INTERNATIONAL RELATIONS THEN 
AND NOW: WHY THE GREAT RECESSION 
WAS NOT THE GREAT DEPRESSION

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Why did the global financial crisis of 2007-2008 result in 'only' a severe, stubborn recession, but not a second Great Depression? Better public policy was a crucial factor in determining this outcome. Less appreciated is the extent to which international political factors – the relatively benign international political environment in 2007-2008 compared with the intense security dilemma of the inter-war years – were also essential in not making a bad situation worse. Nevertheless, two perennial political problems of international macroeconomic relations—the unique challenges of monetary cooperation and the strategic conduct of monetary diplomacy—remain present now, as they were then, and could still contribute to the consequential deterioration of global economic conditions.

1. Introduction

Why did the global financial crisis of 2007-2008 result in 'only' a long, serious, stubborn recession, but not a second Great Depression? Having pulled back from the abyss this time, it is too easy to forget how close the world economy was to the brink of an utter disaster on the scale on the inter-war catastrophe. The initial economic disturbances during the more recent crisis were at least as disruptive as those that led to the Great Depression.

Several factors contributed to this relatively (but markedly) superior outcome, including, crucially, superior initial public policy responses. In this paper I argue that the difference in the two international political settings is an essential, underappreciated factor in explaining the variation in outcomes. Indeed, international political factors contributed to the dysfunctional nature of the policy responses in the 1930s, which in turn further poisoned relations between States, exacerbating the global downturn and contributing to a self-reinforcing feedback loop of discordant economic and political choices.

This paper proceeds in five parts. First, I briefly address the question of why 2007 was not 1931 – that is why was one global financial crisis

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contained while the other spiraled out of control. The crucial difference is to be found in the art of not making a bad situation worse. I then consider the international political setting of the inter-war years, and illustrate how the intensity of the security dilemma prevented States from taking the cooperative measures necessary to contain the 1931 financial crisis. This can be contrasted with the relatively benign great-power international security environment in 2007, which provided the space that allowed States to pursue the policies that contained the crisis. But international politics never stops; and a darkening of the contemporary security environment might still trouble the global economy. In three sections that follow, I review the practice of monetary diplomacy then (and show how the pathologies of the inter-war era might be reprised in the contemporary context), consider the unique and perennial challenge of international monetary cooperation, and illustrate how the distinct politics of money shape the prospects for cooperation, then and now.

2. The Importance of Not Making a Bad Situation Worse

The origins of the Great Depression are, in broad brush, well understood, and are not dissimilar from the causes of the current 'Great Recession': the bursting of a speculative bubble that exposed the underlying fragilities and interdependencies of an under-regulated financial system. Such crises tend to be self-perpetuating, as individual actors take steps to protect their positions — actions that are individually rational but collectively disastrous as the contraction of liquidity threatens the ability of additional actors to meet their obligations, and so on. Economic activity contracts and it is thus very common for financial crises to cause serious recessions.¹

But why, from there, was the Great Depression so deep, and why did it last so long? This question is more actively debated, but three factors made that bad situation much worse. Into the teeth of the depression, States pursued counterproductive deflationary politics, motivated by an ideology of economic orthodoxy reinforced by a misguided commitment to the gold standard. States also pursued protectionist trade policies (with the justly infamous US Smoot-Hawley tariff leading the charge), creating another collective action problem: efforts to 'protect home markets' did little more in aggregate than cause total world trade to spiral downwards. Finally there was the utter failure of international cooperation more generally, which reinforced the tendency for myopic and counterproductive policy choices.²

² There is obviously an enormous literature on the Great Depression. From the perspective of international relations, two seminal contributions are Eichengreen 1992 and Kindel-
Thus in the Great Recession, bad public policy made a terrible situation much worse. Monetary and fiscal policies resulted in an asphyxiating illiquidity and starved an already anorexic aggregate demand. In the wake on the crisis of 2007-2008, then policy makers had what interwar leaders did not—a closely studied guidebook of what exactly not to do. Contemporary policy responses were by no means perfect, but, in the immediate aftermath of the crisis, there was a fairly broad consensus on what the right policy levers were: fiscal stimulus and a flood of liquidity (after the initial crisis had been contained, it should be noted, many states—especially in Europe—saw the disintegration of the political coalitions that had backed emergency stimulus measures). And international cooperation has been adequate—in particular, despite inevitable squabbling, States have avoided the naked and egregious resort to beggar-thy-neighbor policies. This may seem like faint praise, but it stands in contrast with the dysfunctional behavior of the inter-war years. Again, the lessons of the past mattered—ubiquitous warnings that the global recession might lead to an increase in protectionism and a replay of the collapse of world trade probably helped make that outcome less likely.

