CAMBRIDGE
UNIVERSITY PRESS

Trustees of Princeton University

The Politics of International Currencies
Author(s): Susan Strange
Source: *World Politics*, Vol. 23, No. 2 (Jan., 1971), pp. 215-231
Published by: Cambridge University Press
Stable URL: http://www.jstor.org/stable/2009676
Accessed: 12-12-2015 14:06 UTC

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at http://www.jstor.org/page/info/about/policies/terms.jsp

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

*Trustees of Princeton University and Cambridge University Press* are collaborating with JSTOR to digitize, preserve and extend access to *World Politics*.

http://www.jstor.org

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

# THE POLITICS OF INTERNATIONAL CURRENCIES

By SUSAN STRANGE

As a direct result of growing economic interdependence and of the accelerating expansion of the international economy and its increasing impact on national economic life, it seems highly probable that diplomacy and international relations among governments will be more and more concerned in the future with financial and monetary matters.

Already in the 1960's these matters had given a new style and content to foreign policy-making and to the conduct of foreign relations. In the United States, the Nixon administration is not the first to find problems of monetary management demanding more time and trouble than it expected. The new British government, too, will soon learn that sterling's troubles are not, after all, quite over and done with. Even countries like Germany and Japan (and in some respects Italy), which congratulate themselves on their economic miracles, do not manage to escape the proliferation of problems of monetary management and the consequent need for an ever more active and resourceful armory of monetary diplomacy. All the rich, developed countries, in short, are finding themselves behaving toward each other more and more often as the defenders and guardians not so much of national territory or of national groups of people as of national currencies and monetary systems.

As Richard Cooper and others have pointed out, there are two broad developments, stemming from economic interdependence, both of which lead in this direction.[1] One is the increasing probability that the monetary management of one national system wittingly or unwittingly causes damage and frustration in the monetary management of another and thus adds to the sources of conflict between states. The other is that the need to take advantage of the benefits of the expanding international economy and of the interdependent system it represents requires of governments that they devise more and more complex and sophisticated monetary and financial arrangements and forms of association among them. The negotiation of these associative arrangements and the resolution of these monetary conflicts are therefore likely to become not a less but a more important part of the stuff of international politics in the 1970's.

[1] Richard N. Cooper, *Economics of Interdependence: Economic Policy in the Atlantic Community* (New York 1968), 5-6 and 273-79.

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

Yet the political scientists in the field of international relations show themselves singularly ill-equipped as well as disinclined to explain, analyze, or illuminate what are still—despite their economic content—essentially political questions. On the other hand, the economists who are much concerned with the technical aspects of the question, with the analysis of the functioning of monetary and other economic mechanisms, unconsciously tend to ignore or overlook the political elements involved. Between them, there is what I have described elsewhere[2] as a "middle void": a no man's land, an empty quarter unwatered by the academic mainstreams, neglected by most universities, and subject only to sporadic forays by a few financial journalists and to isolated expeditions by a few academic hybrids.

This article is such an expedition. Its purpose is to map out in a rough and tentative way a political theory of international currencies. This theory may, I believe, help a little to explain to non-economists as well as to economists some of the divergent attitudes taken by governments in matters of monetary and indeed of broad economic diplomacy. For there is little doubt that the political element is the missing component in much current discussion of international financial and monetary issues. The debates over Special Drawing Rights two or three years ago and more recently over flexible exchange rates are both good examples. And though the study of international relations has always acknowledged the existence and the power of variant national economic interests, it has done little since the 1930's to develop or elaborate this concept and still less to bring it up to date with the realities of the contemporary international economy.

Honesty compels me to admit that this theory was first evolved in the course of a recent study[3] of the interaction between British policy (including aid, defense, trade, monetary, and broad foreign policies) in the ten years 1958-68 and the position of Britain as the guardian of sterling, a currency used both nationally and internationally. This study revealed first of all that the international use of sterling was of several kinds, distinguishable in political as well as in economic terms, and that because of these multiple roles, the effect of sterling on British policy and on British foreign relations was likely to have been complex rather than simple. The study also revealed the inability of economists, academic and official, to throw much helpful light on the political effects that might be expected to follow from possession of a cur-

[2] Susan Strange, "International Economics and International Relations: A Case of Mutual Neglect," *International Affairs*, XLVI (April 1970).

