 2007–8—the legitimacy of the Second Post-war American Order also collapsed. Even if one is inclined to reject the view that the American model of uninhibited finance was flawed, the following three propositions are uncontroversial and consequential: (1) for much of the world, the Global Financial Crisis was the second major financial crisis of the past ten years; (2) the United States was the epicenter of the Crisis; (3) the interpretation of the crisis implied by US policy is not shared by some important international actors. In particular, the American response to the crisis suggests that a "market fundamentalist" approach—one that continues to embrace Rational Expectations Theory and the Efficient Markets Hypothesis—still holds sway. From this perspective, the Global Financial crisis was a "black swan," akin to a plane crash: a regrettable, but nevertheless rare and unpredictable event.

And as such, about which little can be productively done—air travel, and the financial system, are as safe as we can practically expect them to be. Modest tweaks or reforms might possibly make the system even safer, but finance is essentially efficient and self-regulating.

This interpretation contrasts with what I would dub a "KKM" perspective, named after John Maynard Keynes, Charles Kindleberger, and Hyman Minsky: financial markets, especially ones left to themselves, are prone to crisis. This view holds that financial crises are common throughout history and invited by unregulated, unsupervised financial systems. It implies that the US financial-economic model 1990s is flawed and in need of fundamental reform. I would note that KKM clearly has history on its side[9]—but it matters not for this discussion who is right—it matters that a disagreement exists, and different actors now hold pointedly different ideas about organizing the financial economy.

THE AMERICAN FINANCIAL GLOBALIZATION PROJECT ABROAD

The American push for liberated finance—both at home and abroad—was a purposeful, political project: as Summers explained at the time, "[f]inancial liberalization, both domestically and internationally, is a critical part of the US agenda." The style of that push, I argue, primed actors throughout the world (not just in Asia, but in Latin America, Russia, and elsewhere), to push back when given the chance. The United States, and its ally, the IMF, were not of a mood to encourage financial liberalization—they were inclined to insist. In the mid-1990s, the IMF moved to force member states to completely eliminate their capital controls (despite a lack of evidence to support the contention that this was appropriate economic policy). This ambitious project was in accord with America's perception of its national interest. But greasing the political wheels was an economic ideology—actually, a leap of faith—as the IMF declared on the eve of the Asian Financial Crisis that "international capital markets appear to have become more resilient and are less likely to be a source of disturbances." Some faiths are hard to shake; in April 2006, the IMF announced that "the rapid growth of derivative and structured credit markets in recent years, particularly among more complex products, has facilitated the dispersion of credit risk by banks to a broader and more diverse group of investors . . . [which] has helped to make the banking and overall financial system more resilient and stable."[10]

Bilaterally, the United States was, if anything, even more aggressive. In 1995, during negotiations for a free trade agreement with Chile, Treasury representatives insisted that elimination of Chile's modest, innovative, market-friendly controls on short-term capital inflows must be included as a condition of the deal. In 1996, as Korea sought membership in the Organization for Economic Cooperation and Development (OECD), the United States insisted that Korea speed the pace of financial deregulation and provide increased access for American firms. From the mid-1990s, as one account described, "[w]orking through the IMF or directly with other countries," Summers and Rubin, with the encouragement and support of Greenspan, "pushed tirelessly for . . . free capital flows."[11]

The confluence of forces—ideas, interests, and power—that led the United States and the IMF to push, hard, for universal, uninhibited capital deregulation, are, like so many questions about monetary affairs, not easily disentangled.[12] The architects of the Second US Postwar Order were certain that markets, even financial markets, are always right and always know best. But interests and power are not to be underestimated. In the post-Cold War world of American unipolarity, the promotion of financial globalization was also was recognized as maximizing US comparative advantage and further enhancing American geopolitical primacy.

But the US/IMF push coincided, and not coincidentally, with an increase in global financial instability—most notably, but not at all exceptionally, with the Asian Financial Crisis of 1997–98. Sparked by a currency crisis in Thailand in July 1997, an international financial crisis quickly and unexpectedly spread throughout region, engulfing the Philippines, Malaysia, Indonesia, Hong Kong, and, astonishingly, South Korea, which announced in November that it had no choice but to turn to the IMF for a rescue package or it would face national bankruptcy.

This crisis, and the US/IMF reaction to it, exposed an ideational and political fault line at the foundations of the American system. In Asia (and elsewhere), the crisis was easily recognized as a classic international financial crisis. But a different narrative held sway at the IMF, in

Washington, and on Wall Street. In those quarters, blame was placed, squarely and entirely, on the Asian economies. IMF accounts were typically myopic, not to mention amnesic, placing blame exclusively on the domestic economic policies of states whose economies and macroeconomic management the Fund had only recently been touting. The IMF's Stanley Fischer focused exclusively on domestic causes of the crisis: "weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among governments, banks and corporations were central to the economic crisis." There is, of course, an unintended irony here—ten years later, this would have served as a particularly potent indictment of the *American* financial model. But in any event, the point was clear: "I emphatically reject the view," Fisher argued, "that turbulence on international financial markets suggest caution with capital account liberalization." Greenspan, Rubin, and Summers were similarly unequivocal and (over)confident in their assessments; Greenspan placing the blame entirely on "poor public policy" within the affected states, Summers arguing that if anything, the IMF should "accelerate" rather than "slow the pace of capital account liberalization."[13]

Much of the world disagreed with that assessment (including Japanese and Brazilian representatives at the IMF), but although the drive to amend the IMF's charter stalled in the wake of the Asian Crisis (and subsequent crises that quickly followed), the underlying philosophy continued to hold sway at the Fund, and, especially, in the United States. In 2003, while completing free trade agreements with Chile and Singapore, the United States demanded, over the vociferous objections of its counterparties, clauses in these trade treaties that demanded each country renounce the right to introduce any form of capital controls. What this had to do with free trade, whether it is remotely wise policy, and that these were instruments the states in question did *not* want to give up were of little concern to Bush Administration negotiators.[14]

In sum, in Asia and elsewhere, a defining attribute of the Global Financial Crisis of 2007–8 is that it came at the heels of the 1997–8 crisis. Whereas recent US behavior suggests a belief that the crisis is epiphenomenal (as it emerges from the crisis with an even more concentrated financial sector playing by modified versions of most the old rules and all of the old norms), in much of the rest of the world, the crisis is a "learning moment"—the valedictory lecture in a long and difficult course of study demonstrating that unbound finance does not work.

The current crisis, then, has delegitimized the culture of American capitalism, especially as it applies to finance, and, as noted above, this will affect both state choices and international politics. John Ikenberry and Charles Kupchan have argued that "socialization"—the embrace by elites in secondary states of the substantive beliefs of a great power—is an important source of influence for a hegemon. Their work focused on the establishment of hegemonic socialization, and how such legitimacy crucially buttresses its political influence.[15] What we will witness in the coming years is the flip side of that phenomenon, the likely *erosion* of that influence, as others come to reject the ideas that they once embraced or at least tolerated. With this legitimacy reversal, continuity in the United States and change elsewhere will contribute to a "new heterogeneity" of ideas about finance. States will commonly have divergent preferences about the global financial order, reducing US influence and making cooperation about the governance of money and finance more problematic. In particular, many states will search for ways to insulate themselves from the dangers of unmediated global finance.

The United States has emerged from the crisis with its financial model largely intact. The modest Dodd-Frank financial reforms are vaguely specified, and, in the words of Robert Shiller, represent "only a beginning of dialogue on how move our financial system into the twenty-first century." But this dialogue is not taking place. In the United States, the "regulatory landscape has been little changed," Paul Volcker observed in August 2013. "Here we are, almost three years after the passage of Dodd-Frank, with important regulatory and supervisory issues arising from the act unresolved." This matters, especially if the United States is "returning to normal" and becoming "more like others" with regard to the basic level of its exposure to potential financial crises. Even Robert Lucas recently observed "the fact that during the 66 years that [Glass-Steagall] remained in force the United States did not experience any widespread financial crises commands respect, or at least curiosity."[16]

Throughout the rest of the world, however, considerably more rethinking about the governance of money and finance is taking place. This need not cohere in a single, competing model that will vie for influence with the American way. Rather, the New Heterogeneity is just that—the flowering of a multitude of ideas about the viability of capital controls, the optimal level of inflation, and macroeconomic management more generally. Even at the IMF, a tolerance for new policy experiments characterizes what Ilene Grabel has dubbed "productive incoherence" with regard to strategies of economic governance.[17] Contrasting ideas about money and finance combined with a new wariness of American financial stability do not bode well for the trajectory of US international power and influence.