During the Great Depression, then, bad ideas, like commitments to economic orthodoxy and the gold standard, were crucial accelerants of the catastrophe, whereas at the onset of the recent crisis, obvious policy blunders were avoided. But there was an additional reason why States reached for, and stuck with, collectively disastrous policy responses. Just

Berger 1993. Eichengreen shows how commitments to the gold standard transmitted and compounded deflationary impulses throughout the system. Kindleberger emphasizes the absence of international leadership by a great power, with Britain no longer able and the US not yet willing to take on such a role. The two arguments are largely complimentary, but note that Kindleberger’s would tend to emphasize how breaking with the gold standard could be a form of beggar-thy-neighbor exchange rate competition, whereas Eichengreen would focus on the fact that States, freed from their ‘golden fetters’ would be free to pursue reflationary economic policies. See also Kindleberger 1934.

1 In the Great Depression, for example, the U.S. Federal Reserve shot the economy in the foot. By contrast, in 2007 the chairman of the Fed, Ben Bernanke, had made his academic reputation as a student of those blunders. See for example Bernanke 2004.

2 Most mainstream economists promptly recognized the need for fiscal stimulus. Influential conservative economist Martin Feldstein saw eye to eye with liberal Alan Blinder: “Well I think Alan Blinder was right on. I think the plan has to be big. It has to be quick, and it has to be focused on creating employment.” (PBS NewsHour, “Parties Seek Consensus on New Financial Stimulus Plan”, November 10, 2008; transcript available at http://www.pbs.org/newshour/bb/business-july-dec08-stimulusplan_11-10/, accessed May 2014). Chinese elites reached similar conclusions; see Economist 2008 for an overview of their massive fiscal-stimulus package which the Economist endorsed as a “giant step in the right direction”. On liquidity see, for example Wieland 2010.

3 Much of Europe’s problems derive from the functioning of the Euro system, which, in many ways, have recreated the deflationary pressures that Eichengreen illustrated with regard to the inter-war gold standard. See O’Rourke and Taylor 2013; see also Feldstein 2013.
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as important for making the Great Depression Great was international politics. The corrosive geopolitical environment of the time meant that cooperative measures that might ameliorate the crisis were not forthcoming. In particular, the geopolitically-rooted failure of macroeconomic cooperation—which reflected the intensity of the security dilemma in Europe especially—sealed the fate of the world economy. The political and economic scars of the Great War had not yet healed; nor had the war resolved the pressures that propelled Europe into that apocalyptic, suicidal fight. A decade later the traumatized survivors eyed each other with enormous suspicion. In this context the already compromised international financial system sputtered in disrepair, an accident waiting to happen. In sharp contrast, the great power security environment in the early twenty-first century was relatively—even absolutely—benign, and this was a crucial permissive reason why States were able to avoid the mistakes of the past (this nevertheless suggests potential clouds on the horizon—because continued geopolitical stability cannot be indefinitely guaranteed).

3. INTERNATIONAL RELATIONS, THEN

The start of the Great Depression is often dated to 1929, especially in the United States. Yet, as Harold James (2009, 47) observed, «the really severe jolt, the annus horribilis, came in 1931», with the failure of the Creditanstalt, the largest bank in Austria. More than anything, the failure to contain banking crises is what made the Great Depression Great. The US suffered major banking panics in 1930, 1931 and 1933. But it was the failure of the Creditanstalt that marked the point of no return. This was not due to a misguided commitment to economic orthodoxy. When bank officials informed the Austrian government that the Creditanstalt was teetering on the edge of bankruptcy, the government there promptly threw everything it had into an emergency rescue package. Despite these efforts, an avalanche of bank runs caused the failure of the Creditanstalt, and from there the crisis spread to Germany, laying waste to its financial system. Still the crisis continued, overtaking the London markets and forcing the pound to sever its ties with gold. After-shocks of the crisis were felt in the US and Japan.1

Why did the international financial system collapse? It was not due to bad ideas—but bad politics, bad international politics. As Barry Eichengreen (1992, 259-260) noted, «on the single occasion when it was most desperately required, international cooperation was not forthcoming».

1 Schubert 1991, 3-4, 11-13; Bordo and James 2011, 128; Aguado 2004, 202; Accominotti 2012.
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But cooperation failed because of the unsettled European security situation. The utter failure of the powers to conclude a politically viable peace treaty left a toxic political environment. The ambivalent Americans, decisive in determining outcome of Great War, returned home; the post-civil war Russians also disengaged from the continent. Germany sought to shed burdens of the Versailles Treaty that had been imposed upon it. France, not without reason, saw everything through the lens of an anticipated future German threat.1

In 1931, these politics haunted the crisis every step of the way.2 Elites immediately understood that once the public became aware that the Creditanstalt might fail, a panic would quickly spread to Germany, whose financial institutions were assumed to have close ties with Austria. Britain was especially alert to the risks of a banking crisis spreading across the continent, and favored prompt support for Austrian government’s rescue efforts. France, on the other hand, saw the crisis as presenting a rare political opportunity. Austria and Germany had been taking steps towards a Customs Union, a move which both sides favored but which was not permitted by the Versailles Treaty. France had seemed destined to protest the inevitable union from the sidelines; now, instead, it demanded that the Austrian government abandon its plans in exchange for emergency assistance.3