[3] Susan Strange, *Sterling and British Policy: A Political Study of an International Currency in Decline* (London 1970).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

rency used outside the confines of the nation-state. But, although it was originally suggested by the sterling question, I believe that the theory also has some relevance to the problems of the dollar as an international currency and to the policy options that have faced—and will continue to face—successive governments of the United States.

The theory is concerned with both the causes and the effects of the status of international currency: first, with the political as well as the economic conditions under which national currencies come to be used beyond national frontiers; and second, with the political as well as the economic consequences that follow for the issuing state when this happens. And instead of the mechanistic taxonomy of international economics (which classifies international currencies only by function, for instance, as reserve, as vehicle, or as intervention currencies), I have attempted a taxonomy that is deliberately both political and economic, consciously regarding the two as inextricably intermixed. I have distinguished four types of international currency—Top Currencies, Master Currencies, Passive or Neutral Currencies, and Political or Negotiated Currencies. Each role is distinct but none is exclusive. A single currency can play one of these four roles, or two, or three; or, in the case of the dollar, all four at once. But the political consequences of the different roles will not be the same.

Of the four, the Master Currency is distinguished from the others because the causative factor is primarily political, whereas with the other three types the causative factors are primarily economic. It is the political domination of the state issuing the currency over other areas, which may include, besides direct and acknowledged dependencies, areas that operate as (and for other purposes are treated as) sovereign and independent political units but that either have been or perhaps still are subordinate to it.

As a result primarily of this political domination, either the subordinate state or territory uses the Master Currency or else its own currency becomes a dependent of the Master Currency, so that its monetary policies, including the exchange rate with third currencies (or the volume of trade and capital transactions with third parties), interest rates, and other policies governing the availability of credit are determined by the exigencies affecting the Master Currency.

Obvious examples of Master Currencies are the franc in the franc zone; sterling in the sterling area; and the dollar in the "inner" dollar area of states so closely dependent politically on the United States as effectively to be its protectorates: South Vietnam, South Korea, Thailand, Taiwan, and, probably, the Philippine Republic, and most of the

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

small states of Central America and the Caribbean—Mexico and Cuba excepted. A minor example is the escudo in Portuguese Africa.

An arguable, borderline example of a Master Currency area is the Soviet bloc in Eastern Europe. The Soviet rouble is not, it is true, used for reserve or vehicle purposes in the other countries of the bloc. Each of their currencies keeps its individual identity and does not necessarily maintain a fixed parity with the Master Currency as the Indian rupee used to do to sterling. Yet the political reality is very similar to that of the Indian situation. The currency area is run as a unit, inasmuch as the subordinate states are not free to decide for themselves any matter of monetary or commercial policy considered in Moscow to be vital to the cohesion of the bloc; this applies especially to those questions that might affect political and economic relations with third parties. This limitation the Czechs tragically discovered in 1968. The monetary and commercial reforms contemplated by the Dubcek government proved less acceptable to Moscow than the seemingly more provocative economic nationalism asserted by the Rumanians. More recently, it has been the Hungarians who have been trying cautiously to extend the limits of political dependence in monetary matters,[4] with what success remains to be seen.

In fact, although the Soviet bloc is possibly an extreme variant of the type, there is seldom much uniformity in the methods used by Master Currency states to keep their subordinates under control. France, for instance, managed to control the franc zone after the African states became independent by a combination of dependence on French aid, preferential access to the French market, and a monetary system that, though apparently free inasmuch as it allowed members to acquire unrestricted amounts of French francs, yet gave ultimate monetary control to confederal *instituts d'emission* that remained (in practice) under close French surveillance.