China and Accelerated RMB Internationalization

This changing orientation will be especially visible—and is already observable—in China. Prior to the Global Financial Crisis, elites in China anticipated future RMB internationalization. But the dominant position of the dollar, the emergence of the Euro, and the fragility of China's sheltered, murky, domestic financial sector tempered expectations about how quickly the RMB might take its place as an important international currency. Nevertheless, such ambitions, however distant, were clearly harbored, and as China continued its rise to great power status it was natural to assume that a greater international role for a maturing RMB would be part of that process. As a long term project, Beijing could envision the day when the Yuan would be the currency of choice in East Asia, a prospect that would further enhance its political leadership and influence there. In the wake of the crisis, that timetable has been accelerated *and* a new and important motivation has emerged—to establish some distance from the dollar, and to explore models of economic governance that offers some alternative to radically unmediated global finance. Whatever forms they take, such new approaches and initiatives will reflect the fact that, as Benjamin Cohen observes, "in both words and deeds, the Chinese have appeared to underscore a dissatisfaction with the status quo," and "Beijing appears to be working hard to tilt the global balance of monetary power as much as possible in its favor."[18]

The Japanese experience from the late 1980s holds a number of lessons that provide insight into the case of contemporary China. As Japan emerged as the second largest economy in the world, many Japanese officials imagined an internationalized Yen as a major currency as a means of further enhancing Japan's growing influence. But with the stagnation of the Japanese economy in the 1990s, such attitudes fell into remission, only to resurface, in a very different guise, in the wake of the Asian Financial Crisis. After that crisis, a revived interest in larger role for the yen was rooted in defensive motivations—the search for greater insulation, autonomy, and greater space from the American vision of global financial order. As William Grimes explained, the revived debate was "fundamentally about *insulation*," rooted in disenchantments—with the instability associated with (American championed) uninhibited financial globalization and deregulation, with the US ability to shift macroeconomic burdens of adjustment abroad (and chronic American pressure over ex-rate issues), with the more general implications of the ideological divergence between the United States and Japan over their respective reactions to the Asian Financial Crisis.[19]

These themes all resonate with contemporary politics. On the one hand, China had always been wary of exposing itself to international capital markets, and understood that its controls had spared it from the Asian Financial Crisis and other tumult that had characterized global finance in a succession of crises since the mid-1990s. From the early 2000s, China embarked on a cautious path that accommodated controlled RMB appreciation and modest movements towards financial liberalization. And China's continued economic growth and its massive and increasing holdings of dollar assets assured that, at the very least, discussions of the country's role as a potential monetary powerhouse would take place. On the eve of the crisis, however, most observers would agree with the assessment that "China's power in the international financial system, certainly growing, should not be overestimated."[20]

But the Global Financial Crisis changed this. It provided a new impetus to the promotion of the Yuan, and it also, crucially, altered visions of the trajectory of its path. By exposing profound flaws in the American model, the crisis elicited what I call "buyer's remorse" in China, with regard to its development model that had bound it so tightly to the (weaker than previously assumed) US economy and made it such a stakeholder in the (even more vulnerable that once thought) US dollar. The crisis also redoubled the (already robust) wariness of Chinese elites about the risk of exposure to the global financial economy and reinforced demands for insulation. And the relative rates of recovery from the crisis—swift in China, sluggish in the United States (and Europe)—magnified the pre-existing trends that were already suggestive of a rising China. Finally, and crucially, the crisis de-legitimized the American model that China had been cautiously tacking towards, right up until the crisis, if invariably at a rate deemed inadequate by its Western tutors. The Americans had never stopped lecturing Beijing on the need to move faster—ever faster—on their path of convergence towards the US model. Just months before the crisis, Treasury Secretary Paulson was (again) lecturing that "the risks for China are greater in moving too slowly than in moving too quickly" with financial liberalization.[21] Chinese elites are now patting themselves on the back for resisting this bad advice.

Buyer's remorse also reflects a greater disenchantment with the US management of the dollar and its role in the international financial system more generally, two things about which Chinese observers are increasingly critical. These reassessments have contributed to a desire for insulation from anticipated future instability caused by American mismanagement and demands for reform of the global macroeconomic order for similar reasons. Nor are politics far behind: American policies force others to adjust "in accordance with the needs of the US dollar," argues Li Ruogu, Chairman and President of the China Export-Import Bank; "the US used this method to topple Japan's economy, and it wants to use this method to curb China's development." Increasingly, there is the view that RMB internationalization is necessary to reform, and to pluralize, the international monetary system. "Only by eliminating the US dollar's monopolistic position" can the system be reformed. RMB internationalization is a necessary step towards a multiple currency system that would reduce the influence of the dollar, contribute to systemic stability, increase China's voice, and provide some insurance against a dollar crisis.[22]

In March 2009, Zhou Ziaochuan, Governor of the People's Bank of China, delivered a speech on "Reform of the International Monetary System." Nominally a call for a greater role for the SDR, the Governor's statement was properly understood as a challenge to the dollar. As Chin and Wang argued, the speech reflects "the consensus Chinese view . . . that a multi-reserve currency era is coming, even if only gradually, and that it would be in China's strategic interests to promote such a scenario." Publications by Chinese elites and academics increasingly illustrate this perspective.[23]

There remain barriers to the emergence of the RMB—in particular, the extent of the weakness in and discomforting opacity of Chinese banks and of its domestic financial sector more generally, which many see as the rate limiting factor of the Yuan's rise.[24] Nevertheless, after the Crisis, Chinese leaders decided to step up the pace of RMB internationalization, promote regional monetary cooperation, and encourage reform of global monetary management.[25] Notably, there is both an increase on the *supply side*: China's willingness to have the RMB deployed in a greater role internationally, and at the same time a clearly increased *demand*: a greater desire by states to find ways to transact business in ways that does not bind them tightly to, or at least provides some diversification away from, the dollar, the American financial model, and the US economy. [26]

This also means that a greater international role for the RMB might look somewhat different than would be drawn up on a chalkboard by those envisioning inevitable convergence towards the American model. Most western analysis, for example, consider full currency convertibility and completely open capital markets as virtual prerequisites to establish the international financial centers that would be the platforms for and hubs of international money.[27] But as a matter of practice, this may or may not be the case. China seems poised to act as if, in fact, it is not, and seems set to embark on considerable internationalization of the RMB without pausing to wait, or perhaps even to ever, fully liberalize its capital account.[28] (This is, of course, an illustration of New Heterogeneity of thinking.) According to Governor Zhou, the "definition of capital account convertibility is something that can be discussed, and how standards should be set should have a certain degree of flexibility." In addition, he insisted, "China has to have its own voice in the establishment of international standards." All this may be part of what rejecting the American model of financial governance looks like: putting the infrastructure in place for the Yuan to become more internationalized, promoting its use a vehicle currency, and encouraging other central banks to hold RMBs as reserves—while retaining some capital controls and other market inhibiting devices.[29] But in whatever form, the bottom line remains that China is moving ahead with a panoply of measures that reflect "a desire to carve out China's own space within a US-dominated global financial system," a process that "accelerated with the outbreak of the global financial crisis"[30]

Some scholars have expressed skepticism regarding the import of the measures undertaken by Beijing, suggesting that they are largely nascent, symbolic, and limited.[31] And it is the case that we are early in this game, and that the RMB is currently a marginal presence as a global reserve currency. But these steps are consistent with the pre-positioning of an apparatus that would support the emergence of the Yuan as an important international currency. And, crucially, as noted above, China's willingness to increase the "supply" of international monetary options has coincided, for similar reasons, with greater demand for alternatives to the dollar and to the ideology of unbridled financial globalization as well. The emergence of the RMB is not simply a "supply side" story—there is a robust "demand side" as well.[32]

Interest in different international monetary possibilities is also on the rise. One manifestation of this—of both disenchantment with the American way and a desire for greater voice—is China's sponsorship of the Asian Infrastructure Investment Bank (AIIB), and of the eagerness of others to sign on. Once again, it is important not to let underlying trends run ahead of the facts of the ground, and there is no need to share Summers' hyperbolic reaction to the AIIB ("This past month may be remembered as the moment the United States lost its role as the underwriter of the global economic system"), but on balance the AIIB will enhance China's influence at the expense of the United States, Japan, and the international institutions that those two countries dominate.[33] And whatever the stakes, it is notable that the United States tried, and miserably failed, to undercut the AIIB's emergence. Summers, likely, was fondly recalling his late-1990s role in crushing Japan's proposed Asian Monetary Fund, which was also perceived as a challenge to the leadership of the United States and intuitions it dominated. But China will more assertively, and more successfully, seek to establish opportunities to promote its voice and its interests—and likely find willing partners.