American and British officials had a different perspective. U.S. Secretary of State Stimson lectured the French Ambassador that a financial crisis ought to be contained, not exploited. But such advice fell on deaf ears – France was, if anything, eager to add fuel to the Austrian fire, and quietly withdrew funds from the country in order to exacerbate a flight from the Austrian shilling that had been touched off by the banking crisis. Dismayed, the Bank of England countered the French effort at extortion by extending a large emergency credit, which briefly stemmed the tide, but left the pound itself more vulnerable.4

When the crisis reached Germany, even France became concerned for systemic stability, and on June 25, in partnership with the Bank of England, the Bank for International Settlements, and U.S. Federal Reserve Banks, extended an emergency credit to Germany. France wished to exploit international financial distress, not see the system fail. But this tightrope was not an easy one to negotiate, and when the June 25 credit was exhausted and Germany was in need of more assistance, France

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1 For an overview of the tense security situation in Europe see CARR 1947 and WOLFF 1966.
2 BALDERSTON 1994, 69; GLASGOW 1931, 140-141.
3 LEAGUE OF NATIONS 1931b, 72; AGUADO 2003, 203, 206, 216; BENNETT 1962, 41, 71, 73, 117, 149-150.
attached a range of political conditions to any additional support, insisting on concessions regarding reparations, naval disarmament, and a recognition of various French interests throughout Europe. Instead Germany threw in its hand, and established a complex web of exchange controls that greatly insulated it from global financial markets. The German financial retreat diverted market pressure towards Britain, setting the stage for the September crisis that would knock sterling off the gold standard. From there international monetary and financial relations would become increasingly restricted and compartmentalized.\(^1\)

The failure to contain the global financial crisis of 1931 not only had political roots; it had political effects, which further undermined the prospects for cooperative efforts to ameliorate the deepening, stubborn depression. In Germany, the collapse of the international economy strengthened the hand of extreme political elements. During the Creditanstalt crisis, financial journalist Paul Einzig (1932, 143) predicted that a collapse of the Reichmark is certain to bring about a complete political upheaval in Germany. It is highly probable that the extreme nationalists or the communists will then acquire power. This is not to attribute the rise of Nazism in Germany to the uncontained global financial crisis. Nevertheless, the consequences of that crisis did make their path to power easier. When new external financial pressures visited the nation in 1934, Germany responded with the 'New Plan', an elaborate, complex, and comprehensive exchange control scheme that completely walled it off from the market-based international financial system. The New Plan would allow Germany to embark on its ambitious rearmament program without concerns for inflation (still a sensitive issue in Germany) or for countervailing international market pressures. It also created the financial framework through which Germany would enmesh its small neighbors to the South and East in a web of exchange clearing schemes that could be manipulated to its political advantage.\(^2\)

Had the international financial economy been thriving, the opportunity costs of such closure would have been much greater, and the ability to entrap small Eastern European States reduced. But in 1934, the Nazis did not need to invent exchange control, or need to convince similarly-situated States (that is, those in financial distress) of the appeal of exchange clearing schemes, or need to have a debate within the German government or affected interest groups about the pros and cons of abandoning international financial markets. Those markets were gone, and the measures the Nazis introduced in 1934 were elaborations and

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\(^1\) Bennett 1962, 177-178, 190, 219, 231, 237, 248; Federal Reserve Bulletin, November 1930, 383;
U.S. Department of State 1945, 68; Clarke 1967, 21, 195-196.

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extensions of restrictions introduced by a much more centrist government in its defensive retreat from 1931.

In Japan, the political consequences associated with the crisis of 1931 were, if anything even more tragic. In the 1920s, Japanese foreign policy was greatly influenced by liberal internationalists, who were eager, with the support of western allies, to emerge in the international system as a responsible great power, in the context of the norms and conceptions of legitimacy of the era. But those same liberal internationalists were also committed to a narrow definition of economic orthodoxy, again as understood as the ‘best practices’ of the time, especially with regard to strict adherence to the gold standard (which Japan had suspended during WWI and was eager to restore). But the Japanese experience shows both the ruins of the misguided application of orthodoxy during the Depression – it did make a bad situation worse – as well as the domestic political consequences of the crisis. The application of orthodoxy pushed the already deflating Japanese economy past the breaking point and decisively shifted the balance of domestic political power within the country. The collapse of the international economy, the loss of western allies and supporters (and financial markets), and the discrediting of liberal internationalism, again created an environment in which virulent nationalists were able to thrive, and their aggressive militarism further foreclosed opportunities for mutually international cooperation.¹

The restoration of the gold standard was the defining project of economic policy in Japan in the 1920s – pursued in fits and starts due to parliamentary politics and setbacks including a massive earthquake in 1923 and a related banking crisis in 1927. But in 1929, the government announced its commitment to promptly restore the gold standard.² Finance minister Inoue Junnosuke (1931, 153) understood that restoring the gold standard would require costly deflation. Nevertheless, he insisted, failing to return to gold (infringes every canon of sound finance) and it is the duty of the nation to spare no effort to restore the gold standard. Inoue’s new budget sharply cut government spending, and he instructed the Bank of Japan to raise interest rates. To the applause of the banking community, the gold standard was restored on January 1st, 1930.³