The British system was quite different. In the days of the British Empire the sterling area operated as a single free financial area, throughout which funds could be freely transferred and within which interest rates responded to trends set in London. Control over the subordinates' commercial and financial relations with third parties was indirectly exercised by a rough-and-ready but essentially restrictive check on each territory's money supply. Beginning with the West African Currency Board, set up in response to the recommendations of the Emmott Committee of 1911, each colony was given a colonial Currency

[4] See Andrew Shonfield, "Hungary and Poland: The Politics of Economic Reform" *The World Today*, XXVI (March 1970).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

Board that was statutorily directed to hold sterling balances in London to the value of 110 percent of the colony's fiduciary issue. In return, however, the British government opened the London capital market to the colony's authorities, and did so on preferential terms almost equal to its own. Trustees, for example, who were legally barred from investing funds in risk-bearing equities, were allowed by English law to hold colonial, or later Commonwealth, government stock instead of British government stock, thus assuring these colonial governments privileged access to the London capital market.

Though this system continued to work after the granting of political independence, it was increasingly weakened by it. This weakening was less noticeable in the first postwar decade, after Indian independence, because India and Pakistan had both started with large accumulated credit balances as a result of being military bases in the war, and though they rapidly began to draw these down instead of maintaining the old 110-percent rule, this decrease caused no perceptible strain on Britain because at the same time the rest of the dependent sterling area was busily and conversely increasing its official sterling balance holdings as a direct result of that rule. In the same period, from 1946 to 1958, the other most important preservative of Britain's position in the sterling area and of sterling's position as a viable Master Currency was undoubtedly the strong support, both political and financial, of the United States. Not only was Britain generously provided with American aid and loans, but the United States gave the whole sterling area a special dispensation by allowing its trade policies to discriminate against dollar imports. By this means, the life of the sterling area club was substantially prolonged.

The pinch came after 1958, when a number of new factors all combined to increase the balance-of-payments cost to Britain of trying to maintain sterling as a Master Currency. As independence was given to Malaysia, to Ghana, Nigeria, and then to a series of other African states, the number of sterling area countries who were visibly free of the restrictions of colonial currency boards and the imposed rules of the sterling exchange standard drew the attention of private users of sterling to the notorious "overhang" of official sterling balances over British reserves of gold and foreign exchange. To guard sterling against a resulting loss of confidence in the market, the British monetary authorities had to keep interest rates exceptionally high, and decided to subsidize sterling holders with a cheap insurance against devaluation. This they did, in effect, by supporting the market for forward sterling. As high interest rates and competition from British industry meant that

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

little capital was left for sterling area countries from traditional capital market sources, the British government altered its aid policies from 1958 onward to provide the new states with loans whose terms it gradually softened and whose effect was probably to prolong trade and financial ties with Britain.

Political independence in the Master Currency area also changed the financial impact on Britain of her military and naval bases abroad, which could no longer be charged even in part (as the Indian Army always was in the heyday of the Empire) to the local exchequer. They became a burden on the British balance of payments and, from 1958 on, one that was annually more expensive. For at that date, by another unlucky coincidence, Britain dropped its National Service draft law and depended on volunteers who could be induced to sign on for overseas service only if they were better paid and better provided with amenities than those serving at home, and if some at least could take wives and children with them. It was the capital cost of the resulting installations and the consequent elaboration of the military administrative machine that explained why Britain spent £190 million on defense forces overseas in 1957 and £257 million in 1967, when the number of men abroad had actually been cut by 50 percent.

By the end of the post-convertibility decade, the Master Currency had slipped from its earlier status, based largely on British political power in the Empire, to the more expensive status of Political or Negotiated Currency, so that holders had to be bribed with a variety of inducements ranging from the financial ones already mentioned through the promise of military protection and support and finally to the dollar-value guarantee contained in the special agreements concluded first with Hong Kong and then with each member of the sterling area as a concomitant of the Basle Facility Agreement of 1968.