In sum, even while keeping new developments in context and recognizing that China faces its own real problems and challenges, the RMB will likely emerge as an important international money, and will be associated with and help reinforce a continued rise in China's international political power and influence. It should be remembered, in addition, that it is not just China who will be encroaching on the dollar (nor is it solely actors in Asia that will seek greater insulation from potential American financial instability). The World Bank, for example, in its 2011 *Global Development Horizons* report, anticipates an increasingly multipolar world economy, and, notably, a multipolar currency order, with the RMB, and especially the Euro, increasing in importance as international currencies.[34]

Currently flat on its back, Europe is down but not out, and in the longer run, the Euro will resume its encroachment on the dollar's international role. Certainly, Europe's own troubles have exposed the weaknesses of the Euro as a potential peer competitor to the Dollar, a status that the European currency seemed close to achieving before the Global Financial Crisis exposed its own the problems and, not to be underestimated, contradictions.[35]

To a considerable extent Europe's crisis has handed (yet another) get-out-of-jail-free card to the profligate dollar, left again as the only game in town. And the Euro's dysfunction, and the political paralysis of the countries that oversee it, is not to be underestimated. As Randall Germain and Herman Schwartz elucidate in their trenchant inquest into the Euro disaster, the Global Financial Crisis did not cause the Euro's fundamental weakness, so much as expose it. Monetary integration ran far ahead of political integration in Europe, and "the EU lacks the will, ideas and the capacity to promote the euro into the status of a top international currency." Germain and Schwartz identify another euro-pathology: Triffin's dilemma, which holds that reserve currencies walk a tightrope between too much liquidity, undermining confidence in a system's key currency, or too little, resulting in strangling deflation. In the 1960s, the United States made its choice, and the Bretton Woods system was indeed unsustainable. But the guardians of the Euro, especially Germany, are choosing death by ice rather than by (even the slightest risk of) fire. Essentially, "the current euro-crisis replicates the deflationary problems" of gold standard. The Euro is committing suicide by asphyxiation—thus the dollar endures, unchallenged.[36]

But the failure of others offers only a thin reed of support for the dollar. Against all evidence, Europe will eventually come to solve its problems. Especially with regard to the prospects for international money, the crisis will almost certainly force the EU into a "corner solution": forward or back. The Global Financial Crisis was the stress test that has exposed the fault line of the entire project: the economics of the European Union had run ahead of the politics.[37] Either it will have to move forward with greater political integration, or, with regard to the common currency at least, devolve towards a smaller core of participants. But in either scenario, over time the Euro is likely to emerge as an even stronger player on world markets. And, again, in a relative sense, this can only come about at the expense of the dollar's reach.

Pressure on the Dollar's role as an International Currency: Sorting out the Risks to the Dollar

What does it matter if the international role of the dollar comes under pressure? Three types of consequences follow: the loss of benefits, the management of new burdens, and challenges specific to the American case. I consider these in the abstract, with illustrative historical analogies, and as applied to contemporary politics.

The main perks of issuing "key" currency are (1) autonomy and balance of payments flexibility, and (2) structural power. With regard to the former, in the United States it is underappreciated the extent to which the special place of the dollar has allowed America to shake off the (often costly) burdens of macroeconomic adjustment and essentially dump them on others.[38] In addition, the United States has been able to sustain deficits on its international accounts that other states could not have, and to adopt economic policies that, attempted elsewhere, would have been overwhelmed by a withering "disciplinary" response from international financial markets. The erosion of these perks will circumscribe US power and autonomy, and fights over the burdens of adjustment—the normal stuffing of international monetary politics—will become more a more common and a more salient feature of foreign policy, at least from an American perspective.

The dollar-centric international system has also rewarded the United States with structural power. Structural power is not easily measured, nor obviously "coercive," but reflects "the power to decide how things shall be done, the power to shape frameworks within which states relate to each other." [39] Structural power also affects the pattern of economic relations between states and their calculations of political interest. States that use the dollar (and especially those that hold their reserves in dollars) develop a vested interest in the value and stability of the dollar. Once in widespread use, the fate of the dollar becomes more than just America's problem – it becomes the problem off all dollar holders.

A relative contraction of the dollar's international role, then, would reduce both the "hard" and "soft" power the United States previously enjoyed—its coercive power enhanced by greater autonomy and its structural power implicitly shaping the preferences of others. Further, the United States would face additional burdens—not from the loss of perks, but from the costs associated with managing a currency in relative decline. For issuers of once dominant international money, those new difficulties arise from what can be called the overhang problem, and from a loss of prestige.

The overhang problem arises as a function of a currency's one time greatness. At the height of its attraction, numerous actors are eager to hold international money—governments for reserves, and private actors as a store of value (and often as a medium of exchange). But once the key currency is perceived to be in decline, it becomes suspect, and these actors will, over time, look to get out—to exchange it for some other asset. The need to "mop up" all this excess currency creates chronic monetary pressure on the once great currency; and macroeconomic policy will take place under the shadow of the overhang.[40]

The loss of prestige is also a crucial consequence of managing a currency in decline. Prestige is a very slippery concept, but it finds a home in monetary analysis under the rubric of credibility, which is generally acknowledged to play a crucial role in monetary affairs (even if it, too, is not easily measured). The unparalleled reputation and bedrock credibility of the key currency during its glory days is a key source of the power it provides. The willingness of markets to implicitly tolerate imbalances in accounts and impertinent macroeconomic politics that would not be tolerated in other states rests on these foundations.

The loss of prestige and reduced credibility (which the challenge of the overhang exacerbates) imposes new costs on the issuer of a currency in relative decline. Whereas in the past the key currency country was exempted from the rules of the game—that is, placed on a much longer leash by international financial markets than other states—the opposite becomes true. With eroding prestige and shared expectations of monetary distress, market vigilance is heightened and discipline imposed more swiftly by the collective expectations of more skeptical market actors. A presumption of confidence is replaced with a more jaundiced reading of the same indicators, and the long leash is replaced by an exceptionally tight choker.

Some of these problems can be illustrated by historical analogies. The experience of the British pound in the decades following World War II offers one such example of the challenges faced by an international currency under pressure. In the 19th and early 20th centuries, sterling served as the international currency of choice, and the pound's key currency status enhanced British power. But eventually the management of sterling-in-decline became a vexing problem for British authorities, complicating economic management and exacerbating its chronic financial crises in the 1960s. With sterling invariably on the ropes on international financial markets, the demand for a clean bill of macroeconomic health placed British budgets—and British military spending and overseas commitments—under constant pressure as a result.

The limits of British power and the constraints of financial fragility were brought into stark relief with the Suez Crisis in 1956. On October 31 of that year, British and French forces attacked Egypt with the stated goal of seizing the Suez Canal, but with the additional goal of causing the overthrow of Egypt's President Nasser. But on November 6, just days short of victory, and to the great dismay of the French, Britain called a halt to the operation. Harold Macmillan, Chancellor of the Exchequer (and to that point one of the most forceful proponents of the Suez adventure), informed his cabinet colleagues that a run on the pound, which he claimed had been "viciously orchestrated" in Washington, had become overwhelming, and the country did not have adequate reserves to save the currency on its own. Moreover, the Americans made clear that they would block Britain's ability to seek help from the IMF. On the other hand, if (and only if) the British agreed to an immediate cease-fire and prompt withdrawal from the Suez Canal zone, the United States would facilitate IMF support and provide additional emergency financial relief of its own.[41]

Britain caved in, and the entire affair was a formative experience for a generation of British politicians, who came away with an instinctive sensitivity to the economic limits of British power. That sensitivity would be reinforced by decades of less spectacular but nevertheless chronic hard knocks. Currency weakness and resulting pressure on government spending—austerity to balance the budget, austerity to shore up confidence in the pound, always and everywhere, austerity—would become a defining problem for British governments in the mid-1960s (and beyond), ultimately forcing the country to reluctantly abandon its military role "East of Suez." President Johnson considered sterling's weakness a "major foreign policy concern" and was eager to take steps that would take the pressure off the British currency and thus "sharply reduce the danger of sterling devaluation or . . . British military disengagement east of Suez." But economic pressure on sterling, which staggered from crisis to crisis throughout the period, was unrelenting and ultimately decisive.[42]

Sterling crises in autumn 1964 and again in summer 1965 rocked the British economy. Prime Minister Wilson's response was to cut defense spending without addressing overall military posture, a tightrope which could only be negotiated for so long. With the February 1966 defense review the rope frayed further, with defense cuts eroding British overseas capacities. But sterling crisis and relentless pressure on budgets continued, and 1967 would feature the blows that finally burst the sterling piñata. Yet another defense white paper bowed to the inevitable and finally outlined a phased withdrawal from Singapore, Malaysia, and Aden—British forces would be cut in half by 1971 and gone completely by 1977. Some pretense was maintained regarding Britain's positions in Persian Gulf, but these fig leaves were swept aside by the financial crisis that led to sterling's devaluation in November. Chancellor of the Exchequer Roy Jenkins insisted on a fundamental reassessment of defense policy. Not only was military spending cut further, but the timetable for withdrawal from East of Suez was accelerated and would be complete by the end of 1971. This met with vigorous opposition from the Tories, but pressure on sterling presented stubborn truths. Returning to power in 1970, faced with sluggish growth and the need to fight inflation, the Conservatives could not escape the same financial constraints that had plagued Labour, and the new posture was retained.[43]

Notably, even with the East of Suez question settled, the devaluation of sterling, and the shift to a floating exchange rate, the relationship between Britain's fragile finances and its military capabilities remained. The 1976 financial crisis forced Britain to seek help from the IMF, which insisted on still further cuts to domestic spending. An additional £300 million was squeezed from the military, despite vociferous protests from the Chiefs of Staff.[44]

There are, of course, fundamental differences between post-war sterling and the contemporary dollar. But as a more extreme case, it helps to expose and magnify the mechanisms by which currency diminution can affect national security. The politics of austerity—everywhere—will not spare military budgets, especially in peacetime and especially if such budgets appear large. And it will be generally so that a currency in decline faces increased (and more skeptical) market scrutiny—especially during moments of international crisis and wartime. Markets tend to react negatively to the prospects for a country's currency as it enters crisis and war, anticipating increased prospects for government spending, borrowing, inflation, and hedging against general uncertainty.[45] In that sense, the Suez analogy is not inappropriate. Nor was this an isolated incident—weak currencies make for timid states.