But the economic downturn that followed was more severe than anticipated. The return to gold had the misfortune of coinciding with the

² Asher 2003; Pani and Tomolo 1993; Scalapino 1995; Takefuji 1994, 35.
³ See also Nakamura 1994, 35, 37, 88, 40; Metzler 2006, 324, 326, 333, 343; Fletcher 1991, 256.
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deepening of the international depression already underway. Average household income in Japan fell precipitously, but Inoue, again with the strong backing of the financial community – and like many holding similar beliefs around the world – saw the more dedicated application of orthodoxy as the best medicine. He cut spending and raised interest rates still further (as one prominent banker explained at the time, «adjustment could not be achieved without great hardships; good medicine is bitter to the taste»). Even after Britain was forced off gold in September 1931, the defenders of orthodoxy were unmoved, and backed their rhetoric with interest rate hikes in October and November.¹

Not surprisingly, Inoue’s party lost power in the February 1932 elections, and he was replaced as finance minister by Takahashi Korekiyo, who immediately took Japan off gold. A proto-Keynesian, Takahashi did much more than that – he broke completely with economic orthodoxy and introduced new, policies designed to lift the economy out of the depression.² His policies were remarkably successful – but the (domestic political) damage had been done. Although the increasingly assertive military initially enjoyed Takahashi’s free spending policies, by 1935 he was taking his foot off the economic accelerator, and sought to limit the growth of defense spending. A heroic figure, his policies were overtaken by the rising tide of Japanese militarism (in 1936, at the age of 82, he was assassinated in his home). Takahashi’s successors were subservient to their military masters, and from 1937 pursued free spending policies that quickly required them to impose controls that would insulate Japan from international financial pressures, so that the galloping pace of rearmament could be maintained.³

Once again, all of this stands in marked contrast to the benign international political environment in 2007-2008. This is not to suggest – at all – that there are not important contemporary political rivalries between States that lead them to view each other’s behavior warily, or that war is somehow impossible between them. Rather, it is simply to observe that, contra the inter-war period, none of the great powers felt it necessary to respond to the more recent global financial crisis looking through the lens of pressing concerns for their core national security interests. The US, China, the West European powers, and Japan – none of these actors hesitated to reach for a policy lever due to the


² Takahashi was familiar with Keynes’ writings on monetary affairs and his opposition to Britain’s return to the gold standard at pre-war parity. But Takahashi’s discussion of the multiplier predates the publication of Keynes’ influential paper on that subject (Keynes 1931). See also Nanto and Takagi 1975, Fukuda 1975.

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thought that such a policy might expose them to military invasion; none of them saw in the crisis the opportunity to strike a mortal blow to an existential rival. International monetary and financial relations are always fundamentally shaped by international politics, and, as discussed below, this will likely make future cooperation more difficult. But at the moment of the global financial crisis, those politics did not make a bad situation worse – they offered a permissive environment in which States were able to consider a full range of policy options, and left them less tempted to focus on narrow international political opportunities. Nevertheless, even though 2007 was not 1931, and this mattered, crucially, two types of dangers still lurk – those that were present then, and are just as relevant now – the challenges of monetary diplomacy, and of monetary politics.

4. Monetary diplomacy then and now

One feature of interwar international economic relations that is not different from now is the inescapability of politics. The intensity of the security dilemma may wax and wane, but States will invariably seek to advance their political interests in their interactions with other states. In the interwar period, the most notable (but by no means only) practitioner of monetary diplomacy was France. An oddity of the functioning of the gold-exchange standard, combined with the fact that the respective restorations of the pound and the franc to gold had left the former overvalued and the latter undervalued, meant that France had the ability to draw gold from Britain, essentially at will. And this was clearly understood by the involved elites at the time. The governor of the Bank of England, Montague Norman, knew that «the Bank of France has enough sterling to create a situation at any given moment which would endanger the maintenance of the pound on gold» (quoted in Clay 1957, 231). Emile Moreau (1991, 430), governor of the Bank of France, saw this capability as a «powerful means of exerting pressure on the Bank of England».¹


² For more details, see Kirshner 1995, ch. 6; this phenomena was first observed in Einzig 1931, 33.
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Europe, and sought to displace British financial dominance in the region with its own as a means to that end; the countries also routinely clashed on the German question, with France determined to enforce the terms of the Versailles Treaty and to hold a hard line in negotiations over the revision of reparations agreements.¹

French monetary diplomacy, then, is especially of interest because it is suggestive of prospects for monetary diplomacy, now. In particular, China’s vast holdings of US dollar-denominated debt instruments implies that Beijing, like Paris before it, is in a position to try to advance its interests given its vast foreign exchange reserves and the exposure of an international reserve asset. The source of this potential power should not be misunderstood—the ‘doomsday scenario’ in which China dumps its dollar assets is highly unlikely, for the simple reason that it is not in China’s interest to do so. Beijing is increasingly wary of its dependence on the dollar and of the US economy, but the legacy of its development strategy has left it as a major stakeholder in the value and stability of the US dollar and of the American economy more generally. A collapse in the value of the dollar, or anything that undermined US demand for China’s exports (such as a dollar crisis that contributed to a recession or even one that did little more than cause the greenback’s value to plummet) would be a disaster for China—in some ways, Beijing has more at stake in preserving the value and stability of the dollar than does Washington. Thus it is possible to imagine scenarios in which China might reach for the (monetary) ‘nuclear option’—but these distant prospects would certainly be preceded by a destabilizing deterioration in relations that would present more immediate problems for international money and finance.²