The moral of the tale is simple. The Master Currency depends heavily on the stick. But if the stick is weakened or if the issuing state for any reason becomes too embarrassed to use it, then it must be replaced by carrots. The inducements, *political as well as financial*, that have to be offered, in other words, vary inversely with the exercise of coercive power. Thus, in practice, there is no clear dividing-line between a Master Currency and a Negotiated Currency. The taxonomy is fluid, not rigid. And even the toughest Master Currency state usually finds it necessary to offer a few small carrots. The French, whose power and wealth made the control of the franc zone after the 1959 referendum a very much easier task than Britain's in the sterling area, still found it necessary to offer *surprix* for exports of primary products (at the ex-

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

pense of French consumers), to negotiate—through the Yaoundé Conventions—additional aid from her EEC partners, and herself to provide not only economic aid on a lavish scale but also a military guarantee that is normally discreet and largely invisible but—as the Foreign Legion's expeditionary force in Chad last year has shown—is nonetheless effective in case of need. And even the Soviet Union, though still prepared in the last resort to use tanks and military might to keep control over Eastern Europe, has been under increasing pressure to offer more effective credit facilities than Comecon has yet provided. Thus, if necessary, the Master Currency state will find itself subordinating the short-term economic interests of its domestic economy to the welfare and viability of the currency area as a whole. The conflict between the two is less evident when the units in the currency are small and weak, and their demands are modest, or when the Master Currency state itself is large, wealthy, and powerful. This is the case with the dollar in its limited role as a Master Currency. Moreover, the dollar is also what I have called Top Currency. In this role the schizoid character of policymaking processes is of a different kind.

The Top Currency may be defined as the currency of the state that has world economic leadership, the currency of the predominant state in the international economy, what Guido Carli recently described as the world's "super-economy."[5] It is the leading currency—but it may not always or necessarily be the best currency or the safest to keep money in. It may not be the preferred choice of the market when the market has an attack of the jitters. In short, it does not cease to be Top Currency when it leaves something to be desired as a store of value, so long as its predominance as a means of exchange is invulnerable. Charles Kindleberger expressed this well some years ago when he explained the international use of the dollar in terms not of power or prestige so much as of utility. "The power of the dollar and the power of English represent *la force des choses* and not *la force des hommes*, . . ." he said. "It is not nationalism which spread the use of the dollar and the use of English; it is the ordinary search of the world for short cuts in getting things done."[6] The strength of the dollar as a world exchange standard (or vehicle currency) Kindleberger attributed mainly to the international capital market operating in dollars. Although he implied, he did not spell out fully, that it operated in dollars because the world's biggest capital market was in New York, and that

[5] Guido Carli, *Annual Report*, Banca d'Italia (Rome 1970).

[6] Charles Kindleberger, *The Politics of International Money and World Language* (Princeton 1967).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

it was in New York because the United States was the world's leading economy, had not been twice disrupted by world wars, and was therefore much better able than other developed economies to produce the savings to invest abroad as well as at home.

Of course, it is highly probable that any state economically strong enough to possess the international economy's Top Currency will also exert substantial power and influence. The really rich usually do. But there may still be strict limits to the political power conferred by wealth. The political influence of the Top Currency state, therefore, may well be geographically less extensive than the use of the Top Currency. The contrast between unqualified economic preponderance and leadership and strictly limited political influence will be most apparent in the Top Currency state's relations with those states that for one reason or another are less involved in, or by some means are insulated from, the international economy over which the Top Currency presides.

In the heyday of sterling, when it was Top Currency before the First World War, British political influence was very great throughout the Empire and along the sea-routes linking it together. It was most markedly subject to limitation in China, in Latin America (by agreement with the United States), and in backward non-British areas of Asia and Africa. Today, the use and monetary prestige of the dollar is more extensive than the power of the United States Government. China again, the Soviet bloc, and the developing countries least involved in the international economy have each in its way accepted the monetary leadership of the dollar in the international economy while remaining fairly free from the political influence of the United States.

There are, of course, big differences between the dollar and sterling as Top Currency. One is that sterling had the advantage of a much larger role as Master Currency; the empire within which sterling was used as Master Currency was much more extensive than the "inner" dollar area politically dominated by the United States today. The larger role of sterling as Master Currency confined its political effects as the Top Currency mainly to Europe, to that part of the international economy over which the British had very limited political influence. By comparison, the areas where the dollar is acknowledged Top Currency but where the United States has limited political power are much larger.