This axiom is well illustrated by the experiences of interwar France, a case that offers something of a laboratory for the national security consequences of currency weakness. In this instance, the franc came under withering pressure somewhat "voluntarily"—that is, domestic politics in France enforced an almost obsessive fixation on "defending the franc," which need not have been the only policy choice (indeed, the socialists finally, if very reluctantly, abandoned the cause in 1936).[46] But the pressure, even if to some extent self-imposed, illustrates again two mechanisms via which monetary distress fuels national (in)security—through the relentless march of austerity and existential anxiety about the power of financial markets.

Monetary orthodoxy and thus constant pressure to balance the budget meant that finance was the "soft underbelly" of France's defense posture. These interconnections cannot be overestimated – it was accepted as an article of faith the franc rested on the foundation of the balanced budget – and defense spending was gutted in an effort to achieve that end. From 1930-1933, defense spending was cut by twenty-five percent —in fact military spending at the 1930 level would not be reached until 1937. Between 1933 and 1938, German defense spending would practically triple France's, and during roughly the same period, real military spending in Germany would increase by 470%, in France, forty-one percent. Pressure on the franc routinely provided the major impetus for new rounds of deflation and budget cuts, and repeatedly new weapons programs and efforts at modernization were the first, easiest place to find savings from the defense budget.[47]

A commitment to maintaining the convertibility of the franc into gold at the level established in 1928, even more than the budget cuts, circumscribed French foreign policy. In 1933, the Bank of France explained that it was "resolved to consent to no measure whatsoever that could again endanger the stability of the franc." This contributed to France's sluggish response to Germany's rearmament, which was clearly understood in France by the end of 1932.

The constant threat that a financial crisis would force the franc off gold paralyzed French leaders and contributed to a conciliatory bias in French foreign policy. Adherence to orthodoxy in France required, if not appeasement, something very close to it. In 1934, financial journalist Paul Einzig expressed his grave concern that "monetary orthodoxy will be sufficiently influential to delay urgent armament expenditure in order to avoid jeopardizing the stability of the franc."[48]

But this was the course followed by France until September 1936. Each year leading up to that point France recognized new German challenges and remained passive. A dramatic increase in German military spending in March 1934 had no effect on French policy. In March 1935, Germany announced that its army would expand to thirty-six divisions, more than five times the ceiling mandated by the Versailles treaty. Yet France again stood passively, aside from raising protests and seeking to stitch together a multilateral response, which came to nothing. The threat of capital flight reinforced the policy of appeasement. In the words of one critic, due to such fears, the "government was condemned to a certain impotence."[49]

This would have more severe consequences one year later. On March 7, 1936, Germany remilitarized the Rhineland. Not only was this in direct violation of the Versailles treaty, it also closed the corridor through which France would have, in theory, come to the defense of its eastern allies. Yet again, France took no action, a policy that has been called "the first capitulation." Certainly a number of factors involving both domestic and international politics contributed to this outcome. But financial questions were decisive, and essentially ruled out the use of force, or even the threat of force.[50] Worse, mobilization was incompatible with the protection of the franc. It would have required devaluation.

This stark fact guaranteed French inaction. As one student of the crisis observed, "Hitler and the rest of the world knew" that the French government would "above all . . . do nothing that would endanger the franc." Even *couverture*, the state of armed readiness that would precede a general mobilization, would have cost thirty million francs a day, an expense that would "undoubtedly provoke a run on the franc." Because of the fragility of France's financial position, full mobilization would have led to an immediate "full-scale monetary crisis," and would have "exposed the virtual bankruptcy of the French treasury and toppled the franc." Any doubts about this relationship were erased as capital flight and pressure on the franc increased in the few days before it was known that France would not take any strong measures of resistance. On Sunday March 8 there were rumors that France might use force against Germany, and on Monday the franc came under renewed pressure in international markets. This pressure did not abate until Wednesday, after the announcement that France would act only with multilateral support and within the framework of the League of Nations, which made it clear that there would be no military response to the German provocation.[51]

Twenty-first century America is not postwar Britain, nor is it inter-war France. But the experiences of those countries provide important insights into the types of challenges faced by a country attempting to navigate its grand strategy while nursing a suspect currency. And greater skepticism about the dollar is a new fact of life. Actors may continue to hold their dollars, and even accumulate more of them. But they now do so through gritted teeth. Wariness of the American model adds another stone to the burdens borne by the dollar, the future of which will influence US power in the coming decades. As noted above, the "three Ds"—dollars, deregulations and deficits—have left the greenback still exposed; the necessary policy responses to the crisis only increase suspicions about the dollar's long run health; potential alternatives loom in the distance. Moreover, and crucially, the dollar no longer enjoys the political "safety net" it once enjoyed. Politics always has and will continue to shape the international monetary order. During the Cold War, monetary squabbles took place between the United States and its strategic allies and military dependencies. No longer.

In sum, the dollar is vulnerable in ways that are unprecedented since before World War *One*. Even in the absence of a major dollar crisis, and even though the greenback will remain the world's most prominent currency, the relative diminution of the dollar's international role will present new constraints on US power. This is because American power has been supplemented and at times facilitated by dollar primacy, which has made it easier to project its power abroad and afforded an assortment of other political perks. Were some dollar diminution to take place, the United States would not only lose that capacity and those perks, it would also face new limitations associated with the macroeconomic management of an international currency in relative decline.

In a scenario where the dollar's role receded, and especially as complicated by an increasingly visible overhang problem, American policies would no longer be given the benefit of the doubt. Its macroeconomic management would be subject to intense scrutiny in international financial markets and its deviations from financial rectitude would start to come at a price. In the past, periods of notable dollar weakness led to US borrowing via mechanisms that involved foreign currency payments, designed to insure creditors against the possibility of a decline in the value of the dollar. These experimental mechanisms of the late 1960s and 1970s were only used on a modest scale, but they suggest the antecedents of future demands that might be imposed by creditors.[52] It would also become more difficult to reduce the value of US debts via devaluation and inflation, devices which have served the United States well in the past, but which in the future would both work less well and further undermine the dollar's credibility.

Reduced autonomy, eroding structural power, vanishing prestige, and a growing overhang problem all suggest a challenging general macroeconomic context for American power in the coming years. More specific problems also loom large, in the form of the risk of debilitating crisis and vulnerability to economic coercion. The danger of financial crisis remains—the underlying vulnerabilities of the US financial system have not been addressed. Another crisis could come. And it could arrive during a national security crisis.

The overextended dollar might also leave the United States vulnerable to economic coercion by other states. There is a real threat here, though one less apocalyptic than often suggested by those expressing concerns that China might threaten to dump its enormous dollar holdings as an act of political coercion against the United States. This possibility is severely circumscribed by the fact that it is not in China's interest to do so, leaving this as a mostly empty threat.[53] China now has, as I have argued above, "buyer's remorse" with regard to its vast dollar holdings. But it did not accumulate those dollar assets as an act of philanthropy, and it currently finds itself as a major stakeholder in the future of the dollar and the health of the US economy. China would be a big loser in a confrontation that undermined either the greenback or American consumer demand. Despite its remarkable record of economic growth, China's economy has visible fragilities. Significant dollar depreciation would be a blow to China's economy; a collapse in the dollar that reduced American demand for imported goods would be a disaster. Thus China could conceivably dump its dollars, but this would be the economic equivalent of the nuclear option. It is possible to imagine scenarios, especially regarding confrontations over Taiwan, where China might try and engage in dollar brinksmanship or even pull the currency trigger—but short of that, China's vested interest in the dollar undercuts the potential political advantages of such a gambit.