The prospects for such a deterioration cannot be readily dismissed. For as the French inter-war affair illustrates, China could easily be tempted to engage in more subtle forms of monetary coercion, by manipulating its vast holdings of dollar assets in order to signal its displeasure to the US or pressure it into adjusting its policies. This could occur—quite possibly exacerbate—episodes of international political conflict between the two States. Here again, the parallels to the interwar experience are not dissimilar, but uncomfortably similar. Then,

¹ Regarding Eastern Europe, if the Bank of England takes away from us these customers, whom we are anxious to hold for political reasons, Moreau wrote in his diary: ‘I shall show my displeasure by buying gold in London’ (quoted in Clarke 1967, 146). On reparations, officials from the Bank of France informed the British treasury that if Britain supported a modification of established agreements, the French Government would feel it necessary to convert all the sterling held in London by the Bank of France into gold and transfer it to Paris (ibidem). See Moreau 1901; Boyle 1967, 235-226; Clarke 1967, 146; Liver-Ross 1968, 124.
² Dreznier 2009; see also Chin and Helleiner 2008.
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France was accumulating reserves at a brisk clip; then, France and Britain disagreed over whose behavior was the source of widening disequilibria in the international macroeconomy. And most unsettling of all, then, as seen above, French monetary diplomacy contributed to the utter collapse of the international financial system — even though France had no interest in bringing that outcome about. After the crisis of 1931, France saw its monetary power and financial influence diminished, its allies weakened, and its adversaries radicalized. Little wonder that, when it became apparent to French officials that the pound might actually be forced off gold, they reversed course and (belatedly and unsuccessfully) engaged in vigorous efforts to bolster the position of sterling. Similarly, as Aaron Friedberg (2010, 40-41) notes with regard to Sino-American monetary relations, «just because a situation of MAD (mutually assured destruction) exists, there is no guarantee it can’t happen». This is not to suggest that such an outcome is likely; rather, it is to insist that international political rivalry is perennial and inevitable, and that even though China has every incentive to avoid wrecking the world economy and/or touching off a major dollar crisis, as the interwar period shows, such intentions do not guarantee that costly blunders will not occur. I have argued that the relatively benign security environment was crucial in containing the effects of the global financial crisis in 2007, but the possibility of deterioration in the international political environment cannot be dismissed, and if it occurred, it would an important destabilizing factor.

5. The distinct challenges of monetary cooperation

The risk of small conflicts becoming larger conflicts is another perennial problem with regard to international money and finance because there are distinct challenges to international monetary cooperation. In fact, the barriers to such cooperation are so great that it makes sense to consider monetary discord as the ‘null expectation’ with episodes of monetary cooperation, if anything, puzzles to be explained. This section considers the reasons why such cooperation is so difficult to establish and maintain. Nevertheless, there are special factors which can overcome these inherent difficulties, as illustrated by patterns of monetary discord and cooperation throughout history. The following section illustrates how these factors influenced the pattern on monetary

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1 In 1925, France held less than 8% of the world’s monetary reserves of gold; six years later, it held more than 25% (Federal Reserve Bulletin, June 1931, 568). For illustrations of the pointed, ongoing debates about the sources of monetary disturbances and about distributing the burdens of adjustment, see ROYAL INSTITUTE OF INTERNATIONAL AFFAIRS 1932; LEAGUE OF NATIONS 1932, 1931, 1930. Compare, for example, APPALON 1921 with GREGORY 1931.
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coopration then, and why they are suggestive of increasing challenges to monetary cooperation in the coming years.

There are three special problems that arise when states attempt to reach agreements about how to arrange, oversee and supervise their international monetary relations. First, even when actors agree that they wish to reach a cooperative agreement, they might still disagree on a number of technical issues about how best to manage money, and the diverse structure of their economies will often lead them to value different arrangements as well (small open economies will tend to have different preferences than large closed economies, for example). Much of these difficulties derive from the fact that, unlike international trade (liberalization is globally Pareto efficient), macroeconomic theory is more ambiguous. There is no decisive empirical evidence that establishes which type of exchange rate regime, level and style of capital controls, or even rate of inflation, is the optimal, most efficient, or appropriate.¹

Monetary cooperation also faces the vexing challenge that States' macroeconomic policies generate public externalities – that is, the negative effects of macroeconomic spillovers, such as high interest rates or artificially manipulated exchange rates, tend to be felt generally by all other states in the system. This creates a collective action problem, because the costs of any countervailing pressure applied by one state against the producer of the externality would be borne narrowly by that State, yet the benefits of a remediation of the negative spillover would be enjoyed by all. As a result of this dynamic, the production of macroeconomic 'bads' in the international economy tend to be underpunished.²