On the other hand, the domestic economy of the United States is continental and incomparably larger and more self-contained than was that of Britain, and its lead that much greater over all other developed

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

national economies, both because of their smaller sizes and because of the setbacks experienced during and after the Second World War. Thus, although the United States is better equipped to manage a Top Currency, its problems are at the same time made greater by the tremendous expansion of the international economy. The collective need for an accepted international monetary medium has increased perhaps a hundredfold in real terms since 1914, as has the size and complexity of the credit structure financing international trade and payments. As a result, any tendency in this international economy to disequilibrium will now surely be greater and less easily overcome or counterbalanced. This growth creates the paradox puzzling to many Americans: that for all their power and wealth they are so constrained by their intractable payments deficit.

And here, in the perceived need to try to overcome it, is another way in which the dollar's situation is more difficult. "Ah, the lucky British," American economists have been heard to sigh, "when sterling was the leading key currency, their statistics were so bad they did not even *know* when they had a balance-of-payments problem." ("And what is more to the point," some will add below their breath, "no one else knew either!") Moreover, the British government in Victorian and Edwardian days acknowledged limited responsibility for the value of the currency and the reputation of British financial institutions and did not accept, as does the United States government today, the additional responsibilities of a modern welfare-conscious administration for the level of domestic employment, and the rate of domestic economic growth. Keeping the balance of payments as well as all these other balls in the air requires a much more highly developed economic dexterity.

Because the Americans are so wealthy, and militarily and technologically so powerful, the perverse and obstinate intractability of the dollar problem has not ceased—or so it seems from across the Atlantic—to trouble and bewilder them. They do not seem to be able to understand why it is that, out of all the numerous dodges and devices they have tried out over the last decade or so, none has worked the trick. Why should it be so difficult? Why is it that success eludes them? They are puzzled by the apparent lack of sympathy, and even indifference, of other countries to their plight, and seem to feel vaguely resentful that others do not step briskly forward to lend a hand in sharing this as well as other burdens. The situation is all the more galling because something like ninety out of every hundred professional economists in the world are American, and the preeminence of American universities

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

in the development of economics as an academic discipline is unchallenged and undeniable. If *they* cannot solve the riddle, is it likely that anyone else can?

I would argue—and this is the point of the present article, and indeed of trying consciously to devise a *political* and not just another *economic* theory of international currencies—that others *can* perhaps help. Half the trouble so far may have been precisely because the problem has been left so exclusively to the economists to think about and pontificate on. They do not, mostly—as they are so fond of telling the rest of us—lack intellectual rigor. But they do, too often, lack realism and political common sense. By mechanistic studies they have sought for mechanical panaceas to the problem of the American balance of payments, and have been surprised when each new-found mechanism has broken or proved inadequate. The history of the 1960's has seemed, to the outside observer of this phenomenon, to consist of a series of attempts by the United States to find the perfect economic gimmick.

Now, a basic difference between political scientists and economists is that the study of politics—whether local, national, or international, whether ancient, Renaissance, revolutionary, or contemporary—impresses the student with the unlikeness of the actors involved, with the variety of the generative ideas by which they are influenced, by the quirks and oddities of the systems within which they act. The study of economics impresses the student rather with the likeness to one another of consumers, or of producers, or of markets and mechanisms from Toledo to Timbuctoo. The units along the economic scales are essentially equivalent and undifferentiated.

Small wonder that it is so hard to persuade economists of the simple and commonsensical fact that states operating together in an international economic as well as an international political system think, behave, and react differently, and play essentially different roles. So, of course, do individual human beings in a national economic system. The limitations of the concept of economic man have been widely acknowledged for some time now. Yet the concept nevertheless continues to be used and to influence the thought processes of the economists because, provided the system is large enough, the individual variations quickly become statistically unimportant. As in actuarial calculations, the eccentric accident is lost in the predictable mass. The resulting habits of mind, however, become much more dangerously unrealistic when instead of millions of individual units in an economic system, each taking its idiosyncratic decisions within a statistical scatter, the economist deals with only a handful of individual states. (For though

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

the international political system numbers over one hundred and twenty states, the international monetary system numbers few more than the famous Group of Ten.)