But this does not leave the dollar in the clear. China has a more subtle lever of monetary power at its disposal. It has the capacity to modulate the rate at which it acquires dollar assets, as well as the ability to manipulate the timing and publicity associated with the rebalancing of its reserve portfolio (an effort already underway). And this channel of influence is more of a one-way street. A more confident—or more aggrieved—China might use this more subtle technique of monetary power to get the attention of US during moments of political conflict. Although the circumstances are (again) notably different, this capacity is parallel to the Franco-British monetary relationship in the late 1920s and early 1930s. In that period, the functioning of international monetary system gave France the ability to draw gold from Britain essentially at will. France rather self-consciously used this power to try and push Britain around whenever the two states came into disagreement on important international political issues. If Sino-American relations deteriorate over economic or international political issues, it is likely that US macroeconomic stability will be ruffled by China shuffling its dollar cards, even if it never folds them. Once again, even though the circumstances are quite distinct, the lessons are relevant—and alarming. France did not hesitate to resort to the exercise of monetary power (and it would be naïve to assume that China would abstain from the practice). France's efforts at monetary diplomacy ultimately backfired, and contributed to the collapse of the international financial system and the great depression (a reminder that even though China has every incentive to avoid undermining the world economy, intentions are not always adequate to prevent costly blunders).

In the late 1920s, France was determined to take full advantage of one of the few high cards it held. Towards Germany (and Eastern Europe more generally) France sought to use the financial system, an area of relative strength, as a lever of influence. Towards Britain, as noted, France resorted to boat-rocking—expressing its preferences, as necessary, by exposing the precarious nature of British finances. Whenever Britain and France came into conflict, gold flowed from Britain to France. Those conflicts were invariably over some aspect of the German question, such as negotiations over adjusting reparations.[54]

Push came to shove, unfortunately, in 1931, during the Creditanstalt crisis, an event with eerie parallels to more recent events. On May 8, the bank informed the Austrian government that it was on the brink of failure. Understanding immediately that the Creditanstalt was a Too Big To Fail institution—it was the largest bank in Austria, indeed, the largest European bank east of Germany—the normally conservative, non-interventionist government immediately went to work on a rescue package. Despite the efforts of the government, runs on banks throughout Austria occurred. Things got out of hand, the Creditanstalt failed, and the crisis spread to Germany, whose financial sector was left in ruins.[55] The crisis then spread to London, where, in September, a hemorrhaging of reserves forced the pound off the gold standard for the first time (outside of wartime suspensions) in two hundred years. Major aftershocks from the British break with gold were felt in the United States and as far away as Japan—where they were a decisive factor in the radicalization of politics there.

Why was the crisis uncontained? In a word, politics.[56] Once the troubles of the Creditanstalt were made public, it was understood that Germany would be "at once exposed to the danger of panic withdrawal of capital." Britain, hoping to prevent a generalized European banking crisis, favored finding a way to support the rescue efforts of the Austrian government. France, in contrast, saw a political opportunity. Austria and Germany had been moving towards a Customs Union, but France had argued, reasonably, that such an agreement was forbidden by the Versailles Treaty. Now France could do more than argue—it made any assistance to Austria contingent on the abandonment of the Customs Union scheme—which it presented as an ultimatum on June 16.[57]

The Americans and the British, who had, in May, backed an initial loan to Austria through the Bank for International Settlements (more help was now needed), were displeased by what internal US documents described as "blackmail." Secretary of State Henry Stimson personally told the French Ambassador in Washington that such behavior was not "the proper way to meet a financial crisis." (Actually, France's efforts went beyond blackmail; with the banking crisis there was a flight from the Austrian shilling, and France withdrew funds from Austria in an effort to pour gasoline on that fire.) Faced with the France's demand, the Austrian government announced its resignation, which threatened such chaos that the next day the Bank of England stepped in with a large emergency short-term loan of its own. This temporarily saved the Austrian government, but weakened the position of sterling.[58]

The British credit provided a respite from the storm but could not restore the continent's fragile finances, and soon enough Germany found itself tested—and wanting—by the financial pressures unleashed by the Austrian crisis. On June 25th the situation was adequately dire that even France joined in with the Bank of England, the Bank for International Settlements, and the US Federal Reserve Banks to collectively provide a $100 million loan to Germany. But when that proved insufficient, and it was clear that Germany would need more help from abroad, France introduced a range of political conditions on any new loans, including demands for concessions on naval disarmament, reparations, the Customs Union issue (once again), and recognition of French interests in Central Europe and the Balkans. Instead, Germany retreated behind a wall of exchange controls (which would be adapted and integrated into Nazi grand strategy a few years later), essentially divorcing itself from global financial markets. With the German avenue dammed, the crisis floodwaters were diverted to Britain, and the stage was set for the crisis that would be visited upon sterling in September.[59]

An important difference between the global financial crises of 1931 and 2007 was that in the former case, the perception of intense security dilemmas across Europe inhibited cooperative efforts that might have contained the crisis, and encouraged short-sighted unilateralism that was collectively disastrous. A reminder that politics always has a formative influence on the pattern of international monetary and financial relations; that the relatively benign security environment in 2007 contributed to the containment of that crisis (it could have been much worse); and that there are no guarantees that the international political environment will be as forgiving next time.

CONCLUSIONS: NEW HETEROGENEITY ABROAD—PARALYSIS AT HOME?

Before the financial crisis, trends at home and abroad suggested new macroeconomic constraints on American power. Assuming continuity in these underlying factors—though this certainly need not be the case, and International Relations theorists have repeatedly erred in implicitly assuming continuity over change with regard to trends in world politics[60]—I have argued that crisis has accelerated those underlying trends, and left the United States more vulnerable to the possibility that macroeconomic factors will inhibit, rather than enhance, its capabilities on the world stage, a reversal of the experiences of the past seventy years.

My principal argument in this chapter is that the Global Financial Crisis will present (like the Great Depression and the inflation of the 1970s) a "learning moment" in world politics, but that much of that learning will take place *outside* of the United States. And that lesson will be, to varying extent, import, and consequence, that unbridled capitalism (and, especially, unbound finance), does not work, and that the American model is disreputable. The emergence of a New Heterogeneity of thinking about money and finance will mark the end of the Second Post-War American Order. States will increase their demand for autonomy and insulation from global financial instability, and, due to ideological shifts and the acceleration of underlying material trends, US power and influence will be relatively diminished on this new environment.

In addition to changes to the balance of power and political influence, these developments will also contribute to more acrimonious and chronic macroeconomic squabbling between states, which will place additional pressure on the management of the dollar. The underlying problem is that, in general, monetary cooperation is inherently difficult. States invariably seek to shift the burdens of adjustment abroad—costs that can be quite high and politically unwelcome. (Much of Europe's current crisis is a fight over how to distribute the burdens of macroeconomic adjustment.) Typically, it takes a confluence of exceptional factors for monetary cooperation to be sustained, each of which mitigates the costs of those burdens. A concentration of monetary power can help foster cooperation, because a hegemon can take on a disproportionate share of the costs of adjustment, or it can supervise, police and enforce arrangements about the nature of adjustment. Ideological homogeneity can foster cooperation by giving a cloak of economic legitimacy to the economic distress associated with adjustment. And shared, salient security concerns can increase the willingness of partners to bear the costs of adjustment, because they care more about the security situation.

Note that in contemporary international politics all of these variables are moving in the "wrong" direction. US relative power (and monetary power), is in relative decline. I have argued that there is a New Heterogeneity of ideas about money and finance. And the security interests of key players at the monetary table have not been this divergent (if not necessarily oppositional) in over a century.[61] In particular, it is notable that every major effort to reconstitute the international monetary order in the second half of the twentieth century was undertaken by the United States and its political allies and military dependencies. That is no longer the case.

The implication of these problems can be overstated, and it is important to understand them in context. Dollar "optimists" correctly point to the extraordinary and unique strengths of the US economy, and the additional advantages of incumbency for the dollar as international money.[62] These are good reminders that dollar is extremely unlikely to simply go away, and discussions of its "eclipse" are premature, to say the least. My argument is simply that its international role *is* very likely to *relatively* diminish over time, and that this change in status—

even as modest as remaining "first among equals," will have significant consequences for American power. Optimists also note—again correctly—that for all of the dollar's observable problems, comparatively speaking, it remains the most attractive international money. That is, it remains champion due to the glass jaws of would-be competitors. Nevertheless, however accurate, such a static observation overlooks the fact that this—the lack of alternatives—is the dollar's most important remaining foundation. All of the other pillars that served to provide the bedrock support for the dollar order—common economic ideology, the concentration of power, shared security concerns, and faith in the American economy and its unique invulnerability to financial crisis—have eroded away. The dollar dominates, but its exposure and others' motivations for greater diversity have never been higher.