Finally, monetary cooperation is especially difficult because such cooperation is always, ultimately, about how to distribute the burdens of adjustment that inevitably arise from the normal functioning of the international macroeconomy. Such adjustments are costly, and invariably become more intense in troubled times – just when cooperation is most needed. These conflicts are highly politicized, as governments, held accountable for economic performance, attempt to balance preferences for domestic policy autonomy and international economic stability (an-

¹ Cooper 1977, Cohen 1977, Kirshner 2001. And even when agreements are reached, compliance may be relatively difficult to monitor. With trade, the law is decisive – states can reduce tariffs and eliminate quotas. But promises to intervene in international markets can be complicated by the effect of market forces and the behavior of private actors.

² On these points see Oye 1992. Again the contrast with trade is illuminating. As Oye illustrates, if one nation becomes more protectionist, even if it does so universally, other states can target retaliatory trade policies directly at the protectionist’s exports. Each State can then bargain bilaterally, offering to reduce its tariffs against the offending State in exchange for a reduction in tariffs directed towards its own products.
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other perennial, inescapable, problem for the management of money) – and again, in hard times, political incentives nudge leaders to place less emphasis on the smooth functioning of the system as a whole, and more on local needs.¹ In good times or bad, monetary cooperation will often be challenged as states instinctively try and shift these burdens of adjustment abroad – those burdens are simply more salient in hard times. The terrible post-financial crisis difficulties in the Euro zone largely reflect a conflict over who will bear such costs; more generally, much of international monetary politics is little more than squabble over the burdens of adjustment.

In sum, monetary cooperation is hard. But clearly it is not impossible – there have been many examples in history of important and successful monetary arrangements between States. These experiences, however, have almost always required the presence of some combination of special factors, regarding the concentration of monetary power, ideological homogeneity, or the presence of shared, salient security concerns.

A monetary ‘hegemon’ can offer leadership, through its policies provide an anchor around which expectations can converge, take on a disproportionate share or the costs adjustment, or provide the public good of supervising and enforcing agreements and understandings. These outcomes are possible because a dominant State can come to see its interests as being in accord with the interests of the system as a whole; in addition, economies of scope arguments suggest that monetary systems tend towards hierarchical organization, reinforcing the tendency for a hegemonic state to identify as the system’s leader.²

Changes to the concentration of power help explain Anglo-American monetary relations after WWII, as well as the emergence of the Bretton Woods system. Immediately after the war, the US was relatively aggressive with Britain over monetary affairs – still conceptualizing Britain, which had dominated world finance for over a century, as a monetary rival – as seen, for example, in the conditions imposed by the US in exchange for its 1945 post-war loan to Britain (in particular, the Americans, unwise, insisted on the prompt restoration of convertibility). But within a year it became clear that Britain (and Western Europe more generally) was in much worse shape than had been understood, and the US was in a position of unrivaled economic dominance. America’s attitudes about the bearing the burdens of monetary cooperation were quickly transformed. The US allowed States to take their time integrating the expectations of the rules of the IMF, most notably postponing the shift to generalized convertibility until 1958.³

¹ On domestic autonomy and international stability see KEYNES 1971 [1930], 274, 304.
² KINDELBERGER 1977; CASSEL 1921, 80.
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Such narratives of hegemonic leadership are often compelling, but the historical record is much more ambiguous with regard to the 'hegemonic stability theory' as applied to money. The concentration of power, upon closer inspection, is neither necessary nor sufficient to assure monetary cooperation. Moreover, monetary hegemons, placed in a position of special privilege at the center of the system, can be the source of monetary troubles—a hegemon can be exploitative as well as benevolent.¹ Other variables, then, must also be introduced if the pattern of (or opportunities for) monetary cooperation is to be explained. A second crucial variable is ideology—that is, ideas about money—which defines the contours of the possible, and, importantly, can inhibit debates and arguments about who will bear which burdens of adjustment, by endowing such burdens with the aura of economic necessity. If trying to shake off the costs of adjustment is widely seen as illegitimate—violating a widely shared norm—as opposed to normal politics—renegotiating an old understanding when conditions change, actors tend to be more inhibited from doing it. And indeed most of the grand bargains of international monetary relations were achieved in context of relative ideological homogeneity among participants. As Kate McNamara argued, for example, European Monetary Unification was only possible when the elites finally converged around the same ideational framework.²

Another factor that can provide the glue which can hold monetary agreements together, that might otherwise come undone, are shared, salient security concerns. If partners to monetary cooperation have similar threat assessments, and find those threats urgent, cooperation can be forged and sustained not because its costs are reduced, but because parties care more about the security situation, and are thus more willing to bear those costs. The influence of 'high politics' is often crucial with regard to the prospects for international macroeconomic comity—it also helps explain the mixed record of hegemonic stability theory. Even hegemons need a compelling reason to bear the costs of adjustment. Thus, in 1947, it was not simply the revelation of British economic weakness that changed American behavior—it was the shocking awareness of the collapse of British power in the context of the emerging Cold War. As the security environment seemed increasingly danger-