All I am saying, to put it briefly and crudely, is that the economists are used to treating equivalent units, that their study exaggerates the interchangeability and underrates the eccentricity of governments when it deals with matters—such as international monetary policy and institutions—in which a few unlike governments, which have unlike preoccupations and divergent interests as well as coincidental preoccupations and interests, are the most important protagonists. If the political scientists (who so far have mostly ignored it) were to give even half the attention and thought the economists have given to this major problem of our international political economy, perhaps the problems of the dollar would not seem quite so bewildering and frustrating.

To be more specific, it seems to me that American economists in their discussions and writings have been assuming all along that because the dollar is the world's leading reserve and vehicle currency, and the world's most widely accepted standard of value, it is therefore like other currencies but more powerful and more privileged. My political theory of international currencies, however, suggests almost the opposite to be true. The dollar, because it is Top Currency, certainly has status. But politically it is subject to peculiar disabilities and constraints that differentiate it sharply from the other leading states in the international monetary system.

Let me suggest briefly three such differentiations, all relevant to the current choice of options before the United States.

The first distinction is that the domestic economy of the Top Currency state is not less but more vulnerable than those of others to the economic stresses and pressures of an accelerating international economy. After 1929, it became widely and firmly believed that if the United States sniffled, the rest of the world sneezed—if it did not actually collapse with pneumonia. So much so, that the idea of the United States being the source of economic trouble and the rest of the world its victim dies very hard, as we have seen only last summer from the reactions of the London, Paris, and Frankfurt stock exchanges to the Wall Street slide. Political scientists should perhaps consider the possibility that the boot is on the other foot; and that, as Top Currency state, it is the United States that is more liable than other national economies to suffer financial scares and crises just because its financial markets are larger and more developed than those of other countries.

This was certainly the British experience in the nineteenth century.

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

Judd Polk remarked, in a perceptive study of sterling written some fifteen years ago, on the "economic and financial crises which rocked Britain at roughly ten year intervals throughout the century."[7] Until now, the susceptibility of the United States to such attacks may have been disguised first by the Second World War, then by the Korean War and latterly, to some extent, by the greater vulnerability of sterling—the "front line of the dollar," as it was known before the 1967 devaluation. It may have been mitigated somewhat, too, by the existence of the international capital market in Eurodollars, which is an expatriate market.

In the longer run, however, the United States may well be obliged to look for new safety measures to protect its domestic economic stability from these recurrent shocks. It is striking that both Britain before 1914 and Switzerland in the 1960's developed a habit at times of stress of shedding labor—an important productive resource—from the economy. British waves of emigration, largely to the United States, followed the pattern of economic recession shown by slowdowns in construction investment.[8] And Switzerland, though it is not a Top Currency state, is the possessor of a Passive or Neutral international Currency, which shares with Top Currencies this peculiar susceptibility to financial crises and to cyclical variations in financial activity. In the 1960's it has, however, been able to cope rather successfully with this disability by rapidly shedding resources, by sending home some of the foreign labor that has made up a third of the Swiss labor force; by maintaining a very high ratio of national reserves to liabilities and a national reputation for political stability and economic conservatism; and, lastly, by insulating itself to some extent with measures that make it difficult for foreigners to hold Swiss franc balances yet that allow Swiss banks to act as their intermediaries and agents in accepting and reinvesting foreign funds denominated in other currencies.

By contrast, the United States has left itself little room to use this safety valve. It has become inured to what in most other developed countries is regarded as far too high a level of domestic unemployment; and it has allowed the most vulnerable positions on the margin of the labor force to be occupied almost exclusively by an underprivileged and racially distinct minority but one that—unlike Switzerland's poor Greek and Spanish helots—is politically potent and dangerous. This is the familiar central dilemma of domestic politics. From the

[7] Judd Polk, *Sterling: Its Meaning in World Finance* (New York 1956).

[8] Thomas Brinley, *Migration and Economic Growth: A Study of Great Britain and the Atlantic Economy* (Cambridge 1954); also *The Economics of International Migration* (London 1958).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

outside, it seems as if the United States will not have an effective balance-of-payments policy until it has acquired an effective full-employment policy. But when and if it were to do so, it could conceivably kill two elusive birds with one stone. It could find an economic regulator that would help it to adjust the balance of payments, and it could discover a new way of giving development aid without raising taxes.