In sum, the stage is set for chronic squabbling over international monetary and financial cooperation and governance in the coming decades, and the United States will find it harder to simply shrug off the burdens of macroeconomic adjustment (which will inevitably present themselves) onto others. This will compound the new US sensitivity to external constraints. And a key word here is *new*. It is not just that the United States will very likely face external constraints – pressures for adjustment, new macroeconomic vulnerabilities, the danger of financial crisis – it that such pressures are unfamiliar to the US political system. And that system is already under considerable stress, dealing (or failing to deal) with formidable domestic economic problems, first among which is the need to put its fiscal house in order. Given the strands of unilateralism and isolation that weave their way throughout American history, it is possible that domestic politics will indeed magnify the "real" effect of these new pressures, and present an Achilles heel of American power.

Sustainable national security strategies rest on economic and political foundations. Both global economic trends and domestic political contestation suggest that a careful assessment of the underpinning logics and long run wisdom and viability America's global strategy—which should reflect its priorities, capabilities and ambitions—is in order. In particular, US planners need to be alert to both the international economic and domestic political consequences of another American financial crisis—a possibility that, unfortunately, cannot be causally dismissed. As Barry Eichengreen has argued, the success of the emergency measures introduced in the heat of the moment prevented a second great depression, but "their very success encouraged second thoughts," and "weakened the incentive to think deeply about causes." This has left in place, Financial Times columnist Martin Wolf a financial structure that is "irretrievably unstable," and it is "grotesquely dangerous." [63] Moreover, domestic politics are much more brittle now than they were then. During the 2007–08 crisis, the correct policies were initially chosen; but, applied half-heartedly and incompletely, these measures are commonly considered to have been a failure by the general public. This perception, coupled with (here more accurate) resentment that the tycoons who caused the crisis were largely sheltered from its consequences, has likely exhausted the political will that would be necessary to introduce the emergency measures required to deal with the next big crisis. Thus the economic and political consequences of the next crisis on American national security strategy will almost certainly be even greater.

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[1] See for example Benjamin Cohen, "Towards a Leaderless Currency System," in Eric Helleiner and Jonathan Kirshner (eds.), *The Future of the Dollar* (Ithaca: Cornell University Press, 2009).

[2] Jonathan Kirshner, "Globalization and American Power", workshop memo, April 16, 2004. See also Kirshner, "Globalization, Power, and Prospect", in Kirshner (ed.) *Globalization and National Security* (Routledge, 2006). I was in good company: Paul Volcker estimated there was a seventy-five percent chance of a dollar crisis within five years, "Checking the Depth Gauge: How Low Might the Dollar Sink?" *The Economist*, November 11, 2004.

[3] Alan Greenspan *The Age of Turbulence* (New York: Penguin Press, 2007), pp. 198-9, 257, 375-6.

[4] US Government Accountability Office, *Financial Derivatives: Actions Needed to Protect the Financial System* (1994), pp. 11, 14-15, 39, 124, 126-7; Alan Greenspan, "The Regulation of OTC Derivatives," Testimony before the House Committee on Banking and Financial Services, July 24, 1998; Greenspan, *Age of Turbulence,* pp. 373-4.

[5] Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge: Harvard University Press, 2011), pp. 28, 29, 39, 51; Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (New York: Pantheon, 2010).

[6] Johnson and Kwak, *13 Bankers*, pp. 87, 91.

[7] See Carmen Reinhart and Kenneth Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009).

[8] China's continued economic growth is by no means guaranteed. The People's Republic faces some formidable economic challenges in the coming years, and its rate of economic growth has decelerated and will most likely not return to the unprecedented, galloping rate of the thirty plus years from the 1980s. Nevertheless, most projections of economic growth – even those that are cautious about China and optimistic about America – suggest that even if US growth tracks toward the high end of its potential, and even if China's growth rate checks in closer to the lower end of its commonly anticipated trajectory, each year (and over the years) China will grow faster than the United States, with long run consequences for the balance of power.

[9] See for example, Rogoff and Reinhart, *This Time is Different*, p. 155.

[10] International Monetary Fund, *IMF Survey* May 12 1997; International Monetary Fund, *Global Financial Stability Report* (April 2006), p. 133.

[11] Kristof and Sanger, "How U.S. Wooed Asia," (Chile, Korea); Kenneth Klee and Rich Thomas with Stefan Theil, "Defending the One True Faith," *Newsweek,* September 14, 1998, p. 22 (last quotes).

[12] On these themes see Jonathan Kirshner (ed.) *Monetary Orders: Ambiguous Economics, Ubiquitous Politics* (Ithaca: Cornell University Press, 2003).

[13] Alan Greenspan, "The Current Asian Crisis," testimony before the Senate Appropriations Committee, March 3, 1998. Add Fischer and Summers.

[14] Sidney Weintraub, "Lessons from the Chile and Singapore Free Trade Agreements," in Jeffrey Schott (ed.) *Free Trade Agreements: U.S. Strategies and Priorities* (Washington: Institute for International Economics, 2004), p. 87.

[15] G. John Ikenberry and Charles Kupchan, "Socialization and Hegemonic Power," *International Organization* 44:3 (June 1990): 283-315.

[16] Robert Shiller, "Democratizing and Humanizing Finance," in Randall Kroszner and Robert Shiller, *Reforming U.S. Financial Markets*: *Reflections Before and Beyond Dodd Frank* (Cambridge: MIT Press, 2011), pp. 2 (quote), 5, 9. Paul Volcker, "The Fed & Big Banking at the Crossroads," *New York Review of Books*, LX: 13 (August 15, 2013), p. 33. As one scholar observes, "post-crisis developments seem to indicate that the privileged position of banks has been entrenched rather than diminished." Andrew Baker, "Restraining Regulatory Capture? Anglo-America, Crisis Politics and Trajectories of Change in Global Financial Governance," *International Affairs* 86:3 (2010), p. 655. Robert Lucas, "Glass-Steagall: A Requiem," *American Economic Review* 103:3 (May 2013), p. 43.

[17] Ilene Grabel, "Not Your Grandfather's IMF: Global Crisis, 'Productive Incoherence' and Developmental Policy Space," Cambridge Journal of Economics 35 (2011), pp. 812, 814, 816, 817, 825; see also Jonathan D. Ostry, et al., "Capital Inflows: The Role of Controls," IMF Staff Position Note, February 19, 2010; Olivier Blanchard, Giovanni Dell'Aricca, and Paolo Mauro, "Rethinking Macroeconomic Policy" IMF Staff Position Note, February 12, 2010, "the crisis clearly forces us to question our earlier assessment," pp. 3, 11; IMF External Relations Department Morning Press, "Capital Controls: IMF Shifts its Stance With Plan for Capital Controls," April 6, 2011.

[18] Benjamin Cohen, "The China Question: Can Its Rise Be Accommodated?" in Eric Helleiner and Jonathan Kirshner (eds.), *The Great Wall of Money: Politics and Power in China's International Monetary Relations* (Ithaca:

Cornell University Press, 2014); see also Gregory Chin, "China's Rising Monetary Power," also in *Great Wall of Money*.

[19] William Grimes, "Internationalization of the Yen and the New Politics of Monetary Insulation," in Kirshner (ed.) *Monetary Orders*, pp. 177, 180, 181 (quote), 183-4, 193-4.

[20] Carl E. Walter and Fraser J. T. Howie, *Red Capitalism: The Fragile Foundation of China's Extraordinary Rise* (Singapore: Wiley, 2011), pp. ix-x, 3; Rosemary Foot and Andrew Walter, *China, The United States, and Global Order* (Cambridge: Cambridge University Press, 2011), pp. 117, 120, 123, 265-270; Gregory Chin and Eric Helleiner, "China as a Creditor: A Rising Financial Power?" *Journal of International Affairs*, 62:1 (Fall/Winter 2008), pp. 87 (quote), 92, 97-8, 99.

[21] Geoff Dyer, "Paulson Urges Beijing to Speed Up Reform," *Financial Times* March 8, 2007. Pieter Bottelier, "China and the International Financial Crisis," in Ashley Tellis, Andrew Marble, and Travis Tanner (eds.) *Strategic Asia 2009-10: Economic Meltdown and Geopolitical Stability* (Seattle: National Bureau of Asian Research, 2009), p. 100 ("The crisis has confirmed Chinese leaders in their belief that they were correct in resisting U.S. pressure.")

[22] Li Ruogu, "The Financial Crisis and International Monetary System Reform," *China Finance* 5 (2010); Li Yang, "Reform of the Global Financial System and Asia's Choices: We Need Deeper Thinking," *Studies in International Finance* 10 (2010); Li Daokui and Yin Xingzhong, "New Structure of the International Monetary System: Research on the Post-Financial Crisis Era," *Journal of Financial Research* 2 (2010).