¹ On hegemonic exploitation, see WaLTER 1991. On the limits of hegemonic stability theory as applied to money, see Gallarotti 1993 and Bicheng 1987.
² A neoliberal policy consensus emerged and redefined state interests in cooperation...and induced leaders to accept the domestic policy adjustments needed to stay within the system (McNamara 1997, 2, 79-71, 111). Similarly, although American power assured that the Breston Woods Institutions and the rules of use reflected U.S. preferences and interests, the forging of the postwar monetary order took place in the context of a broad intellectual consensus regarding ideas about money and finance (Krane 1993).
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ous, the U.S. was more willing to bear the burdens of supervising and overseeing the international financial system.¹

1947 contrasts markedly with 1971, when the U.S. suddenly and unilaterally ‘closed the gold window’, bringing an end to the Bretton Woods system. In 1947, to take one illustration, the U.S. was very concerned about the precarious nature of the Italian economy, which, it assessed, was flirting with bankruptcy (the lira would be stabilized by a package of assertive reforms introduced by then deputy Prime Minister and minister of the Budget Luigi Einaudi). Then, at the dawn of the Cold War, the U.S. responded first with improvised, ad-hoc support and followed this in 1948 with the largess of the Marshall Plan.² But in 1971, with Western Europe on much more sound economic footing, the Soviet threat more remote, and the U.S. fixated on the Vietnam War, concerns for the European economy and its monetary stability had considerably receded. President Nixon, when informed that the lira was under pressure, was famously (and explicitly) indifferent to its fate. This new worldview was suggested by his Treasury Secretary John Connolly, who told colleagues «my basic approach is that the foreigners are out to screw us. Our job is to screw them first».³

6. International monetary relations, then and now

This interpretation of the challenges to monetary cooperation and the circumstances under which they are more likely to be overcome unpacks otherwise puzzling episodes from then, and provides insights into the prospects for international monetary and financial politics now. Then, as discussed above, after the global financial crisis of 1931, the world economy collapsed, and compartmentalized into inefficient, politicized, discriminatory blocs. Early efforts by States to undertake coordinated efforts to restore the international economy were unsuccessful. Most notably, a world economic conference, held in London in 1933, ended in utter failure. The failure of the London conference is often attributed to the unwillingness of President Roosevelt (and his Treasury Secretary Henry Morgenthau), only a few months after taking

¹ On the significance of the realization of British weakness, see Christensen 1996, ch. 3; Pollard 1985.
³ Nixon’s chief aide, H. R. Haldeman, asked the President if he wanted a briefing on the British pound, which had just floated. «No, I don’t care», the President responded. When warned that Federal Reserve Chair Arthur Burns «is concerned about speculation about the lira», Nixon responded, «Well, I don’t give a shit about the lira» (transcript of a recording of a meeting between the President and H. R. Haldeman in the Oval Office, June 23, 1972, available at http://www.nixonlibrary.gov/forsresearchers/find/tapes/watergate/wsgp/741-202.pdf, accessed 18 December 2015). See also Calleo 1982; Odell 1982, 263.
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office, to sacrifice his domestic agenda for the sake of international agreements. But Roosevelt's 'bombshell', a declaration the President sent to the conference, was but the most explicit clarification of why the cooperative efforts failed – there was plenty of blame to go around. As Eichengreen assesses, «a combination of incompatible conceptual frameworks and domestic political constraints was ultimately responsible for the conference's failure».¹

Yet three scant years later, Britain, France and the US were able to reach the Tripartite Monetary Agreement, which facilitated the coordinated devaluation of the franc (as opposed to the previous currency devaluations of the period, which were unilateral and often hotly contested), and established the basis for continued cooperative consultation between the three States with regard to monetary affairs. What changed in such a short period of time? Two of factors that influence monetary cooperation – security and ideology – shifted markedly. In 1936, Germany remilitarized the Rhineland (in violation of the Treaty of Versailles), Italy completed its conquest of Ethiopia (which had been a member of the League of Nations), and the Spanish Civil War commenced. The European security situation – and the rise of assertive militarism by the fascist powers – alarmed the Western democracies. Britain and the US thus moved toward France's perspective on national security issues. And in that context, the Anglo-Americans placed less emphasis on the international economic implications of a devaluation of the franc and prioritized instead the fact that such a devaluation would enable France to more easily reflate and rearm. That America and Britain were motivated almost exclusively by security is illustrated by the fact that France continuously violated the spirit of the Agreement, permitting a depreciation of the franc by more than 40% over the following two years. But the US and the UK stuck with the Agreement, fearful that its dissolution would send the wrong signal to the fascist States. Morgenthau, once wary of international monetary cooperation because it would impinge on domestic policy autonomy, now saw monetary cooperation as part of a larger effort by the democracies to resist German power.²

But it was not only the Americans and the British who saw things differently. In 1936 France elected its first socialist government, which, by abandoning monetary orthodoxy and devaluing the franc, marked a fundamental shift in its ideational positions, converging towards those of its tripartite partners.³ These two basic changes, toward agreement

¹ Brown 1940, 128-1286; Blum 1939, 54-65; Eichengreen 1992, 318.
² Kaiser 1986; Frankenstein 1983; Clarke 1977; Drummond 1979, 4, 37, 55; Blum 1990, 160.
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on shared, salient security concerns, and greater ideological homogeneity, facilitated the cooperation in 1936 that was unattainable in 1933.