The needs of developing countries for skilled and mobile workers, and of the United States for an adjustable economic regulator, could both be met by a new policy that allowed immigrant workers to enter on short-term contract visas. As with the Italians and Portuguese in Switzerland, their visas would not be renewable whenever it became necessary to deflate the economy in order to correct a payments deficit.

The second major effect of Top Currency status on its possessor's political economy is what I would characterize as a hypertrophy of foreign investment. For as well as the advantages of economic leadership, the nationals who are possessors of the Top Currency have an added advantage in that their national currency is so widely accepted by others. It thus becomes particularly easy for them to launch economic enterprises abroad; they are never slow to exploit whatever technological and other advantages they may possess. The investments are distributed haphazardly, at random throughout the international economy, wherever opportunities occur for profit or capital appreciation—even, sometimes, for simple expansion in the size of the individual business enterprise regardless of rational prospects of profit.

Production of United States-owned enterprises overseas is now estimated at some $200 billion annually, over a fifth of the entire GNP of the United States. The book value of their capital assets in 1966 was put at $55 billion, and the investment income of the United States now far outdistances that of all other countries. Significantly, the next highest investment income[9] is Britain's—a legacy of the exaggerated habits of overseas investment developed during British tenure of Top Currency role and of her former Master Currency position in the old sterling area. And though in 1968 private financial flows to developing countries from Germany rose rapidly to nearly $1.1 billion, making her the second largest source of private capital for foreign investment after the United States ($2.2 billion), it is the accumulated stock, the result of past investments, that engenders political concern and is the point here. Investment income is a rough-and-ready indicator of this.[10]

[9] I.e., all earnings from direct overseas investments net of losses, plus interest accruing on government loans and to the portfolio and other investments of individuals. See definition of "item 6" in IMF, *Balance of Payments Manual*, 3rd edition (Washington 1961).

[10] See OECD/DAC *Development Assistance, 1969 Review* (Paris 1970).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

INVESTMENT INCOME CREDITS IN 1966
(*$ million*)

| | |
|---|---|
| United States | 7961 |
| United Kingdom | 2632 |
| Netherlands | 555 |
| France | 462 |
| Canada | 454 |
| Germany | 389 |
| Belgium-Lux. | 304 |
| Italy | 275 |
| Japan | 243 |

The British case also indicates how, in this respect, the Top Currency role differs in its effects from a Master Currency role. The latter will also lead to some hypertrophy of overseas investments relative to the norm for developed economies with purely national currencies. But as in the case of the Dutch, or the Belgians, or even the French, the investments will be highly concentrated in the Master Currency area. When sterling was Top Currency, by contrast, British overseas investments in the United States and in Argentina were quite as important as those in its own dependencies of Australia or South Africa. In the British case, the Master Currency role was clearly responsible for a hypertrophy of trade as well as of investment, so that Britain became even more eccentric in her dependence on imported food and raw materials than her geography and economic character alone dictated. A recent comparative study of British agricultural policy concluded that the United Kingdom has had a very high level of food imports, in relation to GNP and per capita production, but that this is the result primarily of an exceptional trading policy rather than of anything inherent in the country's soil or its economic or geographical position. From a policy-making point of view, an eccentrically large involvement in economic enterprise in other countries—some of which are politically associated or dependent and some of which are not—will tend to be reflected in an eccentrically tender concern for the stability, order, and "good government" of areas far from home. Any ideological motivation there may be (e.g., preserving democracy, opposing communism) is reinforced by an economic concern that is not simply mercenary and money-grubbing, but is rather broader and less narrowly self-regarding than Marxist mythology would have us believe.

The point here is really a very simple one. It is that this tender concern felt almost willy-nilly by the United States is not likely to be

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

shared, at least to the same degree, by others. It will therefore be futile for the United States to expect the Europeans and the Japanese to feel a concern equal to its own or a matching commitment to maintain political and economic stability in those parts of Asia, Latin America, the Caribbean, Australasia, the Middle East, and increasingly even of Africa, with which they have no special strategic or historic links.