[23] Zhou Xiaochuan, "Reform of the International Monetary System," People's Bank of China, March 23, 2009; David Barboza, "China Urges New Money Reserve to Replace Dollar," *New York Times*, March 24, 2009; Gregory Chin and Wang Yong "Debating the International Currency System: What's in a Speech?" *China Security* 6:1 (2010), pp 4, 5, 11, 12, p. 14 (quote); Zhang Yuyan, "Internationalization of the RMB: Endorse or Oppose," *International Economic Review* 1 (2010); Zhang Ming, "Reform of the International Monetary System"; Zhang Yuyan and Zhang Jingchun, "International Currency's Costs and Benefits," *World Affairs* 21 (2008).

[24] Walter and Fraser *Red Capitalism*, pp. 25, 27, 38, 77-8, 80, 138-9; Michael F. Martin, "China's Banking System: issues for Congress," *CRS Report for Congress*, February 20, 2012; Sebastian Mallaby and Olin Wethington, "The Future of the Yuan: China's Struggle to Internationalize Its Currency," *Foreign Affairs* 91:1 (January/February 2012), pp. 136, 137; Jeffrey Frankel, "Historical Precedents for Internationalization of the RMB" (Council on Foreign Relations, November 2011), p. 13.

[25] Ming Zhang, "China's New International Financial Strategy amid the Global Financial Crisis," *China & World Economy* 17:5 (2009), pp. 23, 24, 27, 29, 31; Pieter Bottelier, "Future of the Renminbi as an International Currency," *ChinaUsfocus.com* April 29, 2011; Keith Bradsher, "In Step to Enhance Currency, China Allows Its Use in Some Foreign Payments," *New York Times*, July 7, 2009; George Koo and Henry Tang, "How Shall America Respond to Chinese Yuan as a Global Currency," *ChinaUsFocus.com* February 29, 2012.

[26] Chen Siqing, "Deeper-level Analysis of the Reasons for the U.S. Financial Crisis and Its Lessons for China's Banking Industry," *Studies of International Finance* 12 (2008); John Williamson, "Is the 'Beijing Consensus' Now Dominant?" *Asia Policy* 13 (January 2012), p. 3; Nancy Birdsall and Francis Fukuyama, "The Post-Washington

Consensus: Development After the Crisis," *Foreign Affairs* 90:2 (March/April 2011), p. 3; Foot and Walter, *China, The United States, and Global Order*, p. 271.

[27] See for example Sebastian Mallaby and Olin Wethington, "The Future of the Yuan: China's Struggle to Internationalize Its Currency," *Foreign Affairs* 91:1 (January/February 2012), pp. 136, 137; Jeffrey Frankel, "Historical Precedents for Internationalization of the RMB" (Council on Foreign Relations, November 2011), p. 13; Takatoshi Ito, "The Internationalization of the RMB: Opportunities and Pitfalls," (Council on Foreign Relations, November 2011), p. 11.

[28] And this position would appear to be gaining toeholds of legitimacy. See for example Olivier Jeanne, Arvind Subramanian, and John Williamson, *Who Needs to Open the Capital Account?* (Washington: Peterson Institute for International Economics, 2012). On the relationship between internationalization and liberalization, see also Dong He, "Renminbi Internationalization: A Primer", *Hong Kong Institute for Monetary Research*, 31 July 2012, and Christopher A. McNally, "Abstract Sino-Capitalism: China's Reemergence and the International Political Economy," *World Politics* 64:4 (October 2012), pp. 760-62.

[29] Zhou Xiaochuan, "Several Issues in the Establishment and Implementation of Financial Industry Standards" *China Finance*, (5 January 2012). On internationalization ahead of liberalization, see Robert N. McCauley, "Internationalizing the Renminbi and China's Financial Development Model," (Council on Foreign Relations, November 2011), pp. 1, 3 ("In internationalizing the Renminbi within a system of capital controls, the Chinese authorities set out on a path with no signposts"), 13, 21.

[30] James Kynge and Josh Noble, "China: Turning away from the dollar," *Financial Times* December 9, 2014.

[31] Yang Jiang, "China's Monetary Diplomacy: Venturing Beyond Bilateralism?" in Eric Helleiner and Jonathan Kirshner (eds.), *The Great Wall of Money: Politics and Power in China's International Monetary Relations* (Ithaca: Cornell University Press, 2014).

[32] Steven Liao and Daniel McDowell, "Redback Rising: China's Bilateral Swap Agreements and Renminbi Internationalization," *International Studies Quarterly* 59:3 (2015), 401-22; Simon Rabinovitch, "China and Japan Agree on Currency Push," *Financial Times* December 27, 2011; Wang Xiaotian and Gao Changxin, "China-Japan Currency Deal Ushers in a New Era," *ChinaDaily.com.cn*, May 30, 2012; Kosuke Takahashi, "Japan and China Bypass US in Direct Currency Trade," *The Asia-Pacific Journal* 24:3 (June 11 2012); "China and Australia in $31bn Currency Swap," *Financial Times*, May 22, 2012; "China and Brazil in $30bn Currency Swap Agreement," *BBC News*, June 22 2012.

[33] Lawrence Summers, "A global wake up call for the U.S.?" *Washington Post* April 5, 2015.

[34] World Bank, *Global Development Horizons 2011 – Multipolarity: The New Global Economy* (Washington: World Bank, 2011), pp. 7, 13, 126, 131, 140, 144, 152.

[35] The Euro was always a *political* project; part of an effort to forge a common European entity and identity. Considered solely from an economic perspective, the Euro project was incoherent. The monetary union had invited problems and allowed pressures to develop, and when faced with real difficulties states found themselves disarmed of essential policy defenses. Joining the Euro meant the abdication of monetary policy and exchange rate policy,

without gaining any new policy levers. On the problems of the Euro, see Martin Feldstein, "The Failure of the Euro: the Little Currency that Couldn't," Foreign Affairs 91:1 (January/February 2012), 105-16.

[36] Randall Germain and Herman Schwartz, "The political economy of failure: The euro as an international currency," *Review of International Political Economy* 21:5 (2014) 1095-1122; see also O'Rourke, K. and A. Taylor (2013) "Cross of Euros." *Journal of Economic Perspectives*, 27(3): 167-92.

[37] Rawi Abdelal argues that the framers of the Eurozone understood that eventually and inevitably some sort of reckoning would force a reassessment of monetary arrangements in Europe. But they also understood that it would take some sort of crisis (if not quite this big) to propel the union forward. Rawi Abdelal, *Capital Rules: The Construction of Global Finance* (Cambridge: Harvard University Press, 2007), chapter 4.

[38] See Benjamin Cohen, "The Macrofoundations of Monetary Power," in Andrews, *International Monetary Power.*

[39] Susan Strange, "Finance, Information and Power," *Review of International Studies* 16:3 (July 1990) 259-74.

[40] In theory, with floating rates, the "overhang" can be ignored and excess currency "mopped up" by depreciation. In practice, states are very sensitive to the management of this type of problem even in the absence of fixed rates.

[41] Jonathan Kirshner, *Currency and Coercion: The Political Economy of International Monetary Power* (Princeton: Princeton University Press, 1995), pp. 64-70; Harold Macmillan, *Riding the Storm* (New York: Harper and Row, 1971), p. 164. See also Diane B. Kunz, *The Economic Diplomacy of the Suez Crisis* (Chapel Hill: University of North Carolina Press, 1991); Lewis Johnman, "Defending the Pound: The Economics of the Suez Crisis, 1956", in Anthony Gorst, Lewis Johnman and W. Scott Lewis (eds.) *Post-war Britain, 1945-64: Themes and Perspectives* (London: Pinter Publishers, 1989); Howard J. Dooley, "Great Britain's 'Last Battle' in the Middle East: Notes on Cabinet Planning during the Suez Crisis of 1956," *International History Review* 11:3 (August 1989).

[42] Phillip Darby, *British Defense Policy East of Suez 1947-68* (London: Oxford University Press, 1973), p. 293; Michael Chichester and John Wilkinson, *The Uncertain Ally: British Defense Policy 1960-1990* (Grower: Aldershot, 1982), pp. 9-10; Jeremy Fielding, "Coping with Decline: US Policy Toward the British Defense Reviews of 1966" *Diplomatic History* 23:4 (Fall 1999), pp. 633-637, 645; "Memorandum From President Johnson to Secretary of the Treasury Fowler", *Foreign Relations of the United States: 1964-1968 Volume VII,* p. 173.

[43] Clive Ponting, *Breach of Promise: Labour in Power 1964-1970* (London: Hamish Hamilton, 1989), p. 55; Darby, *British Defense Policy,* pp. 283, 304; Fielding, "Coping with Decline", pp. 634-6, 651; Michael Dockrill, *British Defense Policy Since 1945* (Oxford: Basil Blackwell, 1988), pp. 94-5, 97, 101, 103; J. C. Hurewitz, "The Persian Gulf: British Withdrawal and Western Security", *Annals of the American Academy of Political and Social Science* 401 (May 1972) pp. 107, 114; Chichester and Wilkinson, *The Uncertain Ally*, pp. 20, 23, 31-2.