This interpretation of the prospects for monetary cooperation – that it is inherently and distinctly difficult, but that some combination of special factors can help overcome those formidable barriers – can be applied to contemporary world politics. But an assessment of trends regarding hegemony (or the concentration of power more generally), economic ideology, and international security, suggests difficulties ahead.

Hegemony would appear to be eroding. That is, in the coming years, although the US will remain the world’s most powerful state, by a good measure, its relative global power will nevertheless relatively decline, as the balance of power continues to diffuse in the international system, and especially towards Asia. Similarly, although the dollar will likely remain the world’s most widely used international currency, it is also likely that the relative share of the dollar’s international role will be reduced; its range encroached upon at the frontiers of its domain by the yuan and the euro. Certainly, each of these currencies has its own baggage and limitations. Nevertheless, assuming that China’s economy, even as its growth rate decelerates, does not stall the stage is set for considerable growth in the RMB’s role as an international currency. In the wake of the global financial crisis, China has accelerated its plans for the international emergence of the yuan, as it seeks greater autonomy from international market pressure and articulates a marked preference for greater diversification of the international monetary system. (Moreover, this aspiration is shared by many actors, especially in Asia, which should facilitate the increased use of other international currencies, including the RMB) As for the euro, although it emerged from the Global Financial Crisis with its own limitations pathetically exposed, before the crisis it seemed poised to become a competitor to (again, if well short of parity with) the dollar. In the longer run, as the problems of the European Monetary Union are resolved one way or another, the euro will be poised to play a larger role in the international monetary system. On the horizon, then, as the World Bank has projected, is a multi-polar or ‘leaderless’ currency system, which will reduce the prospects for hegemonic stability.

Ideology is also shifting. Before the global financial crisis, there was remarkable ideological homogeneity in that the American model of uninhibited global financial liberalization – promoted by the US after the end of the Cold War – was largely understood by the turn of the twenty-first century to be the single, legitimate model of financial governance. This was reinforced by what John Ikenberry and Charles

1 CHIN 2014, KIRSHNER 2014b.  
2 WORLD BANK 2011, 3, 126. See also COHEN 2009.
Kupchan called «hegemonic socialization» – the widespread embrace of global elites in the substantive beliefs of a great power. But the global financial crisis shattered the legitimacy of the American model, and has encouraged States to experiment with a variety of techniques designed to govern domestic and international money and finance. Even the IMF, Ilene Grabel argues, has abandoned its long-standing, self-appointed role as the guardian of orthodoxy and enforcer of financial deregulation, and this has contributed to what she calls «productive incoherence» as States are permitted to pursue more varied economic strategies.\(^1\)

Security is also suggestive of international macroeconomic discord. It is important to be clear on the nature of this mechanism. The key metric suggestive of discord is not the presence of an intense security dilemma between States with intimate monetary relations (though this would certainly be very problematic), but rather the absence of shared, salient security concerns between such states. Once again, the problem is that periodic stress, at the very least, is to be expected as a normal consequence of international macroeconomic relations. During the Cold War, when these pressures required significant adjustments – 1971 and 1985 would be the most obvious examples of this – the participants in negotiations designed to facilitate these adjustments took place between the US and its political and military allies in Western Europe and East Asia.\(^2\) Indeed, participants in every major monetary conference of the twentieth century shared, more or less, similar international political affinities; every major effort to reconstitute the international monetary order in the second half of the twentieth century could be characterized as conversations amongst friends. This is no longer the case. Major players in the international monetary game, even those with the best of intentions, now have different and often divergent international political agendas. The US and China need not be locked in an intense security competition (although that may come to pass), to recognize that they will often find themselves in political competition. And unlike the US-Japan economic relationship, which featured recurrent bouts of trade-deficit motivated conflicts over exchange rates, Sino-American macroeconomic disagreements do not have the backdrop of a security alliance to make sure that such squabbles are eventually contained. Even the US and its Western European allies no longer have a shared, salient security threat that binds them.\(^3\)

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3 Callen 2009.
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In sum, now is not then, and the Global Financial Crisis of 2007-2008 resulted ‘only’ in the great recession, and not a reprise of the Great Depression, due to better public policy and, as I have emphasized, a much more benign international security environment. But, ironically, avoiding the inter-war catastrophe has created the opportunity for bad policies to re-emerge (public policies after the initial crisis passed were much less productive), and there is never any guarantee that security relations between states will not deteriorate and lead to the unraveling of international political understandings more generally. And monetary conflicts are inevitable, and, as seen in contemporary Europe, often generate bitter disputes about how the burdens of adjustment should be distributed. The prospect that such conflicts will fail to be resolved, and – as in the past – contribute to a darker international political environment, cannot be dismissed.

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