It also follows that it would be vain for the United States to pretend that it can choose how much financial assistance (official aid plus private investment) it will provide to the third world. Because of its generous investments, public and private, in the past, it is not more but less free than others to cut off the supply of new capital, without which the developing economy would wither and shrivel up. As a major creditor, its political position toward all the many debtor countries in the world is one of comparative weakness as much as one of comparative strength.[11] The final distinction of Top Currency status is an ambivalence that may be seen as the direct outcome of the dual concern of the Top Currency state's policy-makers with domestic economic welfare and with the welfare and indivisibility of the international economy. In both the British and the American experiences, this (essentially political) ambivalence has been resolved in the same way. Rather than face up to the inherent conflicts apt to arise between these two interests, the Top Currency state seems inclined to develop a strong political/economic ideology that asserts (a) that the domestic and international interests are coincident if not identical, and (b) that a prime aim of the state should be to persuade others that their national economic interests also coincide with the maximum development and extension of the international economy. The Top Currency state characteristically does all it can to propagate this ideology and to use it to enlist the support of others for whatever measures of international cooperation and support it thinks are needed to protect, defend, and stabilize the international economic system. The incidental damage done by financial crises to its own domestic economy are overlooked, and the opinions of foreigners who put national economic interest before the general welfare are regarded as simply unregenerate and perverse. Indeed, a high moral tone quickly creeps in, and what I would describe as the Top Currency syndrome is distinguished by an obstinate, and to others inevitably an objectionable, tendency to self-righteousness.

This is where the inseparability of politics and economics in the

[11] See Susan Strange, "The Meaning of Multilateral Surveillance" in Robert W. Cox, ed., *International Organization: World Politics, Studies in Economic and Social Agencies* (London 1969).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

real world adds to the difficulties of the Top Currency state. Its monetary partners in the international economy are less sensitive than the Top Currency state to any danger that may threaten this international economy, and are therefore less strongly convinced that they should shoulder short-term costs for long-term collective benefits. And what is more, they are also acutely aware of the impossibility of distinguishing between supporting the economic aims of the Top Currency state and supporting, aiding, and abetting whatever more patently political aims it may elect to pursue. With these, as notably with United States methods and objectives in Vietnam as with British methods and objectives in the Boer War some seventy years ago, they may often find themselves out of sympathy. For no monetary system—and this is the point the economists so often forget—is a riderless horse. Any monetary system is at once the servant and the partner of a political system. This is what the late Henry Aubrey, who wrestled so stubbornly and courageously with this problem, was getting at in his *Behind the Veil of International Money*.[12] "The shortcoming of the current balance of payments thinking," he concluded, "is that we seek an economic solution to what is, in large part, a political problem."

I would take the argument a stage further than Aubrey did. Because of the peculiarities of its Top Currency status and the economic role that this implies, the United States must contemplate the possibility that it will have to make political concessions not equal to but greater than those of others if it is to make any significant progress towards international monetary order. The principle of reciprocity and of the equal rights and duties of states, so familiar that it is taken for granted, is no longer enough. The eagle will have to stoop as low as the other birds if it aspires to lead them where it thinks they ought to go.

This political truth lies right in the economists' blind spot. And because, as I have said already, the United States so dominates the study of economics throughout the globe—as, indeed, Britain did from Ricardo to Keynes—there is now no professionally respectable dissent, no significant school of economic thought that is *not* American-influenced. It is therefore particularly hard for economists to be aware of this blind spot. The ideological convictions of the Top Currency state—and American economic ideology often seems a lot more coherent and consistent than American political ideology—are themselves a prime cause of political astigmatism. It is these Top Currency convictions that obscure the political reality and encourage the illusion in America

[12] Princeton Essay in International Finance (Princeton 1969).

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions

that the monetary goals sought by the United States for the international economy are also sought with equal urgency by all men of good will; that any who do not seek them must be ignorant or misled—or just wilfully subversive. Expound and preach the promised land of orderly international monetary management for long enough, American economists seem to think, and the doubters will be converted. But this is an illusion that could prove dangerous and expensive.

This content downloaded from 128.173.127.127 on Sat, 12 Dec 2015 14:06:38 UTC
All use subject to JSTOR Terms and Conditions