[44] Kathleen Burk and Alec Cairncross, *Goodbye Great Britain: The 1976 IMF Crisis* (New Haven, Yale University Press, 1992), pp. 20, 78, 105; Dockrill, *British Defense Policy*, pp. 104, 106, 107; Chichester and Wilkinson, *The Uncertain Ally*, pp. 47-8; 53; "Britain's Defensive World Role", *The Economist*, November 24, 1979, p. 27.

[45] Jonathan Kirshner, *Appeasing Bankers: Financial Caution on the Road to War* (Princeton: Princeton University Press, 2007).

[46] H. Clark Johnson, *Gold, France and the Great Depression, 1919-1932* (New Haven: Yale University Press, 1997); Kenneth Moure, *The Gold Standard Illusion: France, The Bank of France, and the International Gold Standard, 1914-*

1939 (Oxford: Oxford University Press, 2002); Martin Wolfe, *The French Franc Between the Wars 1919-1939* (New York: Columbia University Press, 1951), esp. pp. 35, 83.

[47] Kenneth Moure, *Managing the Franc Poincaré: Economic Understanding and Political Constraint in French Monetary Policy, 1928-1936* (Cambridge: Cambridge University Press, 1991) p. 17-18; 22, 27, 121; Barry Posen, *The Sources of Military Doctrine: France, Britain and Germany Between the World Wars* (Ithaca: Cornell University Press, 1984), p. 20. Robert Murray Haig, "The National Budgets of France, 1928-1937," *Proceedings of the Academy of Political Science* 17:4 (1938), pp. 26, 29; Talbot Imlay, *Facing the Second World War: Strategy, Politics and Economics in Britain and France 1938-1940* (Oxford: Oxford University Press, 2003), p. 25; Bradford Lee, "Strategy, Arms, and the Collapse of France 1930-40", in Richard Langhorne (ed.) *Diplomacy and Intelligence during the Second World War* (Cambridge: Cambridge University Press, 1985), pp. 59, 63, 64, 65.

[48] Moure, *Managing the Franc*, p. 151. Emile Moreau, *The Golden Franc: Memoirs of a Governor of the Bank of France* (Boulder: Westview Press, 1991), pp. 128, 513-15, 517-8; J. Nere, *The Foreign Policy of France from 1914-1945* (London: Routledge & Kegan Paul, 1975), pp. 127, 129-30; Anthony Adamthwaite, *France and the Coming of the Second World War*, (London: Routledge, 1977) p. 27 ("the franc was the Achilles heel of French Policy"); Haim Shamir, *Economic Crisis and French Foreign Policy, 1930-1936* (Leiden: E. J. Brill, 1989), pp. 16-17, 26, 44; Paul Einzig, *France's Crisis* (London: Macmillan, 1934), pp. viii, ix, 12, 102 (quote), 119.

[49] Nere, *French Foreign Policy*, pp. 152; Rene Girualt, "The Impact of the Economic Situation on the Foreign Policy of France, 1936-9," in Wolfgang Mommsen and Lothar Kettenacker (eds.) *The Fascist Challenge and the Policy of Appeasement* (London: George Allen and Unwin,1983), p. 223 (quote), see also pp. 214, 216; Shamir, *Economic Crisis*, pp. 133, 211, 215. Robert Frankenstein, "The Decline of France and French Appeasement Policies, 1936-9," in Mommsen and Kettenacker, The *Fascist Challenge*, p. 237.

[50] R.A.C. Parker, "The First Capitulation: France and the Rhineland Crisis of 1936," *World Politics* 8:3 (April 1956), p. 367, 371; Nere, *French Foreign Policy*, pp. 186-89; Raphaelle Ulrich, "Rene Massigli and Germany, 1919-1938", in Boyce (ed.) *French Foreign and Defense Policy*, p. 143; James Thomas Emmerson, *The Rhineland Crisis 7 March 1936: A Study in Multilateral Diplomacy* (Ames: Iowa State University Press, 1977), pp. 39, 41, 47; Shamir, *Economic Crisis*, p. 218.

[51] Emerson, *The Rhineland Crisis*, p. 78 (quotes); see also pp. 105, 111, 247. Stephen Schuker, "France and the Remilitarization of the Rhineland, 1936", *French Historical Studies*14:3 (Spring 1936), pp. 304, 330, 334, 335 (quotes); "French Financial Weakness", *The Economist*, March 28, 1936, p. 711.

[52] John Makin, "Swaps and Roosa Bonds as an Index of the Cost of Cooperation in the 'Crisis Zone'", *Quarterly Journal of Economics* 85:2 (May 1971); Anna Schwartz, "From Obscurity to Notoriety: A Biography of the Exchange Stabilization Fund," *Journal of Money, Credit and Banking* 29:2 (May 1997).

[53] Daniel Drezner, "Bad Debts: Assessing China's Financial Influence in Great Power Politics," *International Security* 34:2 (2009); also Chin and Helleiner, "China as a Creditor."

[54] Paul Einzig, *International Gold Movements* (London: Macmillan, 1931), p. 33; Kirshner, *Currency and Coercion*), chapter 6; see also Sir Frederick Leith-Ross, *Money Talks: Fifty Years of International Finance* (London: Hutchinson and Co., 1968); and Moreau, *The Golden Franc.*

[55] Aurel Schubert, *The Cred-Anstalt Crisis of 1931* (Cambridge: Cambridge University Press, 1991). Pp. 3-4. 7, 11-12; Michael Bordo and Harold James, "The Great Depression Analogy," *Financial History Review* 17:2 (2011), p. 128; Iago Gol Aguado, "The Creditanstalt Crisis of 1931 and the Failure of the Austro-German Customs Union Project, *The Historical Journal* 44:1 (2001), p. 200.

[56] See for example Theo Balderston, "The Banks and the Gold Standard Crisis of 1931," *Financial History Review* 1:1 (April 1994), p. 65; George Glasgow, "The Financial and Economic Crisis," *Contemporary Review* 140 (July/December 1931), pp. 140-1.

[57] League of Nations, *World Economic Survey 1931-2* (Geneva: 1932), p. 72; Aguado, "The Creditanstalt Crisis," pp. 203, 204, 216; Edward W. Bennett, *Germany and the Diplomacy of the Financial Crisis, 1931*, (Cambridge: Harvard University Press, 1962), pp. 41, 71, 73, 117, 149-50.

[58] *Foreign Relations of the United States, 1931, Volume 1* (Washington, 1946), pp. 23, 24 ("blackmail"), 26, (Stimson); Schubert, *The Cred-Anstalt Crisis*, pp. 14-15, 160-1; Bennett, *Germany and the Diplomacy of the Financial Crisis*, pp. 151-2. Aguado, "The Creditanstalt Crisis," p. 211, 214, 216.

[59] Bennett, *Germany and the Diplomacy of the Financial Crisis* pp. 177-8, 190, 219, 231, 237, 248; *Federal Reserve Bulletin*, November 1930, p. 383; *Foreign Relations of the United States,* 1931, p. 96.

[60] Major game changing discontinuities are plausible, and easily imagined, and would require a reassessment of my conclusions. A major financial crisis with the United States at its epicenter – either a dollar panic, or what would become known as "Too Big To Fail Two" – would radically accelerate the decline of the dollar as an international currency. The complete implosion of the Euro would bolster the dollar as the only safe harbor in sight, though that assumes that such a crisis did not pull down a major US financial institution along with it, which might be wishful thinking, and not to be underestimated are the effects on the economies of the US and China that would result from a deepening of Europe's economic distress. Finally, it is easy to imagine an interruption in China's economic growth, which, again, would bolster the dollar and decelerate the shift in the balance of power away from the US However, given the likely consequences of economic distress in China: spillover harm to its trading partners and a legitimacy crisis for the CCP, the 'costs' of a slowly growing China will outweigh the 'benefits'.

[61] Participants at every major monetary conference of the twentieth century were by and large political allies.

[62] See for example Doug Stokes, "Achilles' Deal: Dollar Decline and U.S. Grand Strategy After the Crisis," *Review of International Political Economy* (2013); Daniel Drezner, *The System Worked: How the World Stopped Another Great Depression*, (Oxford: Oxford University Press, 2014); Eswar Prasad, *The Dollar Trap: How the U.S. Dollar Tightened Its Grip on Global Finance*, (Princeton: Princeton University Press, 2014).

[63] Barry Eichengreen, *Hall of Mirrors: The Great Depression, The Great Recession, and the Uses – and Misuses – of History* (New York: Oxford University Press, 2015); Martin Wolf, *The Shifts and the Shocks: What We've Learned—and Still Have to Learn—from the Financial Crisis* (New York: Penguin, 2014).